

IN THE KNOW

August 15, 2011

Has the Dow Really Recovered?

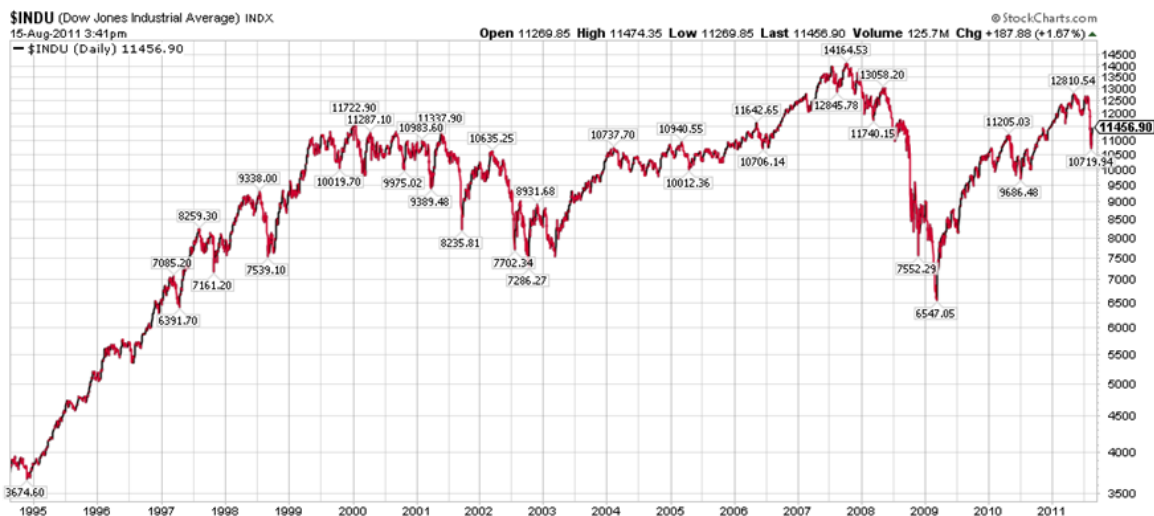
By W. Michael McBride, JD

On July 13, 2011, in his testimony before the House Financial Services Committee, Federal Reserve Chairman Ben Bernanke told Texas Congressman Ron Paul that he does not think gold is money, only an asset. Mr. Paul pressed further and asked, "Why, then, do central banks hold gold as reserves?" Mr. Bernanke, looking a bit like a grade school student in a spelling bee contest that was just presented the word "incongruity," could only muster a one-word answer, "Tradition." Apparently, these central bankers' monetary strategy is analogous to why Americans serve turkey on Thanksgiving. Brilliant! To be fair, given that Mr. Bernanke is the chief guardian and servant to the altar of fiat paper currency, a position of disregarding gold as money is to be expected, even if it ignores 6,000 years of history.

If you concur with Mr. Bernanke that, in fact, gold is not money and only an asset, you may want to stop reading here and move on to other things. The perspective I will present is not good news, and conflicts with most of what conventional financial media tells you. If, on the other hand, you disagree with Mr. Bernanke, or are at least open to another perspective on the markets, by all means, read on.

Looking at the Dow Jones Industrial Average (Dow) in U.S. Dollar terms (USD), we see the average hovering between 11,000 and 12,000. This level would be roughly double from the lows of 2009, exceeding the highs of 2000 and just shy of the all-time high of 14,164 in 2007.

Apparently, these central bankers' monetary strategy is analogous to why Americans serve turkey on Thanksgiving.

