DK Analytics, Post #8: Assaulted property rights (and thus liberty); fiat money focus, installment #1

Central banks will "double down" on financial repression -- accelerate money printing (www.zerohedge.com/news/2015-08-29/citigroup-chief-economist-thinks-only-helicopter-money-can-save-world-now) -- until a global fiat currency supernova repudiation occurs amidst increasingly competitive currency devaluation rounds. The resulting massive increase in the global money supply, or way too much currency chasing way too few services and goods, which is also is also known as inflation, will sow the seeds for hyperinflation.

Americans are especially vulnerable to hyperinflation thanks to over 16trn in liquid greenbacks overseas that could "come home" in significant amounts due to China selling Treasuries (www.zerohedge.com/news/2015-08-27/its-official-china-confirms-it-has-begun-liquidating-treasuries-warns-washington) and to less dollar-based trade: multiple bilateral yuan swaps with OPEC and EU nations have commenced, and staunch ally Japan considering Russian currency swap www.rt.com/business/314193-japan-russia-swap-sanctions

Posted on September 8th 2015

Introduction:
Last month and the month before we devoted a multitude of bytes to the central role property rights -- which are key unalienable rights integrally tied into liberty and happiness -- play in an optimal wealth of nations trajectory.

Let's have another look, with this piece as the kick off blog delving into this key topic in a few installments, each featuring different aspects. Stout property rights protecting the vast majority of earnings constitute the vital underpinning or heart of any functioning, much less thriving, free market economy. Stout property rights incentivize capital formation, risk taking, and payroll growth. In short, they facilitate the very enterprise or free market capitalism that provides greater freedom, wealth, and happiness than any other system. Why? Because property rights are true to our nature and because they are God-given (unalienable or inalienable) rights!

History:
The enabling American governmental structure, which was built upon the critical enabling bedrock of an existing, vibrant civil society that extended all the way back to the "Mayflower Compact of 1620," allowed for the first ever widespread codification of the Age of Enlightenment principles that in turn built on the historical Magna Carta rights secured in 1215. The official, seminal American founding prologue: the Declaration of Independence of 1776. The groundbreaking American governing epilogue: the unrivalled, freedom protecting US Constitution of 1787, wherein the people are the sovereigns and the Founders and the Framers successfully insisted that a Bill of Rights (the First Ten Amendments) be added to the Constitution that guarded individual liberty, assured very substantial state level dominion, and definitively "ring fenced" federal government power.

America's codification of key unalienable individual rights included the pivotal due process, grand jury, and property rights protecting 5th Amendment. It also featured the all too often forgotten 9th Amendment. This Amendment was James Madison's attempt to ensure that the Bill of Rights were not seen as granting to the people of the United States only the specific rights enumerated therein, i.e., that the areas not enumerated could not be taken by the federal government to increase its powers, a de facto "plenary sovereign rights protection clause." Meanwhile, maximization of states' rights was assured in the 10th Amendment; the state "parents" gave birth to both the federal constitution and the federal government, and they rightly feared that someday their central government offspring may become tyrannical. Last but not least, and prior to the Bill of Rights Amendments, the Framers constructed clearly defined,

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limited, and checked (separation of powers) federal government power as per Article I of the Constitution, upon which everything else was based.

What followed was the unparalleled rise of a federalist republic, The United States of America, which became the richest, most tolerant, and (until recently) freest nation on earth in record time! This patently unique nation featured the "codified Declaration of Independence" brilliance to a) maximize individual rights, b) stymie governmental despotism, and c) to right wrongs, such as the untenable contradiction and abomination of slavery, namely via the 13th, 14th, and 15th "Reconstruction Amendments." These Amendments definitively and unmistakably enfranchised black Americans with the very unalienable rights that white Americans enjoyed codification of!

