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## THE ILLUSION OF GOLD AND THE WALL STREET MELTDOWN

A client asked me why their gold fund had not skyrocketed during this Wall Street Meltdown this month. This was my answer:

**The Gold Illusion:** The reason gold isn't rising is because the value of gold is an illusion. Only high demand for gold will make it skyrocket. But the only way to create high demand for gold is to create the illusion that it will bring security to someone who has great fear about the future. Gold has no more utility today than it had last year. Gold is good for jewelry (limited demand, like diamonds), and for electrical contacts in computer systems (for which there are many substitutes). It's not really good for tooth fillings, so what good is it? One must look for "intrinsic value" not speculative value when investing in anything. (Warren Buffet has a good sense of intrinsic value.)

**Speculative Fluctuation:** Now, if everyone believes that gold is a valuable hedge against inflation and drives the demand up enormously, then the price will skyrocket, just as crude oil prices were driven up this summer by speculators who thought the limited supply and increasing demand would create a wild-cat rise in prices. Speculative artificial demand for oil futures drove the price up to \$147/barrel on July 11th. Today (Oct 9th) it's \$87/barrel and dropping. You can see how speculation (which is motivated by fear and greed) can artificially shift prices dramatically.

**Wall Street Mentality:** To understand the Wall Street Meltdown, one must first understand the mentality of the people on Wall Street, and every other major financial market in the world. Willie Sutton, the famous bank robber, was asked "Why do you rob banks?" "Because that's where the money is!" he responded. Thirty years ago I asked a number of my fellow alumni from Harvard Business School why they wanted a career on Wall Street. Behind all the articulate obfuscation, the bottom line: "To make money" (read: to get rich). So, if you were highly intelligent, ambitious, and wanted to get rich, Wall Street was your magnet.

**Deregulation of Financial Markets:** When Wall Street appeals to Congress for Deregulation, the real motive is: Take away the rules so I can Make More Money For Me (MMMMF). This opens wide the door for a den of foxes to raid the hen-house's jewels (401Ks, Pension Funds, Personal Investments) and create a plethora of subterfuge schemes (sub-prime mortgages, hedge funds, CDOs, short selling, management fees, etc.) that use other people's money to feed Wall Street's greed.

**How Some Financial Institutions Preyed upon People:** The Sub-Prime Mortgage debacle was a greed vehicle gone unchecked. Mortgage lenders gave money to poor people to buy houses hoping they would make a boodle later on



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the adjustable rate. Giving more money to those who couldn't pay drove the demand for houses artificially high, which drove developers to build more houses. Speculators, looking to flip or to rent their houses further increased demand, even when there were no renters. Once the supply outstripped demand, the shell game was doomed, and the house of cards could not be sustained. When it came time to pay the piper, the poor and even the speculators defaulted in droves, being strapped with too much debt, compounded by the same tricks the banks used with credit cards. The bubble burst, as do all bubbles like this.

**Wall Street Theft:** Of course, Wall Street mavens were able to make tons of money by buying mortgages then selling them through investment portfolios. Ordinary people's 401Ks and Pension Funds soaked up the bad loans. So when the house of cards fell, Wall Street executives walked away from the meltdown with big bonuses and federal buyouts, while the little guy lost their retirement funds and home values. This is called "robber baron capitalism" that supposedly ended with Teddy and Franklin Roosevelt. But during the Clinton and Bush administrations, Wall Street successfully lobbied for deregulation, which opened the door for this mess. They even had the audacity to advocate shifting people's social security into stock investments! Imagine the mess we'd be in today had that happened. Look for a new spate of regulations, and the cycle will start anew. Unfortunately we live in the United States of Amnesia, and in 10-15 years we will have forgotten these lessons.

Hope this explains your question about gold.

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