HindeSight

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I Want to 'Scream & Shout'

by Benj.AM.I.n. featuring Gold You B@tch

Anyone who has dialled into a contemporary music radio station anywhere in the world this last year will have been subjected to the upbeat *dance* and *electro pop* of 'Scream and Shout' – Only Britney B@tch by Will.i.am, featuring Britney Spears. Its lyrics depict a hedonistic night out on the town. On Friday 12th April 2013, after the beating the gold market had taken, I and my co-manager Mark Mahaffey felt about as interested in a 'night out' as a horse spending its last in a glue factory. Our mood was definitely not upbeat, rather the opposite, we were a tad downbeat.

Just for the record I love the song, and unashamedly love it at that; while I am at it, I love Robbie Williams and all the 'Take That' crew too. There you have it, I confess. Can I at least add that I love the Smashin' Pumpkins and the Red Hot Chillies as well – eclectic taste hey, but excuse me if I get off *track…*

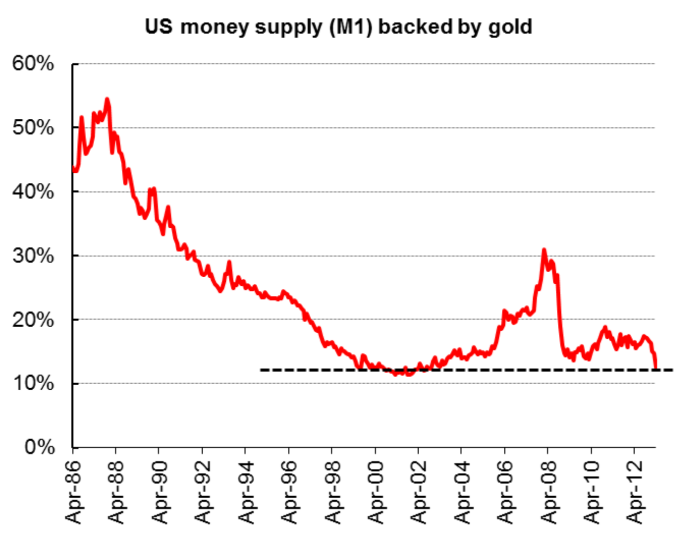
The question on everyone's mind is whether or not the gold bull market is over? Such an utterance seems glib in the face of 8,000 years of history that suggests otherwise. Of course, there is a time and moment to own gold. That time is still now. So you will not be surprised to hear us say, *no* it's not over; it's just getting interesting.

Another question that is on everyone's minds or if it isn't, should be; was the gold market sell-off a product of continued and escalated manipulation? I will explore the answers to both these questions, and by understanding reality we can begin to understand whether gold can reassert itself in its justifiable role as an antidote to the current fiat currency system.

Golden Undervaluation

First off, gold is still undervalued in 'fiat' money terms, but that is merely the easy observation. People have said to me gold has gone up a lot and so it's too high. I always reply that gold has a price and a value. These two constructs are not interchangeable. Price is a level at which you make an exchange, and value is whether it is worth it. Right now gold is at a high price (not anymore), but when examined in the context of other assets, it remains undervalued -- primarily against paper money.

To illustrate this point we can now see how gold is as undervalued, incredibly, as it was in 2000, just before this gold market began to rise in nominal terms.



Source: IMF, Fed, Hinde Capital

One phrase that sums up my thinking – **price has changed, but nothing has changed.**

To develop this statement a little further, I want to quote a friend, Detlev Schlichter, on the recent brutal bloodletting in the gold market. Detlev wrote a really eloquent book Paper Money Collapse, about the inevitable failure of paper money economies. He states:

"After 40 years of relentless paper money expansion and in particular 25 years of Fed-led global bubble finance, the dislocations in the global financial system are so massive that nobody in power dares to turn off the monetary spigot and allow market forces to do their work, that is to price credit and to price risk according to the available pool of real savings and the potential for real income generation rather than according to the wishes of our master monetary planners."

This fact remains, so nothing has changed.

Gold - Taken Behind the Woodshed

TD Securities described the gold 'crash' as 'Gold – Taken behind the woodshed'. I particularly like this seemingly fitting epitaph as I would have to say this recent market experience was as much fun as going to a 'drunken chainsaw juggling contest' – of course one where you are blindfolded or should I say blindsided?

Rumours abound of market manipulation by a bullion bank, a hedge fund or some cartel of each or both and of course there is the usual suspicion of central bank intervention, either directly or indirectly via a conduit.

Answering the second question as to the veracity of market manipulation is harder to answer succinctly, however market manipulation of gold is fact as you will see, but was it responsible for the recent events?

Crashes never occur in isolation. There is an endogenous market process that takes place over months, possibly years. We illustrated this in our Silver Criticality HindeSight letter. There have however been repeated attacks on the gold market that would appear to have been escalating these past few months. We set our clocks by the 1pm daily down draft in our office. There was a sickening inevitability that the market would succumb again to a concerted effort to break the market. One thing is clear in the cold light of day; somebody knew ahead of time of the threat of potential euro central bank gold sales (more on this later). The price action alone in the prior few days was telling; notwithstanding the *inside* hints post the crash as to this fact.

Those who do not know me or the team at Hinde will no doubt be saying – 'typical sour grapes' from a gold manager trying to justify his seeming ineptitude; trying to abdicate responsibility by blaming some malevolent forces. This could be no further from the truth. I tell it like the evidence tells me. Of course there is always room for error, but we play the laws of probability every day and the evidence points to a high probability of manipulation. We would point to our record on claims for and against manipulation:

> In April 2011 we called for a silver crash, released on the eve of the crash itself, describing the magnitude of the sell-off before it happened. Maybe it was us who crashed the market with our selling?! (No, we are not the Quantum Fund). We did not believe it was manipulation but an unwind of heavily margined positions where for once commercial shorts were being closed out not added to, a good indicator of no manipulation, but by no means a definitive.

> We have repeatedly stated for 18 months that mining companies are not viable at $1,600 gold; we are not short (more's the pity) we just don't own many. The miners' poor performance was logical and rational.
>
> We were given information that there was central bank intervention twice at $1,900 – the first on the SNB 1.20 eurchf peg announcement, the second in an overnight (Asia) gold assault. Stops were run using strategically placed orders at a series of bullion dealers to run the gold price down.

Beyond the obvious reasons to manipulate a market for one's own financial gain why would the authorities want to run down the gold price?

