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The California Gold Rush: The Nature of Bubbles

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The California Gold Rush

The Nature of Bubbles

This section features a person who is historically insignificant in the business world, but is included to illustrate a point about bubbles. When bubbles are viewed at a granular level from the perspective of individuals rather than at a fiscal level, it becomes obvious that they are much more complicated than the statistics would suggest. The bubble in question is known as the California Gold Rush and we'll examine it from the standpoint of Johann Sutter, known in the U.S. as John Sutter. He was an immigrant from Switzerland who became famous after the discovery of gold on his property in 1848 precipitated the California Gold Rush.

Sutter arrived in the area of what is today Sacramento in about July 1839, when California was part of Mexico. He became a Mexican citizen in 1840 and was granted title to 48,827 acres of land in the Sacramento area, which is almost 200 square kilometers. His goal was to build an agricultural settlement known as New Helvetia.¹ In the course of building his settlement, he hired a workman named James Marshall to build a sawmill. Obviously, a certain amount of wood would be required to build the dwellings and farm structures of an agricultural settlement. About the time the settlement was being developed, the United States seized the territory of California from Mexico, and it became American territory.

In 1848, while working on the settlement, Marshall found gold, the discovery of which Sutter wished to keep quiet. Sutter had no interest in developing the gold, because he feared, correctly as it turned out, that a gold discovery in the area would cause it to be overrun by squatters. However, since news of that type cannot be kept secret, Sutter's land was, in fact, overrun. The great California Gold Rush of 1849 had begun, and the people who flocked to California in that period of time are known as the forty-niners.

The following facts refer to the consequences of the California Gold Rush rather than to that period itself. They illustrate the effects of a bubble, which are infrequently limited to the initial subject of the bubble. One fact is that the population of the nearby city of San Francisco increased 25-fold in one year which, obviously, had an impact upon property values. The discovery of gold in California did not go unnoticed by the rest of the world. A gentleman by the name of William Aspinwall saw that immigrants to the area would need a means of transportation to California. He was not necessarily interested in developing the gold himself, but saw an opportunity in providing transportation to potential prospectors. In addition, he engaged in an initial public offering in 1848 for the Panama Railway. Before the Panama Canal was built, travelers en route to the West Coast of the United States who did not wish to sail around Cape Horn had to disembark in Panama and then

¹ Helvetia is the Latin name for Switzerland.

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use land transportation across the isthmus. As an aside, in that same year, Aspinwall organized another venture called the Pacific Mail Steamship Company, which became a charter member of the Dow Jones Transportation Index.

Getting back to John Sutter, he wanted to defend his gold claim, but he was essentially pitted against tens of thousands of immigrants. He wrote a letter asking his son to join him in defending the family holdings. The idea was to defend the Mexican land grant, but it was not clearly defensible under U.S. law. Under the treaty by which the United States and Mexico ended the war, the United States was obligated to honor Mexican land grants. However, California was a newly organized territory that had no legal mechanism for enforcement, so it had to be defended in a different manner. Sutter's property became known as El Sobrante, which in Spanish means "leftover." It was an apt title, because Sutter found it very difficult, if not impossible, to defend his claim. In point of fact, in 1858, the United States Supreme Court invalidated his land grant.

When Johann Suter Jr. arrived in the U.S. from Switzerland, he realized that a person could get killed defending a land grant against an American mob that was suitably enraged by gold fever. However, he observed that the Sutter property was on the American River, which joins the Sacramento River and eventually flows into the San Francisco Bay. He realized that the many settlers overrunning the city of San Francisco would need another place to live. He thought that the confluence of the Sacramento River and the American River would be a good place for another real estate development, and thus was founded the city of Sacramento.

A certain mythology surrounds Levi Strauss, since many believe that he made a lot of money in the California Gold Rush by selling picks and shovels to miners. It turns out to be completely false. Levi Strauss did not arrive in San Francisco until March 1853. By that time, the gold fever was somewhat exhausted. He did, however, operate a successful dry goods store. His big success came in 1873 when he met a tailor by the name of Jacob Davis who had developed the idea of reinforcing the textile strength of denim work pants by using copper rivets. Davis had patented that process and received patent number 139121 but, being a poor tailor, he was afraid that he would be unable to afford the legal fees for defending his patent against the inevitable challenges. He and Levi Strauss became partners, and Strauss's wealth was created in the blue jeans market. It was really an accident.

Returning to the consequences of the Gold Rush, in 1854, the capital of the California territory was moved from San Jose to Sacramento. San Jose had been the capital of California under Mexican rule and during the first years of U.S. rule. It was the capital because it had been the site of the largest mining complex in the State of California. That

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complex was called the New Almaden Mine. It mined quicksilver, otherwise known as mercury, which was used in the then-current technology used to separate pure gold from gold ore. The New Almaden Mine was the largest mercury mine in North America.

