

July 10, 2013 – Misperceptions

Misperceptions

Something I try to always avoid is criticizing anyone else's analysis. It's not that I don't see statements and conclusions that I disagree with; I avoid direct criticism because it generally seems unprofessional and you come off looking like a know-it-all. I find it better to just write what I think is important about silver and gold and have others do the same and let the reader decide for him or herself based upon the merits of the argument and the facts.

Sometimes, however, I feel less reluctant to criticize when many seem to embrace a particular thought. Recently, there has been much written about certain interest rates in the gold leasing market and how these rates might suggest backwardation and a pronounced tightness or shortage in the gold market, leading to sharply higher prices. As I think you know, my outlook is for a big jump in gold and, especially, silver prices, so part of me hopes the gold lease rate stories are correct and do lead to higher prices. Perhaps one of the worst analytical and human traits is to agree with another on what might occur, but differ bitterly on the reasons for the potential occurrence. Life's too short to argue about everything.

On the other hand, if someone says the gold price will go up because the moon is made of green cheese, if the price of gold goes up there will invariably be those who will assume they can then conclude what the moon is made of. So rather than spend time digging into the intricacies of the rates surrounding the leasing of gold and other metals, let me instead speak of the leasing of metals in general. In a word, the leasing of gold or other metals is a scam that makes no legitimate sense. I don't doubt that gold leasing has and can be used to contribute to a manipulation of the price, but that just confirms metals leasing is a scam. I know that many might disagree with my statement at first, but when you try to understand the mechanics of gold leasing, your head will be spinning with all the complicated explanations for how it works. So let me instead speak of it in the simplest terms possible.

We all know what a lease is and have probably been on either side of a lease transaction at some point in our lives. Who hasn't leased a car, a piece of business equipment, or rented or rented out an apartment or house or office? Leasing is such a familiar transaction that a gold lease sounds rather unremarkable on its face. Here's a simple definition of lease –

<http://en.wikipedia.org/wiki/Lease> However, there is a very big difference between any lease you may have transacted involving a car or real estate and a bar of gold (or silver or other metal). The difference is that any common lease involves the temporary use for payment and ultimate return of a productive asset to its owner.

How the heck can you "use" a bar of gold without selling it or destroying it by converting it into a different form (say jewelry)? Certainly if you leased a house or a car you couldn't legally sell it to someone else or destroy it in any way. Yet there would be no practical use in leasing a bar of gold if you couldn't sell or convert it. You could take a bar of gold or other metal to a bank and borrow against it, but that's not a lease, that's providing collateral for a secured loan. I'm not trying to mess with your head "I'm just trying to point out that "leasing" has a different meaning for gold or other metals than any other lease you may have experienced.

This scam called gold leasing was what prompted me to write on the Internet originally. Really long-time readers might recall that my very first article on the Internet (circa 1996) was a copy of my letter to then-Fed Chairman Greenspan and Treasury Secretary Rubin about the fraud of gold and silver leasing. (Unfortunately, I can't find a working link to that article). Despite my and others' warnings about the fraud of metals leasing, the practice continued and grew into the early 2000's, advanced by the participation of major gold mining companies like Barrick Gold and AngloGold Ashanti.

In fact, it was the broad participation by mining companies in forward selling that resulted in the growth of gold leasing to more than 100 million ounces at its peak around 2001. The way it worked was that central banks would "lend" gold and silver to bullion banks (Goldman Sachs and JPMorgan) that would promptly sell the gold into the market and loan the cash proceeds to the mining companies at a lower than market interest rate with the promise that the mining company would return the gold someday from future production. The central bank, in essence, relinquished ownership to the metal and received none of the sale proceeds (only an ultra-low "lease" rate of a fraction of one percent annually). This relinquishment of ownership without real payment to the central banks was what made the fraudulent gold lease daisy chain possible.

