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Michael J. Kosares, Editor

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SPECIAL REPORT

A Layman's Guide to the Rules and Laws of Finance and Investment

Gresham's Law, Say's Law, the Rule of 72, Marginal Utility, Diminishing Returns, Regression to the Mean, Unintended Consequences, Murphy's Law, Occam's Razor, Law of Attraction, Law of Polarity, and more

by R.E.McMaster

www.REMcMaster.com

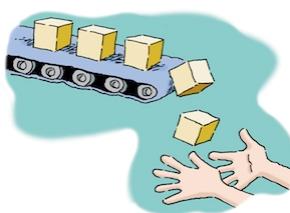
Editor's note: There is an old saying that not all that glitters is gold -- as in the gold coins many of you have held in your hands. There is another kind of gold that inhabits the practical wisdom of the ages. In today's "go-get-'em," "read-it-and-forget-it" world of everyday web browsing, it can be a challenge to separate the run of the mill from the meaningful. It is with that thought in mind we offer this compendium of the rules and laws of finance and investment by long-time market analyst R.E. McMaster. Formerly the writer/editor of the widely-circulated *The Reaper* newsletter, McMaster is known for his occasional forays into the realm of economic philosophy and history. I think you will agree with me that these skillfully condensed descriptions are indeed meaningful -- a wellspring of knowledge worth reading, re-reading and passing along to friends and family, especially the kids and grandkids. MK

1. **Gresham's Law** - Bad money drives good money into hiding. Example: Fiat funny money created by the central banks and made compulsory to use by the governments causes real money of substance, gold and silver, to rise in price in terms of such fiat currency and to be hoarded, to disappear from circulation. Corollary: The Cantillon Effect - Those who get the newly created central bank money first, benefit most (banks).



2. The Golden Rule - Whoever has the gold makes the rules.

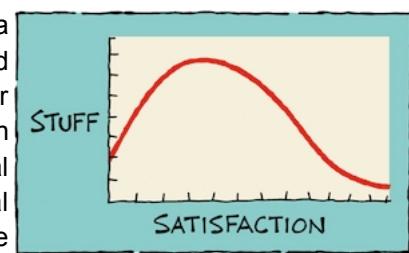
3. Pareto's Law - The 80-20 Rule. 80% of the effects stem from 20% of the causes. Example: 20% of the pea pods will contain 80% of the peas. 20% of the people will own 80% of the land. 80% of your business will come from 20% of your customers. 20% of your customers will give you 80% of the grief. The markets will tend to change trend when 80% are bullish and only 20% are bearish, and when 80% are bearish and only 20% are bullish. If someone can accomplish a task 80%+ as well as you can do it, and you have the ability to delegate the task to them, then by all means delegate. Great accomplishments, great fortunes, are made by leveraging one's time/life/money, by making use of OPE (Other People's Energy) and OPM (Other People's Money). (Money is representative of stored energy/life/time.)



4. Say's Law - Supply creates its own demand. Production is more important than and precedes consumption. Production is the source of demand. Think of the invention of the personal computer, the invention of the smart phone, the tilling of virgin soil. This means savings has to exist in a society to be able to create the means of production that in turn results in consumption. Taxes and consumption, of their very nature, are non-productive.

5. The Rule of 72 - Compound interest is the 8th wonder of the world. Want a quick rule of thumb to know how long it takes money to double? Simply divide the annual interest rate into 72. So, if you have money out on interest at 9%, it will take 8 years for your original amount to double (72 divided by 9%). It likewise means if you are borrowing at an annual rate of 9%, if you pay nothing on your loan, the amount you owe will double in 8 years. Debt is death and slavery, and implicitly assumes you can predict the future accurately regarding payback. Better to be debt free, pay off and burn the mortgage, to live free. Debt should primarily be used for productive purposes, for investment in businesses, practical education and improvement in viable skills. And never forget that for most of us, making money is a byproduct of doing something else well, productively.

6. The Rule of Marginal Utility - Simply put, an additional unit of a product you own, such as your next pair of shoes, normally has reduced marginal utility, less value preference, gives less satisfaction. For example, if you own 10 pairs of shoes, how much satisfaction, how much happiness, does the 11th pair of shoes bring you? What is the marginal utility of the 11th pair of shoes? Marginal utility is the change in total utility divided by the change in quantity. Change always occurs at the margin, where the action is, making decisions based upon small changes in resources, such as *"How should I spend the next hour?"* *"How should I spend the next dollar?"* When things change, it happens in small incremental movements. It occurs in the present, in the now, at the margin. The extent to which we can control our lives, it occurs at the margin. As much as possible, we want to keep our inner core personally, professionally, financially and investmentwise intact, and only make meaningful changes/expansions at the margin where/when the potential return, weighed against opportunity cost, is several times the time/energy/money/ emotion we expend. We want a large return in exchange for a minimal investment at the margin. If we are patient, such opportunities appear in our lives at the margin from time to time. We make money when we buy right, at the right price and time at the margin.





