APRIL 2014
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the BENEDICT *REPORT*

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WHO MAKES OUR MONEY?" WHAT VALUES OUR "MONEY?"

Inflation, Deflation, Printing Money, Gold, Federal Reserve, Interest Rates, Deficits...

If you are a "news" watcher or reader, especially the financial "news," then you are constantly bombarded with economic jargon, stock market analysis and, of course, predictions. A big news maker is how the Federal Reserve did this or that to: strengthen the economy, lower unemployment or some other benefit to us lowly souls.

> ### The Federal Reserve's Dual Mandate
>
> **1977, Congress amended The Federal Reserve Act, stating the monetary policy objectives of the Federal Reserve shall be maximum employment, stable prices and moderate long-term interest rates."**
>
> (SOURCE) Federal Reserve Bank of Chicago website)

The Federal Reserve was created in 1913 thus we "celebrated" the august organization's one hundredth birthday last December. As I was reading a commentary on the Fed and its doings I got to thinking. Thinking about how a few individuals over the last one hundred years seem to have had a profound impact on our personal economic situation. Did their actions make my economic life better? Don't know. Worse? Don't know that either. Let's go back to our early currency and then look at the three economic "biggies."

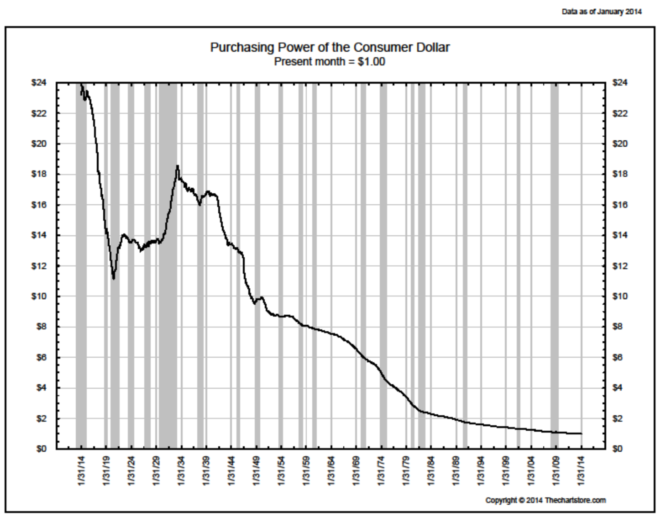
As a country our first currency was the paper money created by the Continental Congress, known as "continentals." The country needed a lot of money to finance the Revolutionary War and printed more and more "continentals." At first that was not a problem but eventually it led to rather severe inflation. Eventually people lost faith in the notes and the phrase "not worth a continental" came to mean "utterly worthless." The "continentals" were backed by the same thing our current dollar is backed by...nothing...except faith in the government issuing the money.

We had a couple of tries with a national bank and both lasted until the "other" political side got into power and discontinued it. Meanwhile the local banks issued their own "currency" or notes to help the flow of local commerce.

THEN:

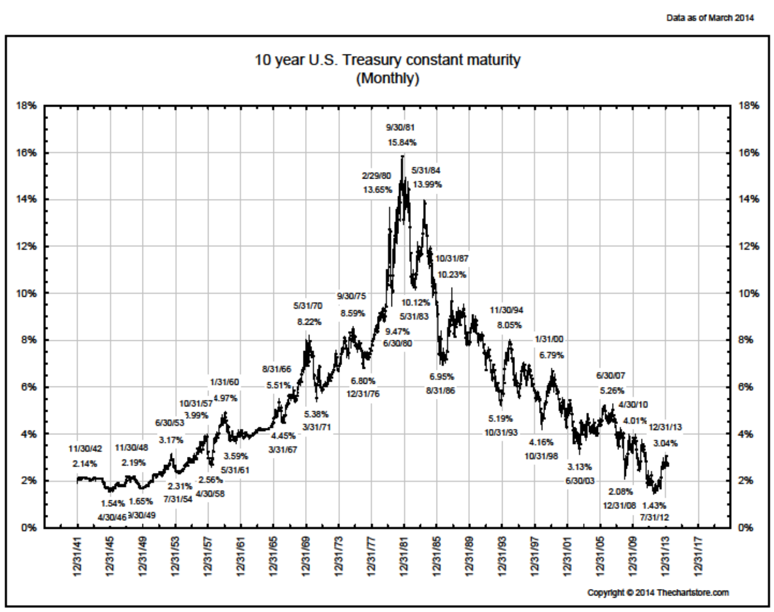
BIGGIE I: The Federal Reserve was created in December 1913. It was created in response to an economic panic...naturally. There was still strong opposition but one political party had the power and the central bank was created. We were assured that it would be "good for the people of our great country." Over the years it has been given more and more power over our nation's currency and monetary system. Has it done a good job?