America's first-ever widespread codification of Enlightenment Age principles had broad Western coattails, including exportation of America's Constitution to Switzerland, a liberty-loving, independent, democratic beacon of a nation that has held high rule of law ethics beginning with its pre-Age of Enlightenment founding in the 13th century. The upshot: codified liberty (freedom with civil responsibility) and property right protections have gone hand in hand with unequaled tolerance, wealth, and progress. Sadly, this same framework is being torn down nowadays at an ever faster, increasingly brazen and multifaceted pace to the detriment of the people and to the detriment of a republican/representative form of government, aspects of which we will examine in future blogs on this topic.

Fiat money and divergent paths:

So much for "grounding" and historical background, which we will link to in future installments of this series. Now that we've "set the table," let us get into specific examples of today's increasingly eviscerated property right protections. Let us, in this first blog devoted to "assaulted property rights," hone in on fiat money and its deleterious impact on property.

History shows that fiat money -- money untethered from the discipline of but 1 – 2% average growth in above ground gold or silver -- has always morphed into monetary debasement, the road to worthlessness over time. Central bank-based fiat money creation ultimately ends up being significantly in excess of real economic growth (about 1.5 – 2% on average over the past two centuries) for reasons of political expediency. Specifically, each time public officials -- there are no "independent central bankers" any more than there are "independent moons" -- the world over discover that they can print the money necessary to achieve military or partisan goals and/or to give citizens governmental transfer payments/benefits beyond the government's tax receipts without any perceivable near-term fallout (inflation is a stealthy wealth thief), they can't resist the power this brings with it.

This is why the *sovereign* state-based Framers of the US Constitution enshrined hard money into the Constitution. At the time the Constitution was ratified by nine of 13 states in 1788, the federal government had limited funding and clearly enumerated/circumscribed powers, as enshrined/fortified by the Bill of Rights, which came into effect in 1791. Moreover, virtually all of the economic activity, trade, and taxation would continue to be conducted at the state level. And no state could "make any Thing but gold and silver Coin a Tender in Payment of Debts," a de facto gold and silver money standard.

Let us fast forward to the present reality. We are losing republican or representative government at an ever faster rate. Leading government officials spending too much time on "K Street" know that they can continue to enrich or make solvent their crony capitalist pals (e.g., "TARP") while not keeping the re-election promises they ran on. The same officials do this knowingly and increasingly brazenly at the expense of balanced budgets and taxpayers, especially young taxpayers, as they a) simultaneously feather their own prospective (lobbying) nests, b) opt themselves out of legislation they impose on the voters (such as Obamacare), and c) stand in line to enjoy gold-plated retirement and healthcare benefits courtesy of taxpayer funding, even as most citizens have lost defined benefit retirement and healthcare plans (if they are still lucky enough to have a full-time job). The great enabler of all this malfeasance: the printing press!

Staying on topic, please note that just since 2006, the combined balance sheets (monetary bases) of the world's central banks have expanded from $6 trillion to $22 trillion by year end 2014! This is a compound annual growth rate