7. The Law of Diminishing Returns - Basically, this occurs when adding more of something to the production process (while everything else is held constant) yields less return than it did before, and at some point adding a significant amount of something can reduce return/production. For example, adding fertilizer to a field increases crop production. But at some point, adding more fertilizer yields less increase in crop production (diminishing return) than previous fertilizer additions. And at some point, adding too much fertilizer to the field will even reduce crop production. The Law of Diminishing Returns effectively states that "*with all other factors remaining the same, the addition of more units of one factor of production will at some point result in a lower yield per unit.*

There is always an optimum combination of factors of production which yields the highest return per unit of production. Increase one of these units beyond that optimum and the yield provided starts to drop. This does not necessarily mean that the amount of output drops. It means that the output is now not being produced in the most efficient manner. Factors of production are being wasted" (Bill Buckler). It is wise to optimize not maximize.

Central banks have created too much money and have long passed the point of diminishing returns where the central bank created monetary stimulus creates meaningful economic activity. With each new stimulus injection Bernanke makes, the equity boosting effect becomes less and less in the stock market. (Law of Diminishing Returns) Also, why invest in other people unless the return is synergistic, yielding more than the input? Certainly it is a waste of time, energy, money, words, mentality and emotion to invest in people beyond where the Law of Diminishing Returns kicks in.

8. Regression to the Mean - Reversion to the mean, often called "*regression to the mean*", is an idea/theory suggesting that prices and returns eventually move back toward the mean or average. Put differently, the greater the deviation of a random variate from its mean, the greater the odds (probability) that the variate recorded next will deviate less, and that over time the variates will tend to return to the mean. For example, if the average rate of return historically is 3%, over time an investment that yields 7% will face competition by way of new entries into the market seeking that juicy 7% return and eventually real returns in this particular investment will gravitate back toward 3%. Another example: When prices in a trading market rise quickly, way above their long-term trend line and moving averages, prices will eventually tend to decline back down toward their long-term trend line and moving averages.

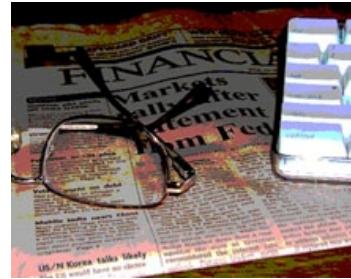
9. The Law of Unintended Consequences - Things occur differently from what was expected, usually detrimental, negative and/or perverse; outcomes that are different, unexpected and unanticipated from a purposeful action. Intervention in a complex system often creates unanticipated and undesirable outcomes. Man's plans go awry, with spin-offs (consequences) that are neither expected nor anticipated when man tampers with complex systems. For example, when the government intrudes into the economic marketplace or social structure in an attempt to solve a problem, it often creates a number of greater problems and distortions long-term that were neither anticipated nor desirable. The unintended and unanticipated bad consequences of well-intended government welfare programs are numerous and have been well-documented. Remember Skynet in the Arnold Schwarzenegger "Terminator" movies? Unintended consequences. The use of GPS in agriculture? Unintended consequences (positive).



10. Murphy's Law - If something can go wrong it will. Anything that can go wrong will go wrong. This is why in nearly everything we do, we need to factor in and create a 20% buffer zone, what I call my "fat zone", my reserve zone, whether it is time, money, attention, etc. Whatever it is, like with a wedding, Murphy's Law kicks in; things go wrong, take longer, costs more than originally planned. Moreover, if you have to work too hard to make something happen/work front end, if you have to put too sharp a pencil to it literally or figuratively to make it work, odds are it will not work out, whether it is an investment, business project, relationship, etc., it likely will fail down the road. Making something happen by forcing it is usually the road to ruin and failure due to Murphy's Law. Forcing things usually breaks things. Life is full of curve balls and unexpected occurrences. We can never know the future perfectly, often little at all, so predicting the future, which is what an entrepreneur attempts to do when he creates supply anticipating demand, is a high risk activity.