Here is a chart of the “Purchasing Power of the Consumer Dollar” from 1913 until current times.



It appears that IF a major objective of the Federal Reserve was to maintain a stable dollar it has not done a very good job.

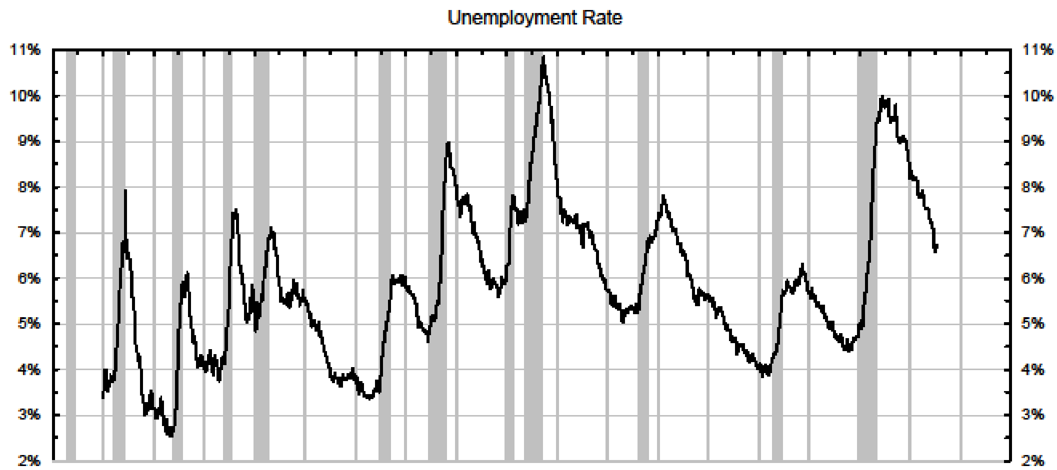
Here is a chart of the interest rates of the Ten Year Treasury Bond.



The Chart Store

It appears that IF a major objective of the Federal Reserve was to maintain stable interest rates it has not done a very good job.

Here is a chart of the Unemployment Rate since World War II.



The Chart Store

It appears that IF a major objective of the Federal Reserve was to maintain full employment it has not done a very good job.

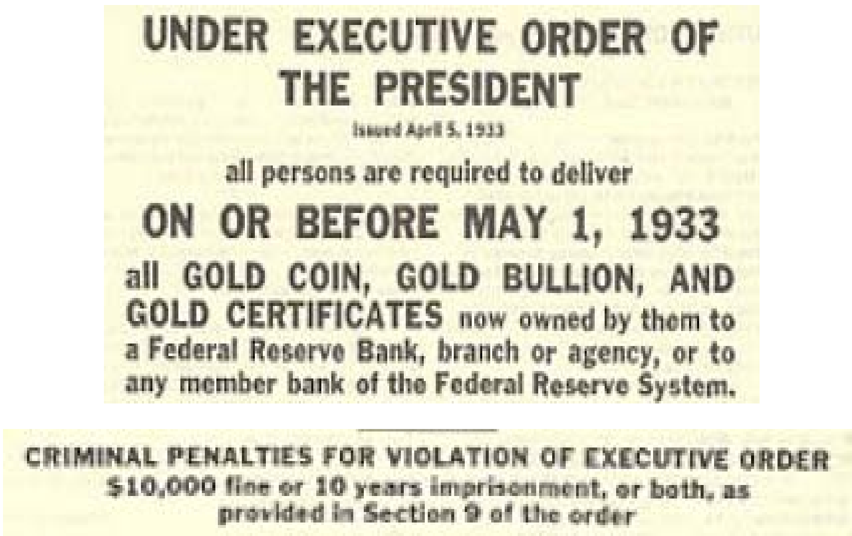
But, maybe these are not valid ways to judge the work of The Fed or maybe it is.

