Who is Draining GLD?

Actual GLD Vault

There seems to be a misunderstanding in the gold market that when you buy or sell shares of GLD you are putting pressure on the price of gold. That selling shares of GLD into the exchange is somehow analogous to selling physical into the marketplace. Or that buying shares of GLD is somehow, somewhere down the chain, removing physical gold from the marketplace.

We often look at apparent correlation and assume a certain cause and effect. GLD is *designed* to track the price of gold. It is not actively managed to track the price of gold. Instead, it does so through opportunities that arise whenever it doesn't. Imagine GLD as a big lump of gold just sitting there in Town Square. The price of gold is "discovered" elsewhere and shares in this big lump just trade based on that elsewhere-discovered price. If the share price is too high, then an opportunity exists to sell your share and buy "gold" elsewhere. Likewise, if it is too low, there is an opportunity to sell elsewhere and buy into this lump on display.

Occasionally, lately, someone comes along and shaves a chunk off of the lump, reducing its overall size. And financial reporters and analysts everywhere are struggling to correlate the price of gold and the GLD holdings with some semblance of cause and effect:
The Street – Alix Steel

Gold prices were breaking even after another double-digit selloff Tuesday as investors ***dumped*** their holdings. The SPDR Gold Shares exchange-traded fund ***dropped*** more than 30 tons of gold on Tuesday.
Reuters

Traders in Asia reported strong physical gold buying, particularly from China, on Friday, but large bullion-backed exchange-traded funds continued to see ***outflows***.
Reuters - Amanda Cooper and Jan Harvey

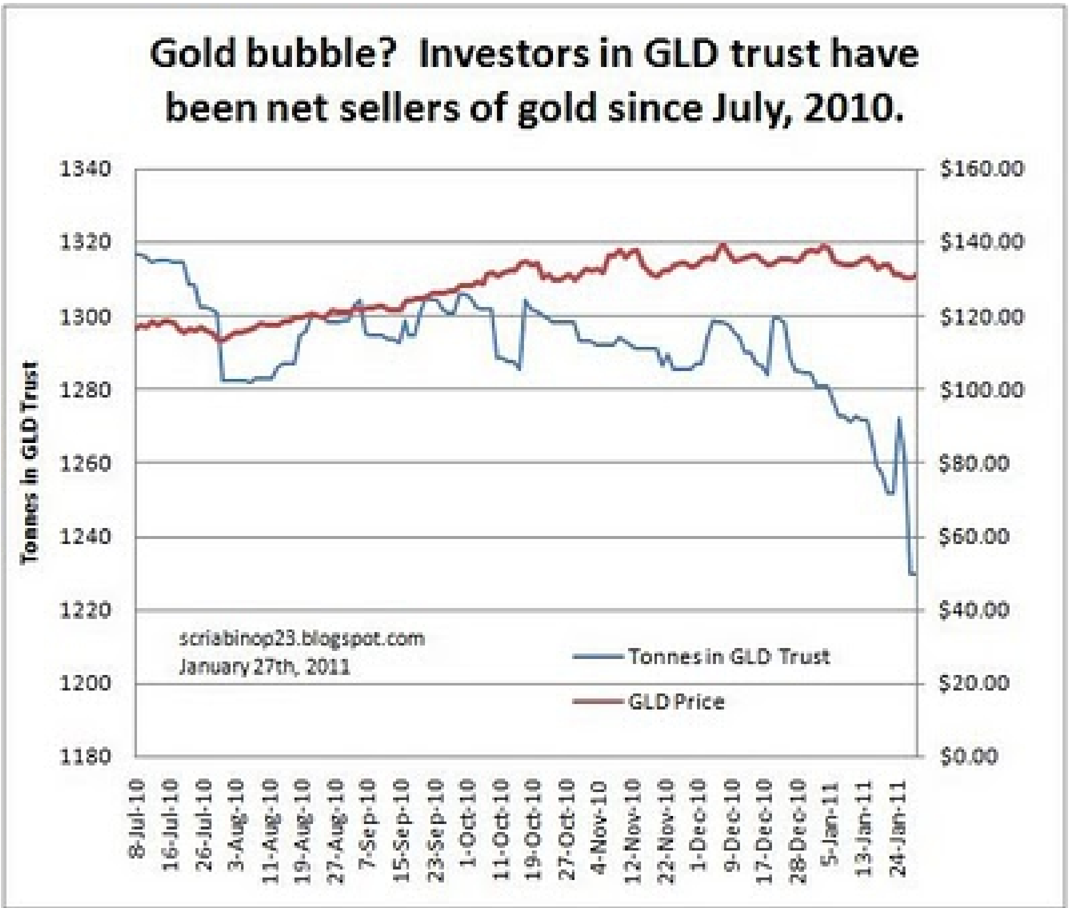
But ***investor sentiment towards gold has soured*** in the last few sessions, as ***evidenced by the largest one-day outflow*** in three months from the world's biggest exchange-traded gold fund. Holdings in the SPDR Gold Trust fell 10.926 tonnes to 1,260.843 tonnes on Jan 24.
Funny. When we're talking about gold, an outflow to one person is an inflow to another, is it not? Randy Strauss at USAGold.com rightly responded to these silly reports with the truth [emphasis mine]:

RS View: Silly reporters. Instead of calling these "outflows" from the ETFs, it should be called what it is — ***a redemption of a basket of shares for physical gold by the Authorized Participants (e.g. bullion banks)****. Such share redemptions would actually be a bullish sign because it entails* ***a reduction in the global supply of paper gold*** *while at the same time signifying a* ***preference*** *by the redeeming party* ***for*** *having* ***the metal*** *over the ETF shares. That is, of course, unless the drawdown in physical gold merely represented the routine sales of the gold inventory that occur to cover the ETF's administrative expenses.*

*[RS View:](#) I've said it before and I'll say it again now, the reporters are getting it wrong when they equate outflows of gold from the ETFs with "sour" investor sentiment. What they need to work harder to understand is that **these are NOT actively managed funds whose gold inventory is tweaked to ebb and flow based on public sentiment in the shares**. Instead, the ETFs are more like a central coat-check room in which the various bullion banks have temporarily hung out their own inventories (i.e., meaning, their unallocated stock which they hold loosely on behalf of their depositors). And whereas the claim tickets (ETF shares) may freely circulate on the open market, any significant outflow of physical inventory is simply and primarily indicative of **a bullion bank reclaiming the original inventory based on a heightened need or desire for physical metal in a tightening market — for example, to meet the demands emerging from Asia.***

Here's another one. I found this to be an interesting post, even though the blogger is toeing the same line as the reporters above [emphasis mine]:

[Gold Bubble?](#)



Usually in a bubble, investors are holding a bag.

Investors have been net sellers of about 100 tonnes in the last 7 months. The IMF has disposed of another few hundred tonnes. Yet gold price is higher by around 10% in the same period.

***To put this into context, since December 21st alone, 2.2M ounces have been sold from the ETF, basically a bit more than an entire quarter of production from Barrick gold** (the world's largest producer). The normal run rate of global recycling plus mine production is approximately 2.95M ounces per month. So in the same period, assuming GLD was the only source of outflow, total global absorbed gold supply was 5.15M ounces. **If outflows continued at the current rate, the GLD ETF (the largest investor depository of gold by far) would have no gold in 18 months**.*

Supply increased 75% in the short term to see price only fall 4.5%.

Someone else is doing the buying, clearly.

2.2M ounces is more than **68 tonnes**... since December 21! Who is taking this stuff?

Now here's a bloodhound that might be on to a scent worth following. Lance Lewis, in his [subscriber newsletter](#), follows what he calls **"the GLD puke indicator"** which tracks GLD physical gold regurgitations [emphasis mine]:

Just in case anyone missed it in last night's letter, our GLD puke indicator that has nearly a flawless record at marking lows in gold triggered a buy signal yesterday after the ETF spit up 31 tonnes (and some blood) to trigger a 2.48% decline in its bullion holdings.

As we've noted before, one-day declines in the holdings of this ETF of over 1% have tended to be capitulatory in nature and have typically occurred near important lows in the gold price during gold's secular bull market.

*Consider that since the GLD ETF's creation back in 2004, it has seen 1%+ one-day declines in its bullion holdings only 41 other times. When one goes back and looks at where these declines in bullion holdings have occurred, virtually all of them occurred "at" **or were "clustered at" important lows in the gold price**.*

When we update this familiar (see above) chart for today's 1%+ decline in bullion holdings, we can once again see where I have labeled the past eleven 1%+ declines in the ETF's bullion holdings (plus today's decline) with red dots and then placed a corresponding white dot below the price of GLD in order to show where that decline (or clusters of declines, as was the case in 2008) occurred relative to the price of the GLD, which is obviously tied to spot gold.

You will recall that we most recently used this indicator back on July 28th, 2010 in order to identify what was then the summer low in the gold price, and we used it again on October 7th, 2010 to recognize that a sudden 1 percent slide in gold from an all-time high was actually a just a one-day setback that led to new all-time highs being hit once again just a few days later.

The pattern you see emerge after today's 1%+ puke, just as on those prior occasions, is that these "pukes" of bullion by the GLD ETF have always tended to occur at or very close to important lows in the gold price, and declines of over 2% have only occurred at MAJOR lows, such as the two major lows that were hit in 2008.

Note that one of those lows on September 9, 2008, which is the closest in size to today's puke, also occurred just one day before a 5-day short squeeze/meltup of 30 percent in the gold price that kicked off on September 12, 2008. Perhaps the remaining shorts in the gold market will now pay a similar price for betting against a bull market?

Perhaps history will repeat and perhaps it won't with respect to such a short squeeze, but given this indicator's near flawless record at marking lows in gold, it's not to be ignored.

What we appear to have here is a severely tight noose around the supply of Bullion Bank deliverable physical gold at a time when the Giants are chomping it up! Bullion Banks have many means at their disposal to shuffle around a globally limited quantity of gold reserves and get it to where it needs to go. Especially when "important clients," like those in the East or Middle East, come calling for physical delivery or allocation.

Upon getting requests from unallocated depositors for either outright withdrawal, or more simply for transfer into allocated accounts, any Bullion Bank has options. Yes, it can seek to acquire (through borrowing or purchase) the requisite ETF shares for redemption of a "basket" in its special capacity as an Authorized Participant of GLD, or it can pursue alternate avenues such as buying gold on the open market or, better still, borrowing it from either its own unallocated pool of deposits or turning to other members in the BB fraternity to borrow the adequate quantity to cover the immediate needs. Whatever combo is deemed most efficient or cost-effective is what the bank will do.