A Primer on a Gold (manipulated) Crash

Human beings like to find meaning or understanding to seismic events, statistical outliers. This past week was certainly a seismic event for the gold market. People want to understand why, but often ignore the obvious because it undermines their cosy reality. I will endeavour to provide some thoughts so you can derive your own understanding and even meaning to all of this.

Why do we desire to understand? Don't worry I don't want to transgress into some metaphysical debate about god, life, the universe; but suffice to say people look for solace in understanding as perhaps an antidote to our subconscious awareness that our existence is truly mind-blowing. We want to wrest back some control through understanding – I believe it's a visceral impulse.

Religious faith cannot be dissuaded. If I ask a Christian, a Jew, a Muslim – 'how do you know there is a divine being?', 'God exists to me', says the Christian. It's irrefutable. One cannot deny this individual their faith as you cannot prove otherwise.

Gold has engendered similar polarisation between religious believers and non-believers. The marmite analogy is prescient. You either love it or hate it. Logic can be applied though to whether or not gold protects us from currency debasement – it again is irrefutable; but what should be of more interest is the debate as to whether or not gold is manipulated.

Now for some they believe this requires faith as there is no evidence. I beg to differ GATA has provided significant evidence in support of this fact. Ferdinand Lips in his book Gold Wars, provided 'inside' evidence from former Federal Reserve officials and Treasurers of interventions in the gold market. My personal experiences this past two years reinforce my understanding as highlighted earlier.

'So what' I hear you say – 'doesn't affect me'. But it does and here is why.

It is in the interest of any government who wields a monopoly control over the issuance of fiat currency to restrain gold. A rising gold price signals the debasement ie over issuance, of paper money. It is this over issuance that enslaves you to remain a wage slave until your dying days, no retirement plans for you at the beach, as your disposable income and savings are eroded out of existence.

By suppressing the gold price, and reweighting growth and inflation indices to mask the effects of rising prices, a government can maintain stable and lower yields in the domestic sovereign bond markets, thus enabling them to have a virtually endless supply of paper money. Remember currency in circulation is created by central bank purchases of government debt which then helps supply the financial system with money and credit.

Today there is much more at stake than ever before. A falling exchange rate will encourage inflation domestically, drive bond rates higher, but with so many banks capitalised by bonds, and sitting on off-balance sheet debt-laden derivative positions which outstrip their mediocre reserves by a factor of infinity, the financial system would evaporate. Panic would ensue. A type of panic, we don't know the meaning of.

The irony is we accept, albeit uneasily, that bond markets are manipulated. QE has undeniably kept bond yields lower, but because the central bankers have told us this would happen, we accept it. Notice that Ben Bernanke can barely bring himself to utter the word gold. **It is as if the very restraint on his vocabulary is a restraint on gold itself.**

If he says 'buy equities', after all that is what his portfolio channel effect is advocating, then so we do. His scant use of the word gold, his *aurophobia*, is a palpable testimony to the very importance of gold. Ben wants control – he wants to prevent the Global Crisis continuing which he helped induce through his abuse of credit proliferation. Ben is not omnipotent. Ben's price controls are wreaking havoc and disruption on the value of money and hence our daily labour and livelihoods. Price controls always end badly with devastating impacts. Ben hopes to prevent his credit edifice from collapsing, which he will not be able to, the only question is will credit collapse or will money inflate too much. It is binary – we will see deflation or high inflation – there will be no middle ground.

I write of Ben Bernanke here, because he controls the reserve currency but as we have attested in our 'Central Bank Revolution' I and II pieces, there is a loosely coordinated global central bank effort to reflate the economic system. Central bankers who rely on fiat currency issuance oppose gold as it's the last asset class that can undermine their ability to issue money, after all 'they are' the bond market these days; the only other asset class that could signal warnings of impending currency failure. Nobody dislikes an equity rally, but people should remember equity markets will rally aggressively when there is serial debasement of a domestic currency. It's just that your share of equity will buy you very little in such event.

Let's assess at face value a series of ***remote*** events that I would argue led to this past week's gold event:

1. 18 months of gold's diminished response to central bank QE escalation
2. BoJ in excess of $1 trillion qualitative and quantitative easing strengthened dollar which didn't help gold sentiment in dollars
3. Chinese rampant 60% y-o-y credit expansion yielded sub-par growth and triggered no commodity rally
4. Excess commodity supply and overcapacity has seen a relentless slide in industrials, creating a view that gold was relatively overvalued to financial participants (who don't view gold as money)
5. Portfolio Channel effect has boosted equities as central banks around the world have taken longer duration off the market and forced private investors to replace bond duration yields that are too low, with equity and credit risk
6. Equity 'induced' strength has hoodwinked individuals into believing the economies are experiencing a return to financial health. (A rising equity market was not a sign of health in 2007 it was a warning, its internal structure revealing the true nature of its debt margined rally and so it is the same today.)

7. A litany of 'Gold –It's over' research from major banking institutions weighed on the psyche of investors who after years of non-stop gold returns looked longingly to rising equity returns whilst their holdings languished
8. Stale longs and late-comers sit uncomfortably long, forgetting the reasons for their holdings as Draghi's 'whatever it takes' bring a euro 'irreversibility' rally and repayment of LTROs that sees contracting Eurozone liquidity
9. European periphery countries move into current account surplus – things must be better – but nobody read the small print. This was due to demand destruction as imports had collapsed. 'Europeans lose half their body weight' says Il Figaro – 'they have stopped eating' as can't afford to import food – no more British ready frozen lamb imports either…

Then came the ***proximate*** causes of the crash

1. Fed minutes reveal discussion of QE tapering
2. Lower gold prices bring in an escalation of even more anti-gold research (as if emboldened by the price action) and we see issuance of covered call Gold ETN products by US bailed out banks. 'Viva' Equities they cry - sell-side love to get back to their traditional asset classes, where stock lending is so lucrative
3. Euro crisis is back-on, Cyprus is collapsing no bail-outs only bail-ins expropriating depositor money, gold rallies $70 above $1,600 – but fear of deposit flight contagion across periphery is quelled when extensions to existing debt restructuring deals of Portugal, Ireland and Greece is granted
4. BoJ ramps up QE announcements, foreign asset purchases denied, but periphery bonds rally as Japanese Lifers and Insurers switch JGB allocation to higher yielding debt overseas.
5. Record gold selling by Ms Watanabe on record Gold yen highs (gold only stale in US dollar terms at this point)
6. US payrolls disappoint, labour participation rate still falling, gold speculative paper longs rise causing small rally
7. Thursday 11th April talk of Cyprus having to sell gold reserves is brushed off as insignificant
8. Friday 12th April EcoFin meeting - Draghi announces Cypriot gold sales should be used to help cover any potential ELA loss:

   "What's important, however, is that what is being transferred to the government budget out of the profits made out of the sales of gold should cover first and foremost any potential loss that the central bank might have from its ELA."

