

INCISIVE VIEWS FROM PROFESSIONALS

HEDGE FUND INSIGHT

LEAD ARTICLE

Gold (or Silver) Over Fiat Currencies



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With the gold bull experiencing a healthy correction, interested investors who missed the opportunity of getting in at a favorable price are currently considering doing so at these levels. An equal consideration is being given to the mining shares and which underwent a much deeper decline.

The majority of investors have little or no interest in gold and after a multi-decades long campaign by the mainstream media and central banks, aimed at talking it or selling it down. Some of these investors still carry painful memories of being burned in the gold market in the past, and find it difficult to get excited about precious metals; they are in a similar situation to Mark Twain's cat that sat on the lid of a hot stove, and would never sit on any lid anymore, hot or cold.

The purpose of this article is to reawaken a dormant memory in investors related to the value of gold and silver, and to remind the reader about the position of the precious metals relative to the unbacked currencies in circulation.

We do not attempt to make an accurate estimate on how many dollars or euros an ounce of gold or silver should fetch, and as the entire price discovery mechanism for both metals has been subverted by the central banks; current market prices for physical gold and silver are far from reflecting the result of a free interaction between the actual supply and demand for gold. This is due to a central banks led market price manipulation, coupled with the creation of a 'paper gold' scam still being used to cheat investors from their physical gold and silver by diverting actual investment funds away from the physical supply and into a Ponzi scheme.

Absolute and Universal Currencies

Sought by kings and beggars alike, with a brilliance and shine that captures the mind and imagination, it's no coincidence that gold and silver have been extremely desirable over the ages, and tower to this day as absolute and universal currencies. Shocking as it is, and at time where the dollar and euro could crumble at any moment, it is estimated that less than 3% of investors own gold or silver.

Understandably, investors rarely visit the cemetery of defunct national currencies, and which share the uncanny pattern of becoming worthless as a result of over issuance and the inevitable inflation that follows.

When you own a U.S. dollar, you are actually choosing to invest in an interest bearing Note issued by the Federal Reserve. Each printed dollar is hence a note that remains the obligation of the Federal Reserve. While this note was issued against gold at its inception, and was redeemable in species then, the Federal Reserve decided to play dirty once it amassed the bulk of the gold, and, by closing the gold window, made the dollar no longer redeemable. A dollar holder today is hence an unsecured creditor, lending his value to the Fed but without requiring a counter asset.

The fate of that green paper today clearly remains directly linked to the fate and credit worthiness of the Federal Reserve, a for-profit private company, an impostor of a governmental body working for the public good.

After multiplying the base money supply of these dollar notes by multiple folds post 2008, depositors and investors have not understood the full implications of such, or how to take effective counter measures, besides jumping as a herd into low-yielding financial markets or buying overpriced and under funded real estate of major cities.

Back to basics: What happens to the value of a BitCoin if its supply is multiplied by a factor of 5 or 15? What becomes of the value of a dollar if its base supply is multiplied by that many times? Does hyperinflation come to mind? How about a spike in interest rates and a currency crisis?

With the Fed avoiding an open discussion on gold and its chairman dancing around questions related to the currency backing, global investors who have adopted the dollar can only presume a worst case scenario: The original gold has either been sold in the open market, or has been reduced to a fractional backing in the single digits.

Having amassed the good part of all the gold ever mined, by cheating or forcing citizens – especially during the wars of the past century – to surrender their gold against redeemable paper receipts, the Fed went on to breach its promise later on in 1971.

Further, and as of 2008, it has developed the reputation of terrorist extraordinaire in the gold and silver paper markets, and when it now and then would bomb the gold market with unbelievable amounts of forward sales that create crashes and panicked sales.

Central banks have been constantly suppressing the prices of the metals, to scare people out of them. The purpose being, of course, to keep people fenced into a virtual currency system, and a very well camouflaged usury and Ponzi scheme.