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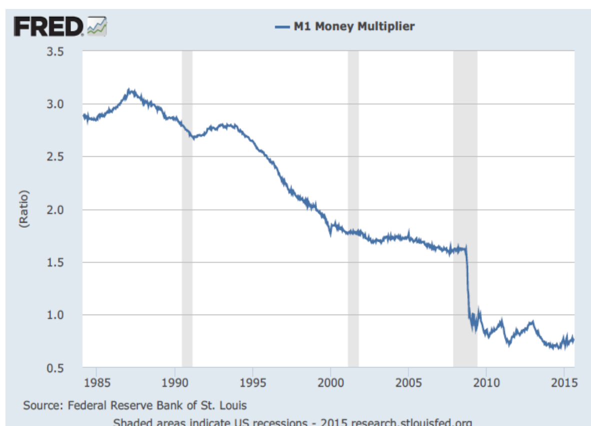
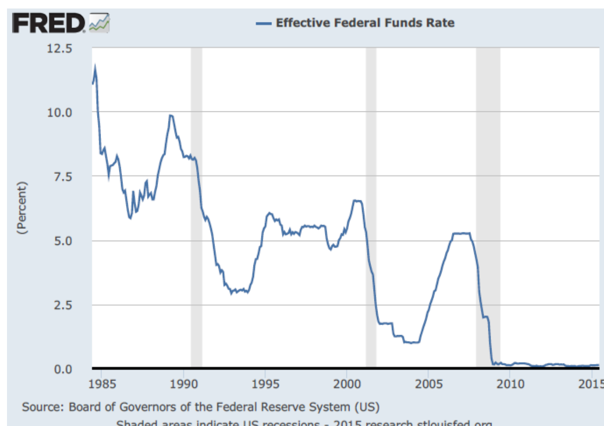
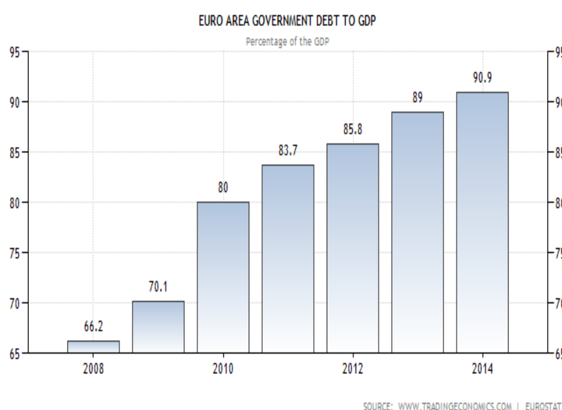
(CAGR) of 18% p.a., ten times the annual global real GDP growth rate of approximately 1.8% over the same time period! Moreover, please recall that in a fractional reserve monetary system, such as our global system, eventually monetary base expansion shows up in the money supply via the money multiplier. While the multiplier can slow dramatically, as has been the case over the past seven years of private (though not corporate) sector deleveraging in the US (and elsewhere) since the financial crisis of 2008, and thus constrict money supply growth, eventually that same multiplier is mean-reverting. A higher money multiplier could occur if interest rates rise above zero (Fed funds rate), and currency at the margin is shifted out of assets such as stocks and junk bonds and into bank deposits.

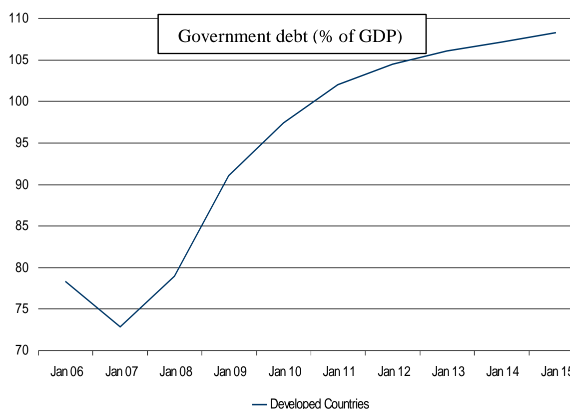




A recovering money multiplier could also occur if demand for credit grows based on corporations' and individuals' changing inflationary expectations. Corporations could move away from maximizing inventory turns to purchasing maximum inventory so as to secure the lowest possible cost of sales in an increasingly inflationary world. Customers could also increasingly stock up on items for similar reasons, thereby availing themselves of credit lines.

Ultimately, and this is key, central banks won't be able to sell their bulging bond portfolios because those same entities won't be able to reduce their massive monetary bases. Why? Because neither their extremely leveraged balance sheets nor the long duration of their bond portfolios (translation: rising interest rates would reduce the value of the bonds) will allow it. And neither will a "welfare era" featuring marked growth in old-age dependency and declining productivity, both of which virtually assure growing secular public deficits and debts from very high levels, especially as we step further and further away from robust property rights/robust individual incentives.





