PRECIOUS METALS INVESTMENT SYMPOSIUM
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Keynote Presentation:
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Gold: A Barbarous Relic or Life Raft on a Turbulent Sea

In a debt-leveraged ocean full of financial whirlpools, complacency is not an option. Investors need to stay ahead of the game. Don Mackay-Coghill is well qualified to navigate today's often confusing market signals. He will share his views and introduce some new Perth Mint investment products, designed to protect your portfolio and give you some peace of mind.

What is a barbarous relic? We all know that John Maynard Keynes, the British economist, coined the phrase. We all have been told he was referring to gold, but was he?

I hope to convince you this morning that this is not the whole truth. It's closer to a half-truth. Yes, there are a few barbarous relics around today but gold is not one of them.

I suggest we are here today precisely because gold is *not a barbarous relic*. My argument will not be controversial in this place, or in this city, or in this state. In central bank boardrooms, however, it might ruffle the few feathers still left on what used to be a nation's golden goose. I'll come back to that later.

We are also here because gold is money. It's nature's legal tender. Gold is scarce. Gold is not a bank liability. It's not a promissory note. It's not a crypto-currency. Gold has real value. The miners at Beta Hunt near Kambalda know what I mean. They found a vein 500 metres below the surface worth at least $15 million dollars last month. (Reference: WA gold find - 10 Sept 2018)

We are here too because we are the heirs of Australia's most enduring gold rush. We follow in the footsteps of the many thousands of men and women, the dreamers and the desperate, the "great unwashed" from many countries – today they would be called "resilient" – men, women, horses and camels who played their part in a marathon race for riches that has continued for over a century.

They believed that anyone could get lucky out there, especially after a few beers. And drink they did. By 1900, Kalgoorlie and Boulder - just two miles apart - were cities of 30,000 people with 93 hotels and eight breweries.

The gold fever was so contagious the London *Investor's Review* warned City punters about the "West Australian Alchemy". Even Sir Malcolm Fraser, the State of Excitement's agent-general, found himself in its sights in the October 1894 edition.

> "Surely the government of Western Australia does not pay its representative to deliver his soul like this for the benefit of company promoters, syndicates or other buccaneering agencies?"

Beneath the froth and bubble, however, was real gold. It was 125 years ago that prospectors William Brookman and Samuel Pearce registered the Great Boulder lease, now swallowed up by the Super Pit, Australia's most famous gold mine.

Their discovery ensured the great Kalgoorlie rush continued to this day. It had begun three months earlier, when prospectors Paddy Hannan, Thomas Flanagan and Dan Shea found gold at Mount Charlotte a few miles away.

Mr Hannan, by the way, never made another find as big as this one. Who would have thought then that he would die in near-poverty in Brunswick, Melbourne on November 4, 1925, leaving an estate valued for probate at only £1,402?

Today the World Gold Council ranks the Golden Mile as the fifth most productive gold district in the world, with a cumulative output of more than 60 million ounces. At A$1,650 an ounce, that's worth A$100 billion.

But in the early days they did not get A$1,650 an ounce. The gold price was fixed by law - Newton's law - at 3 pounds, 17 shillings, 10 1/2 pence per ounce. That's Sir Isaac Newton, discoverer of the three laws of motion, and Master of the Royal Mint from 1696 to 1727. (Reference: Royal Mint)

He also discovered the universal law of auriferous attraction: that every person in the universe is attracted to any piece of gold, no matter how small, with a force directly proportional to the amount of money in an account bearing his or her name, and inversely proportional to the square of the distance between them.

Newton stumbled on it in late 1720, after losing £20,000 trading shares of the South Sea Company, the hottest stock in England at the time. No one was allowed to speak the words - 'South Sea' - in his presence ever again. You can read all about it in Benjamin Graham's 1949 classic, *The Intelligent Investor*.

But back to John Maynard Keynes. What he actually wrote in his 1924 paper, A Tract on Monetary Reform, was:

> "In truth, the gold standard is already a barbarous relic. All of us, from the Governor of the Bank of England downwards, are now primarily interested in preserving the stability of business, prices and employment, and are not likely, when the choice is forced on us, deliberately to sacrifice these to outworn dogma, which had its value once, of 3 pounds, 17 shillings, 10 1/2 pence per ounce. Advocates of the ancient standard do not observe how remote it now is from the spirit and the requirements of the age."

The barbarous relic, then, was the gold standard, not the precious metal itself.

The gold standard was a monetary system where the value of a currency was linked directly to gold. Countries agreed to convert their fiat or paper money into a fixed amount of the metal on demand. A country that used it set a fixed price for convertibility and bought and sold gold at that price. All trade imbalances between nations were settled with gold. So governments had strong incentive to stockpile it for more difficult times.