   ELA which stands for Emergency Liquidity Assistance, is a lifeline that can be offered by national central banks in the euro region to commercial banks that can't get funding, through access to ECB liquidity. Since when has the ELA been a loan? It has never been a loan.

9. Gold trades badly all Thursday and Friday, I believe in anticipation (or prior knowledge) of Ecofin announcement (turns out it was a Troika edict) that Cypriot Central bank must sell their 13.9 tonnes with inference that European CBs would be forced to sell gold holdings in event of bail-in/outs

10. Gold flashes through ‘technical support’ at $1520/ tr.oz. after CTAs and HFs sell aggressively at $1535 breaking this support and with no seeming gold supportive left ‘stale’ and late speculative longs from week before start bailing on gold market
11. Rumours abound of a single entity selling over 400 tonnes of actual or paper gold (transacted in COMEX). If this was a naked short the margin would be 10 to 20% depending on if was a commercial ‘hedger’ ie bank eg JPM / GS etc. or speculative seller

This last point begs the question was there some sinister invisible hand that manifested itself in a very visible attack on the vestiges of gold as an ‘unsound’ money siren beyond mere anti-gold propaganda. The aftermath of this ‘flash’ crash as Andy Xie of Morgan Stanley described it, points overwhelmingly to a *bear raid*. Let’s hope Xie’s terminology will be a prescient analogy for the duration of this sell-off ie short-lived.

Let’s also look at some of the fascinating statistical records that were set this past week as a testimony to the carnage that can be wreaked on markets by a not so invisible hand.

Golden Numbers

Third worst 1 day gold move on record, Monday 15th April 2013; the worst was on 22nd January 1980.

If we take into account Friday 12th April with the 15th, this two day period was the 5th worst consecutive two day fall since 16th /17th January 1980; the worst being 22nd/23rd January 1980.

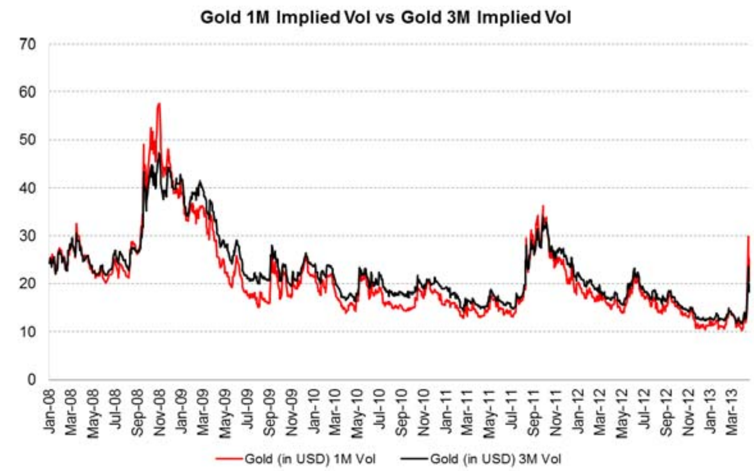
	Today is X th			Today is X th			Today is X th	
	worst 1 day move	**3**		worst 2 day move	**5**		worst 5 day move	**11**
1	-13.24%	22-Jan-80		-18.24%	23-Jan-80		-26.59%	28-Jan-80
2	-12.10%	28-Feb-83		-14.00%	28-Feb-83		-20.00%	25-Jan-80
3	**-8.02%**	**15-Apr-13**		-13.03%	17-Mar-80		-19.03%	28-Feb-83
4	-7.46%	17-Mar-80		-12.97%	28-Jan-80		-17.26%	17-Mar-80
5	-7.26%	26-Mar-80		-12.64%	15-Apr-13		-15.56%	18-Mar-80
6	-7.26%	04-Jan-80		-11.68%	22-Jan-80		-14.73%	01-Mar-83
7	-7.09%	20-Feb-80		-11.33%	27-Mar-80		-14.12%	14-Mar-80
8	-6.98%	13-Jun-06		-10.92%	01-Mar-83		-13.75%	22-Oct-08
9	-6.94%	10-Oct-08		-10.71%	14-Mar-80		-13.50%	27-Mar-80
10	-6.83%	25-Jan-80		-9.86%	04-Oct-79		-13.49%	06-Nov-78
11	-6.59%	28-Jan-80		-9.09%	26-Mar-80		-13.32%	15-Apr-13
12	-6.44%	28-Sep-81		-8.78%	13-Oct-08		-13.02%	20-Feb-80
13	-6.42%	21-Mar-80		-8.70%	02-Nov-78		-12.47%	23-Sep-75
14	-6.36%	05-Aug-93		-8.59%	07-Nov-80		-12.46%	29-Jan-81
15	-6.29%	01-Jun-83		-8.57%	20-Jul-76		-11.90%	16-Oct-08
16	-6.22%	01-Nov-78		-8.39%	20-Feb-80		-11.86%	20-Jul-76
17	-6.09%	15-Apr-80		-8.34%	22-Oct-08		-11.42%	31-Mar-80
18	-6.02%	14-Mar-80		-7.93%	18-Mar-80		-11.24%	04-Mar-83
19	-6.00%	01-Dec-08		-7.62%	11-Dec-80		-11.24%	13-Apr-81
20	-5.96%	17-Jan-91		-7.50%	17-Oct-08		-11.10%	13-Mar-80

Largest ever aggregate volume trades on 15th April gold comex futures of 702,957 contracts*

This is equivalent of 70.3mm tr. ounces or 2186 metric tonnes.
This is equivalent of 80% plus of annual mine supply.
Average daily volume = 150,000 to 180,000 comex futures; 460 to 560 tonnes.

*Comex futures are transacted on margin levels of approx. 5% of notional amount equivalent a trader would have to deploy if had to post full proceeds. This leverage allows traders to take on positions 20x an actual single oz of gold. So for every 1 tr.oz a trader can buy or sell 20 tr.oz.