However, the California Territory Legislature, in its search for revenue—and here we see that the California revenue crisis is nothing new—saw the vast influx of immigrants as an opportunity. It passed a law in 1854 that imposed a tax of \$20 per month on any foreign miner, of which there were many. In 1854, \$20 was a great deal of money, and the miners, of course, did not want to pay it. To facilitate collection of the gold tax, the state capital was moved from San Jose to Sacramento. As an aside, the local newspaper of San Jose is still called the *San Jose Mercury News*. The reason for that publication's name was that the city was home to the largest mercury mine.

The anti-foreigner tax ultimately drove many of the foreign miners from the mining properties, but there were many Americans as well who, in the inevitable scramble for resources, found themselves unable to stake a claim or, if they did stake one, they were unable to find any extractable gold. One of those failed California Gold Rush miners, who was nothing more than a victim of the bubble, was a man by the name of William Greeneberry Russell. He married a Cherokee woman whose relatives lived near the South Platt River at the foot of the Rocky Mountains in what is now Colorado. It happens that Russell's Cherokee relatives told him that there were gold deposits in the area, which were apparently of no value to the tribe.

Russell took a party of 107 prospectors to what is today known as Pike's Peak, and they found gold there in 1858. That discovery started the next gold rush. Pike's Peak is located not far from the city of Denver, which was built as a mining town. As a matter of fact, the first incorporated county of Denver was known as Auraria, from the Latin word for gold. Today, if you drive on Colfax Avenue in Denver, also known as U.S. Route 40, you will pass by the Auraria Campus of the University of Colorado. That's a reminder that Denver was built on yet another gold bubble. Those three cities, San Francisco, Sacramento, and Denver, were built as a result of financial bubbles. I should tell the readers that I have left out a great amount of economic activity that wouldn't have occurred if not for these bubbles. One of many examples that I could give was the Sacramento Valley Railroad that was built to carry gold to the port of San Francisco.

Among the many people attracted by the Pike's Peak Gold Rush was a man named William Cody, better known in American history as Buffalo Bill. Some of the stories in his autobiography cannot be authenticated, including one that says he was a prospector. However, it's not unreasonable to believe that he was attracted to the area by gold fever, like so many others. If, in fact, he was a prospector, he was a failed one. As such, he

HORIZON RESEARCH GROUP

became a scout for the U.S. Cavalry, and he fought in the Plains Wars against the Indians. He was a scout for nearly 14 years, and he won the Congressional Medal of Honor in 1872.

While in the U.S. Cavalry, he met another cavalry veteran by the name of Texas Jack Omohundro, who was a veteran of the Confederate Cavalry, and had served as a scout under Jeb Stuart. The two heroes, Texas Jack and Buffalo Bill, liked to entertain the troops by the campfire in the evenings by telling of their many adventures and exploits. Though some of the stories may not have been true, the other soldiers found them so amusing that the two decided to go into business together. They formed Buffalo Bill's Wild West Show.

At the end of the Civil War, Texas Jack had found a child whose parents had been killed—in other words, an orphan—and he raised him as his own son. Naturally, the son was called Texas Jack Jr. When Texas Jack Sr. died in 1880, his son did not wish to remain partners with Buffalo Bill, so he started his own Wild West show. Over the course of some years, Texas Jack Jr. changed the format of the show to a rodeo/comedy format. In 1902, Will Rogers got his start as a comedian in the Texas Jack Jr. Wild West Show.

Buffalo Bill took his Wild West Show to Britain in 1887 to celebrate the Golden Jubilee of Queen Victoria. At some point in his travels, he met an Italian novelist known as Emilio Salgari, who was very impressed by the tales told by Buffalo Bill. Salgari became a bestselling Italian novelist by writing books that were inspired by the various Buffalo Bill adventures. If the following people can be believed, Salgari was the inspiration for Sergio Leone and the old “spaghetti westerns” that were made some years ago. Federico Fellini claimed to have been influenced by Salgari. In the world of Italian and Hispanic literature, many of the leading figures claimed to have been enchanted and mesmerized by Salgari, and said he had strongly influenced their works. These writers include Pablo Neruda (a Nobel Prize winner), Carlos Fuentes, Gabriel Garcia Marquez (also a Nobel Prize winner), Jorge Luis Borges, and Umberto Eco, who is probably one of the bestselling novelists writing in the Italian language in the world today.

The point of these remarks is to illustrate that, while bubbles may be commonly understood as irrational actions resulting from rational actions taken to unsustainable economic extremes, when they are examined in their granular, human form, they appear in a very different light. Many times, they begin as irrational economic activities, but they bear fruit that transforms them into rational and useful products. Bubbles are very complex, and I don't think that they are necessarily understandable exclusively through pure time series analysis.