THEN:

BIGGIE II: In 1933 just a few weeks after taking office during a severe economic downturn, President Franklin Roosevelt announced through Executive Order (#6102) that it was immediately illegal for individuals or companies in this country, citizens or not, to own gold. People had a few weeks to sell all their physical gold to the government for $20.67 per ounce of U.S. Dollars. He said the measure was "temporary." He claimed the "hoarding" of gold was one of the major causes of the poor economy. (Many of the "hoarders" had apparently purchased gold as a hedge against the inflationary days of the 1920's.) Of course he was playing on the common man who owned no gold. He even went so far as to make the ownership of gold a crime punishable by prison. The President literally seized the gold of private citizens.

> *His actions seemed more dictatorial than presidential, but due to the economic panic and his newly elected status and the overriding majority of his political party, he was not successfully challenged.*

Then the President, after the government owned all the gold, arbitrarily announced a few weeks later that the new price for an ounce of gold now would be $35.00, giving the government more money to spend and thereby devaluing the U.S. Dollar by about 70%. (First we take your gold and then we devalue your savings.) (Dictatorial or Presidential? Didn't he need to consult with Congress?) Naturally he told everyone that this would be good for average Americans. Actually, the economy did show some strength for many months afterwards before falling back into depression.



UNDER EXECUTIVE ORDER OF THE PRESIDENT

Issued April 5, 1933

all persons are required to deliver

ON OR BEFORE MAY 1, 1933

all GOLD COIN, GOLD BULLION, AND GOLD CERTIFICATES now owned by them to a Federal Reserve Bank, branch or agency, or to any member bank of the Federal Reserve System.

CRIMINAL PENALTIES FOR VIOLATION OF EXECUTIVE ORDER

$10,000 fine or 10 years imprisonment, or both, as provided in Section 9 of the order

THEN:

BIGGIE III: In 1971, by Executive Order (#11615), President Nixon ended the era in which the U.S. Dollar was "pegged" to gold at the rate of $35 per ounce. This was a biggie because for almost 200 years the dollar had been convertible into gold, but only by foreigners after 1933. Of course, he did this "to increase the general prosperity of the American people." He announced this during a Sunday evening televised speech, not in front of Congress. When the Treasury Secretary was asked if this meant that America was abandoning its commitment to the gold standard he "assured the country that this was an act of America taking charge to stabilize the US economy and decrease unemployment and lower inflation and benefit the working man." (Isn't it amazing how the abuse of power by our leaders is always to help the "working man" or the "middle class?")

Nixon's speech talked about "new prosperity" and "new jobs" and how this will "protect the position of the American dollar as a pillar of monetary stability around the world." (Dictatorial or Presidential? I guess he didn't need to consult with Congress.)

I realize these events took place over a period of one hundred years, but they were all big events at the time and all have had a profound impact on our economic lives since. What does seem a little scary is that all were rather abrupt responses to an economic panic at the time. I can understand the necessity to respond to hardships; however, the responses literally changed the course of our economic history and in rather dictatorial ways and always when one political party was in control of Washington D.C.

I didn't mention a couple of other big events in our economic/money lives with one being the creation of the Federal Deposit Insurance Corporation (FDIC) in 1933. This seems so wholesome but the opponents way back then warned that it would lead to bankers taking dangerous risks in their lending decisions to make greater profits. Also, we separated "traditional banking" from the "investment banking" done by the Wall Street firms. The retail banks would deal with "safe" money and Wall Street would handle the "investments." This was known as the Glass-Steagall Act. Both were part of the Banking Act of 1933. The Glass-Steagall was repealed in 1999 by the Gramm-Leach-Bliley Act which allowed banks to offer investment securities and insurance products again. I still wonder whether that was a wise move.

All of this history and I haven't answered the question…who determines what our money is worth? A partial answer might include:

A. Buyers of our bonds. The government borrows money by issuing bonds. If the bond buyers believe that the dollars they receive when the bonds mature will purchase a lot less than they purchase today, they will likely demand a higher interest rate on their loans (bonds).

If you are China and you see how the U.S. is “printing money” trying to make our currency less valuable, wouldn’t you start reducing your purchases of U.S. bonds. When a big buyer like China stops purchasing our bonds is it likely we will have to pay higher interest rates to the remaining willing buyers?

BUT, what if the main “buyer” of our bonds is our Federal Reserve?

B. Traders. If I am working for a global corporation with millions of dollars of “cash” available, then I’m constantly looking to earn the highest rate of interest I can earn…safely. If I get even a hint that the U.S. may not honor their commitments I either quit buying their bonds or at least demand a higher interest rate to compensate for the risk, which could "cheapen” our currency.