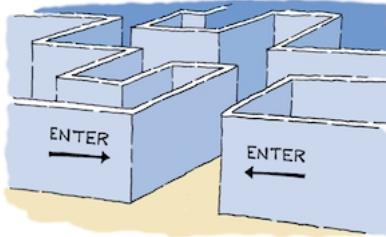
Mankind is imperfect, makes mistakes, seldom accurately anticipates most of the problems that arise in any endeavor or relationship in life. So, if we play good defense, the offense will tend to take care of itself. If we practice good money management and cut our losses short in investments, business ventures and relationships, long-term the profits will tend to take care of themselves and appear. Why worry? 90% of worries are derailed before they ever reach us. The future is seldom what we expect. But, truth does kill those who hide from it. If we choose to live life with blinders on, or by wearing rose-colored glasses, or by burying our heads in the sand, odds are we will surely get blind-sided and suffer.

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11. The Law of Attraction - What we need we combat, what we fear we attract. This is a law of human nature. What we broadcast in the infrared range of the light spectrum from the imprinted layered frequencies of our ancestors DNA/RNA (at least 10 generations), as well as our own flaws and errors (sins) from living our lives, comes back to us as we are all infrared receivers as well as broadcasters. What goes around comes around. We reap what we sow. We tend to eat our allergies, food wise and emotionally/spiritually. Birds of a feather flock together. Like attracts like homeopathically. When we become the right person, we attract and hold the right people. We are only vulnerable where we are defensive/fearful.

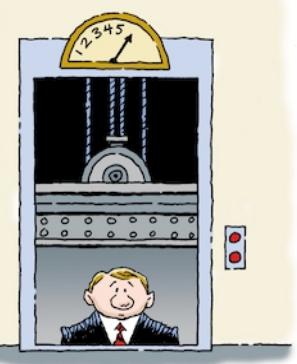
12. The Law of Polarity - Everything that is healthy in nature has polarity (+,-), harmonically, comprehensively, synergistically so. The stronger the polarity the greater the vitality, particularly as polarity is held in dialectic tension/balance, like both the north and south poles on either end of a bar magnet. Other examples of this polarity of dialectic tension include, polarity of the one and the many (the collective/community and individuals), yang and yin in the Eastern culture, the north and south poles of the earth, the acid and alkaline nature of the soil, the sodium/potassium exchange at the cellular level, the positive and negative ions in the atmosphere, and in relationships feminine & masculine.



13. The Law of Entry & Exit - It is easy to get into most things, but usually more difficult to exit most things. Example: It is easy to buy a house, buy a car, get married, get pregnant, take out a loan, speak in anger. It is not so easy to sell a house, sell a car, get divorced, handle an unwanted pregnancy, pay off a loan, repair the damage caused by hurtful words. So, use caution, go slow, before getting involved or engaged with anything. Think things through, research, analyze, get advice, reflect, ponder, run the numbers. Pause before you speak. Accordingly, "*Look before you leap*" is

more important than "*He who hesitates is lost.*" Money is made, relationships are long-term meaningful, when we "*buy right,*" when we take our time, are cautious, do our research, allow time to percolate important factors to the surface, up from our subconscious for our consideration, and finally the decision becomes easy and obvious, and we gracefully step into it without stress because we have "*looked before we leaped.*" We all have to live with the consequences of our words and actions.

14. The Peter Principle - We tend to be promoted to our level of incompetence. We are good at what we do, successful, and so we are promoted again and again until we reach the level where we are in over our heads, until we have reached the level where we are incompetent. This is why it is often wise to quit while we are ahead, or to choose to stay where we are comfortable, competent and confident. No tree grows to the sky. When things go too good for too long we need to exercise caution, to avoid that King Kong, on top of the world feeling of dangerous pride. All of us are subject to the natural progression of the "S" curve, which ends in decline. When we level off in any activity, we need to consider the reality that we may have peaked. Nearly every "S" curve has a tipping point. Still, 97% of people only change when the pain of change becomes less than staying where they are. People keeping doing the same old thing expecting a different result. This is insanity. If we want a different result, we need to believe, think, feel, say and do things differently.



15. Parkinson's Law - The time we allow to complete a task will fill it. Work expands to fill the time allowed for its completion. If we allow 5 minutes to sew a button on a shirt, it will take 5 minutes to complete the task, to sew on the button. If we allow 15 minutes, it will take 15 minutes to sew on a button. We tend to work at the speed and the intensity of focus to fill the time we have allotted to complete the task. Humans have a natural tendency to waste time, not to use time wisely or redeem it. And yet, that is the only place in life where we are all equal. We all have only 24 hours in a day and the choice in how to use it. Corollary: Want to know what is truly important to someone? Find out how they spend their time, money and who with. This is what is important to them. This is where their priorities in life are. Anything else is hot air.