Sources: IMF, CS

Furthermore, central bank government bond sales amidst massive and expanding public sector financing requirements would logically drive interest rates sharply higher, threatening to balloon governmental financing costs (a one percent point higher dollar-based financing cost/interest rate would increase the US deficit by $180bn p.a. currently) on the

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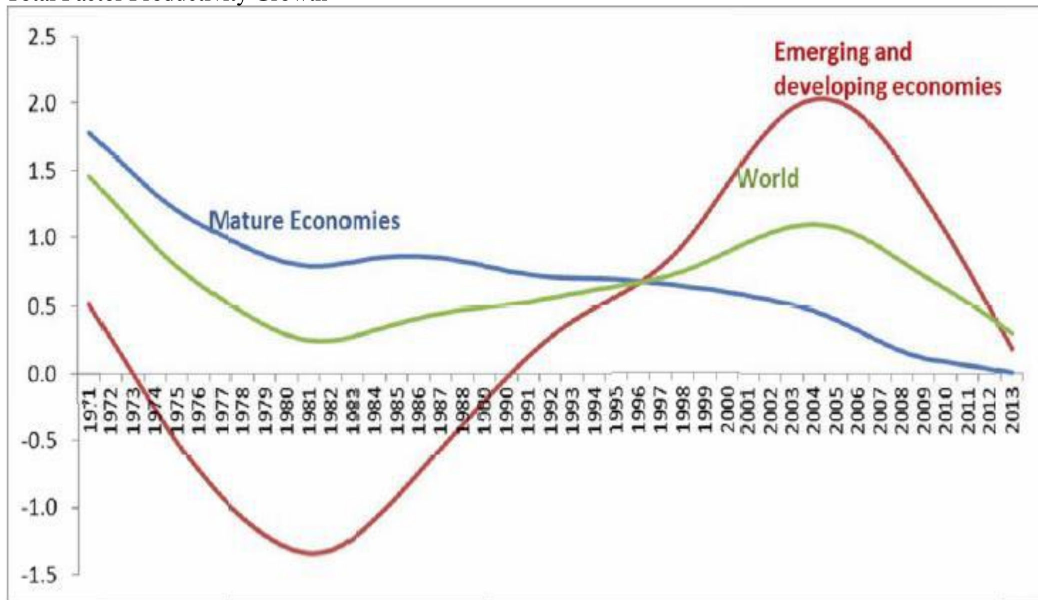
one hand and threatening to "sink" a much more interest sensitive/indebted US (and world) economy on the other hand. Upshot: given our deficit-based and debt-laced economies featuring increasingly emaciated property right protections, central banks have little choice, if they seek to hold on to their immense central planning-based power, but to underpin our unsustainable trajectory as long as possible for the benefit of the few and at the expense of the many (and especially at the expense of the young and future generations). Translation: central banks will "double down" on financial repression -- accelerate money printing -- until a global fiat currency supernova repudiation occurs amidst increasingly competitive currency devaluation rounds. The resulting massive increase in the global money supply, or way too much currency chasing way too few services and goods, which is also is also known as inflation, will sow the seeds for hyperinflation (30% plus annual inflation, according to the International Accounting Standards Board), especially when "overlaid" on drooping productivity:

Total Factor Productivity Growth



Sources: Andy.Lees@macrostrategy.co.uk, U.S. Conference Board

Even more rapidly increasing prices will hit the vast majority of the population that can't protect itself well against inflation the hardest, as the majority tends to have modest "investable" savings to allocate as inflation hedges/purchasing power protection. Most people also sadly lack the economic and financial understanding to peer behind the veil of the global anti-wealth trajectory our fiat government, fiat money crony elites have long been embarking upon at the expense of the people. This limits people's ability to optimally structure IRAs and 401Ks and other defined contribution plans for sustained global currency debasement while defined benefit plan pensions remain off limits but increasingly tenuously funded, be they of the corporate or the governmental (social security and pensions) variety.

