Thursday, April 16, 2009

What is Money?

What is Money? Actually, money is whatever the government says it is. How does that make you feel? There was a time when a dollar bill was actually a warehouse receipt for 1/20th of an ounce of gold. World War I and the need for world governments to finance all its catastrophic events was the beginning of the end of a stable asset backed monetary system, and marked the beginning of fluctuating fiat currencies.

In 1934 the dollar was devalued from 1/20th of an ounce of gold to 1/35th of an ounce. To average Americans this conversion right was a hollow promise as ordinary citizens were prohibited from owning gold. Paper currency could only be converted to gold by foreign governments and central banks, which ultimately caused a drain on our gold bullion reserves. Governments, including ours, began pyramiding paper currencies on top of gold, causing further inflation and never stopped. Finally in 1971 we abandoned the last traces to the gold standard and here we are. For what it's worth, the value of a dollar is now calculated at about 1/900th of an ounce of gold at today's spot market.

This post isn't about a return to the Gold standard, although I must admit I have been harboring a fantasy theory about how that could be done which I'm saving for *"When I Paint My Masterpiece"* [circa 1971, Bob Dylan]. This is actually my first ever recommendation on how to preserve the purchasing value of a dollar using commodities as the cornerstone of this strategy.

So again, what is money? Money is a medium of exchange for the things we need and buy. Our most basic needs are food, energy, and shelter. So what would be a better proxy for money than an instrument that actually tracks and owns the basic items that we need for everyday life. Well there is one and it is an ETF (Exchange Traded Fund) with the symbol DBC. This is a commodity index tracking fund that invests in six future contracts in the following commodities:

1. Crude Oil [34%]
2. Heating Oil [17%]
3. Aluminum [11%]
4. Corn [13%]

5. Wheat [14%]
6. Gold [17%]

Gold is included in the above list, because it is still the one commodity that is universally accepted, easily divisible, and homogeneous in nature. Commodity prices may rise and fall due to fluctuations in supply and demand, but remember their values are always expressed in DOLLAR terms. Unless you have been living under a rock lately, you are aware we are in an unprecedented period of money supply expansion and it looks like it will continue. The inevitable result of this will be hyper-inflation meaning it will take substantially more dollars to buy the commodities we need to exist.