Company News

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Gold conspiracy: can you afford to ignore it?

By Rob Mackinlay

In London, the "man on the street" appears to be running a similar strategy to some hedge fund managers: buying physical gold and holding it, whatever the price.

According to ATS Bullion, punters are ignoring daily price gyrations and buying in ever increasing numbers – paying a 10%-12% premium on gold krugerrands, double the 5-6% premium paid in August.

Meanwhile sophisticated investors, hedge fund managers, appear to be doing something similar. Ben Davies, co manager of Hinde Capital's gold hedge fund, said: "We currently hold almost 100 per cent bullion as the deleveraging of the system has obliterated the market value of the mining equity."

However, despite the apparent demand for physical gold, global prices are falling. Yesterday (22 October) prices fell to a five week low, below $750 per ounce. For many the disconnect between the price of real gold and gold futures is a sign that the system is breaking down: one commentator saying "There's no rational explanation for the incredible disconnection between gold's physical demand and the paper trading of it on the Comex."

While some analysts say that current events can be explained by traditional fundamentals, theories about sustained and sinister manipulations of global gold prices are prevalent.

The idea that central banks have purposefully suppressed the price of gold might come as a surprise to some, but the allegation has been around for years.

A brief history

The bulk of the information in this article has been found via the US-based organisation the Gold Anti-Trust Action Committee (GATA).

One of the key documents on the GATA site is from British economist, Peter Warburton, possibly the first to formulate the theory. In 2001 Warburton wrote "The Debasement of World Currency: It Is Inflation, But Not as We Know It"

In the piece he says Western central banks: "incite investment banks and other willing parties to bet against a rise in the prices of gold, oil, base metals, soft commodities or anything else that might be deemed an indicator of inherent value. Their objective is to deprive the independent observer of any reliable benchmark against which to measure the eroding value, not only of the US dollar, but of all fiat currencies. Equally, their actions seek to deny the investor the opportunity to hedge against the fragility of the financial system by switching into a freely traded market for non-financial assets."

Even if its true, what does it mean for investors?

Chris Powell, secretary and treasurer of GATA, said: "While people look to GATA for information bearing on their investments, GATA is not an investment adviser. We maintain mainly that central banks have been manipulating the gold market, largely surreptitiously, for many years now and that their power over the market is likely to diminish or even end when they run out of gold to dishoard. How much clarity does this understanding bring to the gold market? Well, I don't think ANY analysis of the gold market means anything if it does not start with central bank involvement."

Ben Davies, said: "I believe strongly of late that the authorities, in trying to shore up the financial system, have implemented every means possible at their disposal to subvert the realities of the dire situation the world is in."

But he said: "Which would you rather do lend AIG $85bn (and growing) to fill the derivative hole or would you rather buy the entire future gold and silver mine supply of the world for $80bn and have $5bn in change. If I was Paulson I would direct 80bn there to re-coup losses."

Davies said: "The physical market in silver is in backwardation and gold is heading that way. This means the Physical market is trading at a premium to forward prices. This is a sure sign of shortages. If holders of futures have the cash to do it they should take delivery for the physical come expiry and I think we will find, particularly in silver, that the shorts cannot deliver. This disconnect is lending credence to sanguine financial commentators claimінig that the authorities are indeed suppressing prices of gold and silver in the paper markets."

"Prices will snap back like an elastic band"… or not?

So investors have to decide whether they believe conventional measures of gold's value or ignore what global markets say.

Davies said the intervention of banks was understandable, but added: "If you intervene in free markets, through price fixing in the commodity space, eventually fundamentals will reassert themselves. In fact by suppressing the paper market you are sowing the seeds for greater shortages. Production falls as commodity prices fall below the marginal cost of production. When you push reality exponentially from the mean the correction is never back to fairvalue, it overcorrects to an extreme the other way. Prices will snap back like an elastic band."

Davies cites another gold commentator, John Embry. In a piece called Rescue will send gold to surreal price level, Embry said: "This whole event (bank rescue) confirms my long-held belief that when push comes to shove, the US authorities will not hesitate to debase their currency in an attempt to salvage the financial system. In the fullness of time, this will be wildly inflationary and should propel gold and silver to prices that would be viewed by many in today's context as surreal."