England was the first country to adopt it in 1821; Germany fifty years later. By 1900, most developed nations were linked to it. From 1871 to 1914, the gold standard was at its zenith, but the First World War changed everything.

Before Federation, the Australian colonies had their currencies tied, through sterling, to the gold standard: bank notes were an entitlement to a specific quantity of gold, to be paid on demand. Mints in Melbourne, Sydney and Perth minted sovereigns which had the same gold content as those minted by the Bank of England, 113 grains of fine gold. In 1900, gold coins comprised 51% of all coins and notes held by the public. (Reference: H Colebatch, 1996, page 64)

By the 1920s, however, the gold standard was essentially dead. Banks and governments killed it. Governments wanted more money to spend and bankers wanted to lend it to them. The standard prevented excess credit growth and new money creation. It had to go.

So it should not surprise us that an economist - whose theories urged more and more government spending - would consider the gold standard to be a barbarous relic.

There's another reason. When Britain returned to it in 1925, it did so at too high a rate. British goods became uncompetitive abroad. It caused a domestic financial crisis. There were speculative attacks on the pound. They eventually forced it off the gold standard on September 19, 1931. Keynes celebrated the event in a radio broadcast:

> "It is a wonderful thing for our businessmen, our manufacturers and our unemployed to taste hope again. But they must not allow anyone to put them back in the gold cage, where they have been pining their hearts out all these years."(J M Keynes, radio broadcast, September, 1931) video reference

He probably had a glass or two of French champagne that evening with his wife, the Russian ballerina Lydia Lopokova.

As I said earlier, the "gold cage" was the standard, not gold. That said, it is true Keynes was no fan of gold. But he did not say it had *no value*. The direct attacks on it came later, from anti-gold central bankers and others misquoting him.

The final nail in the currency-gold coffin was banged in decades later by President Nixon. He terminated US$35 an ounce convertibility on Sunday August 15, 1971, ending the 1944 Bretton Woods system. And the rest is history.

For some, however, the current system is even *more barbarous*. They attribute today's "destabilizing excesses" and asset inflation to the very central banks whose job it is to manage it; with a little help from hedge funds, the wolves of Wall Street and the shadow banking system.

They say that those who fail to learn from history – or in this case can't remember what happened in 1987, 1997 and 2008 - are doomed to repeat it. Are we? Does anyone doubt that today's mega-bubble will burst?

How did we get here? We got here after ten years of international "monetary stimulus". Unprecedented low global rates encouraged a spree of public and private debt accumulation. The pace is perhaps the biggest predictor of market trouble. Keynes's "spirit and requirements of the age" has produced a monster.

Six months ago, the Institute of International Finance reported that global debt had reached an "all-time high" - *$237 trillion in 2017* -- more than 327 percent of global GDP. Since 2007, debt has increased by a stunning $68 trillion. That's an average rate of $7 trillion a year.

In developed markets, the ratio of debt-to-GDP is now around 380 percent. In emerging markets – which have begun to worry international agencies - the ratio is also above 200 percent.

Link http://www.usdebtclock.org/

Christine Lagarde, the IMF managing director, expressed concern last month about several countries struggling with surging interest rates, inflation, investor flight and public anxiety. That's Argentina, Turkey and Venezuela. When I last looked, inflation in Caracas was hurtling towards one million percent. [Link-reference]

The IMF did not see "contagion" spreading to other countries yet, but Lagarde warned that "these things could change rapidly". The increasing prospect of a serious trade war between the US and China was another big danger facing the developing world – and indeed Australia.

Despite Lagarde's warning, the US imposed an additional tariff of 10 per cent on another $US200 billion ($277 billion) worth of Chinese imports just last week. The total is now $US250 billion. That's about half of the value of all US imports from the country.

China responded by imposing 5 to 10 per cent extra taxes on $US60 billion of American goods. That retaliation triggered a lift in the latest 10 per cent tariff to 25 per cent by next year. The remaining $US267 billion of Chinese imports also becomes the next US target. AFR - US trade war update - 24 Sept 2018

Central banks are finally committed, they say, to taking away the punch-bowl (again). They call it "normalisation". But what's normal in the mad world of money politics today?

Whatever they do, they have lost their mystique of infallibility. Their models are broken. Their prognostications are dubious. Their experiment – the world's largest and longest - in what they call "unconventional monetary policy" has failed. Worst of all, their prodigious debt creation has imposed an impossible task on the world. We are trapped in a Catch-22 situation from which there is no easy escape, *if any.*

Rana Foroohar, a New York-based Associate Editor at the *Financial Times*, summed it up in a column last month. She urged the US Fed to pay more attention to financial market bubbles. "When 10 per cent of the US population owns 84 per cent of the shares, asset price increases do not create inflation, but inequality."