But what if those other options are disappearing faster than a sack of currency left on the COMEX trading floor? If gold (in size) on the open market is scarce, the unallocated pool is spoken for (in other words, undergoing allocation) and the fraternity brothers are all suffering the same noose, what do you think becomes the most efficient and cost-effective option? Raiding the GLD reservoir perhaps?

Did you even know that you could take physical delivery from GLD? Apparently many didn't. I was just chatting (online) with one of my supporters yesterday, let's call him "Small Giant" (a term explained in my last post) because he *is* in that eight figure savings bracket that might find this information useful. On top of that, he makes his living assisting funds in their management of eleven figures.

So he says to me:

Small Giant [6:10 P.M.]: I think very very few people realize that you can convert GLD shares to actual physical
Small Giant [6:10 P.M.]: can't say I know of anyone who has ever done that

Okay, let me back up.

Small Giant [5:47 P.M.]: there is clearly panic in the ranks of the longs
FOFOA [5:47 P.M.]: The more it goes down, the bigger the pressure on physical. I think the draw down in GLD suggests other options for physical delivery in size are gone.
Small Giant [5:47 P.M.]: I agree
FOFOA [5:49 P.M.]: With $13 million, you could take possession of a basket of physical from GLD at a good price.
Small Giant [5:49 P.M.]: what is the minimum threshold?
FOFOA [5:50 P.M.]: 100,000 shares is a basket. Must be redeemed through an "Authorized Participant"...
Small Giant [5:50 P.M.]: wow this is getting very very interesting
FOFOA [5:50 P.M.]: Authorized Participants are: BMO Capital Markets Corp., CIBC World Markets Corp., Citigroup Global Markets Inc., Credit Suisse Securities (USA) LLC, Deutsche Bank Securities Inc., EWT, LLC, Goldman, Sachs & Co., Goldman Sachs Execution & Clearing, L.P., HSBC Securities (USA) Inc., J.P. Morgan Securities Inc., Merrill Lynch Professional Clearing Corp., Morgan Stanley & Co. Incorporated, Newedge USA LLC, RBC Capital Markets Corporation, Scotia Capital (USA) Inc., and UBS Securities LLC
Small Giant [5:51 P.M.]: so how would that work?
Small Giant [5:51 P.M.]: you buy 100K shares of GLD
Small Giant [5:51 P.M.]: then what?
FOFOA [5:53 P.M.]: You've got to go to one of those APs and have them create a basket for you. That gold is then transferred from the GLD allocated account into your broker's unallocated account. Then you redeem your basket and have your broker allocate the gold to you.
Small Giant [5:54 P.M.]: so it's really is that easy?
FOFOA [5:55 P.M.]: I'm working on a post tentatively called "Who is Draining GLD" using a lot of snips from the prospectus. The entire world of confused financial analysts is misinterpreting the GLD inventory reduction as if it is gold negative. But it is precisely the opposite. GLD doesn't buy gold when it's going up and sell when it's going down. Doesn't work that way. But that's what everyone thinks.
FOFOA [5:57 P.M.]: GLD might be the last reservoir for the giants to drink from. That's my Thought of the day. Because there should be easier ways to buy a tonne of gold.
Small Giant [5:58 P.M.]: u lost me
Small Giant [5:59 P.M.]: count me as a confused financial analyst

So after this chat I started thinking that I should write this post for other "small giants" out there that might be looking for tonnes of physical at a good, off-market price.

Does anyone remember the Jim Rickards comment I quoted in Open Letter to EMU Heads of State? Here it is:

"One point that does not get enough attention is the impact of size in the physical market. It's one thing to say that COMEX is $1,100 per ounce and physical might be $1,200 per ounce for one metric tonne if you can find it. But what about 100 tonnes? 500 tonnes? Physical orders of that size are impossible to execute outside of official channels. Size of order is relevant in any market but I have never seen a market (short of a full blown manipulation or short squeeze) with as much price inelasticity as physical gold which is why the buy side overhang keep their intentions to themselves."

Now you are probably thinking, "why bother with GLD where a minimum "basket" is a whopping 100,000 shares (around 10,000 ounces) for $13 million dollars when you can take delivery of as little as a 400 ounce "LGD bar" from Eric Sprott's PHYS for just over a half million dollars?" If you thought that, then you are not thinking like a Giant. Read Jim Rickards' comment again. Giants like to keep their intentions to themselves. Why? Because they prefer to buy in off-market transactions – ones that do not influence the price of gold – in order to maximize the number of ounces they receive for their normally market-moving quantities of currency. They know that the size they want to convert would move the price, and then they would get less gold for their money.

Now let's compare PHYS with GLD and try to think like a real Giant for a minute.

	PHYS	GLD
Total Ounces	820,753	39,356,622.80
Total Tonnes	25.5	1,224.12
Market Value	$1.1 billion	$51.9 billion
Redemption minimum in ounces	400 oz.	10,000 oz.
Redemption minimum in market value	$536,000	$13 million

The one day drain from GLD just the other day was larger than the entire PHYS ETF by more than 5 tonnes. So what would have completely emptied the Sprott warehouse was only 2.48% of GLD. The amount drained from GLD since Dec. 21st was 268% of Eric Sprott's PHYS. And what has it caused but barely a blip on the radar? Can you imagine the fuss (or price explosion!) if one single billionaire decided to clean out PHYS? That's right. PHYS represents maybe one real Giant. That's not exactly a "reservoir" for the giant class to drink from.

If you are a Giant, or even a Small Giant, you should know about this off-market opportunity to take giant amounts of physical into your possession at a good price. And you should know this before it is all gone. As my Small Giant friend wrote, "very very few people realize that you can convert GLD shares to actual physical." He didn't know until yesterday. But it's all there in the prospectus. It tells you how to do it, and who to contact to get it done. If one of the Authorized Participants refuses your business, just call the next one on the list. There are 16 of them!

I am reposting portions of the prospectus from the SPDR Gold Shares (GLD) website right here. It may seem like a lot to read, but trust me, this is a highly abbreviated version of the 46 page prospectus. This is actually from the reader-friendly "FAQ" section of the website, although some of it comes directly from the prospectus. This is all you really need to know!

From: http://www.spdrgoldshares.com/sites/us/faqs/

8.Can you take physical possession of the gold?
The Trustee, Bank of New York, does not deal directly with the public. The trust handles creation and redemption orders for the shares with Authorized Participants, who deal in blocks of 100,000 shares. An individual investor wishing to exchange shares for physical gold would have to come to the appropriate arrangements with his or her broker.

14.How is the gold price set?
The spot price for gold is determined by market forces in the 24-hour global over-the-counter (OTC) market for gold. The OTC market accounts for most global gold trading, and prices quoted reflect the information available to the market at any given time. The spot price can be found on: www.thebulliondesk.com.

The London Bullion Market Association (LBMA) has about 70 full members, as well as many associate members. Twice daily during London trading hours the ten market making members of the LBMA fix a gold reference price for the day's trading. These prices are based upon the actual buy and sell orders for gold in the global OTC market. A good analogy for the London fix versus OTC trading would be to consider the London fixes similar to opening/closing prices for stocks and to consider the spot price for gold as the continuous market price throughout the trading day.

The COMEX division of the New York Mercantile Exchange (NYMEX) is a futures and options exchange that acts as a marketplace to trade futures and options contracts on metals, including gold. Gold futures contracts typically trade at a premium to the spot price. Further discussion can be found in the prospectus.

15.What is the relationship between the GLD Net Asset Value, the GLD share price and the gold spot price?
The investment objective of the Trust is for the value of the shares to reflect the price of gold bullion, less the expenses of the Trust's operations.

The Net Asset Value (NAV) of the Trust is determined by the Trustee each day that the NYSE Arca is open for regular trading. The NAV of the Trust is calculated based on the total ounces of gold owned by the Trust valued at the Gold London PM fix of that day plus any cash held by the Trust less accrued expenses. The NAV of each GLD share is the NAV of the Trust divided by the total number of shares outstanding.

The gold spot price is determined by market forces in the 24-hour global over-the-counter market for gold and reflects the information available to the market at any given time. The Indicative Intraday Value per GLD share published on the www.spdrgoldshares.com website is based on the mid-point of the bid/offer gold spot price adjusted for the Trust's daily accrued expenses.

The NYSE Arca is an electronic exchange which displays orders simultaneously to both buyer and seller. Once orders are submitted, all trades are executed in the manner designated by the party entering the national best bid or offer. The buy and sell offers are posted on NYSE Arca in price order from best to worst and if the prices match up, they are ordered based on the time the buy order or sell order was posted (earliest to latest). These prices reflect the supply and demand for shares which is influenced by factors including the gold spot price and its impact on the NAV.

20.How is gold transferred to or withdrawn from the Trust?

The Bank of New York Mellon, as trustee of the Trust, or the Trustee, and the Custodian have entered into agreements which establish the Trust's unallocated account and the Trust's allocated account. The Trust's unallocated account is principally used to facilitate the transfer of gold between Authorized Participants and the Trust in connection with the creation and redemption of Baskets (a "Basket" equals a block of 100,000 SPDR® Gold Shares). The Trust's Authorized Participants are the only persons that may place orders to create and redeem Baskets and, in connection with the creation of Baskets, are solely responsible for the delivery of gold to the Trust. The Trust never purchases gold in connection with the creation or redemption of Baskets or for any other reason. All gold transferred in and out of, and held by, the Trust must comply with the rules, regulations, practices and customs of the LBMA, including "The Good Delivery Rules for Gold and Silver Bars." The specifications of a London Good Delivery Bar are discussed below. The Trust's unallocated account is also used to facilitate the monthly sales of gold made by the Trustee to pay the Trust's expenses.

Except when gold is transferred in and out of the Trust or when a small amount of gold remains credited to the Trust's unallocated account at the end of a business day (which the Custodian is directed to limit to no more than 430 ounces), the gold transferred to the Trust is held in the Trust's allocated account in bar form. When Baskets are created or redeemed, the Custodian transfers gold in and out of the Trust through the unallocated accounts it maintains for each Authorized Participant and the unallocated and allocated gold accounts it maintains for the Trust. After gold has been first credited to an Authorized Participant's unallocated account in connection with the creation of a Basket, the Custodian transfers the credited amount from the Authorized Participant's unallocated account to the Trust's unallocated account. The Custodian then allocates specific bars of gold from unallocated bars which the Custodian holds, or instructs a subcustodian to allocate specific bars of gold from unallocated bars held by or for the subcustodian, so that the total of the allocated gold bars represents the amount of gold credited to the Trust's unallocated account to the extent such amount is representable by whole bars. The amount of gold represented by the allocated gold bars is debited from the Trust's unallocated account and the allocated gold bars are credited to and held in the Trust's allocated account. The process of withdrawing gold from the Trust for a redemption of a Basket follows the same general procedure as for transferring gold to the Trust for a creation of a Basket, only in reverse.