But other gold bugs who also suspect dark forces at work in the current crisis are "hunkered down" for a long a possibly painful wait: "The meltdown will continue until it runs its course, over the next eight-nine years plus or minus, with 6-18 month 'mini bull market' rallies along the way, to allow insiders to take profits and sell short."

Commodities torpedoed by Fannie Mae and Freddie Mac nationalisation

Don Coxe, Global Portfolio Strategist at BMO Financial Group (Bank of Montreal), a respected voice in the commodities space, said that commodities speculators had been a target when the US government stepped in to nationalise Fannie Mae and Freddie Mac.

Coxe said that prior to making the decision to nationalise the two mortgage companies, US officials scrutinised commodities futures market data. Coxe said the data showed a spike in speculative money in commodity futures markets from late May to early July, as opposed to industry participants. He said that the architects of the nationalisation plan would have known about useful side-effects in commodities prices: "They knew then that there was going to be enormous pressure to unwind these positions… it caused a 40% rally in bank stocks and, in the process, what it did was force massive sales of commodity futures and commodity stocks."

There seems to be little disagreement about Coxe's version of events. John Embry said this about Don Coxe: "I feel his view carries considerable weight. He is a contemporary of mine in Canadian financial circles and is one of the brightest, well-informed individuals that I have had the pleasure to know. He is also a member in good standing of the financial establishment, so for him to make this allegation is truly significant."

Ben Davies of Hinde Capital said: "When seasoned respectable individuals like Don Coxe start verbalising in full about the intervention in markets you have to stand up and take note."

But Coxe told investegate.co.uk that gold bugs had got it wrong if they saw what happened as a conspiracy: "I said it was a brilliant strategy and they (central banks) may have saved the world, there was nothing infamous or conspiratorial about it."

"There was nothing conspiratorial about gold in this. They weren't wasting a lot of time on gold, the focus was on oil. They were faced with enormous pressure with several investigations going on at the time."

He said: "I'm sorry, but in this case I have vigorously denied that there is a conspiracy of central banks to hold down gold prices. My attitude is that they cause me no end of trouble, these gold bugs."

Conspiracy or not, the fall in commodity prices appears to have been engineered and a desired and predicted side product of a bank rescue. The question gold bugs are now asking is whether the central banks' power to control these prices is never ending.

Despite his different take on conspiracy theories,Don Coxe appears to remain a gold bull

The other side

Traditional analysis of gold prices generally ignores this debate. Brock Salier, mining analyst at Ambrian Capital, said he discounts the theory outright: "I lump it in with all the other holders of gold and gold stocks who are confusing what they would like to see and the reality."

He said: "There are a few key points that the US$1,500/oz punters miss;

1. If we need a perfect storm to get gold up – well we're in the perfect storm, gold isn't up, so the only direction left is down.

2. I completely agree that investors move to safe-haven, and this is seen in huge inflows to ETFS, BUT still gold still isn't going up, so what does that tell you? To me it means more people are selling than buying, and the logical choice would be governments. With all these bank bail outs, and gold at an all time high, it has to be logical that central banks will sell gold.

3. Jewellery demand is elastic – forget the price of gold and focus on disposable income which even in India is going down in the global down-turn.

Salier said: "I can see that a conspiracy theory would offset some of these arguments, but in all honesty there is enough fundamental support for gold to fall that any fall isn't so massively illogical that is must be a conspiracy."

In a "Gold Overview" sent to clients earlier this month, Salier said: "Central Banks are unlikely to turn into buyers, mined supply isn't dwindling significantly in the short term and over 60% of demand is for gold jewellery. These factors could be argued to imply that gold is unlikely to see dramatic upside in the immediate credit-crunch scenario despite the prolific ETF buying underway. Beyond that we should see support at US$750/oz which should allow low-cost expanding producers to prosper."

A similar view came from Simon Ward, chief economist at New Star asset management: "There may be something in this, but statistical analysis suggests gold price movements are largely explicable by macro factors like interest rates, inflation, money supply, industrial production etc., without any need to invoke conspiracy theories."

John Redwood MP said: "I don't agree with this conspiracy theory, I am afraid. Gold is a freely traded commodity which people can buy if they think it is a good store of value. Its value will relfect supply and demand for the metal as well as speculative elements."

Could owning gold be banned? Hedge fund warning

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