THE CAPITALIST ADVISOR

TOP DOWN INSIGHTS . . . BOTTOM LINE RESULTS

Greenspan's Record: Better Than Predecessors, Not As Good as Gold

Richard M. Salsman, CFA
President & Chief Market Strategist

JANUARY 31, 2006

Since today is Alan Greenspan's last day as Federal Reserve chairman, it's an appropriate time to assess his 18½-year track record – and what it has meant for investors. Our review can also serve as a guide to those trying to assess the likely impact of the next Fed head.[1] Contrary to popular assessments, we find that Greenspan's track record falls well short of what it should have been.

For many years now Greenspan has been virtually deified by economists and Wall Street strategists. He was the so-called "maestro" who purportedly "orchestrated" all the good that occurred and acted valiantly to mute or fix various crises. This is utter nonsense. Greenspan's policies *caused* many of those crises. While he had a few critics, in general they lambasted him for precisely the wrong reason: they repeatedly claimed that he improperly "allowed" U.S. stock prices to "rise too much" in the 1990s – or "allowed" house prices to "rise too much" in recent years. In fact, Greenspan's truly improper behavior entailed enviously smashing such wealth gains with rate hikes and inverted yield curves. With today's rate hike Greenspan inverted the curve yet again; we have no doubt that his successor – himself a Greenspan acolyte – will get the blame for all the trouble that ensues.[2] He'll only partly deserve it.

As for a "legacy," Greenspan has left none that could possibly be defined, other than this: he established as a norm the vicious pattern in which the Fed chairman is deemed worthy of speaking on every possible topic under the sun, of monitoring every possible variable (hence none) and of doing whatever the hell he wishes, free of oversight and devoid of any rational, objective standard. There was no "Greenspan Standard" – and this was his great failure. Given Greenspan's background and knowledge he, above all, *knew better* than to leave the U.S. dollar in a wholly standard-less state.

Power-luster. There's only one reason a central planner seeks to do whatever he wishes, to willfully obfuscate his aims, deliberately deceive questioners and operate unaccountably: because he's a power-luster. That was Greenspan. The idolatry he received from Wall Street, academia, Congress and the White House only emboldened him to secure and exercise still more political power than he already possessed when he began. Consider the near-disappearance of intellectual independence under his reign. If Greenspan decried investors for their alleged "irrational exuberance," so did all the trained seals at the Fed, in the financial media and on Wall Street. If he blamed crashing markets on the so-called "infectious greed" of corporate executives these same trained seals dutifully repeated the phrase. If he declared that bond-yield trends constituted an alleged "conundrum," so did all the seals.

What explains this? The seals have been trained by university economists to believe that central bankers

[1] See "The Next Fed Head – Part 1," *The Capitalist Advisor*, InterMarket Forecasting, Inc., November 7, 2005. Part 2 of our assessment of the likely impact of new Fed chairman Ben Bernanke will be published next week.
[2] "Will the Yield Curve Invert? Sir Alan's Attempt at a Parting Blow," *Investor Alert*, InterMarket Forecasting, Inc., June 17, 2005.

THE FORUM - SUITE 202-4 ▪ 1777 FORDHAM BLVD. ▪ CHAPEL HILL, NORTH CAROLINA 27514
PHONE 919-942-2419 ▪ FAX 919-338-2652 ▪ RMSALSMAN@INTERMARKETFORECASTING.COM

are god-like central planners. Forget the collapse of the U.S.S.R. – widespread allegiance to central planning lives on in academia and at the Fed; hence it lives on in media and on Wall Street.

We're proud to say we never participated in the appalling sycophancy that was Wall Street's bizarre love affair with the incoherent Mr. Arbitrary. Indeed, we've alerted investors to the great harm Greenspan was wont to inflict.[3] We'll see below that if Greenspan's track record looks favorable, it does so only when compared to the pathetic performance delivered by his immediate predecessors at the Fed. A longer view of history reveals that Greenspan's performance pales in comparison to that delivered by Fed officials who no one can now remember by name – because they operated long ago and not by whim or power-lust but under a truly *objective* monetary standard: the *gold standard*.