Is it possible that at some point in time the U.S. Government won’t pay back its debts?

You would think that as long as we have the ability to “print” our own money there would be little chance that we won’t pay our debts. But just as the printing of the “continentals” was so aggressive that they became pretty much worthless is there a risk that we “print” too many dollars?

The traditional thinking is/was in order to get our finances in good order, meaning assuring the world that we will pay all our commitments, we need to:

- Drastically reduce spending, or
- Drastically increase taxes, or
- Create inflation (reducing the value of our dollar) making our debts easier to pay

So far all we have gotten is political talk. Despite all this political talk we have basically not cut any meaningful spending. Taxing the very high earners, while politically popular with the masses, will never raise enough money to solve the problem because we don’t have enough rich people. And there are too many middle-class voters who won’t let us raise their taxes…at least not directly.

If the above thinking is correct, that pretty much leaves inflation OR default…renunciation of our debts, as the obvious result. Or does it? Who says we can’t just keep “printing” more and more money?

As I alluded to in a January article, the United States seems to be trying to create inflation, Japan seems to be desperately trying to create inflation and Europe probably needs inflation plus a lot of other things to save the Euro.

But, does “printing” more money cause inflation? I’m not sure…so far it does not seem to be working in any of the above mentioned countries. And, so far, it does not seem to be pushing interest rates up. We will write more about inflation in the future, but maybe the high inflation of the 1970’s was due more to commodity shortages…oil, copper, iron ore…than the “printing” of money. I was always taught that “printing money” creates inflation…does it? I don’t know…it hasn’t over the last few years.

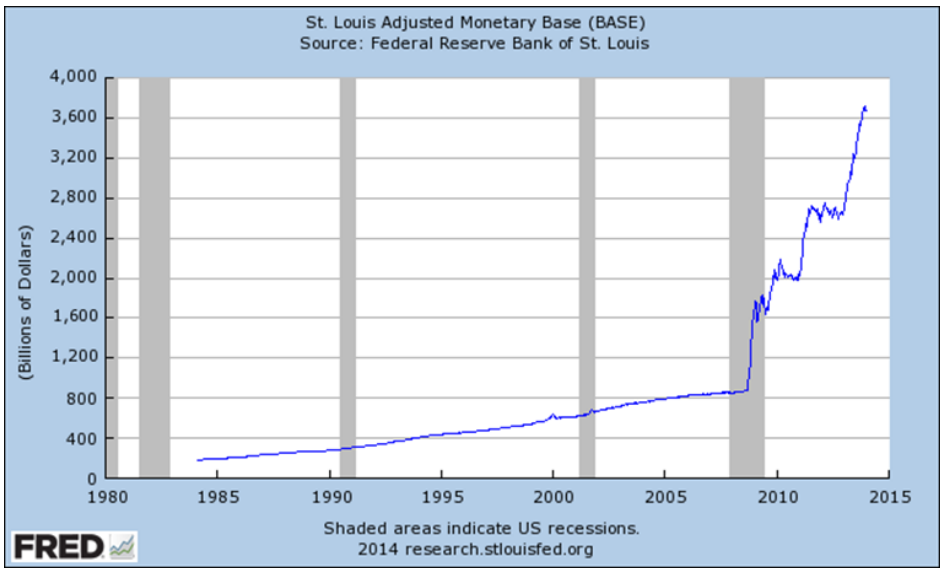
Alan Greenspan said that the Social Security obligations can always be met because we have unlimited dollars at our disposal. I basically agree with that. But, will those dollars buy as much? I don’t know. Is there no limit to how much money the government can create? I don’t know. But there might be a limit in the future, won’t there? I would think so, but I don’t know.

And another thing that goes through my mind…will new forms of “currency” be created in the future? What about the new digital currencies some of you have read about? What about countries that trade a lot with each other, creating their own accounting of the trading of goods and services.? For example if China needs Brazil’s natural resources and the two countries create some sort of digital accounting that they are both happy with, what is the need for dollars? For gold? For anything else? Could this be a major trend about to happen? I think so.

I have spent quite a bit of time wondering about “currencies,” “money,” “deficits” and the like. My very strong nature is that a country, like a household or a business, should NOT spend more than it takes in as income. But, am I just old fashioned…financially?

I have always felt that the limitations on how much money we could “print” was sort of a rudder that kept our politicians from doing really, really stupid things. But, we saw FDR cut a big hole in the “rudder.” Then, Tricky Dick made the hole even bigger. Are we better off or worse off because of their actions? I don’t know.