Volatility 1 month & 3 month does not hit record high for equivalent transactional volume in 2008 high volatility prints. A sign this may well be over.

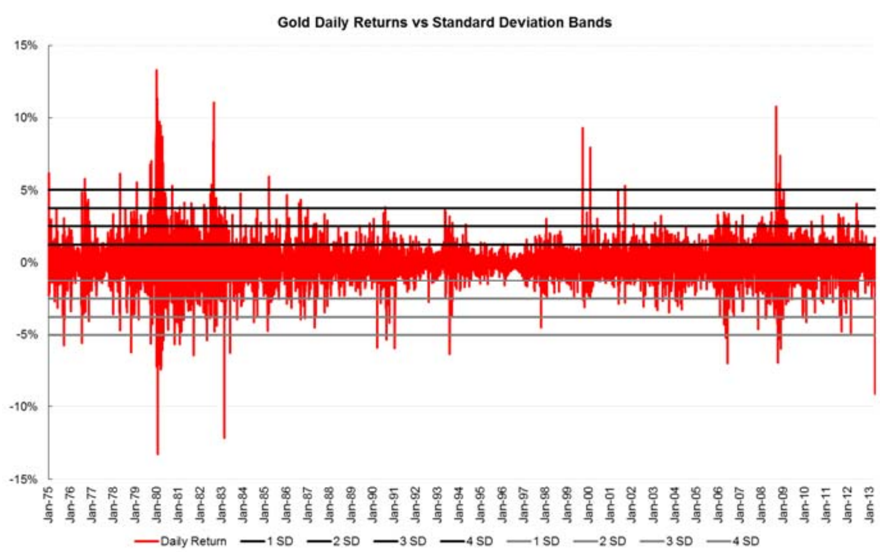


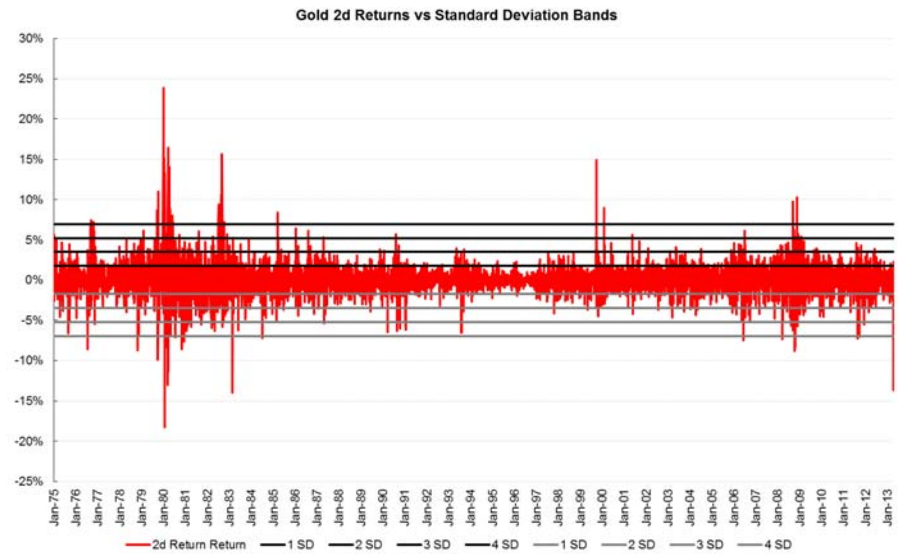
Source: Hinde Capital

Corrections

2013 peak to trough correction was 30% over 18 months (50% occurred in 2 days ie 15%).
2008 peak to trough correction was 33% over 8 months.
1980 initial correction 43% over 3 months.

Magnitude (sigma) of 1 day and 2 day XAUUSD moves is 7.22 SD 1-day and 7.86 SD 2-day





Source: Hinde Capital

A Golden Transfer of Wealth

If we observe a price correction from $1,600 to $1,400 then:

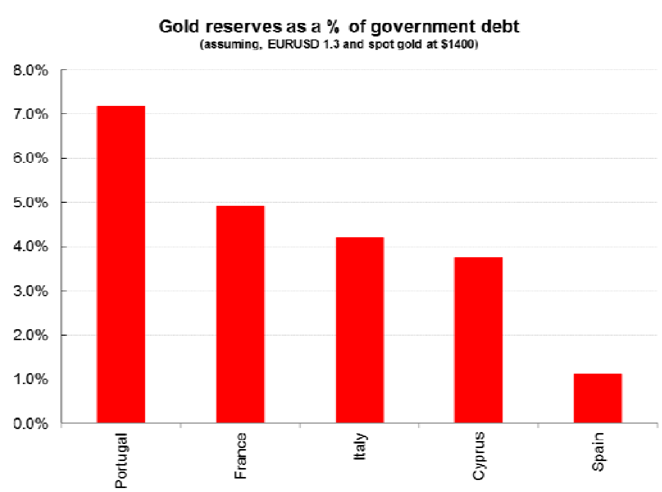
U$ 1.1 trillion value wiped off total gold ever mined (assuming 170,000 tonnes)
U$ 262 billion value wiped off investment gold (assuming comprises 1.0% of global financial assets of $210 trillion)
U$ 52.3 billion value wiped off US gold holdings (assuming mark-to-market)
U$ 20 - 22 billion value wiped off Bundesbank & IMF gold holdings (that would be the gold that's in transit, probably better to sink the Bismarck again)

European CB gold holdings, the proceeds they would receive at $1,400 tr.oz:

	Tonnes	Gold Price = $1400 EUR value bn (1.30)	Gold Price = $1000 EUR value bn (1.30)
ECB	502.1	€ 17.40	€ 12.40
Germany	3,391.30	€ 117.42	€ 83.87
Italy	2,451.80	**€ 84.89**	**€ 60.64**
France	2,435.40	**€ 84.32**	**€ 60.23**
Netherlands	612.5	€ 21.21	€ 15.15
Portugal	382.5	**€ 13.24**	**€ 9.46**
Spain	281.6	**€ 9.75**	**€ 6.96**
Austria	280	€ 9.69	€ 6.92
Belgium	227.5	€ 7.88	€ 5.63
Greece	111.9	€ 3.87	€ 2.77
Finland	49.1	€ 1.70	€ 1.21
Slovakia	31.8	€ 1.10	€ 0.79
Cyprus	13.9	**€ 0.48**	**€ 0.34**
Latvia	7.7	€ 0.27	€ 0.19
Ireland	6	€ 0.21	€ 0.15
Slovenia	3.2	€ 0.11	€ 0.08

Source: RBS, Bloomberg, IMF

What these proceeds would pay down of outstanding government debt:



Source: Hinde Capital

'Zip all' is the answer.