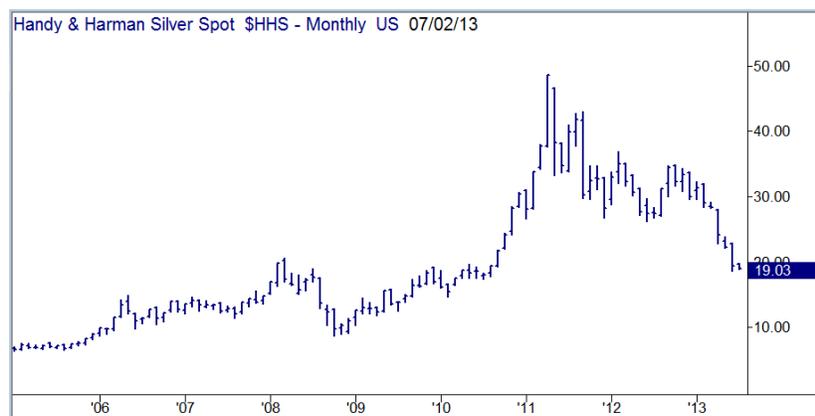
Another objective is to inflict severe losses and psychological pressure on gold and silver holders, and scare them into liquidating their position so that the Fed and its bullion banks could buy them back on the cheap.

These constant assaults have ravaged and impoverished the precious metals mining companies over the decades, and pushed many companies in this industry beyond already being in a survival mode and to the brink of extinction.

Imagine being hijacked on your flight, just to find out that the hijacker is in fact the pilot. This is the situation that gold and silver investors find themselves in, under the current monopoly of the Fed.

Back in June of 2006, this author went on record in recommending a long exposure to commodities, and highlighted silver in specific with a favorable demand and supply situation. From around 10 dollars an ounce at the time, the silver price managed to reach a level just short of \$50 during May of 2011, and is now sitting slightly above \$19 an ounce. Gold more or less mirrored the path of silver, starting at around \$600 an ounce and ending close to \$1200 as of June 2013.

It is worth noting that while gold hit a high of around \$1875 during the summer of 2011, tripling its starting price of \$600, silver managed to mark nearly a 5 folds increase at just under \$50 an ounce.

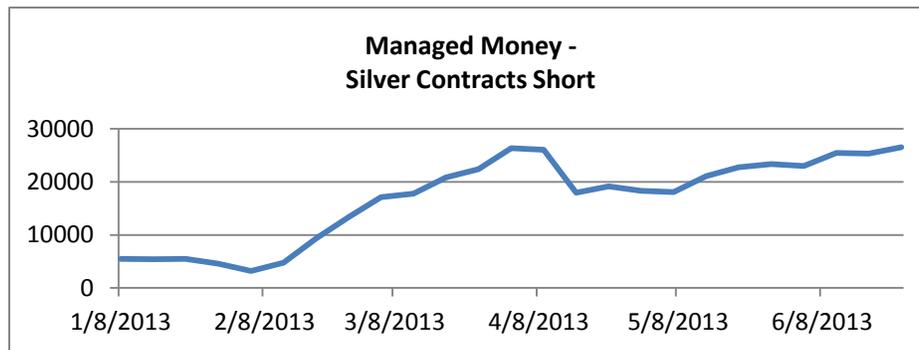


We picked silver over gold at the time given its dual function of both a metal with growing industrial applications, as well as due to its intrinsic value of a monetary metal.

During the past few weeks, and on the heels of a severe price takedown, the mainstream media was too anxious to rejoice and declare the bull market in gold as dead. To provide some perspective, these media channels had kept talking gold down in unison over the past six years at least, and all the way up till the bullion banks were caught in a short-squeeze and went into a full panic mode around mid-2011. The ascent of gold and silver during

that time may have given us a preview of what's yet to come, and could have very well have played a role in the collapse of Bear Stearns.

The noteworthy recent development nevertheless has been the one of the smart money increasing its bet for lower prices in the precious metals. The chart below shows the number of short silver contracts within the managed money category on the COMEX:



Source: COT Report, Commodities Futures Trading Commission

A typically well informed group, it would be irresponsible to dismiss its opinion in the same ease as one would do with the media. So we ask: What is the premise of the current hedge funds short positioning in silver? How much further can prices drop from here? Have the shorts become blind to an 'all-in mining cost' likely to be in the low \$20's an ounce?

