Popular Misperceptions

There are two popular misperceptions that I'd like to discuss today. One, I suppose, that is relatively harmless, except to waste productive thought; the other, if perceived correctly, represents an outstanding investment opportunity. The first misperception deals with the continuing discussion on gold leasing and leasing rates, including GOFO, the gold forward offered rate. This is an obscure (and I would say fictitious) rate that many are reading way too much into to divine the current and future price prospects for gold. The discussion has even gone mainstream, as evidenced in this recent article on Bloomberg – http://www.bloomberg.com/news/2014-11-17/gold-lending-rate-most-negative-since-2001-on-longer-refining.html

Basically, commentators examine daily changes in the GOFO rate to judge how "tight" the physical gold market might be based upon gold lending activities. Please don't take me wrong, I think the physical gold market is tighter than the current price may indicate, but I can't see how that is evident in GOFO or any other lending rates for one simple reason – I don't think there is much, if any, gold lending going on. And if gold lending is occurring to any great degree, the lending involved is highly illegitimate. I freely admit to being very much alone on this matter and I am open to being set straight by anyone who disagrees with my take. But please hear me out.

First, the meaning of the word “lend” is commonly understood to involve the temporary granting to another entity the use of something and its eventual return. Whether it is a power tool loaned to a neighbor, the rental of an apartment or the lease of a car, lending is a pretty basic word and concept. Certainly, money lent is expected to be paid off (returned) at some point. The Bloomberg article above describes how industry standard 400 oz bars of gold are being loaned and melted into smaller denominations and shipped to Asia. But how can that be considered a gold loan?

One would expect a neighbor to return a borrowed tool and for apartments and cars to be returned at the conclusion of a lease; but those buying the smaller gold bars in Asia have no obvious intent or requirement to return the gold they purchased. Certainly, these buyers aren't borrowing gold; they are buying it. An industry standard 400 oz gold bar has no inherent use, other than to be sold or converted into another form of gold (jewelry or small bars). Of course, such bars, like any other asset could be used as collateral for a loan denominated in currency, but the collateral must reside with the lender as security at all times. That's not what we're talking about here.

Gold loans in the context of the Bloomberg article and the continuing Internet commentary share no commonality with loans of any other type. That's because gold loans are not loans after all, but some convoluted and perverted sale, in which the original gold owner gives up physical possession for a paper promise of the gold's return someday and receives only a piddling interest rate (much less than 1%) in the interim. Meanwhile, the borrower of the gold either sells it and pockets the money or converts it to other forms (and pockets the proceeds). If all this all sounds confusing, don't feel bad as it is so dumb as to be confusing.

In an ironic twist of timing, the sequel to the popular movie, Dumb and Dumber was recently released. Seventeen years ago, I used the original movie to describe why gold (and silver) loans were as dumb as dirt and how the whole metals lending experiment must end badly. It took some time, but eventually gold and silver loans came to be discredited. Or so I thought.
http://www.gold-eagle.com/article/dumb-and-dumber

In the 1990's, gold loans, despite their inherent wackiness and fraud, blossomed into a market involving upwards of 150 million oz, or two to three years of world mine production. What enabled gold loans to grow to such enormous levels was that Wall Street (the bullion banks, like JPMorgan) were able to convince the world's gold miners to participate in the ill-fated scheme – to the miners eventual regret. In the end, two gold miners, Barrick and AngloGold, cost shareholders more than $10 billion each by falling for the gold loan/forward selling scam. More than one gold miner went bankrupt as a result of gold loans/forward sales.

The way the cockeyed scheme worked was like this the Wall Street banks convinced central banks to physically release great amounts of gold (sitting fallow in CB vaults for eons) to the banks in return for a below market interest rate. The Wall Street banks then sold the gold on the open market (depressing prices) and lent the money to gold miners for expansion and capital projects, with the banks receiving fees and interest rate differentials galore. The miners agreed to pay back physical gold as their mine production increased. It all sounded great on paper (and worked that way for years) until gold prices went up. Then, it became increasingly clear that the gold miners had been tricked into establishing a giant short position in gold that nearly destroyed them.

Gold loans are fraudulent through and through, because the real owners don't get the proceeds when the sale is made and the collateral ends up with an unrelated third party who has no obligation to return the metal. But because they appeared to work for a while, otherwise intelligent people overlooked the obvious fraud and collected the benefits while they were available. Today, those tracking gold loans report the amounts of these loans outstanding are down 95% from levels at the peak around the year 2000. For me, I can't figure out how even 5% of these loans could still be in existence.

That's why I'm skeptical about all the talk of GOFO and gold lending as who in their right mind would ever loan or borrow metal under the circumstances I've described? There are few, if any, documented instances of specific loans and the parties involved or to the purpose of these loans. I suppose it might make sense to be a borrower if one intends to default on the loan, but that's hardly legitimate. Likewise, I suppose a central bank might lease metal if there was an illegitimate intent to depress prices, but that couldn't be discerned from GOFO rates.

