

Sep 10, 2009 - The Dumbest Trade Ever?

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In this day and age of massive financial miscalculation and blunder, it's not easy coming up with the single trade that holds the title of the dumbest of all. After all, we have seen trading positions that have, quite literally, destroyed large firms, like Bear Stearns and Lehman Brothers. We've seen large individual trades gone sour to the tune of billions of dollars, as in the case of Amaranth and Soc Gen.

Common denominators in these trades included massive leverage, little transparency and/or unauthorized trading, and the fact that the trade or positions unraveled quickly. The firms involved almost didn't know what hit them until it was too late. With that filter, I've chosen a trade that wasn't highly leveraged, was mostly transparent and that took many years of going bad before it was recognized as a being a clunker. My award for the dumbest trade of all time goes to Barrick Gold and its ill-fated gold hedge. This is a trade that was doomed from the start.

The occasion for the award is Barrick's latest attempt to close out and rid itself of this rotten trade. Here's a pretty good review of the story

<http://www.globeinvestor.com/servlet/story/RTGAM.20090909.wbarrickhedge09>

[08/GIStory/](#) Or, if you prefer, here's the actual press release from Barrick directly

<http://www.barrick.com/News/PressReleases/PressReleaseDetails/2009/BarrickAnnouncesPlanToEliminateGoldHedges1121019/default.aspx> What's not in the review or the actual press release is the suggestion that this is about the dumbest trade of all time. Let me explain why I think it is.

First, even if everything goes as planned, the short gold hedge that Barrick is trying to rid itself of, still won't be closed out completely. What's more, Barrick has made previous announcements, over the years, that it plans to close out its short gold position and has never completely succeeded. A trade is really bad when you can't close it out even after you decide and publicly announce your intention to do so. Who allows themselves to get into a trade that you can't close out, even if you want to?

Nowhere in the article or the press release is stated the total cost of Barrick's venture into short gold hedging. Let me rectify that. My estimate is that Barrick has lost, in total, more than \$10 billion overall since it started the nutty idea of over-hedging its gold production. That's larger than any single derivatives loss on history. That's more than Barrick has earned in its existence. That's \$10 billion that could have gone to shareholders in the form of dividends, or to be used for acquisitions or legitimate corporate purposes, like eliminating debt or buying back shares. Instead, it was \$10 billion completely squandered. Now,

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shares must be issued to pay for the gold short loss, diluting shareholder value. To add insult to injury, the management responsible for such a debacle rewarded itself lavishly.

But the magnitude of the loss and the ineptitude of entering into a transaction in which there is no ease of exit are but two components of what makes this the dumbest trade of all. The deciding factor that crowns this the worst trade of all-time is how long the trade has existed and how much Barrick was warned all along about how the trade made no sense. The level of arrogance displayed by Barrick management over the years to anyone, including shareholders, who tried to point out the folly of the short gold trade, boggles the mind. Please remember, the gold shorts being closed out now by Barrick were established at near \$300 an ounce, meaning losses of \$600 to \$700 per ounce are now being taken on millions of ounces. I would submit that would be hard to accomplish, even for whoever might be the world's worst trader.

I was one who warned Barrick about the folly of this trade before anyone else, to my knowledge. In fact, my very first writings on the Internet, going back to 1997, concerned leasing and forward sales and Barrick. Incredibly, after my warnings, Barrick dramatically increased the size of its short position. Here's an article from 2006, about Barrick (and a silver hedger, Apex Silver, that eventually went bankrupt due to that hedging), that contains links to some earlier articles

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http://www.investmentrarities.com/ted_butler_comentary/01-03-06.html I didn't just warn Barrick, I warned their accountants and auditors, the CFTC, and even complained to the SEC about Barrick's fraudulent hedging and non-disclosure to shareholders. The great irony is that the lack of action by all involved, who supposedly exist for shareholder and public protection, played heavily in the subsequent \$10 billion loss.

Here's a bit of history many readers are probably unaware of. In researching previous articles for this piece, I ran across an article that I wrote back in 2000, which offered suggestions for GATA, which was newly formed back then.

http://www.gold-eagle.com/gold_digest_00/butler061100.html Although my main interest has always been silver, I wrote extensively about gold initially, as many of the issues in gold applied to silver as well. I also knew more people were interested in gold than silver (they still are), and it would be easier to make my case in silver by enlisting the support of gold people. I believe my early writings on gold manipulation, for instance, served as the genesis for GATA. I find it amazing how constant many of the issues have remained to this day, not just concerning Barrick, but others as well. GATA did pick up on my allegations against Barrick, much to their credit. But what amazes me the most about this article was suggestion #4, concerning position limits, which 9 years later, has turned into the main issue of this time for the CFTC and its new chairman, Gary Gensler.

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The point of this article is not to lambast Barrick or stroll down memory lane, as there is usually little to be gained in that. There is a broader point I would like to make. Even those who appear most connected to what may be really happening in gold and silver, such as the world's largest miner, or the largest bank, or the biggest exchange, or an army of regulators, can get it wrong. Especially when common sense is suspended and legitimate warnings are ignored. Just like common sense has been suspended in the shorting of silver and legitimate warnings have been ignored. But just like the day of reckoning came for Barrick Gold, so will it come for the silver shorts. Believe me when I tell you that the big silver short position will eventually win the ultimate prize for the dumbest trade ever.