Given a fragmented market structure for gold and silver and added to a very large derivatives notional market that dwarfs the actual physical metals in existence, the complexities and intricacies of a price analysis are daunting and not a simple task to complete. Further, basic data such as gold on deposit vs. gold on lease at the Fed are purposefully withheld. This violates generally acceptable accounting principles, and undermines confidence in the central bank and its currency.

Nonetheless, there are sufficient elements to create a mosaic that fully supports the case for ownership of the precious metals:

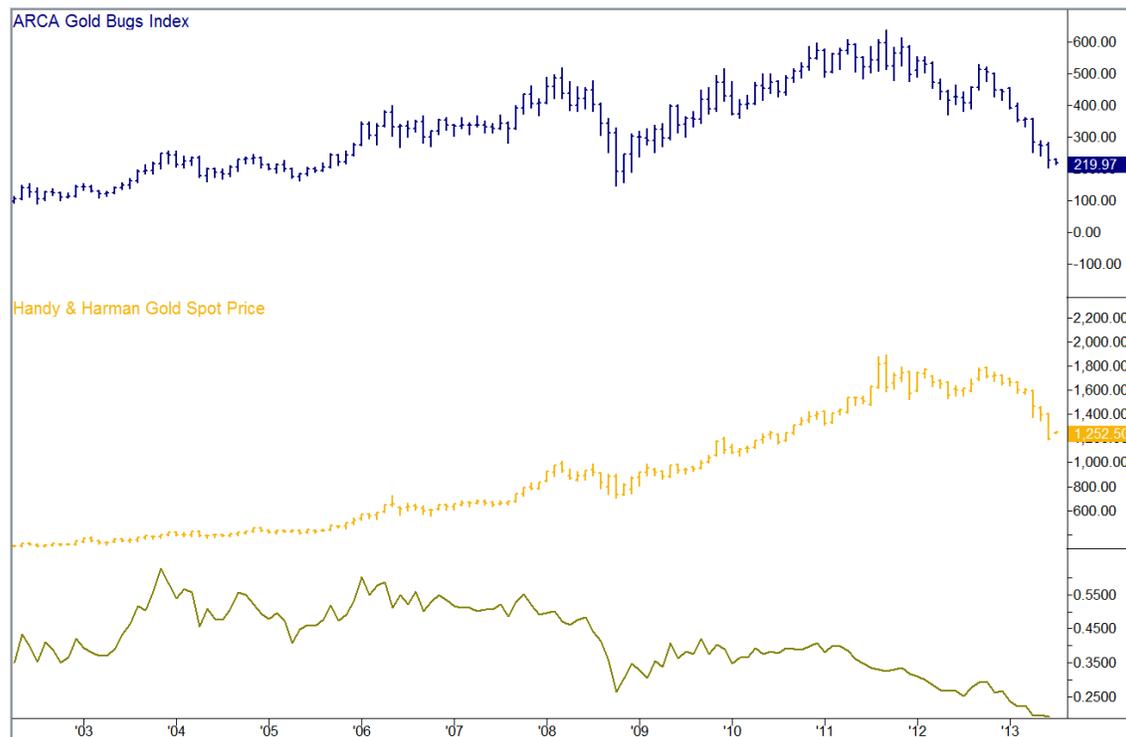
- An infamous investigation which started around 5 years ago, relates to a London trader who notified a CFTC senior regulator, days in advance, about the precise date and time of a gold and silver impending manipulation; JP Morgan traders were overheard, in fact boasted at a bar, about planning to take down the gold and silver markets. To his great surprise, the regulator witnessed the events as foretold, and launched an investigation. While most CFTC cases are usually investigated and closed in less than 6 months, this one remained open for 4 years, and with no action being taken to this day.
- Another possibility could be that a significant part of the large short positions showing on the chart above belong to large hedge funds known to always use their capital in a manner that pleases the central bank, and in exchange for information. With Bernanke starting to hint about 'tapering' during the latest FOMC meeting, the hedge fund positioning could be consistent here.
- It is a possibility that some large banks are unhappy about reporting their positions to the CFTC in the Bank Participation Report, and may have opted to engage in some sort of a swap, and conduct part of their trades through some hedge funds accounts that'd report under the 'managed money' category. Is this a way to cover up the actual short positions of some banks? A similar situation relates to the case of

the 'London Whale', and where JP Morgan reportedly relied on a third party hedge fund to unwind its trades in an anonymous way.