Table One

U.S. Economic-Financial Performance Under Three Monetary Regimes

August 1950 - January 2006

	Gold-Based	Non-Greenspan	Greenspan
Era:	**Federal Reserve**	**Federal Reserve**	**Federal Reserve**
From:	Aug. 1950	Mar. 1969	Aug. 1987
To:	Feb. 1969	Jul. 1987	Jan. 2006
# of months	222	222	222
Variable		**% change per annum**	
Money Supply (M-1)	4.0%	14.7%	4.6%
Gold Price ($/ounce)	1.2	53.1	1.3
Oil Price ($/barrel)	1.1	32.2	11.2
FX Value of US$ vs. 5 Top Currencies	0.0	-0.9	-0.6
Consumer Price Index	2.6	11.8	4.0
Purchasing Power of US$ (in CPI)	-1.8	-3.7	-2.3
Industrial Production Index (IPI)	6.9	2.8	3.7
Productivity	3.3	1.9	2.8
Real Hourly Wage	3.4	1.2	1.4
S&P 500 (nominal)	24.4	11.1	16.9
S&P 500 (real - in terms of CPI)	21.8	-0.7	12.9
Variable		**average level**	
Federal Funds Rate	2.91%	8.58%	4.81%
10-Year Treasury Bond Yield	3.76	8.98	6.29
30-Year Treasury Bond Yield	3.68	8.88	6.64
30-Year Mortgage Rate	4.60	10.65	7.89
Unemployment Rate	4.7	6.8	5.5
Misery Index *	-18.5	5.2	-4.9

* U/E rate + CPI rate + mortgage rate - change in real wage (p.a.) - change in S&P 500 (p.a.). (all X 100)

Since Greenspan's tenure was 18½ years (August 1987 - January 2006), we compare his track record to that delivered by Fed officials in the 18½ years *before* he arrived (March 1969 - July 1987). Going still further, it's informative to compare the track record delivered by the Fed in the 18½ years *before that* (August 1950 - February 1969). Why? In this period Fed chairman were not household names. They delivered far fewer speeches, rarely testified, changed interest rates less frequently and generally exercised far less power – because their main job was simply to issue a gold-convertible dollar. This was the Bretton Woods "gold-exchange standard" – which was politically sabotaged in 1968-1971. Although not a true gold standard, it was better than the post-1971 fiat paper system.[4]

In the table above we provide evidence for the performance of such variables as the U.S. economic growth rate, inflation and interest rates, commodity prices, real wages, productivity, unemployment and the S&P 500 – for each of the distinct, 18½-year eras, which we label, successively, the "gold-based

[3] See, for example, Richard M. Salsman, "WARNING: The Fed Can Be Hazardous to Your Wealth," *The Political Economy in Perspective*, H.C. Wainwright & Co. Economics, Inc., September 2, 1999; Richard M. Salsman, "Greenspan Raises the Equity Risk Premium," *The Capitalist Perspective*, H.C. Wainwright & Co. Economics, Inc., November 15, 1999; Richard M. Salsman, "What Kills Expansions? Interest Rate Hikes," *Financial Post (Canada),* February 19, 2000; "Why Greenspan Trashes the Markets," *The Capitalist Advisor*, InterMarket Forecasting, Inc., February 22, 2000; "Greenspan's 'Reserve Armies' – and Your Portfolio," *The Capitalist Advisor*, InterMarket Forecasting, Inc., May 7, 2001; "Greenspan's Gremlins," *The Capitalist Advisor*, InterMarket Forecasting, Inc., September 10, 2002.

Federal Reserve" (August 1950 - February 1969), the "non-Greenspan Federal Reserve" (March 1969 - July 1987) and the "Greenspan Federal Reserve" (August 1987 - January 2006). We don't wish to suggest that the Fed *alone* (or any Fed chairman alone) exerts complete and utter influence over all of these variables. Obviously other policies (besides monetary policy) have exerted influence on them – such as tax policy, regulatory policy, trade policy and foreign policy. For example, U.S. tax rates were much higher in the 1950s, 1960s and 1970s than in the years since the early 1980s. But monetary policy exerts the most powerful influence. Examining the same set of variables in each era, we at least have a common source of legitimate comparison.

AU beats AG. It's obvious from the table that while U.S. economic-financial performance under the Greenspan Fed (1987-2006; see the right column) was *less-bad* than it was under the non-Greenspan Fed (1969-1987; see the middle column), performance was spectacular and far superior under the *gold-based Fed* (1950-1969; see the left column) compared to *each* of the others – *including* the Greenspan era. For example, the S&P 500 gained an average of 21.8% per annum in real terms under the gold-based Fed, versus a loss of -0.7% per annum under the non-Greenspan Fed and a rise of just 12.9% per year under the Greenspan Fed. U.S. industrial output grew 6.9% a year under the gold-based Fed, compared to 2.8% under the non-Greenspan Fed and 3.7% under the Greenspan Fed. Under Greenspan the U.S. CPI rate averaged 4.0% a year, down from 11.8% per year under the non-Greenspan Fed, but not nearly as low as the 2.6% annual rate seen under the gold-based Fed.

