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## **Riots, Revolutions and Great Reformations**

Forgive me, but I have to start with an illustrative joke from the early 1950s. A beatnik is standing at a corner in Greenwich Village snapping his fingers in a very cool way.

A friend asks why and he answers:

*"It keeps the lions and tigers away."*

*"There aren't any lions and tigers in Greenwich!"*

*"Does a hell of a job, doesn't it!"*

To be serious, this is a proxy for the failure of the Fed. It was formed in 1913 to prevent bad things from happening and the fifth Great Depression since the advent of reckless central banking soon followed. Another classic bubble climaxed in 2007 and there is sufficient evidence to conclude that Great Depression number 6 is underway.

For the Fed it is the second Great Depression and in a financial sense Wall Street has been over-run by lions and tigers. Most folks are beginning to discover the scam of policymaking.

Politically, the focus is the basic cost of living soaring and popular unrest has become the next global phenomenon. It will likely end another experiment in authoritarian government and begin another Great Reformation.

The popular uprising started with the Tea Party in early 2009 and it appears in the Middle East as the Arab Spring or the Jasmine Revolution. These are similar to the fall of the Berlin Wall or Czechoslovakia's Velvet Revolution that ended the long-running Communist Revolution. Just so that we will be prepared for it – when it reaches Iran it could be called the Chai Party.

Clearly, popular unrest can become a good revolution or a bad one. Bad ones happen when the uprising falls into the hands of neurotic intellectuals, who really believe people need to be controlled. The Communist revolutions of the early 1900s and the French Revolution of the late 1700s are the examples and they both occurred with the start of a long rise in price inflation.

In good revolutions the uprising has remained in the hands of ordinary people and the examples have been the American Revolution which occurred after a long expansion had ended. That was marked by the bubble that blew out in 1772. Similarly, England's "Glorious Revolution" of 1688 was guided, not by intellectuals, but by Protestant

business interests in London. It also occurred after a long expansion. Moreover, it became part of a Great Reformation as it helped end the long reign of absolutist kings.

In the early 1900s, bad revolutions launched a long experiment in authoritarian government. Each country participated in its own way. In America, this is reaching a peak with the current administration. A good revolution is ending it.

Egypt is providing a fascinating uprising and the provocation has been soaring food prices and distress as the governing classes continue to live well. These have been called "peasant bread riots" and date back to the start of organized agriculture. Of which, Ancient Egypt provides the model. There have been thousands of bread riots, but the literature provides no record of governing class bread riots.

In the 1970s I read Barbara Bell's thesis that Dynastic Changes in Egypt would follow a long period of rich harvests when a series of poor harvests would create hardship. Bread riots would be resisted by the palace guards who were not part of the privileged governing classes. Being part of the people, the guards would eventually lay down their spears and grain would be more evenly distributed. Some historians called it anarchy – perhaps it could be called the first Chai Party. At any rate the political capital did not have enough funds to record the magnificence of its rulers.

The political economy worked much the same then as it does now. The pharaohs fronted government that was really run by the priesthood. Bell's thesis also related the poor harvests to climate change reducing the annual floods. As conditions worsened, the priests would promote new pharaohs who were sure to make the gods smile and prosperity would return.

Perhaps interventionists should look into the effectiveness of the gods of Ancient Egypt.

Other big stories in political economy would include the long-running trends in intrusive politics. In a 2004 Dinner Meeting I reviewed that over the past two thousand years there has been three great experiments in authoritarian government and each was accompanied by deliberate and chronic price inflation. In the senior economy, these occurred in the Third, Sixteenth and Twentieth centuries. The latter seems overly long but compares to the earlier examples. They ran for around one hundred years when the privileges, demands and burdens of the governing classes became intolerable to the average taxpayer who initiated the reform.

In the last tyrannical century with state-induced price inflation a reduced harvest prompted another bread riot, but as a twentieth-century historian wrote it – "***a typical peasant bread riot turned into an iconoclastic rebellion***". This was in the late 1500s and against the authoritarian government in the Spanish Netherlands.

Conventionally called the Protestant Reformation, which deals with theological differences, the process of rejecting or changing bullying politics fits into the theme of Great Reformations. Within which every agency of authority and arbitrary intervention is reviewed and reformed.

In the 1500s most governments were depreciating perfectly good and ample coinage but in the early 1600s they stopped. Bullion shipments from the New World began to diminish and eventually the will to depreciate became limited. Although volatile, the

transition to more stable financial conditions worked best in England and in the world's financial center in the Netherlands.

Recently, most governments, including the US have broadcast their intentions to continue to depreciate. Although the concept is ancient, the honesty is refreshingly new. The question is – if central bankers will not surrender the privilege of depreciation how will our one hundred years of deliberate inflation be halted?

Market forces combined with a change in the general public's submission to the will of the state will do the trick.

It is important to understand that the Fed needs speculators' leverage to get the money out the door. In the 1930s it was called "pushing on a string". In so many words, at the end of a bubble the power shifts from the Fed to the margin clerk.

A couple of weeks ago, crude oil and silver prices started a severe plunge, which presents exquisite irony. *"No matter how shocking, bloody, embarrassing and just plain devastating a panic is – within two weeks there is no one that did not see it coming."*

Our research team did. One of our proprietary models – the Forecaster – has been reliable in commodity booms.