This graph says it all. Why would these countries bother selling their gold? After all they will need it for the coming new monetary regime, but they have no intention of selling as coerced by the ECB. It was just a ploy to shake the golden tree.

Humour me though, let's assume that nothing so sinister was taking place, and take the other side of the argument that this was a 'free' market phenomenon.

Cyprus Crisis and EMU Gold Sales

In a Hinde Blog Cyprus – Oh the Irony?! I wrote about bail-in attempts and a potential depositor flight across Europe, little did I envisage that two weeks later the significance of this seismic event would actually create an acute seismic event for Hinde Gold Fund, our investors and indeed all gold holders:

"A bail-in takes place before a bankruptcy, and involves losses being imposed on bondholders, something that has rarely taken place throughout the GFC and euro crisis. In fact taxpayers (the government) have consistently bailed-out the private sector in full. The Cypriot bank rescue is no exception, except this time there is a bail-in and ironically again not of bondholders but of the depositors first. This is a direct contravention to the usual legal claims on the capital structure."

What I pointed out was this bail-in did not follow the legal creditor claim pyramid, but that I would support a legal version of this bail-in. If done properly I fully endorse bail-ins where the bank debt holders, in the proper claim sequence, pay for the insolvency of the banks. I stated that expropriating the monies of secured bank depositors was **an unprecedented assault on individual property rights and every individual in the developed world should take notice, and far from stabilising the Eurozone, the bail-out likely heightens contagion risk across the EU.** I would add I personally believe that state deposit insurance, is a manifestation of our 'nanny' state that harms us not helps us. Individuals have to realise that when you deposit money in a bank you forfeit ownership of one's money and one receives a claim against the bank (it's a loan).

Depositor risk is clearly masked by state deposit insurance as no private insurer would have held the promise to pay out monies to deposit at zero insurance premiums in the light of Cyprus woes which were manifest some few years earlier. We should abolish such insurances. It creates a false sense of security and has misled individuals as to the sanctity of bank deposits.

A bail-in across Europe would be highly deflationary as the credit system would be contracting rapidly. Depending on the leverage of the banks which are insolvent, it is quite possible that the sovereign debt that helps capitalise them would remain unscathed as other bank creditors would be wiped out and sovereigns could rebuild the banking system by providing them with more debt.

So horrific would the collapse of the financial system be that even if bail-ins were invoked, government deficit financing would run rampant causing prices to rise again disruptively to arrest the vertical collapse in the global economy.

So whilst bail-ins are negative for gold, they are also highly negative for every other asset class. Do you think a withdrawal of money in this manner would be positive for equity markets and even bond yields as debt is destroyed?!

> In our piece, the *Central Bank Revolution II - Chasing the Dragon*, we illustrated how the effects of central bank monetary policy, today, have already distorted the term structure so monstrously that assets have been driven to yields more akin to those of holding money. The yield grab has extended into riskier and riskier assets and structures, resulting in a diminished return profile that is not compensated for by the falling credit quality, and the heightened duration risk. The stage has been set for capital losses, as once again investors indulge in levered products, with suspect collateral value, and invest in plain vanilla assets with no margin of safety.
>
> There is no value in the market place which is engineered by state control of the monetary structure. Investors have begun to treat asset classes as 'money-like', ie relatively riskless.

> Central banks have engineered this reality. They appear to be implementing portfolio channel theory with success. This is where central banks drive long end rates lower in a hope to encourage investors to seek higher returns in other risk assets – primarily equity markets. The aim is to drive equity prices higher creating a wealth effect that will encourage consumption and in turn encourage businesses to invest in more capital production in response to this demand.
>
> For now all central banks have achieved is greater speculation in financial markets. We believe that real output will not be forthcoming because of the continued overhang of stale credit, and only prices will rise, except this time it will be in the price of goods and services which could arrest too aggressive a move higher in equity markets even though they look 'cheap' in real terms.

If we have actually just witnessed a free market adjustment in gold, it is quite possible that this portends a deflationary cycle and that it is signalling that the central bankers cannot keep the credit edifice afloat anymore with their printing presses. But as we depicted in our Central Bank revolution pieces:

> Central bankers have begun a concerted effort to fight the global debt problem by taking a far more aggressive and activist role in pursuing a new framework for growth and inflation by seeking an alternative way to conduct monetary policy. It's called Nominal GDP Level targeting and it is in our opinion as significant a moment as Volcker's appointment to the Federal Reserve governorship in 1978.

So we believe they are far from done. Who else can fund the government's debt?

The irony is that as equities have been trading higher once again upon a sea of margin debt a la 2007, because of excessive credit availability spurred by cheap money, suddenly a gold holding seems less relevant. This is reinforced by bond volatility which remains benign. However the recent JGB revolt from all time low yields certainly sends a warning shot across the bow of the central bankers 'credit' fleet, that to proceed further could lead to a bond revulsion. We should watch for more repressive tactics in Japan. They may well limit bond sales by domestic institutions and limit foreign access to borrowing bonds or just raise haircuts on repos in an attempt to prevent speculative sales.

To even speak in terms of the 1980s sends shivers down any student of history or gold investor, because 1980 marked the peak of a bubble in gold. Back then Fed governor Volcker was intent on crushing inflation, but he wasn't faced with the abundance of credit and debt we have today. This is not a reality for today's bankers. They have already declared their game-plan – a market monetarism salute – a re-priming of the monetary pumps; because they think it works. And with equities and bonds rallying, it's only a matter of time before the economy grows in their eyes….really.

A Golden Reality?

Two weeks ago the danger of depositor flight from European banks to gold and even mattresses was very real, the Cyprus bail-in had all the hallmarks of contagion risks. It seems so coincidental that gold should suddenly collapse in the face of this very real danger. At worst it would languish where it had been.

I firmly believe that despite real bail-in risks across the globe, as evidenced by legislation change in UK, Canada and the euro periphery since the Cypriot debacle that authorities were and are wary of flight to gold from deposits. Although there was no ostensible evidence (TARGET 2 data is not available yet) it would appear smart money (corporates and *insiders*) have been shifting out of banks. I do fear that as the populace is ill-informed they perceive Cyprus as a one off, and so I understand the reluctance of people to withdraw from the banks, as we live in a cash (bank) society and most don't understand the virtue of gold. Throw in some downside gold volatility and one is bound to keep one's money (cash) in the bank.