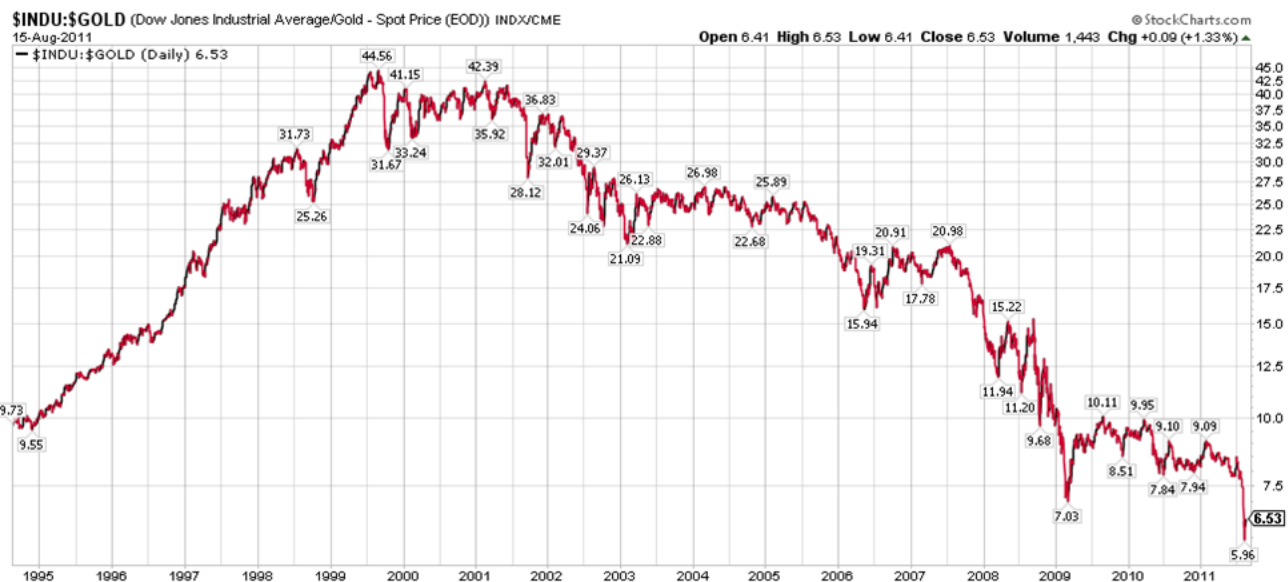


This, of course, begs the question, “So what?” Yes, in nominal terms, the Dow recovered sharply from its low of two years ago and is within spitting distance of its recent record high. However, no rational investor seeks only nominal gains. Imagine you wake up tomorrow, pour a cup of coffee, and turn on your favorite cable news financial show to find flashing banners across the screen announcing the Dow has magically doubled overnight to 25,000. Overwhelmed with excitement, you spill your coffee onto your nice new carpet, creating a classic Rorschach pattern. No matter, you think, I can afford a new one. Visions of early retirement to a South Pacific island dance in your head. In the middle of conducting imaginary high fives in an empty room, you read the “Breaking News” scrolling at the bottom of the screen announcing that gasoline is now \$8 a gallon, milk is \$7.50 a gallon, a loaf of bread is \$4.00, and the auto manufacturers have announced a doubling in prices of all their new models. You slump into your chair, staring at the TV and asking yourself two questions: 1. “What just happened?” and 2. “Can I get that coffee stain out of the rug?”

In our scenario, what just happened is that nothing changed. Investors don’t seek to achieve nominal gains; rather, they seek to acquire purchasing power. In April of 2008, just prior to the Dow’s cliff dive, we wrote, “Dow 15,000, So What, Who Cares, Big Deal.” (Copy available at MasonMcBrideCapitalAdvisors.com.) In that article, we made the point, using government stated inflation evidenced by the Consumer Price Index, that the Dow would have to close near 15,000 just to maintain purchasing power with the 1999 closing average. Our point was, and continues to be, that nominal numbers mean nothing without purchasing power context.

Presently, the conventional financial media lauds the advancement of the Dow to near 13,000, yet they provide no context. If you disagree with Mr. Bernanke and believe that gold is money, then pricing the Dow in terms of gold can help provide that context. There is a distinct difference between money, money substitutes, and currency. Gold is money and, as such, does not lose its purchasing power over a reasonable measure of time. The USD used to be a money substitute that was redeemable for gold or silver, which is money. Presently, the USD is a currency, or, more cynically, an illusion whose value is conditioned upon the confidence in the U.S. government’s fiscal and monetary discipline and the associated perceptions. No further comment necessary.

Looking at the Dow in terms of gold, we find that the Dow peaked in 1999 when it took just over 44 ounces of gold to buy one unit of the Dow. Today it takes about 8 ounces to buy one unit of the Dow, a decline of 82 percent. Stated in purchasing power terms, if you sold one unit of the Dow in 1999, you would have been able to buy 44 ounces of gold. Today, you can only buy about 8 ounces. The Dow has not maintained purchasing power in terms of gold.



In terms of USDs, the Dow has essentially gone nowhere from the year 2000, as evidenced in the previous chart. Yet, in terms of real money – gold – the Dow has crashed 85 percent, falling from 44.56 ounces to 6.53 ounces! Is it over? Given the present dysfunctional behavior of those managing the national budget and economy, you certainly would be wise to reserve an allowance for a further slide in the Dow/Gold ratio. In addition, the 20th century secular bottom in this ratio was achieved at a much lower ratio of 2:1 in the 1930s. Of course, conventional wisdom from the financial and economic “experts” will tell you that the folks in charge are much smarter and have better tools – and it’s different this time. Is it?

Viewing the financial world in terms of real money not only puts the inflation/deflation argument in proper context, but also helps an investor stay focused on real progress in terms of purchasing power. If you or your advisor are not thinking or speaking in these terms, it may be time to change your strategy.

W. Michael McBride is President of Mason McBride Capital Advisors, LLC.

Securities offered through LPL Financial
Member FINRA/SIPC

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. Gold and other commodities can experience fast price swings, which result in significant volatility in an investor’s holdings.

Charts courtesy of StockCharts.com

We’re here for you.

Contact:

Mason-McBride, Inc.
3290 West Big Beaver Road, Suite 503
P.O. Box 7028
Troy, Michigan 48007
248-822-7170 phone
248-822-7150 fax
www.Mason-McBride.com