The Custodian updates its records at the end of each business day (London time) to identify the specific bars of gold allocated to the Trust and provides the Trustee with regular reports detailing the gold transfers in and out of the Trust's unallocated account and the Trust's allocated account. The Trust's website includes a list of the gold bars held in the Trust's allocated account. The list identifies each bar by bar number, brand, weight, fineness and fine weight and is updated once a week.

21.Who are the Trust's Authorized Participants and what is their function?

Authorized Participants are the only persons that may place orders to create and redeem Baskets; the Trust does not deal directly with individual investors. Authorized Participants must be (1) registered broker-dealers or other securities market participants, such as banks and other financial institutions, which are not required to register as broker-dealers to engage in securities transactions and (2) Depository Trust Company (DTC) participants. Each Authorized Participant must establish an unallocated account with the Custodian in order to be able to process the gold transfers associated with creating and redeeming Baskets. Authorized Participants can place an order to create or redeem one or more Baskets on every day the NYSE Arca is open for trading. The Trust issues new Baskets to Authorized Participants in exchange for their delivery of gold to the Trust upon a creation and transfers gold to Authorized Participants in exchange for their delivery of Baskets to the Trust upon a redemption. In creating or redeeming Baskets, Authorized Participants may act for their own accounts or as agents for broker-dealers, custodians and other securities market participants that wish to create or redeem Baskets. An order for one or more Baskets may be placed by an Authorized Participant on behalf of multiple clients. A list of the Trust's current Authorized Participants may be found in the Annual Report or Prospectus of the Trust most recently filed with the Securities and Exchange Commission.

22.What is an unallocated account?

An unallocated account is an account with a bullion dealer, which may also be a bank, to which a fine weight amount of gold is credited. Transfers to or from an unallocated account are made by crediting or debiting the number of ounces of *gold being deposited or withdrawn. As gold held in an unallocated account is not segregated from the bullion dealer's assets, credits to an unallocated account represent only the bullion dealer's obligation to deliver gold and do not constitute ownership of any specific bars of gold. The account holder is entitled to direct the bullion dealer to deliver an amount of physical gold equal to the amount of gold standing to the credit of the account holder. When delivering gold, the bullion dealer allocates physical gold from its general stock to the account holder with a corresponding debit being made to the amount of gold credited to the unallocated account.*

The Trust's unallocated account is only used for the transfer of gold to and from the Trust's allocated account.

23.What is an allocated account?
An allocated account is an account with a bullion dealer, which may also be a bank, to which individually identified gold bars owned by the account holder are credited. The gold bars in an allocated account are specific to that account and are identified by a list which shows, for each gold bar, the refiner, assay or fineness, serial number and gross and fine weight. The account holder has full ownership of the gold bars.

The Trust's allocated account is only used for holding the allocated gold bars of the Trust.

26.Is the Trust's gold ever traded, leased or loaned?
Gold held in the Trust's allocated account in bar form or credited to the Trust's unallocated account is the property of the Trust and is not traded, leased or loaned under any circumstances.

And from the latest 10K filed with the SEC, here is the list of the current Authorized Participants [emphasis mine]:

Authorized Participants may act for their own accounts or as agents for broker-dealers, custodians and other securities market participants that wish to create or redeem Baskets. An order for one or more Baskets may be placed by an Authorized Participant on behalf of multiple clients. As of the date of this report:

BMO Capital Markets Corp.
CIBC World Markets Corp.
Citigroup Global Markets Inc.
Credit Suisse Securities (USA) LLC
Deutsche Bank Securities Inc.
EWT, LLC
Goldman, Sachs & Co.
Goldman Sachs Execution & Clearing, L.P.
HSBC Securities (USA) Inc.
J.P. Morgan Securities Inc.
Merrill Lynch Professional Clearing Corp.
Morgan Stanley & Co. Incorporated
Newedge USA LLC
RBC Capital Markets Corporation
Scotia Capital (USA) Inc.
UBS Securities LLC

…have each signed a Participant Agreement with the Trust and may create and redeem Baskets as described above. Persons interested in purchasing Baskets should contact the Sponsor or the Trustee to obtain the contact information for the Authorized Participants. ***Shareholders who are not Authorized Participants will only be able to redeem their Shares through an Authorized Participant****.*

So now I offer up a scenario, not as a statement of fact, but as fodder for thought and discussion. In this scenario I am not assuming that the drain on GLD to date has been the direct redemption of ETF shares by Giants. I presume it is simply redemptions by Bullion Banks in order to meet the delivery demands of "important clients," real Giants, perhaps from Asia and the Middle East. And because the BBs would normally have better options than plundering GLD, I am assuming those options are either gone or far more problematic than legalized looting.

Also, following Lance Lewis' "puke indicator," one could be forgiven for suspecting that the Bullion Banks have some way to temporarily "pound" the price of gold down on the COMEX in order to buy back ETF shares during a "good price window" with the intention of redeeming those shares into deliverable gold for clients that purchased it at a higher price. Perhaps it would take, what, a month or so to churn such a profit from a Giant delivery? Reminds me of that fella Jim Rickards spoke of on King World News:

Jim Rickards - Swiss Bank Client Denied His $40 Million in Gold

Jim: *"Correct and upon request to move the gold...the bank demurred, the bank said, 'Well, no, not so fast' and he said, 'What do you mean?' Anyway, long story short I could see that taking a day or two...This took thirty days to complete delivery. Now if the gold is sitting there it shouldn't take thirty days. Oh, and by the way I should add that the individual had to threaten to go public, in effect say I'll call Reuters or I'll call King World News or I'll call Dow Jones and let them know* *that you don't have the gold, you're not good for it."*

Eric: *"And he had his lawyers get involved?"*

Jim: *"Correct, and through all of that eventually the individual did get his gold, but this is something that should have taken two days, three days, a week at the most, although I would say even a week is a long time. But it took thirty days, and it took lawyers, it took threats of publicity, it took a lot of pressure to do that, which my inference is that that gold was not there. The bank had to scramble, go out and find it somewhere before they could make good delivery."*

I wonder when that was. And I wonder if GLD "puked" any "baskets" around that time.

Someone is draining GLD of its gold. Someone is taking in millions of ounces and tonnes of physical gold at off-market prices while the paper bug cheerleaders call it "dumping" or "offloading" the gold. Again, one man's "outflow" is another man's pickup truck (or dump truck as the case may be) backed right up to the loading dock at the GLD depository.

As of 2008, some analysts estimated there were still 15,000 tonnes of unallocated (un-spoken-for) gold floating around the Bullion Banking system. Of course some of that is still there, along with a decreasing supply from the mines and a scrap supply that, after rising since 2006, appears to have plateaued in 2010. You can continue to go after that diminishing flow "on market" by playing the paper game like Dan Shak. But one day soon, it will all be spoken for. And you don't want to be left holding only paper on that day. And if the BBs are raiding GLD like it seems, that 15,000 tonnes may be closer to 1,200 tonnes than you or I would be comfortable knowing about.

Jim Rickards wrote about 100 tonne and 500 tonne lots being impossible to come by "outside of official channels" meaning off-market prices. But from what I can tell, there are still twelve 100 tonne lots or two 500 tonne lots available through one of the 16 dealers listed above. The instructions are all there. This isn't like the private sector trying to buy gold from the public sector, like Sprott being turned down by the IMF. This is the reverse! Go for it, I say. Why not?

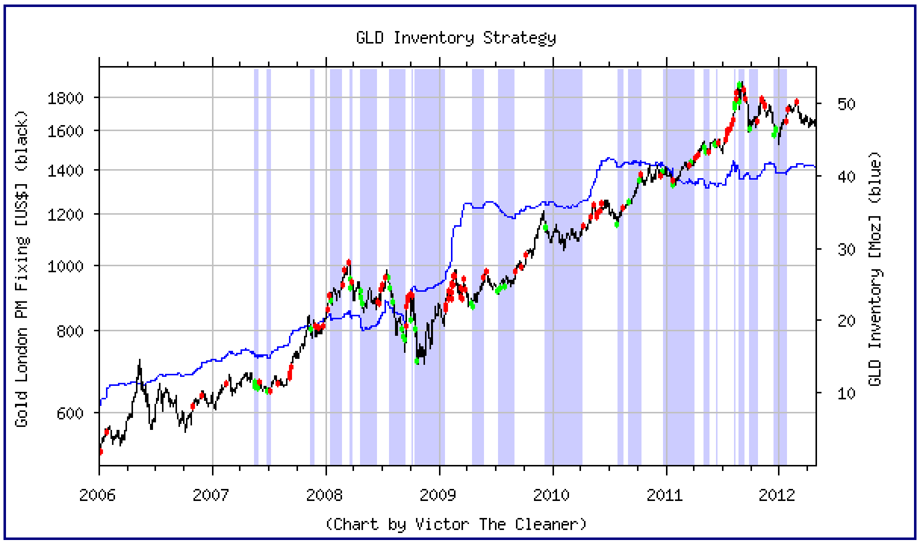
And for those of you GLD fans that think you will simply hold onto your shares until the bitter end, I have a warning for you. These Giants don't need to over-bid your shares away from you. They can always buy them at the price of paper gold trading in London and New York. And there will come a point when you are watching the premium on physical coins jump from 5% over GLD to 50% on its way to 500% over the paper gold price. How long are you going to stubbornly hold onto your precious paper before you finally relinquish it to that last Giant's delivery "basket?" Remember, unless you've got $13 million, you've only got paper.

Sincerely,
FOFOA

GLD – The Central Bank Of The Bullion Banks – By Victor the Cleaner

1 June 2012 [50 Comments]

The black curve (left scale) of the following chart shows the London pm gold fixing in U.S. dollars from 1 January 2006 to 30 April 2012. During the light-blue intervals which span about 35% of the entire period, the gold price increased at an annualized rate of 41.1%. During the remaining intervals, the price increased only at an annualized rate of 7.9%. The light-blue intervals are the result of a trading algorithm whose buy signals are indicated by the green dots and whose sell signals by the red dots.