What about interest rates, the job market and wages in each era? Our table reveals that the Fed Funds rate, the 10-year T-Bond yield and the 30-year mortgage rate averaged 4.81%, 6.29% and 7.89% per year, respectively, under Greenspan – certainly lower than the 8.58%, 8.98% and 10.65% rates witnessed in the immediately-preceding era, but not nearly as low as the 2.91%, 3.76% and 4.60% rates enjoyed under the gold-based Fed. Now consider unemployment, productivity and real wages. Under Greenspan the U.S. unemployment averaged 5.5%, while productivity rose 2.8% per year and real wages advanced 1.4% per year; again, while that was better than the 1969-1987 era (when the jobless rate averaged 6.8%, productivity grew 1.4% per year and real wages gained just 1.2% a year), the gold-based era (1950-1969) outperforms again – with an average unemployment rate of just 4.7%, annual productivity gains of 3.3% and average annual gains in real wages of 3.4%.

They don't get it. Remarkably, economists and strategists today, aping the views of their professors and Fed officials, continue to insist that fast economic growth and low jobless rates "cause" higher inflation. Our table shows otherwise: there's a clear *inverse* relationship between inflation and growth. The 1969-1987 era saw "stagflation" – a lethal combination of low growth and high inflation which killed stock gains. The gold-based era, in contrast, saw fast growth, low inflation and low interest rates – which, in turn, brought healthy stock gains. The Greenspan era, we see, fell somewhere in between these two extremes. Now, ask any economist or Fed official: "Do you have more respect for Alan Greenspan or for the gold standard?" They'd answer: "Greenspan, of course." Then they'd deride the gold standard as a "barbarous relic," echoing their other big hero – John Maynard Keynes.

Viewing our table, there's an undeniable kernel of truth in the widespread impression that Alan Greenspan was a good central banker. Given the

[4] See "The Crime of '71: A Retrospective," *The Capitalist Advisor*, InterMarket Forecasting, Inc., August 15, 2001. Technically, the Bretton Woods system was a "gold-exchange standard," not the *classical* gold standard. Only the dollar was directly convertible into a fixed weight of gold (1/35th ounces); in turn, the currencies of other countries were convertible into a fixed number of dollars. This was a mix of the classical gold standard and today's pure fiat paper system. Under the classical gold standard (1879-1914) private banks and central banks alike issued currency convertible into a fixed weight of gold; balance sheets consisted primarily of gold coins and short-term loans denominated in gold-convertible money. Convertibility was available between private citizens and banks. "Monetary policy" consisted primarily of central banks simply buying and selling gold so as to retain its fixed weight in each currency. Interest-rate manipulation and government bond monetization were limited. Inflation was virtually non-existent. More than sixty countries were on the classical gold standard before War World I. Economic growth, international trade and global capital flows flourished. That gold still played *some* role in the Bretton Woods system ensured that inflation and interest rates were lower than they would have been under a pure fiat paper regime; to that extent it was a beneficial (or "less harmful") system than the arbitrary *non-system* that followed it in 1971.

atrocious performance of U.S. central bankers from 1969 to 1987, such a conclusion is easy to draw. But there's certainly no reason to drop the context of what we enjoyed in the 1950s and 1960s, while declaring Greenspan to be the greatest central banker who ever lived. In truth, the greatest "central banker" that ever lived *was the gold standard* – precisely *because* it was a system that effectively *tied the hands* of central bankers.

He knew better. It's ironic that the gold-based U.S. monetary system of the 1950s and 1960s beats the Greenspan Fed hands down, for during that era Greenspan became an eloquent, clear and knowledgeable proponent of both the gold standard and free banking (that is, *no central banking whatsoever*).[5] Some people are aware of this history but, given Greenspan's subsequent sell-out, they dismiss his earlier writing as the scribbling of a misguided young man. But Greenspan was 40 years old when he wrote in favor of gold and against the Fed in 1966. And whenever he was asked, subsequently, about his views, he always claimed that he still held to them. Right. Did he not have the power and influence to act on those views? At root, Greenspan lacked the will and the *integrity* to *implement* them. He had no interest in having his hands tied; and that is the mark of a political power-luster.