Draghi et al. have attempted to kill the gold market psychologically speaking as a 'tool of protection' by suggesting that central banks will have to meet ELA repayment. The fear that all central banks will have to sell in a default situation was used as a ploy to scare investors away from gold. Since when is ELA a loan? I want to cite the case of Ireland as an example. Our macro research partnership Variant Perception wrote at the time about Ireland and ELA:

> Despite a weak economy the recent decision to liquidate Anglo Irish may offer Ireland a rather shrewd way out of its government debt obligations, perhaps setting a precedent for other European countries. Under the agreement, the Irish Central Bank will first assume full ownership of the €25 billion in in promissory notes issued by the Irish government when it bailed out Anglo Irish. These notes will then be exchanged for Irish sovereign bonds with maturities of up to 40 years.
>
> The first principal payment will not be made until 2038 and the average interest rate on the new bonds will begin at just over 3%, compared with an interest rate of well over 8% on the promissory notes. **This is clearly outright monetary financing and raises two important issues. Firstly, the decision by the ECB to not question the agreement raises issues about the initial use of ELA funding and what this may eventually entail for the eurosystem (in Spain, Greece etc). Secondly, it paves the way for other countries to learn from Ireland and thus funnel government debt through its banking sector, on to the NCB, and ultimately onto the ECB balance sheet.**

So in practice Irish bank debt was funded by the ELA. At the time Draghi said it was an NCB decision and had no bearing on the ECB. Now the rules have changed. People now fear Europe's gold will be used as part of the solution. The *insiders* who had been 'hat-tipped' were already selling in the days leading up to the gold collapse. The announcement of gold sales by Draghi tripped off an already nervous market place with large volume gold sales in the OTC and Comex gold futures ensuing as the market fell through long-term 'visual' support at the $1500-20 zone. Yes this was about a highly leveraged gold paper market down trade not a physical ownership capitulation.

Even the benchmark gold ETF GLD failed to be shaken significantly. And if I had one nagging concern left it is that these holders could yet reduce holdings further. Average Known ETF holdings as comprised by Bloomberg have fallen from a peak of 2,629 mt/ 84.54 mm tr.oz (Dec 2012) to 2471 mt/77.42 mm tr.oz (April 2013). We suspect due to settlement dates on transactions last week that ETF market makers are still to redeem share baskets and hence we will likely see a fall in this number to reflect more of the price action from last week.

Source: Bloomberg, Hinde Capital

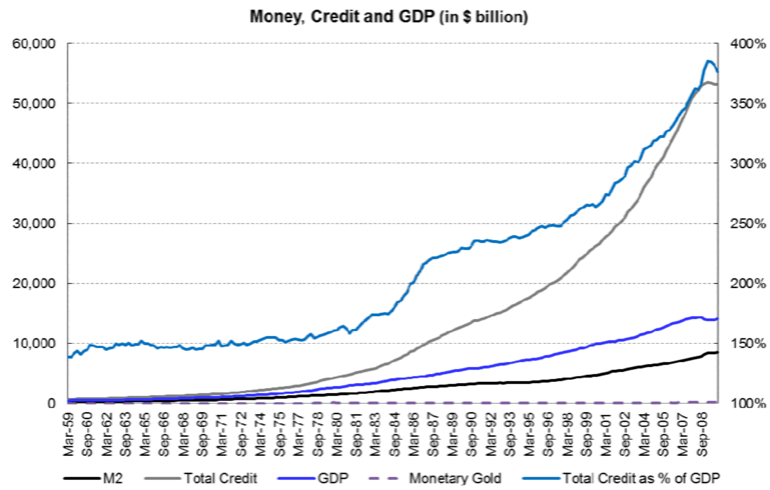
In my opinion with anti-EMU rhetoric rising in the periphery amongst their grandees, Soares in Portugal, the clown in Italy, and even alternative EMU movements in Germany, such as the AfD, there is not a chance of coerced gold sales. They will leave the EMU before this.

You may think I am creating a song and dance about nothing but I want to wind the clock back a few years to justify my position. We have witnessed this type of distortion before and nobody would listen.

A Golden Song & Dance

For over a decade, Mark and I have traded and invested in the gold market, seven of those years at our own firm Hinde Capital, managing the Hinde Gold Fund. Prior to this we ran risk in fixed income markets, observing the rise in credit. We watched first hand numerous credit induced asset bubbles come and go, incredulous at the denial of individuals to the reality of our irresponsible and febrile monetary system.

We tried to explain to people that wealth was predicated on an illusion of excessive credit creation, that all prices were a monstrous fabrication and divorced from long-term reality. We said a collapse of this system was highly likely if we continued such madness. We begged, we cajoled, and yes we ranted (I prefer excitably explained) to all and sundry that they needed to protect themselves from the day when reality would catch up with the illusion. In short we created a bit of a song and dance.



Source: Hinde Capital

On 15th Sept 2008 we witnessed the collapse of Lehman Brothers, and only then do I truly believe people understood that the seemingly impenetrable fortress that was our banking system was no longer immune to failure. And so reasoned people, surely if the banks were not immune to failure then surely the product they deal in - money and credit – was possibly not worth the paper it was written on?

Faith in the construct of paper money was severely tested that day and has been every day since. Losing faith in money is highly unsettling; for the majority of us who are 'wage slaves', to undermine the validity of money is to undermine the value of our daily labour.

Ask any of my former colleagues at RBS Greenwich Capital and they will attest to the torrent of rabid commentary I had about the impending credit collapse. (Mark was the same I would add, in his own inimitable and humorous style. We will be in need of a lot of humour right now). I was apoplectic at times and just like an Englishman shouting at a foreigner in English very loudly and slowly, however much louder I got, I was no more audible to that person than if speaking to a deaf person. *La meme* for proselytising my beliefs – the more I shouted the less I was heard, but the calmer I was, the less convicted I was deemed to be, I couldn't win. Quite frankly they didn't speak my language, either they didn't want to acknowledge such an outcome or they didn't understand, but burying your head in the sand is not a game plan. It helps no one. If the boat is going down, not attempting to swim is no excuse. The angst of nobody really listening was palpable at that time, even if I was sitting in a lucrative albeit 'stressful' profession.