GLD Inventory Strategy from 1 January 2006 to 30 April 2012

In this article, we explain how the signals can be computed from the variations of the inventory of the SPDR Gold Shares exchange traded trust (NYSEArca:GLD). We explain why the inventory adjustments can hardly be caused by price arbitrage between the GLD share price and the loco London spot price alone. We rather claim that bullion banks finance their inventory by lending it or selling it to GLD investors and that bullion banks manage their physical reserves by accessing the physical gold inside GLD.

The fact that a certain type of inventory adjustments has predictive power, supports the idea that large inventory changes are the result of active reserve management. This provides us with a unique window into the flow of physical gold that is usually obscured by the dominance of paper gold trading. A similar, but somewhat less robust result is shown for the iShares Silver Trust (NYSEArca:SLV).

WARNING (April 2013): This article uses the term *buy signal* in a technical sense. It does not mean that you ought to buy anything without understanding what you are doing. Notably, the rapid price increases after the *buy signals* have been absent since the fourth quarter 2012. Now you might dismiss the trading algorithm as a statistical fluctuation. Alternatively, you can wonder whether something might have changed.

The idea of a trading strategy based on changes to the GLD inventory goes back to Lance Lewis' *GLD Puke Indicator*. The term *Central Bank Of the Bullion Banks* was coined by FOFOA who wrote about the GLD Puke Indicator in Who Is Draining GLD. In that article, FOFOA expands on Randal Strauss' idea that GLD redemptions indicate a preference for physical gold over paper gold (see his Gold Dips

Towards $1360/oz … and Gold Nears 3-Months Low…).

Creation and Redemption of GLD Baskets

The method by which GLD grows or shrinks differs radically from the way in which conventional investment funds operate. If you want to invest in such a fund, you wire money to the manager. If you wish to withdraw money, you fax them a withdrawal notice. Depending on the contributions and withdrawals, the manager then either invests the contributed cash or sells investments in order to satisfy the requests for withdrawal.

GLD is managed differently. As of 29 May 2012, there exist about 421 million shares of the trust. Each share corresponds to roughly 0.097 ounces of gold. The trust therefore contains 40.84 million ounces of gold (1270 tonnes) that are worth $64.5bn at the London pm fixing price of $1579.50 per ounce.

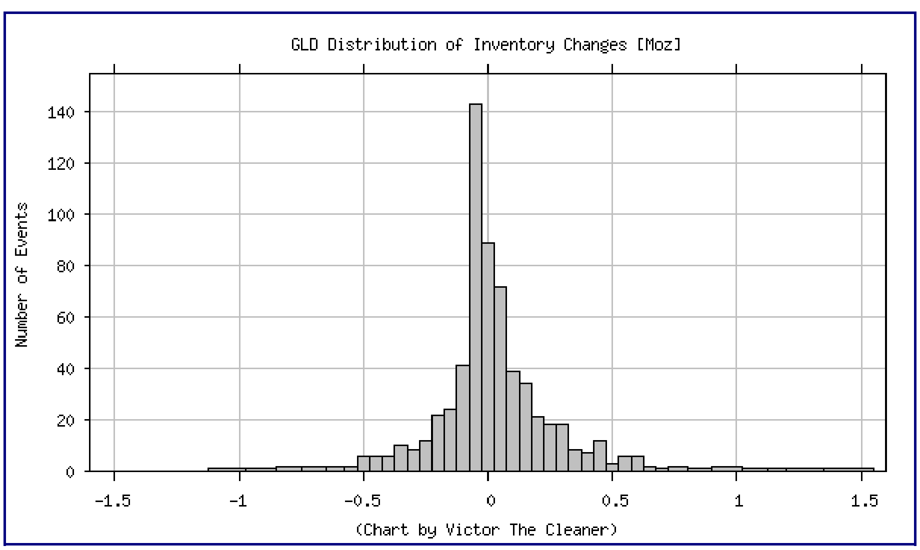
The number of shares of the trust can be changed only in multiples of a *basket* (100000 shares) and only by the so-called *Authorized Participants* (APs). According to the prospectus of 26 April 2012, these are Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, J.P. Morgan, Merrill Lynch, Morgan Stanley, Newedge, RBC, Scotia, UBS and Virtu Financial. Each of these APs can

- Transfer the physical gold that corresponds to a basket of shares to the trustee. The trustee then creates a basket of new shares and transfers them to the AP in return (*creation*)
- Transfer a basket of shares to the trustee and receive the corresponding physical gold in return. The trustee then cancels the shares (*redemption*).

Note that all the gold held by the trust is allocated except for an adjustment term that is smaller than one 400oz London Good Delivery (LGD) bar.

Creation and Redemption Statistics

Before we consider why an AP might wish to create or redeem baskets, let us take a look at the statistics of these creations and redemptions. The following histogram shows the frequency of the daily inventory changes depending on their size in millions of ounces (creations are counted positive, redemptions negative). Days on which the inventory remained constant, are ignored. We have analyzed the period from 1 January 2006 to 30 April 2012. Recall that one basket consists of 100000 shares which presently represents 9700 ounces or 301.67kg of gold, worth about $15.3 million.



Distribution of daily GLD inventory changes in millions of ounces from 1 January 2006 to 30 April 2012

We see that the changes to the inventory are not exactly normally distributed. In addition to a skew towards small redemptions and larger creations, there are obvious fat tails on both sides. In the following, we are interested in these fat tails, i.e. in the excess number of large creations and large redemptions.

The Trading Strategy in Detail

For GLD, we are interested in creations and redemptions that exceed the threshold of 250000 ounces on a single day, i.e. about 25 baskets or 7.78 tonnes (presently worth $394 million). Note that this threshold essentially captures the fat tails of the distribution of inventory changes displayed above.

On the first day (1 January 2006), our strategy is not invested. At about 4.50pm New York time on every New York trading day, i.e. after the close, the current inventory of GLD is published. If the strategy is not invested and the inventory has decreased by 250000 ounces or more compared with the previous trading day, our strategy buys gold at the London pm fixing price on the following day. If the strategy is invested and on any New York trading day, the inventory has increased by 250000 ounces or more, our strategy sells the gold at the London pm fixing price on the following day. These buy and sell signals are indicated by the green and red dots in the chart at the beginning of this article. The blue curve (right scale) shows the total inventory of GLD in millions of ounces.

Recall that the original GLD Puke Indicator by Lance Lewis counts a decrease of the inventory by 1% or more as a buy signal. We prefer an absolute threshold (250000 ounces) rather than a relative one. This yields a more consistent performance of the strategy over the entire period from 2006 to 2012 and is also more plausible in view of our interpretation of the inventory changes as reserve management (details below). Note that GLD began trading on 18 November 2004, and we have omitted the first 13.5 months from the analysis.

Of course, nobody would actually trade according to this strategy, simply because even during the times at which the strategy is not invested, the gold price still increases at an annualized rate of 7.9%. The strategy merely serves to demonstrate that inventory changes do have some power of predicting the future gold price.

Price Arbitrage

Let us now consider why an Authorized Participant (AP) might wish to create or redeem baskets of GLD. We therefore need to understand how GLD is priced and which type of arbitrage might enforce this price.

Assume you know from the data sheet that one share of GLD corresponds to 0.097 ounces of gold and that the London spot price is $1579.50 per ounce. This yields a Net Asset Value (NAV) of $153.21 per share. Even if you do not know the price at which GLD is currently trading, you nevertheless know that one share of GLD is worth $153.21. So if you bid $153.21 per share (plus spread), you should be able to purchase your shares of GLD, simply because GLD contains physical gold loco London that you could equally well purchase directly for the spot price (plus spread).

If you bid less than $153.21, you cannot expect to receive any shares, simply because the seller would be foolish to sell at this price. If you bid more than $153.21, you would effectively hand a free lunch to the seller. In fact, if you did, your counterparty can indeed capture this free lunch by arbitrage.

Paper Gold Arbitrage

Suppose there is a buyer of GLD shares who acts foolishly and who drives up the price of GLD shares well beyond their NAV. Any arbitrageur can now go short GLD and long any other gold investment that follows the London spot price. This allows him to capture the arbitrage, i.e. to lock in a risk-free profit. This works because GLD will eventually trade at its NAV again, and the arbitrageur can unwind both positions at that point in time. We call this form of arbitrage *paper gold arbitrage* because the arbitrageur can go long unallocated gold in addition to short GLD while the physical gold inside GLD is not touched.

If for some reason, GLD trades at a discount to its NAV, the arbitrageur can go long GLD and short paper gold. Most likely, GLD will sometimes trade at a small premium to NAV and at other times at a small discount, and so the arbitrageur can easily unwind the paper gold arbitrage after a short period of time.

Let us stress that paper gold arbitrage should be largely unnecessary though, simply because every investor knows that the NAV is the price at which GLD ought to trade. Deviating from this price would be foolish, and so in most cases the threat of arbitrage ought to be sufficient in order to keep the market efficient while the actual arbitrage would not be necessary.

In the unlikely event that there is so much buying pressure that GLD consistently trades at a premium even though paper gold arbitrage is performed, the short GLD and long unallocated gold positions of the arbitrageur would keep growing. How can this be avoided?

Creation-Redemption Arbitrage

The answer is that if an AP performs such an arbitrage and his position of short GLD versus long unallocated gold has grown beyond the size of a basket, he can unwind the position at any time by having a basket created, i.e. he

- has a basket worth of his unallocated gold allocated,
- transfers the gold to the trustee,
- receives a basket of created shares,
- uses these shares in order to close his short position in GLD.

If GLD has traded at a discount for some time, and the AP has accumulated a position of long GLD versus short unallocated in order to lock in the arbitrage profit, he can unwind this position by redeeming a basket, i.e. he

- transfers a basket of shares to the trustee for redemption,
- receives a basket worth of allocated gold,
- uses this gold in order to close his short unallocated position.

Whereas paper gold arbitrage has very little transaction costs, the creation and redemption of baskets involves the reallocation of gold and possibly even physical movements of gold bars into another vault, and is therefore subject to higher transaction costs. Note that Warren James at Screwtape Files discovered a fax from HSBC, the custodian of GLD, that confirms the reallocation of about 760000 ounces (or 1907 LGD bars of about 400oz each) related to the redemption of 79 baskets by Merrill Lynch, Goldman Sachs, and J.P. Morgan on 16 August 2011.

Due to the transaction costs, the APs will avoid the creation-redemption arbitrage as far as possible and perform it only if their paper gold arbitrage position gets way out of balance. Let us finally recall that every market participant knows the NAV and the spot price and therefore the fair price of a GLD share, and so even paper arbitrage should normally be unnecessary.

Then why do we see so many inventory adjustments? Is there a second reason for adjusting the inventory beyond the obvious price arbitrage?