In testifying before the House Banking Committee in May 1999 Greenspan said "gold still represents the ultimate form of payment in the world. Gold is always accepted and is perceived to be an element of stability in the currency and the ultimate value of a currency." He made similar statements at other times. Greenspan was right about gold. Yet a month later (starting in June 1999) he chose to evade the evidence of a low and falling gold price (a signal of dollar strength and low inflation) and to obsess about rising U.S. stock prices. He and his Fed cohorts embarked on a year-long series of rate hikes that eventually inverted the U.S. yield curve (2000-2001) and caused the financial debacle of 2000-2002. Greenspan knew that an inverted curve usually precedes recessions.

Greenspan also knew better than most the virtues of the gold standard and the dangers of central banking – especially central banking conducted arbitrarily. Yet that's precisely how he conducted policy at the Fed – arbitrarily. Greenspan made no attempt to move the Fed back to a gold-based system, even though he had accumulated the political (and persuasive) power to do so and even though he was able to explain the practical details necessary to achieve such a transition in a *Wall Street Journal* article in 1981[6] and soon thereafter in testimony before the U.S. Gold Commission (1982).

When the time became *politically propitious* for a move to gold – i.e., when President Reagan himself advocated a return to a gold-based dollar in the early 1980s – Greenspan joined with Milton Friedman to scare him out of it.[7] He warned that the U.S. might lose all its gold stock (true *only* if the "re-entry" exchange rate between gold and the dollar was set too low), that a return to gold was practical only if (and when) the Fed could ever improve its monetary policy to the point where it "replicated" the economic-financial performance seen under the gold standard.[8] As our table makes clear, that performance certainly was *not* replicated under Greenspan – so, conveniently, he could cling to his lame excuse for never moving the U.S. back to gold.

Back when times were relative prosperous under Greenspan (mid-1999) an editorialist for *The New York Times* wrote an op-ed piece titled "Who Needs Gold When We Have Greenspan?"[9] The editorialist observed, quite correctly, that the gold price had declined materially (to below $300/ounce), that both inflation and unemployment were low and falling, while the U.S. economy and stocks were rising robustly. All true. But the editorialist took that to mean Alan Greenspan was far better as a "standard" for the dollar than the gold standard

[5] See Alan Greenspan, "Gold and Economic Freedom," in Ayn Rand, *Capitalism: The Unknown Ideal* (New American Library, 1966).
[6] See Alan Greenspan, "Can the U.S. Return to a Gold Standard?" *The Wall Street Journal*, September 1, 1981.
[7] See "The Secrets of Reagan's Success (Part II): Economic Policy," *The Capitalist Advisor*, InterMarket Forecasting, Inc., June 21, 2004, p. 30.
[8] Greenspan's disingenuous argument also appeared in his 1981 *Wall Street Journal* article (see footnote 6).
[9] Floyd Norris, "Who Needs Gold When We Have Greenspan?" *The New York Times*, May 4, 1999, p. A30.

ever was or could be. How wrong he was. That same month (May 1999) Greenspan had begun hatching his plot to raise the Fed Funds rate, invert the yield curve, smash stock prices and push the U.S. economy into recession – to defeat so-called "irrational exuberance" and force everyone to live by *his depraved sentiments* (dour pessimism and malevolence), all the while ignoring the message from gold. Greenspan destroyed trillions of dollars of wealth. And today the gold price is twice as high as it was back then, while stocks remain lower than five years ago and the yield curve is now inverted yet again – signaling yet more trouble in 2006-2007.

Data-head gets it wrong. In a farewell cocktail party at the Fed today Greenspan sanctimoniously told his colleagues: "We are in charge of the nation's currency. The central bank, because of that, is involved in everyone's daily lives. We are the guardians of their purchasing power." Has Greenspan lost his mind? Is this not the man universally acclaimed for his astute and penetrating knowledge of the data? Under his tenure at the Fed the U.S. Consumer Price Index rose from 113.8 to 198.0. Take the inverse of these numbers and you get a rough measure of the change in the dollar's power to purchase a representative basket of goods. Fact: the dollar's purchasing power has declined 43% on Greenspan's watch. That's a decline of nearly *one-half*. No such thing ever happened under the gold standard. No central banker today – least of all Alan Greenspan – acts as the "guardian" of the purchasing power of the currency he issues; he is, in truth, the proverbial fox guarding the hen-house.

Alan Greenspan's 18½-year track record at the Fed may, in fairness, be described as better than that of his immediate predecessors. But that isn't saying much – because it drops important context. Greenspan's track record was nowhere near as good as gold's – because the dollar itself wasn't as good as gold under Greenspan. Given the history, the question we *should* be asking is the exact reverse of the one posed by the editorialist: "Who needs Greenspan (or Bernanke) . . . when we've got gold?"