16. Occam's Razor - The simplest and most obvious and uncomplicated solution is often the best. Other things being equal, a simpler explanation is better than a more complex one. Among competing hypotheses, the one that makes the least assumptions should be selected. By way of corollary, if we are humble and listen to what the environment is telling us, whether it be the market, our customers, people with whom we have business and personal relationships, we can then make meaningful adjustments, fine tune if you will, like a ship's captain is ever making small course corrections to reach his destination from one port to another. It does not matter who is right or wrong; it does not matter who gets the credit or the blame. What is important is getting things right as soon as possible, period, and often the simpler answer is the best one.

17. Rules of Relationships - Whoever loves least is in control, unless proven Rules of Successful Relationships are applied. If there is not character, maturity and a givers' perspective intrinsic to both parties in the relationship, the relationship will fail long-term or be miserable/exhaustive. A successful relationship requires both commitment and chemistry, and commitment is long-term more important than chemistry. Chemistry only holds a relationship together short-term unless commitment undergirds it. Generally, a man will only stay long-term with a woman (and a woman with a man) if he perceives that she makes his life better than it is on his own or with any other woman. The best relationships have 1st, 2nd, and 3rd Circle relationships integrated and in harmony. In a relationship, how something is said is more important than what is said, and languaging determines with nearly 90% accuracy if a couple will stay together long-term. Nothing trumps picking the right person from end, however, from the get-go.



Invest your heart just like you do your money in investments. Do your research front end and prove it out. If you want to receive love, you must first give love, meet the other person's needs, just like a merchant must first serve his customer before he is paid. Selfishness does not work. Put your heart on the line and let your profits run and cut your losses short. With anyone, we can give them enough rope to either build a bridge or hang themselves, and we can buy the rope front end. Don't get old with regrets of what you wanted to do, and should have done in life but were too fearful to risk. The elderly nearly unanimously regret not their mistakes, but not taking risks in life to do what they really wanted to do, and to be with whom they really wanted to be with in life. Don't let fear, the opinions of others and unreasonable social taboos keep you from risking love.

The elderly nearly unanimously regret not their mistakes, but not taking risks in life to do what they really wanted to do, and to be with whom they really wanted to be with in life. Don't let fear, the opinions of others and unreasonable social taboos keep you from risking love.

18. The Rules of Communication - There are basically only two ways to communicate:

1. Confrontational (masculine), like two bighorn sheep butting heads;
2. Complementary (feminine), coming along side, like an aircraft joining a formation of other aircraft.

The latter nearly always works because it activates The Golden Rule of Communication: "*You can seldom go wrong asking a question kindly and respectfully.*" Why? Because "*nearly everyone only cares to hear after they first hear that you care.*" Besides, "*Friends come and go, but enemies accumulate.*" So, we want to keep as many friends as possible and create as few enemies as possible, and the Golden Rule of Communication usually makes this possible. The Golden Rule of Communication works wonderfully with all people everywhere, those above us, below us, with our contemporaries. It is as universal as a smile. The ultimate wealth is found in human connections, and the more positive and powerful that human connective force is in our lives with positive productive people, the more enriched our own lives. Corollary: Never guess when the information is available. It is lazy and unprofessional to guess when the information is available. Ask. Research. Discover intent first before you respond. When in doubt, check it out, always, like when you hear an unfamiliar sound inside of your home.

The greatest bargain available to man is the low cost of good advice. Pay for good advice. Hold people accountable for their representations. Anyone can, and will, say anything. But can they deliver on their representations, can they back up their words with credible action? Do they have a proven track record? Careful planning followed by productive action are the only things that count in the real world. Words are cheap in this sense. Finally, we all have black holes, blind spots, where we do not accurately perceive vulnerabilities in our own lives that others close to us, others who care about us, see readily. Encourage those who care about you to speak freely, critically and constructively into your life for your own good long-term.



19. The Law of Long-Term Time Preference - Those who plan, invest and execute long-term win. Win-win decisions, looking to the long term with short-term work and sacrifice, are historically the tickets to success in all areas of life - short-term sacrifice for long-term benefits, deferred gratification rather than instant gratification. This is the difference between wealth and poverty, between class and trash. Those who make primarily fear-based, ego-based, selfish, win-lose, lose-lose, emotional and/or short-term decisions as their primary mode of operation in life nearly always end up miserable, often as losers in a comprehensive sense in life. Such people are walking tornadoes to be avoided.