- A more direct data point could be the reported gold and silver inventories at the COMEX, showing a rather accelerating decline in its inventories. Some watchful observers have noted that the exchange has added a disclosure to state that it does not even guarantee the accuracy of its reported inventory. Now, had the exchange been a farmers market, one could understand such a disclosure, but when gold and silver bars carry serial numbers and are placed in a highly secure vault, such a disclosure is anything but assuring and raises a big red flag.

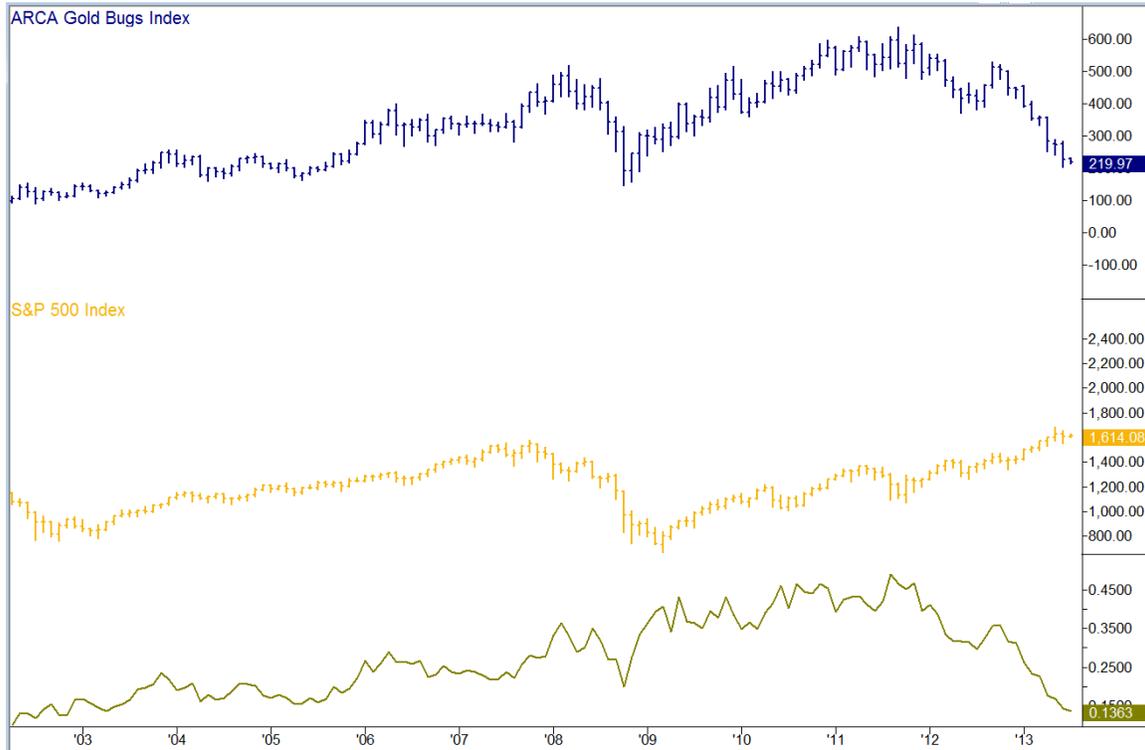
On the other side of the Atlantic at London's LBMA (the London Bullion Market Association), it is now reportedly asking for a record 100 days delay to deliver physical gold and settle some sales. Moreover, it apparently has been pleading with those awaiting delivery to accept a cash-settlement instead, and have proposed to pay a 25% premium in price for that favor. Interestingly, the story reports that the exchange is asking such parties to sign a non-disclosure agreement and so the word would not get out that it has been stripped of its gold and sitting in a vulnerable position. Can the gold and silver shorts spell the word shortage?