In the very words of Will.I.AM's Britney 'b@tch':

I wanted to *SCREAM* and *SHOUT* and *let it ALL OUT*! (as no one really cared). I am bastardising slightly as the original lyrics go somewhat like this:

I wanna scream and shout and let it all out
And scream and shout and let it out

We saying oh wee oh wee oh wee oh
We saying oh wee oh wee oh wee oh
I wanna scream and shout and let it all out
And scream and shout and let it out……

Those feelings of old are back. I have the very same urge again to SCREAM and SHOUT, and so I will until reality comes to pass once again.

A Golden Swan

Our first ever HindeSight Letter of 2007 Mourinho's Black Swan began with an explanation as to our genesis:

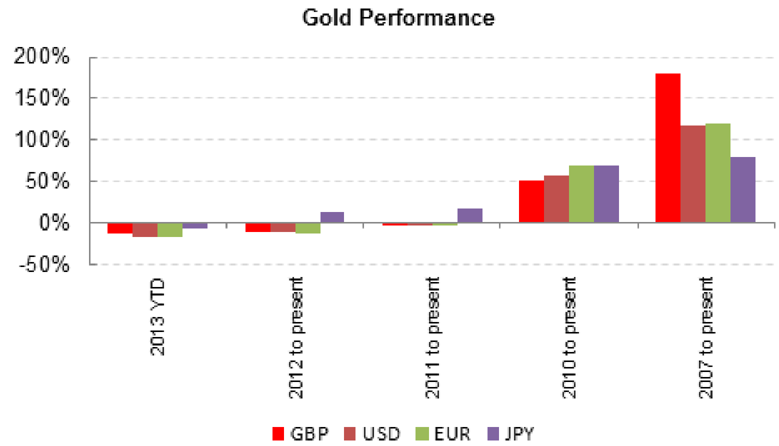
> *Hinde Capital Ltd as Investment Managers to Hinde Gold Fund has been established to enable investors to have exposure to gold and silver within a low leveraged, highly liquid and actively managed fund. We aim to navigate the turbulent waters of a rapidly globalising world, by offering investors a tangible asset class with which to both protect and appreciate their capital. Hinde Gold Fund was set up in the belief that we are at a Monetary Juncture.*

I think it is fairly safe to say we have had very turbulent times and we are clearly at a key monetary juncture in so far as individuals really have begun to obsess about the validity of this current monetary system. We had mixed emotions about using gold in an investment vehicle, because arguably gold isn't an investment. Monetarily speaking, it's base money, or currency. It's just not *de jure;* it is no longer deemed money by the State. We can't pay our taxes in gold.

So we band the phrase "investment" in reference to gold with the explicit acknowledgement that it is not money today, but it is *de facto* money and its price advance is arguably the reciprocal of paper money and credit creation. In light of this and the absence of a gold bank (yes we have thought of this), providing a vehicle of refuge such as ours was as good an alternative for then as it is now.

Running a long only managed gold fund is no fun in big down markets and never seems to be enjoyable enough in the 'up' markets; but in truth it's not about directional spasms, it's about whether or not gold provides a long-term store of value. This is irrefutable in a period of negative real rates and excessive money and credit creation.

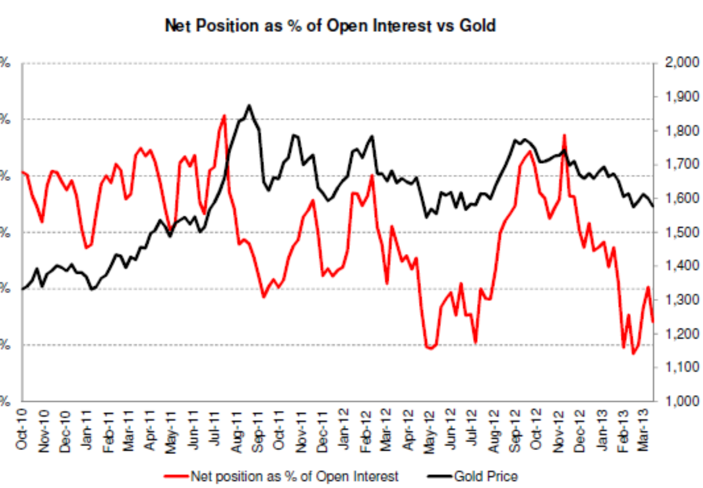
These past 5 years since the crisis revealed itself, for it had been gestating for over a few decades prior; investors have sought to find refuge from the equal and opposite forces of credit deflation and State reflation by investing in gold. By having gold in their portfolios or even in preference to cash, for fear of repressive tactics by the seemingly immovable face that is Leviathan they have felt they would have some respite from such forces. And in truth they have – here is the return in gold for various currencies:



Source: Hinde Capital

Individual's faith in gold has risen as much as the exponential creation of paper money, but my greatest nagging fear that gold would have a substantial correction has come to pass. The ferociousness and magnitude of the correction in the face of so much fundamental justification for a rising or even stable gold price has created another fear. **Will individuals now shy away from gold as a means of security from monetary travails and return to the perceived relative safety of bank deposits – even in the face of bail-in risks?**

The net long positions going into the 'crash' were light, usually indicating a market that is leaning leveraged short. Although I was acutely aware that markets often crash from 'bottoms' as stale longs become tested, it was far from obvious that they would have the power. In hindsight, this had all the hallmarks of a classic bear raid, where the new leveraged shorts, rather than get squeezed break into stale aged longs and force a capitulation in an illiquid market. The investors' sudden desire to stop the pain and move to cash allows the leveraged shorts to cover with a tremendous volume turnover on Monday and the new longs now have an entry point on their investment that is at current prices.

