

GOLD EXPLAINER



Gold is Finding the Sweet Spot
Between Inflation and Deflation

| Edited by Gregor Macdonald

FEATURED CONTENT

Automobiles on Java	5
California Watch	6
Data Map of the Week	6

ALSO INSIDE:

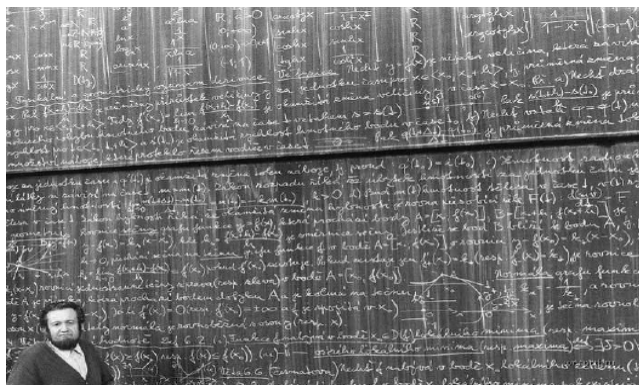
This week on StockTwits.TV:

Crack in to Autumn
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CONTENTS

GOLD EXPLAINER

The math behind gold's rise appears complicated to many. Perhaps it's more simple than all that. In a time of zero economic growth in real terms, with a loss of purchasing power and price instability, gold may be functioning as capable storage unit of capital. No belief in gold as a savior, nor criticism of gold as a mania, explains gold's rise over the past 10 years. Instead, gold as a tactical solution may even be "rational."



FEATURES

Automobiles on Java 5

It appears Indonesia, like China, is going to race to adopt automobiles. But limits now approach.

California Watch 6

The total number of employed persons in California is back. As in, back to Summer of 2000 levels.

Data Map of the Week 6

What if we defined US geography by distance, from the nearest McDonald's?

A NOTE FROM THE EDITOR

Welcome to StockTwits Macro Weekly, the weekly magazine of the StockTwits investment community. Each issue features a core essay, written by the Editor. Around this, we build in the key news events and observations, from the past week. [To have each issue sent to you, sign up here.](#)

You will also find StockTwits Macro Weekly functions as a live document, that is eminently clickable and is therefore a helpful launching pad to other relevant content. Feedback from readership is welcome, and we are always on the lookout for written contributions from the community: gregor@stocktwits.com

A promotional banner for Gregor Weekly. On the left is a logo with a house icon and the text "Gregor Weekly". To the right is the text "Gregor Weekly" in a large serif font, with "gregorweekly.com" below it. A yellow starburst graphic contains the text "Premium Blog". Below this, a list of member benefits is shown: "Hand crafted model portfolio", "Real time changes to model portfolio", "Mid-week portfolio discussion", and "Weekly macro note". At the bottom, a dark red button contains the text "Sign up for two-week free trial".

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Premium Blog

Member Benefits

- Hand crafted model portfolio
- Real time changes to model portfolio
- Mid-week portfolio discussion
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GOLD EXPLAINER—Once upon a time before the advent of fossil fuels, when economic growth was tied to the agricultural cycle, there existed the problem of capital storage. Living, as people were, in an Age of Wood meant that many of the capital storage solutions we're accustomed to today--mainly savings and credit in paper currency form--were not as viable, or robust. Agricultural economies, powered by wood and labor, did not produce enough energy, or enough complexity, or enough *growth* to produce the long-cycle credit instruments or other forms of wealth storage that could be relied upon for decades into the future. Tied to the seasonality of the agricultural cycle, and held back by the lower energy outputs of wood, and human and animal labor, one of the few ways regions and states could accumulate power was to seize foreign lands. By conquest, states or empires could then pick up the productivity of distant farmland and labor. Indeed, in the fossil fuel age, we are so accustomed to the notion of leverage, of extracting greater productivity from existing resources, we have lost touch with a flatter, slower world that was more resistant to leverage. Whereas gold and silver were durable solutions, therefore, to the problem of capital storage for several thousands of years, the fossil fuel age would both challenge and with the exception of a few brief periods, mostly obviate the need for silver and gold. The reason is simple: in the fossil fuel age, capital storage vehicles--whether cash, credit instruments, or ownership--could be more reliably protected or redeemed by *growth*. When you read [a contemporary Op-Ed piece](#) in a Western newspaper, ridiculing gold ownership, this is precisely the point that is made: Why invest in an inert metal, during an age of boundless growth opportunities? Indeed. Why do such a thing?