A brief look at the major gold producers (the unhedged miners index) vs. the gold price shows that their equity has been decimated over the last 2 ½ years. Even if gold were to hold at current levels, the major producers would need to triple in value to reclaim their relative valuation to gold. Admittedly, their margins have been sandwiched between rising mining cost and a knocked-down gold price. With costs unlikely to be decreasing anytime soon, it won't take long before the producers require a higher price for their products.



The chart below shows the unhedged miners index against the S&P index. It's easy to notice that an all out assault has taken place against the mining industry; as of mid 2011, the mining index has sunk by over 60%. Given the large scale operation conducted by the central banks in this sector, we wouldn't be surprised to learn

about some naked short selling to have taken place in these shares. Savvy investors have grown very suspicious on that front and some have started registering their shares directly to prevent them from being abused.



A Multi-decade Disinformation Campaign

Overall, most indicators point to a serious scam taking place in gold and silver, and which is unlikely to last much longer from here.

The 'paper gold' price has so far indicated that the Fed and its large banks, have managed, by hook or by crook, to stem the rise of gold and silver so far. This has been accomplished by running a multi-decade disinformation campaign to confuse and deceive the public on the rarity and true value of gold and silver.

When all else failed, the Fed initiated brutal market takedowns, and victimized investors, money managers, mining companies, and mere savers alike, and all who had sought refuge in the metals outside crumbling currencies and precarious banks.

For a public now accustomed to accounting and running its books in paper currencies, both gold and silver appear excessively volatile. It is good practice to maintain an alternate set of books using the precious metals as the reference currency. Gold and silver have always been the absolute benchmark in fact, and in the same way that the speed of light is considered to be an absolute constant.

Accounting in dollars or euros is in fact a poor and unreliable choice at this stage, and given the higher variability of their supply under a money-printing paradigm. Clearly, neither the dollar nor the euro should serve as a monetary unit of reference in such an instance.

With the metals prices being close to their production cost and coupled with an increasing demand in the physical market, the timing couldn't be any better to buy the precious metals. We have a preference for silver over gold

once again, and given the extremely tight available inventory. Unlike gold, which remains above ground in the form of ingots and jewelry, the extracted silver is used up in products and no longer available.

As far as this author can see, central banks could be living on borrowed time at this stage, and as their policies have reached the point of no return; it is a matter of time before the public learns about the abuses discussed in this paper and the fate of paper money.

It's been taking more than a 100 monkeys for this realization to occur, but this is not necessarily a negative. It is actually a positive proof that the bull market is in its early stage. Sooner or later, the public cannot but wake up to a resounding aha moment.

Either metal is capable of crushing any fiat currency in an instant, and a big sucking sound of emptied gold and silver vaults could very well be on the horizon!

Bullion or Shares?

In terms of bullion vs. shares, we'd rather focus on investing in the unencumbered bullion itself rather than the miners: Too many things could go wrong with the shares, and even more so as the management of these companies have not demonstrated good business acumen on average, and have not stood up as a group to defend their industry and shareholders interests. Further, the risks of their nationalization or a possible moratorium on deep drilling for environmental reasons are real and would carry drastic consequences.

The shares are clearly an excellent value, but as a matter of an investment priority and being environmentally responsible, best to invest in the available bullion first and take direct custody. Leave the manipulators running short and naked and the price of the shares will be sure to follow.

To wrap up, gold and silver are absolute, noble, and sovereign, and the same reason for which central banks trade them and hold them. Gold and silver have started redeeming their bids on unbacked currencies, and as the paper experiment has been failing before our eyes. Over the coming years, both gold and silver stand a good chance of staging a spectacular ascent.

i Griffin, Edward, May 1998, "The Creature from Jekyll Island: A Second Look at the Federal Reserve", Amer Media, 3rd Ed.

ii Taleb, Karim, June 2006, "Commodities Raging Bull", RobustMethods.net/Research