Two Different Views on Inventory Changes

How can we better understand the creation and redemption of baskets? The arbitrage point of view was the following:

Some investor decides to buy a certain number of GLD shares, but he is not interested in other gold investments. If he is willing to pay a premium for these GLD shares if necessary, he will definitely get the desired number of shares. The price to pay is that an AP who acts as the arbitrageur, can pocket that premium as a profit for the service of creating the desired number of shares.

There is, however, a second point of view on the creation and redemption that is not centred around the GLD investor, but rather around the AP. Let us assume the AP decides to put a certain amount of gold into GLD. He therefore transfers the gold to the trustee, receives GLD shares in turn and sells these shares into the market. If GLD shares trade at a discount as the consequence, the rest of the market can act as the arbitrageur and, for example, slightly favour GLD over other gold investments, and thereby absorb all the newly created GLD shares.

So which one is it? Do the investors in GLD request a certain number of shares, and the AP delivers by performing the arbitrage and creating the shares? Or does the AP decide to place a certain amount of gold into GLD, and then the market absorbs these additional shares?

We suspect that at least those inventory adjustments that constitute the fat tails of the distribution, i.e. beyond the threshold of 250000 ounces per day, are in effect initiated by the AP rather than by the GLD investors.

If it were just the arbitrage in response to the investors, why would the trading strategy work? The only explanation would be that GLD investors represent the 'dumb money' (or 'weak hands') whereas all other gold investments represent the 'smart money' ('strong hands'). In this scenario, GLD would lose a significant amount of inventory when the dumb money sells while the smart money buys, triggering a buy signal. Conversely, when the smart money sells and the dumb money buys, GLD would gain inventory which constitutes a sell signal.

The problem with this view is, however, that there is no reason to assume that GLD is held primarily by the weak hands whereas the other gold investments that are all tied to the London spot price, represent the strong hands. Both GLD and unallocated gold OTC or COMEX futures are held by sophisticated investors, endowment funds or hedge funds. Although many retail investors, i.e. typically weak hands, are in GLD, the same is true for other gold investments such as coins and retail bars, COMEX futures, and bank sponsored gold-related products that, in aggregate, all appear on the other side of the arbitrage, i.e. in the spot market outside of GLD.

The only consistent interpretation would be the following: The fact that the suggested trading strategy works, confirms that in aggregate GLD is dominated by weak hands whereas in aggregate all other gold investments are dominated by strong hands. This point of view is not plausible at all.

We therefore suspect that those inventory adjustments that are relevant to our trading strategy, i.e. those beyond 250000 ounces per day that form the fat tails, are rather initiated by the APs.

Inventory Financing and Reserve Management

Why would an AP decide to increase or decrease the inventory of GLD other than in order to capture some arbitrage profit? There are two plausible scenarios. In order to understand them, let us first note that all market makers except two (Mitsui and Société Générale) and all clearing members of the London Bullion Market Association (LBMA) are presently APs of GLD.

Inventory Financing

Consider a company whose operation requires an expensive inventory. In order to stay in the realm of the gold market, this might be a large coin store, a refiner or mint, or even the market maker of a public exchange. The regular operation requires a considerable gold inventory, but this inventory ties up a lot of capital.

In order to reduce the capital requirement, our company has several options, for example,

- To take out an unsecured loan in order to finance the inventory. This is usually an expensive strategy.
- To Take out a loan for which the inventory serves as the collateral. Given that the inventory is gold bullion, the collateral is easy to liquidate, and so the interest expenses on such a loan should be a significantly lower than those on an unsecured loan.
- To swap the gold for dollars with a bullion bank, i.e. our company borrows dollars from the bank and at the same time lends gold to the bank, both for a fixed term. This is almost the same as taking out a loan that is secured by the gold. Since such swaps are typically limited to 400oz LGD bars, this method is suitable for the market maker, but not for the coin dealer or for the refiner.
- To give private investors an opportunity to own a part of the inventory. The pooled accounts offered by Kitco or by the Perth Mint are examples of this type of inventory financing. Our company can sell the title to gold that forms part of the inventory, to private investors and offer to buy it back from them. Such a pooled account is indeed backed by physical gold, but this is the physical gold that flows through our inventory anyway. Voila, somebody else owns our inventory, and our capital is no longer tied up in order to hold this very inventory.

The London bullion banks can use GLD in precisely the same fashion as the last one of the above examples. They typically have many flow positions that contribute to their inventory, for example, receiving gold that has been sold forward by a mining company and then selling this gold to a wealthy investor. As long as the bullion bank knows which part of their inventory corresponds to this flow and how long it is held for, they can just move this inventory into GLD where it is owned by private investors and no longer ties up any capital.

Even better, should the portion of the inventory corresponding to this flow decrease unexpectedly, they can even purchase a basket of GLD shares in the market, redeem them and recover the gold at any time. In this sense, GLD is even superior to the Kitco pooled account. Kitco can decrease their inventory only if some of the investors in their pooled account decide to sell. GLD offers the advantage that there is a liquid market for GLD shares from which the bullion bank can purchase additional shares at any time. The average daily trading volume of GLD is about 12 million shares which represents an inventory of 1.16 million ounces or 36.2 tonnes.

Reserve Management

A second use of GLD for the bullion bank besides the financing of a part of their inventory is reserve management. This plays a role for every institution that accepts bank deposits in ounces, that lends ounces and that holds only a fractional reserve of physical gold against this created credit. For example balance sheets, we refer to Bullion Banking with Alice and Bob.

The bullion bank can hold gold instruments in various forms, for example,

1. physical gold in the vault,
2. allocated balances with other institutions,
3. shares of GLD,
4. unallocated balances with other institutions,
5. outstanding loans denominated in ounces,
6. long OTC Forward or COMEX futures positions,
7. and many others.

Only the first three of these are free of credit and counterparty risk and can therefore be considered as reserves. This is analogous to the reserves of an ordinary commercial bank that is in the business of lending dollars. The reserves of the commercial bank consist of cash in the vault and of reserve balances with the respective central bank.

Besides the credit risk, i.e. the risk that a counterparty fails to honour its obligations, any bullion bank that holds only a fractional reserve against their customers' deposits, is exposed to liquidity risk. For example, customers might request allocation of their unallocated account balances. In this case, both a liability of the bank (the customers' unallocated account balance) and an asset (a reserve of physical gold) disappear from the balance sheet. This is analogous to a customer withdrawing dollars in cash from a commercial bank or to a customer transferring out credit money from her account.

Since such a withdrawal involves a reduction of our bullion bank's reserves, our reserve ratio deteriorates. We now have less reserves relative to the size of our balance sheet. This is where GLD comes in handy. We can easily replenish our reserves by

- selling unallocated gold or other instruments that involve credit or counterparty risk, and
- purchasing shares of GLD, and optionally
- redeeming these shares for physical gold.

In effect, on our balance sheet, we have replaced credit assets (paper gold) by reserve assets (GLD shares or physical gold).

Shortage of Reserves and Reduction of GLD Inventory

Although inventory financing may be one of the motivations for establishing GLD and for the APs to place additional gold in GLD, it is not the activity that correlates with the inventory changes on which our trading strategy is based. The reason is that our strategy is based on the creation and redemption of GLD baskets, but inventory financing occurs when a bullion bank sells existing shares of GLD to an investor.

Let us try to disentangle these steps. The bullion banks presumably hold a part of their reserve in the form of physical gold in their own vault and another part in the form of GLD shares. Whenever they acquire a larger amount of additional physical reserves, they probably place some of it into GLD and create new baskets of shares, but they do not necessarily sell these GLD shares to investors and even if they do, this need not happen at the same point in time.

Conversely, if a bullion bank faces a large allocation request and needs to replenish the physical gold in their vault, they can redeem baskets of GLD that they already own. In a true emergency in which a bullion bank runs out of reserves, they can even

- sell some paper gold, and
- purchase GLD shares with the proceeds, and optionally
- redeem these GLD shares in order to receive physical gold,

thereby replacing a credit asset (paper gold) with a reserve asset (GLD shares or physical gold).

Since our trading strategy uses only the instances in which shares of GLD are redeemed for physical gold, it is sensitive to the following two situations:

- The bullion bank has purchased shares of GLD in order to boost its reserves. In order to achieve a balance between their two forms of reserves, i.e. GLD and physical gold in the vault, they redeem some of these GLD shares.
- There has been a request for allocation by some investor who requires individual bars in the vault, and so GLD shares need to be redeemed in order to get to the bars.

We therefore expect that some changes to the inventory of GLD are related to the reserve management of the bullion banks. Excess reserves lead to a growing inventory of GLD whereas a shortage of reserves results in a reduction of inventory. If this picture is correct, we should find independent evidence that reductions of GLD inventory correlate with a shortage of reserves. There is indeed anecdotal evidence for such a correlation.

One of the largest recent reductions in GLD inventory occurred on 22 May 2012 with a net redemption of 563024 ounces, i.e. 58 baskets or about 17.5 tonnes. This event coincides up to one week with a negative one-month GOFO quoted by J.P. Morgan on 16 May 2012 as reported by Izabella Kaminska. This indicates that J.P. Morgan was presumably willing to pay a premium in order to swap dollars for gold, i.e. they were willing to buy at spot and sell a one-month forward at a discount.

