

When a Million Wasn't Much ...

Bloomberg News recently reported the number of American millionaires had reached an all-time high. Meanwhile, however, the **U.S. Dollar-Euro exchange rate hit an all-time low.**

by Mike Keliher



The first news item is easily understood. The second, not so readily. Yet for most Americans, the purchasing power of the dollar, not the number of dollars, will dictate their future financial well-being.

What is a dollar?

The dollar, like other currencies, has value because of the willingness of others to accept it. The dollar has not been backed by gold reserves for some time. Instead, the dollar is a fiat currency. Webster's explains fiat money is "currency made legal tender by fiat and neither backed by, nor necessarily convertible into, gold or silver."

Dollars are "Federal Reserve notes." They are printed by the Federal Reserve, which has the discretion to determine the number of dollars it prints. Current Fed Chairman Bernanke, in a November 21, 2002, speech, alluded to running the printing presses and dropping money from helicopters if the Fed believed circumstances warranted. His point: the Fed could "print money" as needed.

When printing money was not a good plan ...

Prior to 1914, currency in Germany was backed by gold reserves. At the start of the Great War (World War I), the Reichsbank switched from a gold-backed mark to a fiat currency, the Papiermark. The notes were issued primarily in denominations from 1 to 20 marks. The fiat mark was worth one U.S. dollar. By 1918, the exchange rate dropped to five marks for a dollar.

At war's end, Germany was forced to pay huge reparations to the French and others. Initial payments were inflationary. The mark had slipped to 65 marks to the dollar by 1921. In 1922, the reparations payments grew to an unmanageable size. German authorities decided to solve the problem by simply printing more money.

The result was a hyperinflation of epic proportions. The mark quickly collapsed. By January 1923, it took 17,972 marks to buy a dollar. In December 1923, one U.S. dollar would have purchased 4.2 TRILLION marks. The largest denomination mark was 1,000 in 1914. In October 1923, it was 100 billion.

This hyperinflation wiped out savers' nest eggs. A January 1923 German "millionaire" could not buy a stick of gum for the million at year's end.

Lessons

For you—don't be so sure that your "risk-free" interest-bearing savings are without risk. For the Fed—there are consequences to paying debts by "cranking up the printing press." +

NOTE: The pictured currency is real. My dad and my father-in-law, Dan Keliher and Vic Kotrla, like many World War II citizen soldiers, came home as teenage German marks' billionaires. By 1945, the match to strike the fire was more valuable than the 100 billion mark note used for kindling.

Mike is a lawyer, CPA and Registered Investment Advisor. This article and current market writings, including his weekly "The Other Side of The Street", can be accessed at www.kelcap.com.