As such, sustained and material currency debasement is arguably the biggest property theft of all for free market participants, i.e., for the vast majority of the population. Why? Because said constituencies are unable to avail themselves of "first mover" crony capitalist misallocation windfalls and because the vast majority of people have limited means and savings (property or capital), making preservation of same even more imperative. This makes them doubly-exposed to the ravages of inflation, especially during retirement, when inflation can force "consumption of capital" thanks to lingering negative real rates of return on the one hand and thanks to chronic understatement of inflation by government(s) on the other, meaning social security increases typically lag "real world" price increases for decades:

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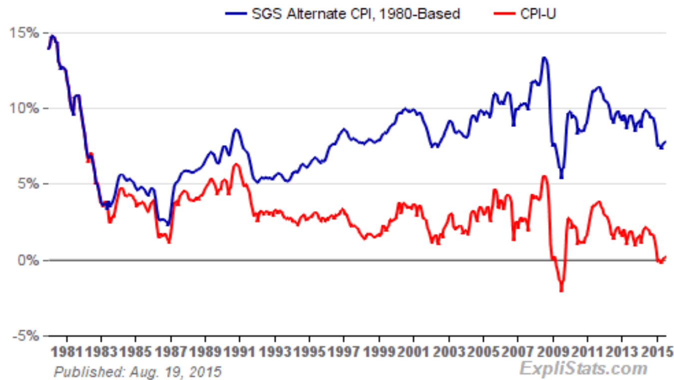
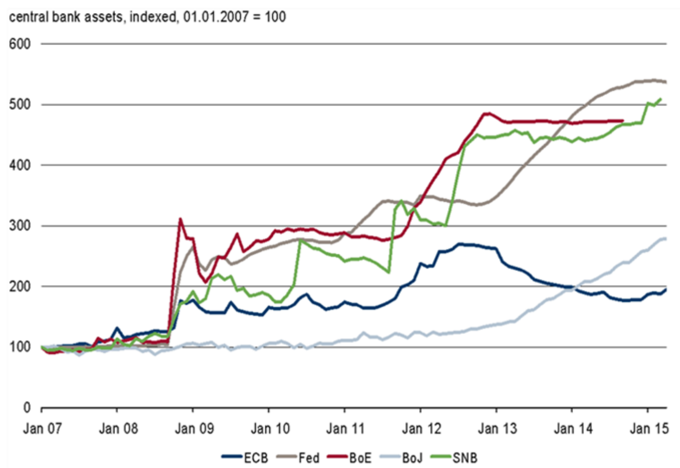


Source: www.shadowstats.com

Inflation-based property disenfranchisement stands in sharp contrast to the bonanza that fiat money (money not tethered to supply constrained gold and silver) can and has been bestowing on the elites, i.e., those leading entities most closely positioned to the teat of expansive central bank balance sheets:



Sources: Datastream, Credit Suisse

> "The gap between the rich and poor continues to grow. The wealthiest 1 percent held 8 percent of the economic pie in 1975 but now hold over 20 percent. This is a striking change from the 1950s and 1960s when their share of all incomes was slightly over 10 percent. A study by Emmanuel Saez found that between 2009 and 2012 the real incomes of the top 1 percent jumped 31.4 percent. The richest 10 percent now receive 50.5 percent of all incomes, the largest share since data was first recorded in 1917. The wealthiest are becoming disproportionally wealthier at an ever increasing rate. …
>
> … This brings us to the second undesirable and unjustified source of income inequalities (not free market-based), i.e., the creation of money out of thin air, or legal counterfeiting, by central banks. It should be no surprise the growing gap in income inequalities has coincided with the adoption of fiat currencies worldwide. Every dollar the central bank creates benefits the early recipients of the money—the government and the banking sector — at the expense of the late recipients of the money, the wage earners, and the poor. Since the creation of a fiat currency system in 1971, the dollar has lost 82 percent of its value while the banking sector has gone from 4 percent of GDP to well over 10 percent today. The central bank does not create anything real; neither resources nor goods and services. When it creates money it causes the price of transactions to increase. The original quantity theory of money clearly related money to the price of anything money can buy, including assets. When the central bank creates money, traders, hedge funds and banks — being first in line — benefit from the increased variability and upward trend in asset prices. Also, future contracts and other derivative products on exchange rates or interest rates were unnecessary prior to 1971, since hedging activity was mostly unnecessary. The central bank is responsible for