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1837              LONDON INTERBANK GOLD FORWARD RATES                      GOFO
                  ~~~~~~~~~~~~~~~~~~~~~~~~~~~~~~~~~~~
=*=  Loco London Gold. Most Recent Lending Rates (v.USD)    =*=    11am CCY snap
=*=  TIME CONTRIBUTOR          RATE    11am MEAN - 17MAY    =*=
=*=  1554 JP Morgan      1 M  -0.06   1 M   0.30833         =*=            v.USD
=*=  1554 JP Morgan      2 M   0.36   2 M   0.34333         =*=  ZAR=  8.309/324
=*=  1554 JP Morgan      3 M   0.39   3 M   0.37000         =*=  AUD=  0.9929/31
=*=  1554 JP Morgan      6 M   0.49   6 M   0.47167         =*=  EUR=  1.2711/13
=*=  1554 JP Morgan     12 M   0.60  12 M   0.57667         =*=

                   ----- REAL-TIME COMPOSITE SUMMARY -----  Gold Spot. USD OZ
TIME  CONTRIBUTOR        1 M    2 M    3 M    6 M    12 M   |  =================
~~~~  ~~~~~~~~~~~        ~~~    ~~~    ~~~    ~~~    ~~~~   |  1837  1574.65/45
0935  BARCLAYS BANK PLC  0.30   0.34   0.35   0.47   0.57   |  -----------------
0944  DEUTSCHE LONDON    0.29   0.33   0.33   0.43   0.53   |   Lon(GMT)Fixing
0934  GOLDMAN SACHS      0.30   0.32   0.34   0.45   0.50   |
0950  HSBC BK USA, LON   0.30   0.32   0.36   0.45   0.55   | AM : 0931 -1547.00
1554  JP MORGAN         -0.06   0.36   0.39   0.49   0.60   | PM : 1403 -1554.00
                                                            |  CCY fixing snaps
0931  SCOTIAMOCATTA      0.31   0.34   0.38   0.48   0.58   | AM: JPY=  80.36/38
0945  SOCIETE GENERALE   0.36   0.38   0.42   0.50   0.63   |   : ZAR= 8.307/311
0945  U B S              0.34   0.40   0.41   0.52   0.63   |   : AUD= 0.9922/24
                                                            | PM: JPY=  79.80/88
                                                            |   : ZAR= 8.350/359
0000                                                        |   : AUD= 0.9908/10
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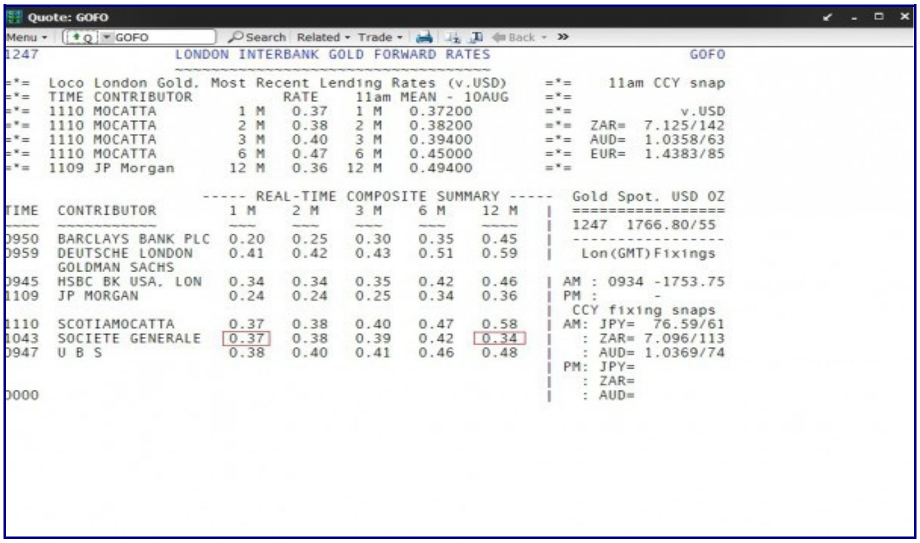
GOFO on 16 May 2012 (Reuters)

Robert LeRoy Parker spotted another example. Some of the largest reductions in GLD inventory occurred on 23 and 24 August 2011 with redemptions of 798417 ounces and 876288 ounces, together 172 baskets or about 52 tonnes of gold. This coincides with the following reported Gold Forward Offered Rates (GOFO) found on the LBMA website at that time. The numbers are GOFO for 1,2,3,6 and 12 months:

19-Aug-11 0.40000 0.41600 0.42600 0.48800 0.51000
22-Aug-11 0.48250 0.43000 0.35000 0.25000 0.08750
23-Aug-11 0.40800 0.41600 0.42250 0.50000 0.52600

The term structure beyond one month was inverted on 22 August 2011, indicating that some bullion bank(s) frantically tried to borrow gold in the OTC market, gold that was needed within one to two months. They were willing to buy one-month forward and sell a longer forward at a discount. Recall that the GOFO rates reported on the LBMA website are not individual quotes that can be associated with a specific bullion bank, but rather the averages from their daily telephone survey of the major market makers. Also note that a few days later, these numbers were ‘corrected’ on the LBMA website.

A third example was again reported by Izabella Kaminska. On 10 August 2011, Société Générale quoted an inverted term structure:



GOFO on 10 August 2011 (Reuters)

Again, this coincides with losses of GLD inventory of 418373 ounces on 9 August 2011, 759559 ounces on 11 August 2011 and 408988 ounces on 12 August 2011, together 1.59 million ounces, 164 baskets or 49.3 tonnes. Since Société Générale is not an AP, apparently someone else took the gold out of GLD and lent it to them.

We have to concede that the published GLD inventory only records the aggregate daily changes. The fax from HSBC that Warren James at Screwtape Files discovered, shows redemptions of 759618 ounces for 16 August 2011. This must have been some intra-day movement that was compensated by even larger creations on the same day because the reported aggregate change of inventory for that day is positive. Apparently the inventory changes are such a good indicator that the trading strategy is still effective even if we work with daily aggregates only.

Interpretation

We arrive at the interpretation that large allocation requests by customers of a bullion bank sometimes force the bullion bank to take physical gold out of GLD. This is a buy signal that indicates a higher price of paper gold in the near future. Conversely, once the bullion bank has replenished its reserve of physical gold and shifts a part of this back into GLD, this forms a sell signal that indicates a less rapidly increasing price of paper gold in the near future.

FOFOA must have had this picture in mind when he called GLD the *Central Bank of the Bullion Banks*, i.e. a depository of additional reserves shared by those bullion banks that are at the same time APs.

It remains to understand why the paper price of gold rises during the period immediately following strong demand for physical gold.

Conservative Interpretation

A simple explanation is the following. Many large redemptions of GLD occur towards the end of a sell-off in the price of paper gold. There might be some sophisticated buyer(s) of physical gold who buy the dips and whose timing is excellent.

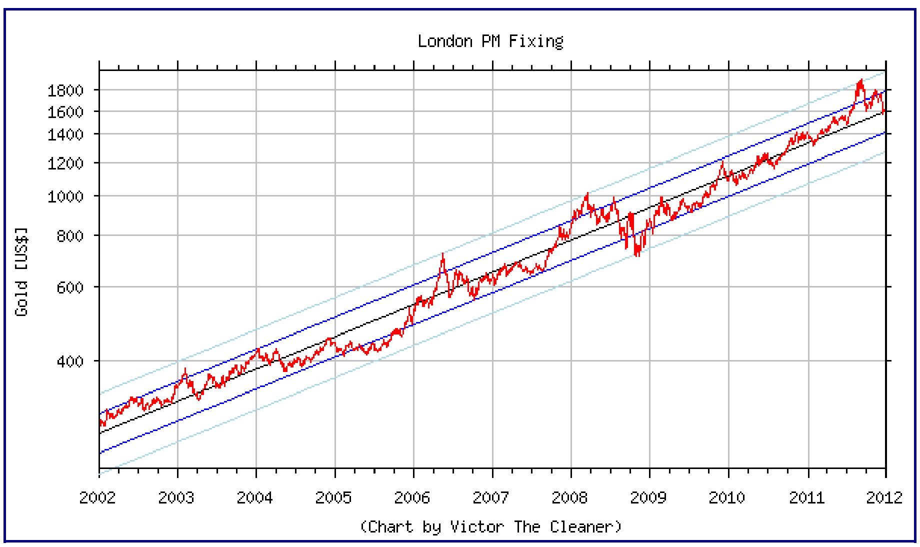
Notice that the buyer(s) purchase only about 5 to 50 tonnes of physical gold on the relevant days whereas about 2700 tonnes of paper gold are sold every trading day (total transaction volume of all sales, assuming 62.5 trading days per quarter) according to the Loco London Liquidity Survey published in August 2011. Although the physical purchase is tiny compared to the trading volume of paper gold, after this purchase the price of **paper** gold increases.

We might attribute this to the excellent timing of the large physical buyer whose activity we can sometimes spot by watching the inventory of GLD.

Speculative Interpretation

If you find this interpretation unsatisfactory and ask why should the paper price increase after the purchase of an amount of allocated gold that is small compared to the volume of paper gold traded, the only way out is more speculative.

What if somebody manages the price of paper gold in such a way as to control the flow of physical gold? The following chart shows the remarkably uniform increase in the dollar price of gold over the previous decade from 2002 to 2011. The black line is the regression line in the logarithmic diagram. It starts on 2 January 2002 at $266.60 and ends on 29 December 2011 at $1589.95 for an annual rate of increase of 19.56%. The blue and light blue bands are a factor of 1.118 and 1.25 away from the black line.



The London pm gold fixing in US$ between 2 January 2002 and 29 December 2011

Does this chart look ‘managed’? Maybe…

How would one manage the price in such a way as to control the flow of physical gold? Let us make up some numbers in order to arrive at a toy model. There is a flow of new gold into the market from mining and recycling. This amounts to about 3000 tonnes per year. If a third of this amount goes through the London market, this amounts to about 4 tonnes per trading day (assuming 250 trading days per year).

In addition, there are some investors who sell allocated gold and some who purchase allocated gold. Let us be generous and assume that this trading volume of allocated gold is three times as big as the flow of new gold. This suggests a trading volume of 16 tonnes of physical gold per trading day in the London market which is tiny compared to the trading volume of paper gold (2700 tonnes per trading day). It is important to keep in mind that the inflow of new gold has an approximately constant weight per day.

It firstly seems plausible that allocation requests of about 5 to 50 tonnes are big enough in order to affect the reserve management of the bullion banks and thereby result in changes to the GLD inventory. It is also plausible that the management of the physical reserve that underlies the gold market is a rather delicate business because the paper trading volume is so huge compared to the physical volume.

Secondly, let us assume that the allocation requests by the buyers of physical gold involve an approximately constant sum of dollars per time. Investors or central banks who gradually switch from dollars into gold or who gradually diversify their foreign exchange reserves. We therefore have an inflow of physical gold that is steady in terms of weight per time, but an outflow that is steady in terms of dollars per time.

In order to manage the flow of physical gold, someone might therefore try to manage the dollar price of paper gold. Since the physical inflow is by weight, but the outflow by dollars, one might try to increase the paper price in response to an increased outflow of physical gold and try to lower the paper price whenever there are plenty of reserves. There you go. This is indeed consistent with what we see in our trading strategy: The price of paper gold increases in response to an outflow of physical gold.

Let us keep this speculation in mind as a second possible explanation of why the trading strategy works.

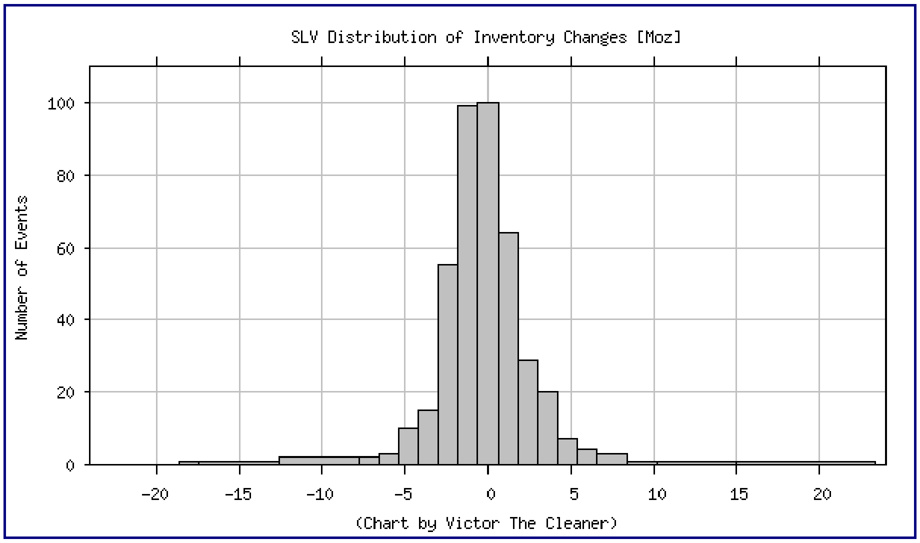
In light of this interpretation, it would be worthwhile watching the total inventory of GLD (the blue curve, right scale, in the very first diagram of this article). The inventory of GLD, the central bank of the bullion banks, should move in line with their total physical reserves. We see that the inventory peaked at 42.1 million ounces (1310 tonnes) in summer 2010, a level that has not been reached ever since. Even though the dollar price of gold rose further from $1200/ounce to $1900/ounce, the investors in GLD were not able to entice the APs to make additional inventory available.

Nevertheless, the present GLD inventory of still 40.84 million ounces (1270 tonnes) forms a considerable reserve of physical gold which the bullion banks can draw on in order to replenish their own reserves. Should the total inventory continue to decline, this would indicate increasing pressure on the physical reserves of the bullion banks. The financial media, however, would presumably tell you that investors are no longer interested in gold, that they sold their shares in GLD and that this was bearish for gold. Nothing would be further from the truth.

The SLV Inventory Strategy

The same trading strategy that we developed for gold, can also be applied to silver. We therefore watch the inventory of the iShares Silver Trust (SLV) whose inventory management is organized in the same way as that of GLD. Note that a share of SLV presently represents about 0.97 ounces of silver. One basket consists of 50000 shares, i.e. about 1.5 tonnes of silver presently worth $1.37 million (London silver fixing of $28.25/ounce on 29 May 2012).

The following histogram shows the distribution of the daily changes to the inventory of SLV.



Distribution of daily SLV inventory changes in millions of ounces from 1 January 2007 to 30 April 2012

The threshold for our trading strategy is an inventory change by at least 3.5 million ounces (about 108.9 tonnes worth $98.9 million). Apart from the choice of this threshold, the trading strategy is identical.