Therefore, I think all the articles and commentary about GOFO are still goofy and unproductive. It seems akin to some deep debate by religious philosophers during medieval times about how many angels can dance on the head of a pin. I'm not trying to be insulting, because I believe there is a negative side to the current discussion about gold loans and lending rates that would be eliminated if the discussion ended once and for all. There is somewhat of a common denominator in the debate over gold lending in that most reporting on GOFO appear to be staunch believers in the ongoing gold and silver price manipulation. It is also well-known that those who insist that there is an ongoing manipulation in silver and gold (like me), are considered to be fringe conspiracy theorists. I think that is somewhat earned because so many who believe in manipulation tend to espouse other conspiracy theories (definitely not me).

There is so much hard evidence of manipulation in the actual data released regularly by the government, in the form of the COT reports and verifiable fundamental data (in the form of ETF flows and COMEX silver warehouse movements), that the discussions about GOFO are so arcane and unsubstantiated so as to discredit the notion of manipulation. That's distracting and unfortunate and I, for one, am sick of it.

There is another popular misperception currently that, when rectified, presents an extraordinary investment opportunity. Quite simply, the misperception involves the popular feeling that gold and silver are one and the same and not two very separate and distinct precious metals (as I would maintain). In most peoples' minds, there is little actual difference between how gold and silver are perceived. I've pointed out previously that I am encouraged that more commentary than ever now includes silver when discussing gold. But perhaps silver being mentioned more with gold is at the heart of the problem of considering them to be the same. Let me cite a specific example.

This week, Eric Sprott was interviewed by Chris Martenson and the interview was carried widely. (In the interest of full disclosure, both are subscribers). I'm going to include the link to Zero hedge because that is a popular site and contained enough comments to the interview to make my point about most people not differentiating between gold and silver. Please take moment and read the excerpt published with the interview.
http://www.zerohedge.com/news/2014-11-16/eric-sprott-global-gold-demand-overwhelming-supply?page=2

I am absolutely certain that Sprott knows that there is only around $15 billion worth of silver inventory in the world (in 1000 oz bar form) and I also know that this is what he was talking about; but a fair reading of the interview excerpt would suggest that he was referring to gold. (Please read it for yourself to see what I am talking about). Most importantly, this issue was not addressed in any of the many comments on the interview, leading me to believe that it wouldn't matter to most readers if he was referring to gold or silver – precisely because they view gold and silver as interchangeable.

Maybe I'm making too big of a deal about this, but I remain amazed that the world continues to miss the most important distinction between gold and silver, namely, how much of each exists. After all, something has to explain why the world's investors are completely unaware of the physical and financial facts surrounding silver. I'll tell you straight out if there were only $15 billion worth of gold inventories in the world, I'd probably be a bigger gold bull than silver bull – if you can imagine that.

Fifteen billion dollars is such a pitifully small amount for what might exist in world inventories for either gold or silver that it would be reason enough to buy either if that valuation applied. Well, it does apply to silver and doesn't apply to gold where the amount of gold in the world is measured in the trillions of dollars ($6.5 trillion, to be precise). Furthermore, very little of the $15 billion worth of world silver inventories is available for sale according to ETF and inventory flows. I can't prove it, but I doubt that if someone tried to buy just one billion dollars' worth of physical silver currently (60 million oz), the transaction could not be completed below $30.

And Sprott is correct just the mere fact that so little world silver exists that could be bought is bound to encourage someone to test if that is true. But right now, investors are interested in other major markets, in addition to confusing gold and silver as being one and the same. This is the misperception that translates into an investment opportunity like no other. Only after silver has achieved its inevitable shockingly high prices will more recognize how mispriced it had been. Of course, recognizing it before those high prices are achieved and acting accordingly will be more rewarding than just recognizing it in time.

When I started this article today, silver and gold were steady, only to sell off suddenly around 10:30 AM (EST). This sell-off was followed by a sharp rally, particularly in silver, only once again to sell-off as I complete this piece. Although I am adamant about reading too much into price movement to gauge what's going on under the surface, there's something about this volatility that is encouraging. I'm still of the mind that the COT structures in gold and silver are exceedingly bullish and it appears to me that this unusual price volatility may be due to JPMorgan and the other big commercial silver shorts shaking the tree to flush out as much outside selling as possible so that these big silver shorts can buy. I can (and have) look dumb in the very short term, but it feels to me like we can move up sharply at any moment.

The more I contemplate the four month price decline since mid-July in silver (and other commodities) increasingly it looks like the setup of all setups. There was an almost unmistakable deliberate intent to the decline and this has been proven out in the futures' positioning changes. While unexpected by me, the recent double-crossing by the big silver shorts of the smaller raptors fits in perfectly with the mother of all setups thesis. And while the big traders on the COMEX can bomb the price at will in the short term, it's hard for me to see what category of traders' remains that can sell significant quantities of futures contracts. Instead, all I see are the many categories of potential big buyers.

Here's the latest announcement from the CFTC warning the public on financial fraud in commodities. Funny, there was no mention of the ongoing scam in COMEX silver which many thousands of market participants have written the agency about. I hate to be cynical but why does this seem like a perfect bureaucratic solution – instead of resolving a manipulation most everyone is aware of, come out instead with a public campaign to warn people of financial fraud in commodities. Marvelous.

http://www.cftc.gov/PressRoom/PressReleases/pr7063-14

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Silver – $16.15

Gold – $1185