So, you might well ask, is central banking the real *barbarous relic* today? If you believe that, you are not alone. Many of the Perth Mint's depository clients believe it.

Well, if anyone has a solution surely it's the Bank for International Settlements. Three months ago the Bank held its AGM in Basel, Switzerland. [link-reference]

The first chapter in its Annual Economic Report is on monetary policy. I call it "between a rock and a hard place". Here's a quote from the summary.

> "The incipient monetary policy normalisation in the major economies raises *tough challenges*, exemplified by continued loose financial conditions. Normalising too slowly could give rise to overheating and financial stability risks, while moving too fast could trigger disruptive market reactions and harm the economic recovery." (BIS, *Annual Economic Report*, 24 June, 2018)

For many, however, "normalisation" is just another word for wishful thinking. As for the outlook, we are told that: "financial conditions could complicate policy by raising the risk of undesirable market disruptions further down the road if they induce or reflect higher risk-taking."

Any good news? There's finally some soul-searching about "monetary stimulus". You will not be surprised to learn from the Report that:

> "…..there are reasons to believe the downward trend in real rates and upward trend in debt over the past two decades *are related and even mutually reinforcing*. True, lower equilibrium interest rates may have increased the sustainable level of debt. But, by reducing the cost of credit, they also actively encourage debt accumulation. In turn, high debt levels make it harder to raise interest rates, as asset markets and the economy become more interest rate-sensitive - a kind of "debt trap"".

A debt trap indeed. Déjà vu all over again. As I said, we are between a rock and a hard place.

Almost a century ago, Keynes noted that:

> "One is often warned that a scientific treatment of currency questions is impossible because the banking world is intellectually incapable of understanding its own problems. If this is true, the order of society, which they stand for, will decay."

He did not believe it was true in 1923; but perhaps he would today.

The French market regulator summed up the fragile mood in its annual report released two months ago: "The world has never been so indebted - even more than before the 2007 crisis - and this debt has never been so risky."

It issued a warning. The biggest risk this year, it said, "was for a *brutal correction* of stock prices". Current valuation levels were high by historical standards, said the regulator. They were also high "in fundamental terms *across a whole range of indicators*, starting with

American equities. Any correction there would most likely spread to other stock markets." (Autorité des Marchés Financiers, July, 2018) [link-reference]

So what does this all mean for you, and for gold? Well, for you complacency is not an option. It's the Age of the Selfie. It's the age of DIY. You have to do it yourself. You have to be the guardian of your investment portfolio, your own central banker. As for gold, it's a form of insurance. It will assist you underwrite your purchasing power.

Keynes had seen what happened in Europe after the First World War. In his 1919 book, *The Economic Consequences of the Peace*, ironically, he wrote:

> "A sentiment of trust in the legal money of the state is so deeply implanted in the citizens of all countries that they cannot but believe that one day this money must recover a part at least of its former value.... They do not apprehend that the real wealth, which this money might have stood for has been dissipated once and for all. This sentiment is supported by the various legal regulations with which the governments endeavour to control internal prices, and so to preserve some purchasing power for their legal tender."

But there's always a day of reckoning, a day when a population wakes up and realises it has been duped, or caught up in a nasty external event.

Paying for a cup of coffee with a wheelbarrow full of Bolivar Soberanos focuses the mind, even if the cash is a newly printed denomination with a few less zeros, as in Venezuela at the moment.

Under a new devaluation plan, 3,600 new bolívares now equal one petro. What's a petro? It's a digital currency President Maduro created in February. One petro equals the price of a barrel of oil – presumably still under the ground because the sector is in such bad shape - or about US$60. So in theory one US dollar equals about 60 new Bolivar Soberanos, or 6 million old ones.

US Treasury officials have called it a scam. The President has banned US citizens from trading or owning any "digital currency, digital coin, or digital token" issued by the Venezuelan government. As they used to say in Rome, *caveat emptor*. Buyer beware.

According to the BIS, cryptocurrencies are unlikely to become "a dominant form of money". Their flaws include an "incapacity to scale", instability of valuation, vast energy use, trust aspects and regulatory challenges.

As for the technology, it may be useful simplifying the settlement of some financial transactions. Indeed, a number of central banks are evaluating new payment technologies, including CBDCs, central bank digital currencies. Watch this space. Link - BIS reference

Meanwhile, many so-called "coin" cryptocurrencies and tokens seem to be going the way of the dodo. The bear market continues with no end in sight. That's no end of crazy-brave speculators losing money.

Three weeks ago, the market capitalisation of digital assets tracked by CoinMarketCap.com shrank to about $US197 billion - down almost $US640 billion ($900 billion) - that's 70 per cent - from this year's January peak.

Australia, of course, is not Venezuela, at least not yet. Latin American leaders tend to have longer terms than our leaders. People there are more concerned with issues like staying alive. We seem more concerned with granting au pair visas and controlling the weather with windmills than, say, with the price of eggs, coal or iron ore in China.