The following chart finally shows the performance of this strategy. The black curve (left scale) is the London Silver Fixing in U.S. Dollars. Again, buy and sell signals are indicated by green and red dots, respectively, and the light-blue shaded areas are the times during which the strategy is invested, i.e. about 25% of the time. During the invested periods, the silver price increases at an annualized rate of 28.7% whereas during the remaining times it increases only at an annualized rate of 11.6%. The blue curve (right scale) finally shows the total inventory of SLV.

SLV Inventory Strategy from 1 January 2007 to 30 April 2012

Whereas in the case of GLD, basically any threshold beyond our 250000 ounces works, as long as it gives a sufficient number of signals at all, it is substantially more difficult to find efficient parameters for the strategy involving SLV and silver. Nevertheless, we do have an effective trading strategy, and so everything said about reserve management and GLD seems to apply to silver and SLV, too.

Friday, June 1, 2012

GLD Talk Continued

As many of you know from the comments here and on Twitter, Victor The Cleaner just completed a great new post called [GLD – The Central Bank Of The Bullion Banks](). The timing was pretty neat. Lance Lewis' GLD Puke Indicator delivered a buy signal on 5/22 and Victor and I have been emailing extensively ever since that day discussing my view of the GLD Pukes.

During our discussion Victor conducted an analysis of the Puke Indicator using a hypothetical trading strategy based on buying spot gold at the puke and selling once the gold in GLD is replenished and found that it optimized at a puke size of about .5% of the inventory. Using 250,000 ounces as the puke size, he found that the $PoG climbed four times as much (annualized) in only one-third of the time (between puke and replenishment) as it did during the remaining two-thirds of the time. This was a significant finding which, at the very least, showed that the Indicator really does work. Using Lance's 1% threshold the trading strategy was a little less optimal, but perhaps Lance's higher threshold is more immediately predictive of big moves like today. I don't know.

But that's *some* timing, huh? Vic finally got his post up late last night and then today we have a jumbo up-move of more than 4%! At the very least I think it demands a little bit of attention.

Costata really enjoyed Victor's post and he emailed me with a few comments about it. I felt that Costata had maybe missed some of what I thought was an important thrust in the post and so I tried to summarize in one short email a few of the things that Vic and I had discussed over nine days of long emails. Not everything we discussed made it into Victor's post. Victor is meticulous in his exposition while I often try to cover too much ground, requiring me to just touch on some things which, if it was Victor writing, would require a toy model, some characters with alphabetical names, and a fancy chart or three.

Anyway, Costata suggested that I should post my email and JR concurred, so here you go, with minimal polish:

Costata: *"It also occurred to me just now that if this analysis is correct, it makes the possibility of a run on the unallocated accounts with the LBMA clearing members even more remote. The "large buyer" at the LBMA that VTC speculates about appears to be extremely disciplined - the BIS perhaps.*

Thoughts?"

Me: No, VtC divided it into two possible theories. Large buyer who knows the bottoms in the markets is one theory, an unlikely one. The second theory he called "speculative interpretation" is the real message.

If the BBs are redeeming GLD shares to fulfill allocation demands, that implies that they do not have enough 400 oz. bars outside of GLD to fulfill those demands. And that also implies that the BBs are using GLD shares as reserves.

Obviously 400 oz. bars come and go. They come in from mines, scrap and hapless investors and they go out to allocation demands and deliveries. That's the flow. So when we see a GLD puke, we infer they were essentially out of 400 oz. bars at the time. There is no other reason for a BB to redeem GLD shares, even if it is performing the arbitrage. GLD shares, for all practical purposes, are as good as 400 oz. bars not in GLD from the perspective of a BB. As shares, the BB reserves can even be lent at interest to those who want to short GLD. In fact, the BBs could potentially have only GLD shares as their reserves, which is why Randall Strauss called GLD a "central coat-check room" for the BBs. The pukes suggest to me this may be the case.

That flow from the mines to investors is the flow. Remember when there's not enough supply in that flow is when the stock to flow ratio explodes toward infinity. With this view, we can infer this may be what is happening with each puke.

We can't really look at the size of GLD and the size and frequency of the pukes and extrapolate a timeline. If you look at Lance's chart, the size of GLD peaked in 2010. If we suddenly see a puke of, say, 10% of the GLD inventory, I'd say it's game over starting there. The largest puke so far was about 4% over two consecutive days last August. That was about 50 tonnes when the PoG was around $1,800. That was HUGE. Almost $3B.

So when the pukes happen, that is BB heart attack time, but then the price rises and eventually (so far) the puke gets replenished. So as the price rises, the reserves are stretched and so is the inflow. As Victor said, the inflow of gold from the mines is relatively constant by weight but the outflow is normally constant in currency terms. So they raise the price until the puke is replenished and then they stop. That's the message in the post.

How they raise it, which he didn't go into, is a little more interesting. From that LBMA survey, we can see that the LBMA had net sales in one quarter of 7,575 tonnes of paper gold. That's a gross increase in the amount of paper gold in existence over only three months. 100:1 actually seems conservative in this light. That's most likely FOREX use of gold as a hedge or a currency play. But even still, the BBs have to hedge their price exposure when selling that much paper gold. Without a hedge, that would be a 7,575 tonne naked short position for the BBs.

So that net increase in paper gold is also a net inflow of cash for the BBs, cash which they use to hedge that net exposure. In fact, we can see from the LBMA survey exactly how much cash it was. It was $338B. That's over 3 months, so it's more like $5.4B per day inflow. That's a small percent considering the daily turnover in paper gold used as a FOREX currency is $240B and the daily turnover of all currencies is $4T. So in a $4T/day FOREX market, that's a $5.4B/day net flow from other currencies into gold. That was $5.4B per day in Q1 2011 that needed to be hedged by the BBs.

There's no way they hedged all of that in the "gold" market (Comex/mining forwards/GLD). It's simply not big enough to absorb that rate of flow without rising a lot faster than we saw it rise. So the BBs must be hedging this exposure the way they hedge net positions against other currencies in the FOREX market, simply using complex formulas and derivatives that look at correlations between different things. Correlations change slower than raw price changes which (they think) gives them time to adjust their hedges if the correlations start to exceed the model parameters.

Anyway, that is a plausible way they are hedging their exposure to the price of gold without doing so in the "gold" market per se. But they can also hedge some of that exposure in the gold market as well, by going long gold on the Comex or some other way. So if they want the price to rise in order to stretch the physical side and (hopefully) replenish the GLD puke, they would simply shift some hedges from complex derivatives into Comex.

So even though they have some control over the price of gold, they are still relying on other market players from the physical side to respond as expected. And from the view of GLD as their reserve pool, we can see that reserves are not only quite finite, but they also peaked almost two years ago.

A/FOA said the ECB/BIS strategy was to "expand and support" the dollar paper gold market so the dollar would eventually "bankrupt itself" just to keep the gold market going and stay in the game with the euro.

FOA (08/13/01; 07:24:30MT - usagold.com msg#96)

A very large part of that war strategy, employed by the ECB/BIS, was to let the dollar / IMF faction hang themselves by expanding and supporting the whole arena of this dollar paper gold market [the ECB/BIS is supporting and expanding paper gold as a strategy]. Inflating the gold market place with so much "paper gold" that we would eventually have to bankrupt ourselves just to keep the dollar in the war game against the Euro.

[…]

So, don't count on this destruction of our paper gold market to mark the real value and availability of physical gold; that ratio will split somewhere down the goldtrail. This action will scare most harden gold investors to death; especially the ones in leveraged gold stocks and lesser white metals!

The war between gold and the dollar has been over for a while now. The action, today, is between the dollar and the euro arena and this is what will break the price lock on gold. Leaving gold bugs with a lot of questions that ask why this: both systems will strive for a higher currency price for gold; one doing it because they have to; the other doing it because they want to! The casualty on this battlefield will be the world gold market as we know it. A market caught between how Western perception thinks gold's price should be "discovered" and at what price level trading in physical gold craters the entire paper structure. A structure of American based "paper gold".

We have been saying for some time that this will be "the" show to watch unfold; but only if your holdings allow you to stay still in your seat as it happens (smile).

They shifted their war on gold to become a war on the Euro,,,, only too late. Now, knowing that the Euro is a fact, we must have a super gold price if the dollar is to stay in the game! The question becomes one of supporting a cheap paper price for the sole function of keeping the market and all its bullion players alive. With the war on gold over, they need to turn their tanks around to face the real enemy but cannot.

So it seems that as the war switched from dollar v. gold to dollar v. euro, the euro side helped make the dollar gold market TBTF. But with a rising physical gold price/demand, the dollar paper gold market has to keep up because it's TBTF now. Too many of those "gold" FDIC stickers out there! If those stickers fail, the dollar loses. So the "gold" market is TBTF. Remember this from FOA?

FOA (10/9/01; 10:05:48MT - usagold.com msg#117)

What doesn't seem to be obvious is the "why for" the paper market grew so large. It grew to dominate because worldwide dollar expansion reached its "non-hedged" peak. In other words, the dollar's timeline was ending as its ability to produce non price inflationary economic gains came into sight.

