

Gold by Montresor

A war of attrition

Two rules for private investment amidst a protracted battle by the banks and central banks.

London gold dealers fixed gold at \$412 at the July 15 fixing, not substantially higher than its range of the past two weeks. The slack price movement since the sharp decline of last month is a symptom of *sitzkrieg*, the sitting war, before reserves have been committed and the test of strength begins.

The group of banks that began the price decline, mostly Italian and Swiss, are not so foolish as to disgorge their and their clients' gold reserves quickly. Indeed, the entire decline between the \$500 and \$400 range for the gold price took place on remarkably thin trading volume, in which a few tons of gold trading hands produced price swings of \$20 to \$30 per ounce.

In legend, old Nathan Rothschild may have flanked the competition at the London Bourse of 1813, pretending a panic in order to buy gilts at distress prices. But although the present "bear raid" is similar in character, all the market participants enjoy more or less the same degree of information. The victor must therefore win a war of attrition.

The secret to the success of the "Venetian" raid against the gold price is the close collaboration of private and central banks, particularly those of France and Italy. Small investors in France hold perhaps a fifth of the 25,000 tons of gold in private hands. The largest single private hoard I know of is that of the Jesuit order, a mere 30

tons. To accumulate gold in significantly large volume, the raider must somehow persuade many private individuals to sell off their hoards.

But the difficulty in obtaining this result is the simple fact that the great concentration of private hoards is among those investors who see gold as a personal insurance policy, particularly in France, where families buy gold rather than insurance policies. Against this must be weighed the brutal consequences of M. Mitterrand's present monetary policy, which has placed the majority of French small businesses at the brink of ruin. They must draw on the reserves of their present insurance policy, or perish. The Banque de France has acknowledged the crisis of the multitude of small businesses, insofar as it has made palliative credits available, but with a ceiling per firm of only 100,000 francs, hardly sufficient to stem the crisis.

Interest rates are the beaters in the hunt, and the position of the small French businessman who considers whether to sell his reserve of gold is not much different from that of one of Europe's giant commercial banks, which lately sold its gold portfolio in order to raise cash to cover bad debts.

Even those who accumulate gold to strengthen their position should the present credit system collapse must, ironically, have ready means of credit in order to

maintain their gold position. It is possible to say with confidence that the present price will drop after another tier of gold investors is compelled to sell off, perhaps to \$350, perhaps even lower; and that the price will rebound upward with a vengeance as present currency arrangements disintegrate.

Yet the price will not break smoothly, but with violence, the way defending troops yield territory to an enemy assault. Rapid price recovery in the short-term followed by an even deeper fall is not to be excluded.

Therefore the first rule for investing in gold is *liquidity*. The investor should not exceed his capacity to endure a financial war of attrition, especially when local credit conditions may become dangerous.

Gold below \$400 is a bargain, and gold below \$350 would be perhaps the bargain of the decade; nonetheless margin positions are in general to be shunned.

The second rule is that the longer the term of the investor's expectations, the greater are the chances for success. Those who say that gold is no different from porkbellies are fools; the phenomenon of rapid gold-price fluctuations comes from a change in monetary era. Ten years ago to the month the Bretton Woods System collapsed, and the interregnum that ensued had no sound basis for continuity. It seems that the apex of the crisis of transition is a matter of months.

Even the most powerful participants in the tactics of this crisis are uncertain to what course of action they should take in a particular week or month. How much more dangerous is it, then, for a small investor to plunge into the short-term ebb and flow of the market?