

Those Stubborn Facts.

By Scott Silva

Editor, *The Gold Speculator*

6-28-11

Gold is stubbornly holding on to \$1500/oz, despite the easing of fears of European debt contagion, lower inflation in China, the surprise release of SPR oil, reports of the imminent deal on US debt crisis and the statements that the US economy is on the mend.

History has shown that in uncertain economic times, gold prices rise. Conversely, gold prices fall when other investment asset classes provide stable and predictable returns. Certainly, the good news on the resolution of the Greek debt crisis and the drop in oil prices below \$100/bbl from added supply via the SPR release should have started gold on a steady decline. And, as everyone knows, the Fed's QE2 is ending, as scheduled, at the end of this month. So, in a few days, the stimulus will have fixed the US economy, just as the Washington central planners said it would.

Is there something wrong with this picture? What is missing here? Well, the facts, rather than political desires, drive us to a different conclusion about the state of the US economy.

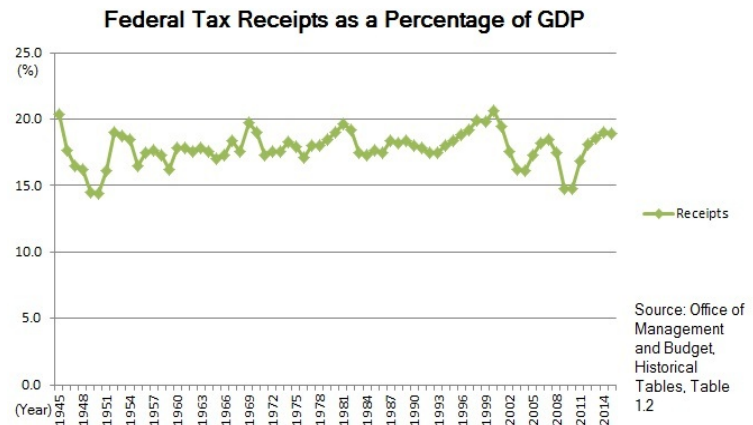
First, it is a fact that the Fed says it is ending Quantitative Easing 2 (QE2) on June 30, 2011. Under QE2, the Fed bought \$600 Billion in US Treasuries and other fixed income instruments for cash in an effort to stimulate the economy. But the Fed created that cash out of thin air. The Fed balance sheet ballooned to \$2.8 Trillion. Every new dollar debases the value of dollars already in circulation which pushes prices up. It's Gresham's law at work.

And, the truth is the Fed is not ending QE2. As Fed Chairman Bernanke stated last Wednesday at his second press conference, the Fed will continue to reinvest proceeds from maturing issues. So the Fed continues to purchase (or repurchase), rather than sell, flooding more cash into the existing stock. The result is higher prices for all. By every measure, the US economy has slowed, rather than grown as a result of QE2, so continued Fed accommodation is not likely to reverse the trend.

The White House says the US debt crisis may be closer to resolution. The president is now taking part in the talks. But there is plenty of room for mistakes as the August 2nd deadline approaches. To be effective, the deficit/debt deal needs to address entitlement reform, tax reform, spending caps and potentially the framework for a Constitutional amendment. Some experts say the Congress is already out of time and simply cannot pass such complex legislation in the few remaining weeks. The rating agencies may not wait to downgrade US sovereign debt.

One new wrinkle today is the president's offer to hike taxes by \$600 Billion. The idea is to tax "millionaires and billionaires" at higher rates and end "subsidies for big oil companies" to increase federal revenues. The rhetoric may sound constructive for middle class voters, but the facts do not support the intended objective. Higher tax rates do not always result in higher revenue. This counterintuitive fact is well known by economists and students of history. In fact the opposite case is true—lower taxes produce more federal revenue. More people pay at the lower rates. Wealthy taxpayers avoid taxes in a high rate environment. For example, when rates

are high, investors put money in triple tax free municipal bonds, or move income generating assets to offshore tax havens. Hauser's law shows US tax revenues since the 1930's are essentially constant at 19.5% of GDP for wide variations in marginal tax rates. That's right, federal tax revenue is about the same percentage of GDP whether the marginal tax rate is 28%, as during the Reagan years, or 91% under FDR. In the 1980's, when the top marginal individual rate dropped from 70% to 28%, federal revenue increased 91.3%. The rich pay more when marginal rates are lower and the incentive to avoid taxes are reduced.



Then why does the White House not use these facts? Maybe the notion is not well understood. But these people are well educated and the staff includes expert economic advisors. Or, it could be that the concept is judged too complex for the average American to understand. But the Great Orator should be able to put it in simple terms for us knuckleheads. It's more likely that it's easier to stir up class warfare than speak the truth. What we need is the simple truth.

Another area where the truth gets muddled is manipulation of the oil market. Oil speculators are hunted by the CFTC and the SEC, but the Great Manipulator has license to manipulate and regulate the price of oil at will. Washington has kept oil exploration in the US at a standstill, refusing to allow permits for existing leaseholders and barring development of huge new finds in West Texas on the belief it endangers the dune sagebrush lizard. Yet, the president has offered billions of dollars to Brazil's state-owned oil company, Petrobras, to finance exploration of the huge offshore discovery in Brazil's Tupi oil field in the Santos Basin near Rio de Janeiro. No dune sagebrush lizards there, I guess. No US jobs either.

The latest manipulation was the sudden release of 30 million barrels of the US Strategic Petroleum Reserve last Thursday, half of the IEA commitment to replace lost Libya supply over the next sixty days. But oil prices peaked in May, falling \$14/bbl before the SPR release on persistent concerns about global growth. Prices at the pump fell in 2010, not because of supply, but lower demand for \$3.00/gal gasoline at the height of the recession. So was the surprise release of oil to the supply based on strategic need, or was it a talking point in the re-election campaign. Maybe the SPR can replace its deficit at a lower price in the future. Maybe not. Today, crude oil futures are bidding up.

And that's not all that's going up. Consumer prices are up. Producer prices are up. Import source prices are up. Unemployment is up. Reports to the contrary, the US economy is not looking up. US GDP growth is slowing down. Stagflation is setting in. And prospects for renewed prosperity should higher tax and continued deficit spending policies prevail are dim. These are uncertain times. What we need is truth. Most of us know the difference between political rhetoric and reality. In the real world, the stubborn facts have a way of surviving.

So it is no wonder that gold is on the rise. Gold is the safe haven for investors around the world. Owning gold insulates the investor from debasement of paper currency. Gold is a store of value. Gold protects individual wealth from political unrest, commodity supply shocks, war and economic uncertainty. Gold survives the thousand slings and arrows of political economies.

GC - Gold (COMEX) - Weekly Continuation Candlestick Chart



Investors from around the world benefit from timely market analysis on gold and silver and portfolio recommendations contained in *The Gold Speculator* investment newsletter, which is based on the principles of free markets, private property, sound money and Austrian School economics.

The question for you to consider is how are you going to protect yourself from the vagaries of the fiat money and growing inflation? We publish *The Gold Speculator* to help people make better decisions about their money. Our Model Conservative Portfolio gained 66.7% in 2010, and 55% for 1Q2011. Subscribe at our web site www.thegoldspeculatorllc.com with credit card or PayPal (\$300/yr) or by sending your check for \$290 (\$10 cash discount) The Gold Speculator, 614 Nashua St. #142 Milford, NH 03055