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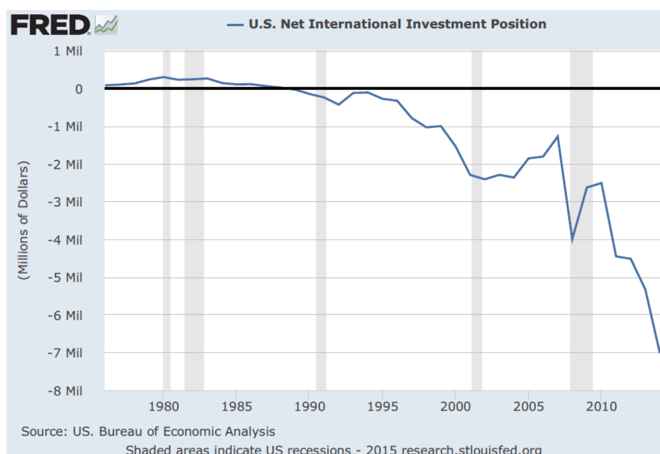
this added risk, variability, and surge in asset prices unjustified by fundamentals. The banking sector has been able to significantly increase its profits or claims on goods and services. However, more claims held by one sector, which essentially does not create anything of real value, means less claims on real goods and services for everyone else. This is why counterfeiting is illegal. Hence, the central bank has been playing a central role as a "reverse Robin Hood" by increasing the economic pie going to the rich and by slowly sinking the middle class toward poverty."

Printed money provides artificially cheap financing for fractional reserve member banks (those that constitute the Fed cabal) and their Wall Street hangers-on; for deficitary governments buying votes on the back of impoverishment of future generations; and for managements and shareholders of big, investment-grade corporations able to borrow at a pittance to repurchase shares (which makes sense even at nosebleed P/Es if the cost of funds is negligible) instead of majoring in cap ex and generic growth initiatives requiring personnel, thereby leveraging their balance sheets and deducting the cost of interest associated with ballooning debt balances as a taxpayer-financed expense of doing business. This constitutes an anti-wealth of nations' counterfeiting double-whammy for the vast majority of the population, i.e., the late recipients of the money. "The people" can't recoup the loss of purchasing power as services and goods get more expensive for they derive no offsetting crony windfall from money's debasement.

Outlook:
Savings in fiat currencies stand to lose purchasing power with greater speed going forward. And it is not a question of "if," it is just a question of "when" 44 years into a fiat dollar standard (historically, paper money has lasted but 27 years). Noteworthy is that salaries/wages in stagflationary or hyperinflationary periods typically lag behind price increases for a host of "legacy" reasons. Meanwhile, debtors get to retire debt in cheaper currency, thereby effectively disenfranchising wage earners ("makers") and creditors of their savings/assets. This is all the more true considering the yield starvation/negative real yields creditors continue to face. To add insult to injury, those same savings may well be misappropriated on a statutory basis. Specifically, Western bank deposits are increasingly no longer creditors' assets (last page of linked piece) and as such can be bailed in to fund cronies and/or bankrupt welfare states. Misappropriation or state-sanctioned theft is the ultimate and immediate "debtor solution" to be deployed just in case debtor-friendly inflationary policies, including taxation, don't shift enough assets to the fiat government, fiat money cronies in time.

Upshot: all the above forms of global monetary property theft are increasingly prevalent and significant. Especially exposed: American citizens. Why? Because the US, thanks to the dollar's leading reserve currency status and the willingness of the rest of the world (ROW) to continue to accept greenbacks over decades (during which time America ran significant and growing trade deficits with the ROW), has been "exporting" dollar-based IOUs for a quarter of a century. According to John Williams of ShadowStats, there are over $16trn worth of liquid assets (mainly Treasuries and other widely traded US bonds) that have accumulated on foreign shores, which is approximate equivalent of US GDP and roughly 2.4 times the size of America's net debtor status vis-à-vis the ROW as of January 2014:



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With roughly 60% of global merchandise trade of over $18trn being conducted in dollars, or roughly $11trn worth (last year's global oil trade of $2.5trn, the world's biggest market, was almost exclusively conducted in dollars), one could state that the ROW has a an annual need of some $11trn for trading purposes -- and that the overage, or some $7trn, is a loan to the US largely reflecting accumulated American trade deficits with the ROW.