It's unfortunate that the current discussion surrounding gold remains trapped in one of the those

Indexes

INDU 10607 TNX 2.62 GOLD 1274.36 VIX 22.01 SPX 1125.59 DXY 81.407

StockTwits.TV: News Desk with Leigh Drogen



You should watch StockTwits Newsdesk each morning (and afternoon) with [Leigh Drogen](#). Why? Because Leigh puts on a great 30 minute mix of charts, news, and commentary that captures nicely that day's global market action.

One of the visual display tools that Leigh uses regularly is a personalized FinViz graphic, that makes for a helpful mix of global indexes, currencies and commodities. And that's one of Leigh's great strengths. Unlike run-of-the mill financial TV shows which often concentrate on personality driven stories, Leigh pays a lot of attention to the overnight action in Asia and Europe that so often provides a crucial tell on the US market open. These days, that's been an especially important area to pay attention to, as currency debasement out of Japan, macro data out of China, and the global trading in Gold and the US Dollar have often set the tone for New York. [Watch the show here.](#)

[StockTwits.TV](#) can also be taken as an iTunes subscription.

all too familiar dead-ends, a mind-numbing either/or-ism between believers and rationalists. Neither the uncritical belief in gold as a vehicle for redemption, nor, the snarky put-down of gold as an example of irrational, social behavior will be of much help from this point forward. In truth, neither of these perspectives have had much if anything to do with gold's advance starting a decade ago. For example, a broad array of fund managers globally have been accumulating gold for some time. They do so without the aid of shrines, and, they provide at least a moderate analytical case for their investment. In other words, gold has not risen globally the past ten years because people are seized with the sudden recognition that gold is money and has always been the only real money, nor, has gold risen without reasonable justification. One way of thinking about the multiple analytical failures which surround gold is to remember the distinction between nominal values and real values. If we look at the past decade, for example, and mark a basket of assets that usually makes good headway during strong economic growth, we find that assets such as real estate, equities, and cash have both risen and fallen in nominal terms--but in real terms have been crushed. For example, the SP500 as of Friday's close is down -23.39% in nominal terms since January 1, 2000. But against a broad basket of commodities, say the Continuous Commodity Index, the SP500 is down a [horrendous -70% in the same period](#). In real terms, the purchasing power of the SP500 has been destroyed over the past 10 years. Let's recall our serial newspaper columnist who likes to call gold a stupid rock, and equities the best vehicle for investment. Is it merely a coincidence that as the SP500 fell hard in real terms over a decade, gold rose at least as much during that time?

From a broader perspective, macroeconomic releases last week also quantified the big-picture decline of purchasing power, and of wealth, in the United States. While the

decline of wealth also looks gargantuan in nominal terms, as total losses now approach [12.3 trillion from the peak in 2007](#), it is the very significant addition to Poverty that strongly indicates the real losses, occurring in the US economy. Poverty levels are a better measure of the holistic combination of wages, debt, and most important of all--purchasing power--that governs actual living standards in United States. In short, the country is getting poorer--not richer, as measured in real, not nominal terms. To wit, the [poverty rate advanced](#) an astonishing 14.3% in 2009, moving another [4 million Americans](#) down below the poverty line. The cost of food, rent, energy, and healthcare--as shown in all data surrounding the prices of these services and commodities--have simply not come down enough in the past 24 months to intersect with flat to declining wages in the United States. It's not merely that millions of jobs have been lost. It's that many jobless have taken much lower paying jobs. Worse, the advance in poverty, according to observers, appears to be continuing in 2010. This is no surprise. Commodities are rising at least as fast if not faster in 2010, with special action taking place in the grains, and other softs. Combine this with oil, stubborn above 70.00, and we should indeed see more Americans falling below the poverty line. 75 dollar oil is [too expensive for the American transport system](#), which was largely built out when oil averaged 10-12 dollars a barrel.