That said, our Reserve Bank is not immune from criticism. Christopher Joye, a portfolio manager at Coolabah Capital Investments, did not hold back in his AFR column a month ago.

> "The Reserve Bank of Australia blew the mother of all housing bubbles with the equivalent of 13 cuts to its cash rate – from 4.75 per cent in 2011 to an all-time low of 1.50 per cent in 2016.
>
> Despite warnings from this column that a bubble was brewing in 2013 and 2014, the RBA recklessly slashed its cash rate another four times over 2015 and 2016. That was after repeatedly assuring us since 2012 that its ultra-cheap money policies would not fuel super-strong house price or credit growth." C Joye, AFR, September 7, 2018

He's right. It was – and is – the "mother of all bubbles". And now the pass-the-parcel blame game has begun.

The RBA blames the banks and consumers. It's finally worried about widespread mortgage stress. It is (quote) "one of the main risks to financial stability" over the next two years. The reasons: high household debt, rising home loan rates, declining home prices and (naturally) years of irresponsible lending by banks. RBA mortgage stress 4 September 2018

Dr Timo Henckel is a macroeconomist and chair of the Australian National University's RBA shadow board.

"There's a danger, he said, "that much like what happened in the US 10 years ago, Australian households get caught out and it becomes a downward spiral." A major decline in housing prices is "inevitable".

Finder's research shows that $706 billion of new home loans were written in 2014-2015, with 42 per cent or $295 billion being interest-only loans. That means borrowers do not have to pay down the loan for an average of five years.

Their time is almost up. The nation's love affair with interest-only mortgages is coming back to haunt it. Thousands of households could be in trouble, not to mention the economy and the dollar.

The total value of residential property in Australia is about $7 trillion. One-third of it is held by investors. Losses to date are approaching $300 billion. AFR - Labor policies crushing house prices - 14 September 2018

If you're struggling with mortgage debt – I hope you're not, but if you are - contact the National Debt Helpline, a free and independent counselling service, on 1800 007 007 or visit www.ndh.org.au. Don't you love that telephone number?

Our banks could struggle too. They hold $1.7 trillion in mortgages for owner-occupiers and investors. That's about 65 per cent of their total lending. It's much higher than any other developed country. Some say Australia is now in the same position as the US in 2006 and 2007.

So to the Australian dollar. It's fallen to its lowest level since early 2016. A fall below US70¢ is possible, especially as President Trump seems determined to tariff every single Chinese export into the US.

The dollar's been under pressure from the emerging market weakness mentioned earlier. With such issues out there on the downside, it's hard to be optimistic. Some say it could weaken to the mid-US60s and beyond. (Reference: AFR - negative AUD outlook - 10 Sept 2018)

Against this background, one has to get serious about wealth preservation and portfolio insurance. We believe so. Indeed, that's why we've developed a suite of new investment products.

The Perth Mint, incidentally, is the trading name of Gold Corporation. It is wholly owned by the government of Western Australia, currently rated A1+. The state guarantees all our offerings and obligations; including, of course, the gold stored on behalf of investors.

We are Australia's largest integrated precious metals refining, minting and depository group. Our refinery is accredited by the five major gold exchanges. We process over 90 per cent of the country's newly mined gold.

We operate the most extensive network of central bank-grade vaults in the southern hemisphere. We hold billions of dollars of precious metals for a wide range of international investors.

We are one of the state's top five exporters. We distribute bars and coins worth an annual $18 billion to over 130 countries.

Two months ago, the Mint launched the world's first sovereign backed gold Exchange Traded Fund on the New York Stock Exchange. The ETF gold held in Perth is covered by the state guarantee. What's more, investors can exchange their ETF shares for physical gold in a wide range of denominations.

Another product, our GoldPass App, enables users to buy, sell and transfer gold between App users. The physical gold backing the product is represented by digital certificates within the App. They give legal title over a specific amount of gold held at The Mint, with the gold itself guaranteed by the state government.

The Mint also operates an online trading platform that allows investors to buy, sell and store precious metals.

If you want more details on these and our other innovative products, simply go to: www.perthmint.com.

Ladies and gentlemen, the Mint is uniquely placed to serve you and your clients. It is uniquely placed to assist you take advantage of gold's natural scarcity and traditional role as a store of value and security. *That's our business*. It's what the Mint's been doing well for over a century.

To conclude, in the Age of the Selfie, one cannot rely on others. One cannot rely on the Federal government, the central bank or Lady Luck to deliver the climate we want, financial or otherwise. One must take personal responsibility. Don't get wet. Buy an umbrella. Buy some SPF 30+ gold too, in case the alarmists are right.

Good luck.
Thank you.

Don Mackay-Coghill