While the global loan to America rests on conviction that America can ultimately pay it back, demand for dollars with which to conduct world trade depends upon sustained dominance of dollar-based trade. Both these assumptions are becoming increasingly questionable. A nation that becomes an ever larger debtor will, at some point, no longer be financed, at least not in its own fiat currency; think 1978 Carter Bonds denominated in Swiss francs and German marks. Alternatively, the cost of financing will rise to reflect both greater default and inflation (money printing) risks of the debtor currency. As regards global trade, China has been busy setting up bilateral yuan-based trade agreements with multiple countries, including leading European and oil export nations. Thus the need for dollars to conduct world trade could fall materially.

In concert, such developments would substantially reduce the ROW's need to hold Treasuries. Sale of Treasuries along the lines of China's alleged $143bn dump in July and a widely heralded $100bn more during just a two-week period recently, if extrapolated into the future in only a diluted fashion, would force the Fed to purchase those dollars or risk an "unaffordable" interest rate spike thanks to the Treasury bond supply far outstripping demand. Such purchases would result in a potentially very large increase in the balance sheet of the $4.5trn monetary base Fed. This would likely also send the dollar tumbling relative to other currencies as the ROW moves back into "domestic currencies," thereby stoking domestic US inflation -- inflation which America has "exported" for roughly a quarter of a century. Such a development could "feed on itself" thanks to heightened inflationary expectations in America superimposed on a rising money multiplier trussed to an exploding Fed balance sheet. For these reasons, "99 percent" of American citizens are especially exposed to the toxic effects of raging inflation going forward. Specifically, the majority of their wealth and purchasing power stand to be materially curtailed by a sharply falling dollar, rising inflation, and rising interest rates (which will balloon government financing needs and ultimately raise tax rates), manifestations of decades of monetary and fiscal malfeasance by the Fed, the Treasury, and the US government in general.

Conclusion:
So it all comes back to distortions created by printing money out of thin air! Whether property (aftertax savings) is lost over time via the initially "silent killer" inflation, which is just as deadly as sustained high blood pressure can be, financially speaking, or whether it is stripped immediately courtesy of other rule of law eviscerating methods such as bail-ins or misappropriations, is secondary, at least as concerns "takings of property." Primary is the fact that monetary malfeasance strips people unable to avail themselves of cronyism of their hard won aftertax profits or savings and then re-allocates the booty to the cronies closest to the Fed teat. Investors, especially small accounts, need to take note and allocate accordingly; they need to pay special attention to attractively priced, vital scarcity properties such as dense energy and ag assets, which productivity-reducing statist misallocations tend to make scarcer still, and thus more valuable over time.

Moreover, investors shouldn't neglect satellite allocations in real money throughout the ages, namely precious (scarce and inherently valuable) metals. Physical precious metals are true assets. They can't be "printed." They also harbor zero counterparty and debt risks, which is of huge property protection importance. They are monetary assets that the cronies running our fiat government, fiat money world have been going to great extents to manipulate, i.e., make them artificially cheap as expressed in fiat currencies so as to make precious metals appear unattractive and nonthreatening to the sustainability of debt-laced fiat money regimes. Such assets, as currently valued, offer attractive strategic (long-term) purchasing opportunities, meaning that investments in said offer very constructive odds of preserving purchasing power while also providing investors with assets that stand to perform well relative to both fiat currencies and other assets/asset classes. Constructive valuation developments could then be put to work down the road to purchase the Nestles and 3Ms of the world, i.e., when such Blue Chips again offer substantial (5 - 7%) dividend yields, which history clearly suggests will again be the case, and possibly in the near future. So spread the word, if this makes sense to you, dear reader, for the good of your family and for the good of "the people." Perhaps you'll find some initial

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ideas as to how you could put some of your hard-earned money to work right here: http://dkanalytics.com/pdfreports. And if you like what you see, the DK Analytics team would be grateful if you could make your friends and colleagues privy to our site!

Greetings,
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