However, it was tantamount to someone renting an apartment (where the landlord was the central bank and the tenant was the bullion bank) and the tenant sold the apartment to an unrelated party and kept the proceeds, promising only to return the apartment to the landlord someday. The selling tenant (JPMorgan, for instance) secured a separate guarantee from mining companies to return the gold someday and the bullion bank made a big profit from what they paid the central bank in rent (say at 0.25% annually) and what they charged the mining company (say 6% or more), in addition to dealer commissions on the sale of the metal. If this sounds convoluted to you, there's a very good reason for that because it is extremely convoluted and fraudulent.

In essence, what the bullion bank did was trick the central bank out of its gold and silver and trick the mining companies into establishing what was nothing less than a giant gold short position. But then again, how hard is it for bullion banks like JPMorgan to trick central banks and mining companies? After all, this is what they do for a living. The most ironic aspect was that the mining companies, like Barrick and AngloGold, bristled at the suggestion they were simply being tricked into creating a massive short position in gold, largely because the financing money flowed so freely. It took a while, but in the end a few years ago, after gold's big decade's long price rise, Barrick and AngloGold and other miners realized that they were just short gold in a rising market and moved to cover. By my calculations, from the very beginning both Barrick and AngloGold each lost \$10 billion on the whole phony forward selling/leasing scam, while JPMorgan and the other bullion banks kept their profits and moved on to other scams (like subprime mortgages and payday loans).

After Barrick and AngloGold and other miners threw in the towel and swore off gold leasing, I thought that was the end to the scam. I was not surprised that neither Barrick or AngloGold or anyone else involved in the leasing financial disaster ever fessed up their gross miscalculation because how often does anyone take responsibility for anything? I still think gold leasing is largely dead because neither Barrick or AngloGold will do this again in the lifetime of anyone reading this, but the recent stories of gold lease rates rising tells me many haven't learned how stupid and fraudulent gold leasing actually is.

When you read the stories about the gold lease market, please try to imagine how it operates in terms of common sense. What good does it do anyone to borrow a bar of gold unless he intends to sell it or consume it somehow and how can that be legitimate? Try selling a leased car and see what happens. What good does it do someone who owns gold to relinquish ownership and only receive a fraction of one percent interest annually and a paper promise for its return when you could sell it instead and receive full proceeds? Further, leasing out gold you own converts what many argue is the ultimate assurance against counterparty risk into perhaps the ultimate counterparty risk. And for what? 0.25% annual return?

Perhaps many are still engaged in gold leasing, but there will never be any concrete way of determining that because, in addition to all its obvious screwy aspects, gold leasing is the most opaque financial activity of all. Because it is largely centered in London (if it exists at all) that means there is absolutely no way of quantifying it, like most commodity transactions there. This lack of transparency gives rise to many misperceptions floating around, like there being a short position existing in gold that is 100 times the amount of actual gold (either in existence or in London (who could know?). No transparency and verification gives rise to outlandish claims, both bullish and bearish. When there is no documentation (like does exist in government data) one can paint any picture desired.

The point of this piece is to rely not only on what sounds reasonable and makes sense, but also to stick to what can be documented and simply explained. The whole essence of gold leasing makes no sense and can't be verified anyway. Sure, a rise in gold lease rates might coincide with a long overdue rally but that still won't mean the moon is made of green cheese.

A quick note on JPMorgan's unusual taking of delivery of silver in the current July contract I first mentioned on Saturday. In the two delivery days since that review, JPMorgan has taken (stopped) an additional 369 contracts, 350 of which were for the bank's house or proprietary trading account. Of the 2220 total contracts delivered so far in the July COMEX contract, JPM has taken 2006 contracts, including 1829 contracts for the bank's own house account. Over the past two days, customers of JPMorgan have delivered close to 200 silver contracts as well, raising the question if JPMorgan is double dealing. Another point is that the 1829 contracts (9.145 million oz) that JPM has taken in its own name is above the level of 1500 contracts that COMEX rules dictate can't be exceeded in any one delivery month by any single trader. Hey Â? have you ever heard of a rule or regulation that JPMorgan couldn't evade? Me neither.

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Silver – \$19.30

Gold – \$1260

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