But those actions are way back in history. What about today.? It certainly looks as though we are living through a big economic event…BIGGIE IV…the “printing of money.” Here is a chart of the Federal Monetary Base that basically shows how much “money” the Federal Reserve has made available.



Does it look to you as though we made a major course change over the last few years?

Since 2009 we (the Federal Reserve) are buying our own bonds (issued by the Treasury Department). For someone with some accounting background, buying our own bonds feels like paying off the mortgage with credit cards, but maybe with a government that has no limit on how much “money” it creates, it doesn’t work this way.

I read articles by lauded economists saying we need to “print” more and more money to *stimulate* our economy and get it back to normal. I grew up in a rural area where common sense was much more common than Harvard degrees and my common sense does not agree with their superior wisdom. Creating more money with no restraint on how the political leaders spend it and no meaningful longer-term plan just becomes vote buying in my world.

I do believe we need some serious infrastructure spending in the country and we have discussed before how it can be funded. I also believe that the more the powers in Washington D.C. attempt to *benefit* or *manipulate* (whatever your view) the economy, the more the private sector hunkers down.

Is inflation in our future, or deflation? High interest rates or continued low interest rates? I guess the answer is something like: yes, no, maybe, I don’t know. But I do know that economic and financial crises seem to have been happening since Paul Revere climbed up the church steeple. We don’t think predictions are the answer, we don’t think we will be able to avoid all the crises, but we do believe we have to adapt to whatever life throws at us.

That is called life!

I asked a question in the title…**What values our "money?"…**have I answered it? Obviously no. Do I know what the future of our money is? Obviously no. But, it is so much fun to be part of the drama that is real life on the stage. I'm trying to sit back and enjoy the action…wondering how it will turn out. Meanwhile, I would still like to be able to "print" my own money…at least a little….what is so wrong with that?

SOURCES:
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"History of the Federal Reserve" www.federalreserve.gov
"Executive Order 6102" Wikipeda
"Nixon's Colossal Monetary Error: The Verdict 40 Years Later" Charles Kadlec in *Forbes* August 11, 2011
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Really? These are the people leading us to the financial Promised Land?

Here are a couple of paragraphs of the Minutes of the December 17 & 18, 2013 Federal Open Market Committee of the Federal Reserve Board. I think you will feel more fiscally confident after you finish reading them.

> Most participants judged the marginal costs of asset purchases as unlikely to be sufficient, relative to their marginal benefits, to justify ending the purchases now or relatively soon; a few participants identified some possible costs as being more substantial, indicating that the costs could justify ending purchases now or relatively soon even if the Committee's macroeconomic goals for the purchase program had not yet been achieved. *Participants were most concerned about the marginal cost of additional asset purchases arising from risks to financial stability, pointing out that a highly accommodative stance of monetary policy could provide an incentive for excessive risk-taking in the financial sector.* It was noted that the risks to financial stability could be somewhat larger in the case of asset purchases than in the case of interest rate policy because purchases work in part by affecting term premiums and policymakers have less experience with term premium effects than with more conventional interest rate policy. *Participants also expressed some concern that additional asset purchases increase the likelihood that the Federal Reserve might at some point suffer capital losses.*
>
> *A majority of participants judged that the marginal efficacy of purchases was likely declining as purchases continue, although some noted the difficulty inherent in making such an assessment. A couple of participants thought that the marginal efficacy of the program was not declining, as evidenced by the substantial effects in financial markets in recent months of news about the likely path of purchases.*

Now, don't you feel a lot more confident about our fiscal leadership?

BENEDICT
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 THE BENEDICT REPORT APRIL 2014

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WHO MAKES OUR "MONEY?"
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WHAT WE DO...

We prepare financial plans, which are essentially blueprints for what our clients are trying to achieve in the future. Much of our planning involves creating a Retirement Income Plan for our clients.

We manage our clients' investment accounts on a fee basis with discretionary authority focusing on meeting their objectives rather than focusing on what the financial markets may be doing.

The primary author of The Benedict Report is Philip C. Benedict, CFP®, an Investment Advisor Representative and Registered Principal with **LPL Financial**, a registered investment advisory firm and member of FINRA/SIPC. Travis M James, CFP®, Mark A Beaver, CFP® and Ashley A Thompson, CFP® provide technical assistance. Jean B Wilson and Jackie Thompson handle the layout and editing of the newsletter.