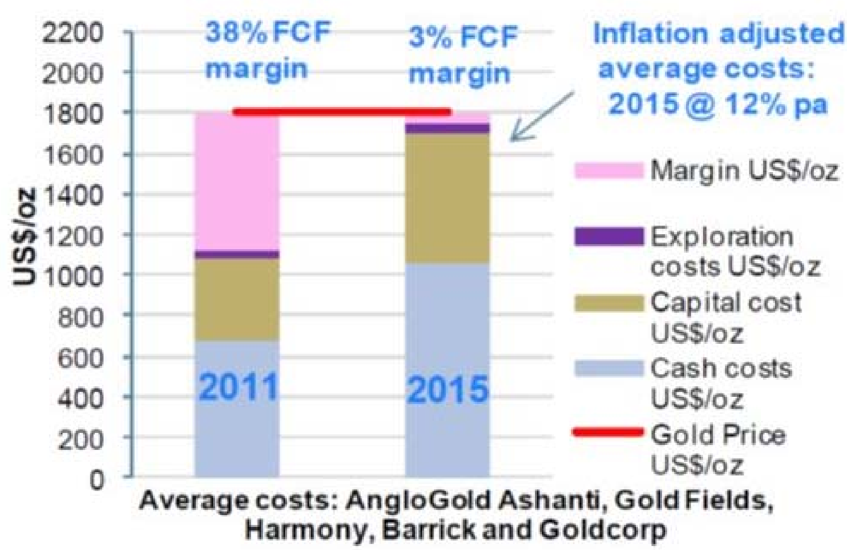


Source: CTFC, Hinde Capital

Our model was trend ready again and at such low valuations it was easy to believe the upside resumption after almost two years side-ways would be up; but there were so many nagging disquiets. Those doubts were confirmed and our only solace is that we didn't own the miners.

Interestingly the miners are a key part of unlocking the mystery of where the gold price will bottom. Mark Mahaffey, the co-founder of Hinde Capital was very early to point out the inconsistencies between what the miners and analysts declared was their true costs and the reality of their lack of free cash flow, even after allowing for sustaining capital expenditure.

Weighted average NCE costs and FCF margin for global majors at $1,800/ tr. oz



Source: SBG Securities analysis

Mark and I believed even before this sell-off, that there will be a raft of bankruptcies, perhaps involving a major miner or two, before the gold stock misery is over. The inability of the gold companies to mine with free cash flow at $1,600 means at $1,400 mines and many junior exploration and small capitalised miners will almost certainly experience closure. With gold below the marginal cost of production this will help produce a stronger and sustainable footing for gold; notwithstanding the fall in input costs, margins are still not viable for the industry.

Mark has been more considerate to the mining CEOs and analysts. I don't feel so charitable. I think there has been gross incompetency bordering on highly disingenuous behaviour towards shareholders. There are large exceptions of course and it is mostly reflected in their reasonable stock performance. My major gripe is with so called analysts. Why did they not point out what was becoming glaringly obvious, that these companies were not worth a dime? Simple, their whole business depends on drawing fees from capital raisings, enjoying broker warrants as companies rise on a raft of buy side recommendations. The gold mining industry is 'equity financing intensive' as I like to describe it. Float and dump, a cycle of financings sucking in retail and even professional managers and allowing insiders to sell into the rising volume from 'insider' private placement offerings of years earlier.

It's a flawed business model near the end of the cycle but not during it, when the mid-cycle is highly lucrative. It is so reminiscent of the 'Internet bubble' equity raisings. Valuations generated on the extrapolation of earnings based on number of website hits are as mystical as the true economic value of ounces in the ground for these miners. Both promise a golden future, most never delivered or will deliver. Analysts were disingenuous in the 'Tech boom', in some cases fraudulent. The gold mining research teams need to reconsider their stance. Some of the more respectful have done so and I commend them; but even then it is too little too late for shareholders. For us this was an opportunity, and it saved us money. If our mandate had been freer I would like to have profited handsomely from such behaviour for our fund.

A Golden Conclusion

We genuinely thought this market crash could severely undermine an individual's confidence in gold and the refuge they have sort from oppressive state behaviour. But as we have been delighted to see gold buyers have turned up in their droves. I won't list all the bullion houses that have been inundated, but in our 'ring' around last week to the bullion banks we trust, even they were shocked at the global demand.

Now let's not confuse 1oz coin and 10oz bar shortages as evidence of widespread metal shortages in allocated LBMA bars. These are bottlenecks and soon new dore melt downs will help meet these demands. However the very act of scaring individuals from the market has backfired and we have witnessed a truly fantastic response to lower gold prices. We are relieved, as the initial reaction was one of panic from individuals. Understandably so, because they just didn't understand the *malevolent* forces at hand.

The market has witnessed a trillion dollar transfer of wealth and the stale longs are out and fresh owners are in. The BRICs must be rubbing their hands with glee. If these countries are divesting themselves of dollars to a new monetary order as the evidence suggests, then this was a bad week for Western governments.

Is it possible the banks needed metal? We don't believe so as there is an abundance of metal supply. So I repeat, what we are witnessing now are bottlenecks in supply. However we would agree with others that if claims on unallocated gold were being asked for and were not being met then this indeed could be another reason beyond those which we cited for a takedown of the paper (futures) market. But we have seen no evidence of this and so cannot comment.

Our money (gold) has been at the mercy of a state engineered gold correction using the threat of coerced European gold sales to scare holders into selling and speculators jumped gleefully on the band wagon. It is highly unlikely any peripheral European country will sell its gold; the rising ground swell of anti-EMU rhetoric amongst challenging parties and even incumbent politicians is manifest. The reality is such sales raise a paltry sum, and just like the ill-advised or manipulative gold sales of the UK this could well mark the new low for gold.

Such crash dynamics usually take months to restore equilibrium to higher prices trading in a dwindling oscillation sideways. After the gold debacle of the last few days I (we) feel an inexorable urge to SCREAM and SHOUT again. I am sure you do to.

But in the inimitable style of the late Baroness Margaret Thatcher – a true free market reformer – 'This firm is not for turning!'

And taking solace from the 'Scream and Shout' lyrics of another glorious b@tch, Britney Spears, it is pretty clear to say that Ben Bernanke and his cabal, far from ignoring gold:

They (are) watching us
They watching us
They watching us
Everybody in the club
All eyes on us
All eyes on us
All eyes on us

But we say to them, even in the event of such price movements:

Bring the action...
Rock and roll, everybody let`s lose control
All the bottom we let it go
Going fast, we ain`t going slow,no,no
Hey yo,hear the beat and let`s hit the floor
Drink it up and drink some more
Light it up and let`s let it blow,blow,blow
Hey yo,rock it out,rock it now, if you know what were talking about
Turn it up,and burn down the house, yeah, house
Hey yo,turn it up and turn it down
Here we go,we gonna shake the ground
Cause everywhere we go we BRING THE ACTION

And do you know what Ben B. and Draghi gold buyers have brought the action back to you. So thanks very much. We have seen record purchases across globe most notably in Australia, Canada, Hong Kong, China, Turkey, and Dubai.

So we say again BRING THE ACTION!

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