In November 1973 food and energy commodities were soaring, the Middle East was in turmoil with the Yom Kippur War. The Fed was printing and would drive the dollar to zero. Our model gave the signal in that November and the buying frenzy ended three months later. Eventually the NBER determined that the recession started in that fateful November.

The recession was due to a natural collapse of speculation that had very little to do with Arthur Burns, the esteemed Chair of the Fed.

The next signal occurred in November 1979 when the Middle East was in turmoil with the Iranian hostage outrage. And the Fed was printing and would drive the dollar to zero. The raging mania in precious metals ended in January 1980. The crash in silver was spectacular and some time later the NBER decided that the recession started in that fateful January.

The recession was due to a natural collapse in speculation that had very little to do with Paul Volker, the esteemed Chair of the Fed.

On this year's mania our model signaled that it would soar to a climax near the end of March, with precious metals and crude running through April.

The recent boom in commodities has been accompanied by acute concerns about food shortages and a troubled Middle-East. The Fed has been almost belligerent in printing and the gold bugs know that this time the Fed is really going to take the dollar to zero.

The collapse has been natural and confirms the probability of the recession starting with the end of excessive speculation. This has nothing to do with the esteemed Chair of the Fed who has kept the printing presses going.

With considerable energy the street has been focused upon two kinds of inflation. One is forced credit/currency by the Fed. The other is just straight running the printing presses

as in Germany in the early 1920s, or more recently in Zimbabwe. In many eyes the Fed is guilty of both and hyperinflation of all prices is in the system and inevitable.

The extraordinary financial manias that climaxed in 1720 provide useful instruction. The lead companies in London and Paris were quasi-government entities, enjoying full and continuous support – right to the end of the mania – but with different features.

Soon to become the senior currency, sterling was backed by a metal standard, but even a gold standard has never impaired a great financial mania. Speculators, reckless banks and soaring ambition will always create more credit than any economy can handle. Despite magnificent efforts by government to keep the party going, the South Sea Bubble blew out in June 1720 and the economy collapsed into a lengthy contraction that can be called the first Great Depression.

The action in Paris was inspired by John Law who was the first really reckless central banker. He had a personal vision that a forced expansion of paper money would provide employment and prosperity. To this end, Law had some eight printing presses going and while it fueled speculation the collapse overwhelmed the rate of currency issue. In the disaster the public demanded that the plates for printing be destroyed.

Throughout business history, rising prices have occurred with prosperity and falling prices with hard times. So the pattern of the recession starting with the end of commodity speculation, as in 1980, 1973, 1929 or 1921 is nothing new. All occurred during the Fed's mandate to prevent bad things from happening.

On the bigger picture, the 2008 stock market crash replicated that of 1929 including the start of that recession. It is only at the end of a classic bubble that the recession starts with the bear and that is one of the signatures of the advent of a long contraction.

The business recovery out of the panic that ended in March 2009 accomplished measurably outstanding speculation in commodities. The recent hit is indicating the start of the second recession within a lengthy post-bubble contraction. This will likely assist another popular reformation of ambitious government.

Will the ancient pattern continue to guide?

There is no guarantee that it will, but then there is no guarantee that it won't. It is prudent to consider the odds.

My own conclusions are that the financial markets are in an immense ending action that will shut the door on the Fed. Natural forces of credit contraction are working to end a hundred years of experimental depreciation.

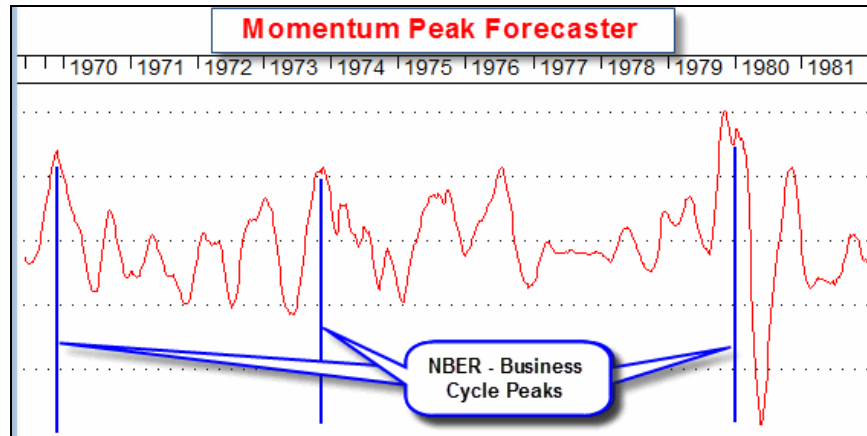
On the political side, the administration's immense and brutal ambition to turn the US into another socialist country seems to also be a form of ending action. The opposition to big government is real and pending default by most levels of government is the catalyst for the people to get control of government affairs and expenditures.

Great Reformations have been happening since the Pharaohs.

We have seen the past, and it works.

## FORECASTER

### Commodity Speculation and Recessions



- The reversal in the Forecaster to down provides the signal.
- Typically, the peak of speculation has been associated with the test of the reversal a couple of months later.

| Signal | Recession Start | NBER<br>Announcement |
|--------|-----------------|----------------------|
| Dec/69 | Dec/69          | *                    |
| Nov/73 | Nov/73          | *                    |
| Nov/79 | Jan/80          | June/80              |
| Jan/11 | ??              | ??                   |

- The initial reversal was set in November 1979 and the test was completed in January 1980.
- The initial reversal occurred in January 2011 and the test completed at the end of April.