20. The Law of the Four C's - Most healthy individuals have a natural yearning to want to be the best at nearly everything they do. Why? Why not just be the best you can be at the things that are really important to you in life, like with your family, and at your work, living at the intersection of your aptitude and motivation, at what you are really good at doing, at what you really love? The rest of it, like recreation? Why not simply enjoy down time and allow yourself to do many things Comfortably, Competently and Confidently and then be Content with it? These are the Four Cs. This will put you up around the 80 percentile (Pareto's Law). And with The Four C's perspective, you can enjoy life, feel free, do many different activities if you wish, and know that it is good enough to be Comfortable, Competent and Confident in them, and Content about it all. This is a very freeing approach to life. Nobody is always #1.

21. The Laws of Freedom - There are two types of freedom:

1. Internal freedom;
2. External freedom.

Internal freedom is when we abide in the present moment in a state of continual joy, peace of mind and gratitude that are not contingent upon the circumstances of life, and we have shed the chains of negative thoughts and emotions such as fear, worry, lust, anger, guilt, jealousy, envy, pride, greed, gluttony, etc. (Emotions are always a choice. Why not choose the emotion from your emotional toolbox that best serves others as well as yourself, win-win?) The pinnacle of internal freedom exists when it feels better to give, to help someone else, to bring joy to someone else, than it does to get, to receive. And throw in a good dose of compassion, forgiveness and mercy. External freedom is when we have the ability, resources, energy, time, health and money to do what we love, what we want, where we want, when we want, with whom we want, how we want, consistent with not violating any other person's person or property, consistent with keeping our covenants and contracts. Eternal freedom is evidenced by living among people who are self-governing with a balance between individuality and community, void of external coercion by civil government.

22. The Master Equation of All Societies - “*Government is always religion applied to economics.*” This is the E=mc² of human action. Israel, Islamic nations, China, the former USSR, for examples, have/had official religions/philosophies that give/gave them laws that govern(ed) their societies and “*human action*” (economics). Every government is the concrete enactment/legislation of someone’s abstract religious/philosophical ideas about right and wrong, good and evil, morality, ethics, justice, these precepts then in turn framing the arena of “*human action*” (economics). Every day, all over the world, we witness just, fixed, equally applied traffic laws that frame the automobile traffic system which allows individual self-governing human action by drivers behind the wheel of a car to create a harmonious collective, where both the needs of the individual driver and that of the collective driving community are met and are in balance. If we know any one of these three - government, religion, economics - we can nearly always triangulate to the other two. Throughout history, theologians and philosophers have struggled with how to balance out the rights of the individual with those of the community. This is the “*One & the Many*” question.

The answer which clearly and consistently brings the highest level of human satisfaction in terms of freedom, peace, prosperity, justice, progress, human fulfillment, healthy happy balance between the individual and the community and environmental integrity, given the constant of human nature, is to allow individuals to be free and personally responsible for creating their own destiny in life by contracting and covenanting for what they need without trespassing on or violating the person or property of any other person, without resorting to force, coercion or fraud. If an individual is self-governing using these principles derived from a fixed set of supernatural (religious) laws, he can pursue his balanced self-interest in the marketplace of life by serving before receiving, each individual serving as a catalyst for “*human action*” (economics). Again, we witness this phenomenon every day globally in the automobile traffic system and also observe it in nature/ creation in the formation of a single dandelion puff where the individual (masculine, linear, +) shafts produce the collective (feminine, non-linear holistic) puff. Government is religion applied to economics.

23. The Cream & Crap Law - In an honest free market, cream rises to the top. In a politicized market, crap rises to the top.

24. [Scientific Laws](#)

25. [Proverbs](#) (Old Testament of the Bible)

(REmark: Feel free to share this 25 point article. I wish someone would have shared the above with me when I was 20. What I really appreciate is when a “*harmonics of reality*” exists, where the same principle is a common thread that runs through any number of fields of study. Then we know we have a hold on a basic powerful principle and truth.)

We invite you to pass along the link.

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Illustrations by Ed Stein

R.E. McMaster is the publisher and editor of one of the most successful and longest continually published commodity investment letters in the United States. Involved in the commodities business since the 1980s, he has thirteen books to his credit, including the best-selling advisory, "The Art of the Trade." He has advised a number of governments on economic policy and the old E.F. Hutton firm rated him the nation's top futures money manager three straight years. Long a well-regarded analyst among professionals in the commodities' trading business, he now works with private investors through his McMaster Online web site.

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