It's also no surprise that gains in gold are offsetting the American tumble in overall, economic *fitness*. Oil that we are not using, either by discretion or by job losses, is being [taken up by China](#). Central bank buying of gold also turned positive in the past 12 months [for the first time in decades](#). That's a pretty clear indication that, among those who helm whole currency regimes and economies, gold for now is a *tactical* solution to global currency debasement. And, this may even become a prescient *strategic* decision should the

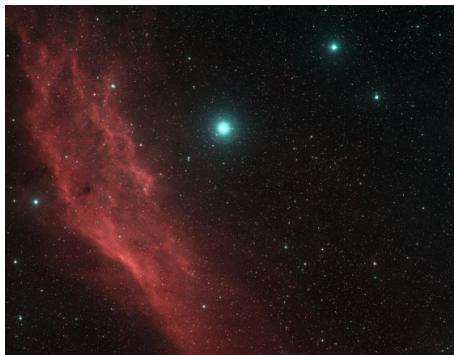
Automobiles on Java



China commands an outsized proportion of newsflow when it comes to monitoring the global economy. It's understandable that China's coal consumption, electrification projects, oil imports, and automobile adoption rates would lead any discussion of growth in emerging markets. However, given some nascent trends elsewhere in Asia, it also makes sense to start paying more attention to Indonesia.

Indonesia's population is currently running at 227 million. Once a member of OPEC, it left that organization after it lost the ability to "export" oil and turned net-oil-importer. Still producing just under one million barrels a day, however, Indonesia has started to track bigger-China in its automobile adoption rates. Purportedly, greater Jakarta--one of the true mega-cities of the world--has seen its car ownership [leap way beyond infrastructure capacity](#). Thus collapsing average road speeds to 5 mph. If observers were thinking peak oil production was set to halt Indonesia's growth, a [second mining wave of the archipelago's massive coal reserves](#) (financed by China) should keep things running for now.

California Watch



From a post crisis low last Winter, California employment--as measured by the total number of persons employed--began a recovery into this Summer. At the bottom, in December 2009-January 2010, California had given back 100% of all employment gains since the year 2000. A lost decade to be sure. But with the recovery in jobs underway at the start of 2010, was there reason to believe a sustainable trend was underway? In short, no.

California employment peaked in late 2007 at 17.07 million persons employed. This Spring, a brief recovery attempt was mounted as employment recovered to 16.06 million in May-June. Since then, employment levels have fallen back below 16 million. About the levels last seen in 2000. In fact, August 2010 employment is almost exactly at the same level as August 2000.

Culprits? Massive debt saturation in the private sector, and wrecked balance sheets. Also, the recovery in the price of oil to the 70-80 range has not been kind to California, heavily leveraged to highway transport. For data just released on Friday, [see a chart update here](#).

global financial system run into further trouble. That Japan would unleash another new round of currency intervention was a green light for gold this week, as it rose to another all time nominal high of \$1277.50.

No doubt gold will stop working as a Capital Storage Unit (CSU?) when resolution comes to the world's financial system. The OECD countries, which are debasing their currencies, are doing so because they are unable to spark growth by another means. This inability to kick-start economic growth comes via debt saturation, a step change higher in energy costs, and lack of political will to reform the system. Precisely the kind of dark swamp in which gold thrives. Moreover, gold helpfully resolves the ongoing inflation/deflation debate as the developed world suffers from paradigmatic deflation after a burst credit bubble, *but*, continues to struggle with loss of purchasing power. In other words, *even when "prices" do come down in nominal terms, they may not be more affordable in "real" terms*. It appears, therefore, that some form of stagflation is approaching on the horizon, and gold--despite noisy chatter of all kinds--is thriving in anticipation.

--Gregor Macdonald, 19 September--Amherst, Massachusetts

Data Map of the Week: updated McDonald's Distance Map of America, from the new blog: [Data Pointed](#).