In order to push dollar holdings further, international players needed and purchased "paper financial hedges" to balance their risk. Within their total mix of derivative hedges were found "paper gold price hedges"; modern gold derivatives. The important thing to remember is that these positions are not and never will be used to demand physical gold. They are held to buffer financial and currency risk associated with holding any form of dollar based asset. To work these items don't need to really perform "dollar price movements" in the holders favor as much as they are present in the portfolio to act as insurance stickers.

In that truth, these paper gold positions act like FDIC insurance at our banks. It can and will manage only a small determined portion of bank runs,,,,, not a full scale failure of the banking system. In a real full banking failure we would all get, perhaps, 80% of our covered $100,000 and 10% of the rest.

The same is true for these gold position's performance; real gold delivery along with true price performance, matching real bullion trading, would be only for the very few. For that matter, an actual functioning paper gold marketplace would be for the very few, too! But, in the same way a bank account owner understands the credibility of FDIC insurance when times are good; the international dollar asset owner will not grasp that modern paper gold hedges cannot be allowed to work until after a real serious price inflationary run begins.

For the first time in this portion of the dollar's timeline and our lifetimes, such an inflation is about to show its face!

So the paper gold of the bullion banks is now TBTF. Of course that doesn't mean it can't fail. It either fails, or the USG hyperinflates the dollar as prices rise. They are related, and each will likely cause the other almost immediately, but either one could end up being the initial cause IMO. If price inflation forces the USG to hyperinflate then the paper gold insurance stickers will have to fail to perform. And if these price rises in the gold market fail to manage the flow (demand) of physical as they have so far, we'll likely see a 10% or larger GLD puke at some point. That would signify more than a 120 tonne allocation demand, a system-busting size. They might think they can rocket the price at that point and get it back, but more likely we'll see more allocation requests coincident with a falling (paper) "gold" price as the longs dump their worthless "insurance" while wishing they had the real thing.

FOA (06/12/00; 19:48:25MT - usagold.com msg#26)
Put your cards on the table!

The current paper gold world will die (burn) as its value to users erodes, not increases!

…Again, most everyone in the Western Gold bug game is running with the ball in the wrong direction.

…So who is in danger of being hurt as this unfolds?

That's right, the Western paper gold long! I'm not talking about just the US market! This is about the entire world gold market as we know it today. The real play will be for the ones that get out in front of the move by owning physical…

It seems every Gold bug sees only half the trade and has great faith that contract law will favor a short squeeze. Yet, none of them see where it is the long that will be dumping and forcing the discount!

As I have said in the past, gold is so oversubscribed through the BB's paper gold it's more of a wonder when the $PoG rises than when it falls. Perhaps now we have a plausible explanation for why and how it has been rising over a decade, and also how it will end.

Sincerely,
FOFOA

PS. I realize there's a ton of stuff I only touched on here. I hope that Victor will grace us with his presence and his meticulous Thoughts. ;)

"Effect And Cause"

I guess you have to have a problem
If you want to invent a contraption
First you cause a train wreck
Then they put me in traction
Well first came an action
And then a reaction
But you can't switch around
For your own satisfaction
Well you burnt my house down
Then got mad at my reaction

Well in every complicated situation
There's a human relation
Making sense of it all
Takes a whole lot of concentration
Well you can blame the baby
For her pregnant ma
And if there's one of these unavoidable laws

It's just that you can't just take the effect and make it the cause

[Chorus:]
Well you can't take the effect
And make it the cause
I didn't rob a bank
Because you made up the law
Blame me for robbing Peter
But don't you blame Paul
Can't take the effect
And make it the cause

I ain't the reason that you gave me
No reason to return your call
You built a house of cards
And got shocked when you saw them fall
Well I ain't saying I'm innocent
In fact the reverse
But if your heading to the grave
You don't blame the hearse
You're like a little girl yelling at her brother
Cause you lost his ball

You keep blaming me for what you did
But that ain't all
The way you clean up a wreck
Is enough to give one pause
You seem to forget just how this song started
I'm reacting to you
Because you left me broken hearted

See you just can't just take the effect and make it the cause

[Chorus]

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victorthecleaner said...

FOFOA, thanks for advertising the article!

Here are some further details from my email exchange with FOFOA. Firstly, the puke indicator works! This fact is thanks to Lance Lewis. But then you need to understand why it works. And the conventional explanation that it is arbitrage because of a mispricing of GLD relative to spot, gives you the following conclusion:

The GLD inventory strategy works. Therefore it is apparently bullish if GLD investors sell and all other gold investors in aggregate buy. And because it is bearish if GLD investors buy, but all other gold investors sell.

Now this implies that GLD investors are dumb and all other gold investors are smart. This explanation certainly misses the point.

If not arbitrage because of a mispricing of GLD relative to spot, then what is it that drives the inventory changes? The only option left is that it is a decision of the AP. That's Randy Strauss' and FOFOAs point of view.

But then you cannot explain why the indicator works. Unless... and here is one of the emails I sent to FOFOA:

Good. I think we are converging.

So the major reason why the gold gets into GLD is because the BBs decided to put it there.

*But here comes the interesting question: The GLD puke indicator works. This means that during the 2-6 weeks after a puke, the *paper* price rises. We need to explain this.*

Assume a giant takes out so much physical that the BBs have to access GLD. Yesterday's 1.3% of GLD were about 15 tonnes. This is still small compared to the paper trading volume (600 tonnes per trading day). [VtC: I got this wrong. FOFOA put it straight. It is rather in excess of 2700 tonnes]

We agree that the 'gold' price is dominated by paper trading. If the hedge funds are all selling, the price will go down, even if our giant takes some physical.

So why does the paper gold price rise during the subsequent weeks?

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June 1, 2012 11:43 PM

victorthecleaner said...

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My picture is this: There are some buyers of physical who effectively have limit orders quite a bit below the day-to-day fluctuations of the 'gold' price. Normally, we don't see it when they are buying. But occasionally, when the price drops enough for one of these orders to execute at a moment in which one of the BBs is short of physical, the BB takes some gold out of GLD. These are the few occasions at which we see a trace of the giant buying.

Now take a look at Lance's bright blue picture. There is a staircase under the gold price. Since the fall *of 2011, the stair is at about $1550. Whenever the price drops to that level, GLD pukes (twice in Dec and yesterday). This is the level at which the giant is buying. (perhaps they are buying higher, too, but when the price drops to that level, they buy everything that's available)*

But why does the price rise after that? The physical taken by the giant is small compared to the day-to-day paper trading, and it is unrelated to all the speculative activity that drives the 'gold' price. Why does the paper price rise after the puke?

Think about your 'Today's "Gold"'. The main danger to the London bullion market is a drop of the paper price to such a low level that they lose too much physical.

But now that we have stated the problem, we also know how to solve it and how to defend the London market. Someone has to monitor the flow of physical. There is some flow coming in from mining and from scrap - that's probably pretty steady in terms of weight per day. And there is the outflow from physical buying. This is probably a steady amount of dollars per day. So if they see that they are losing too much physical, they can simply raise the paper price and thereby reduce the outflow of physical.

Is this the reason why the paper price rises after a puke?

How do they raise the paper price? There is basically only one way: Someone has to go long paper gold. Who? The Fed? ESF? Other CBs? Perhaps even the European CBs?

Funny, isn't it? And tell this to GATA: The Fed is buying paper gold in order to stabilize the bullion market. Hey, I want to see the looks on their faces when they figure this out.

Do you agree that if your picture of the puke is correct, that then the indicator can work only if there is some active management of the paper price?

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June 1, 2012 11:44 PM

victorthecleaner said...

The next question is do we have an idea **who** is managing the paper price up after a 'puke'?

I initially thought it might be some CB or government activity, but then I run the same analysis with silver and SLV, and although a bit weaker, the signal is still there.

Silver is odd because it is the only other commodity besides gold that is traded like a foreign currency. So it shares all the technical issues with the gold market. But if SLV pukes are also an effective signal (albeit at points in time that differ from the GLD pukes), then we need an explanation that does not invoke CBs or governments.

So the conclusion is that it is the BBs who somehow take the price up after the puke. Does it work without CB intervention?

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June 1, 2012 11:50 PM

victorthecleaner said...
The next part is a bit speculative, and I have not yet had time to confirm whether it is technically correct. But here is how the idea goes.

FOFOA pressed me to take the Loco London Liquidity Survey (Alchemist no 63) seriously. If you take these numbers literally, you see that during the first quarter of 2011, the LBMA members who responded to the survey, sold about 7500 tonnes of gold more OTC than they bought. So is looks as if they did enter a huge directional bet in the gold market. Short 7500 tonnes.

Of course, nobody is so stupid as to go outright short 7500 tonnes in a decade long bull market. So how can this number even make sense?

Here is the speculation: They do hedge this exposure. But they do this not in the OTC market for gold. Other options are, for example, they go long the COMEX, etc, i.e. gold investments outside the foreign exchange market.

Then you think about this, and, yes, they can hedge some exposure in the non-OTC paper gold markets, but 7500 tonnes still looks unrealistic (COMEX open interest is only about 1200 tonnes - and there are plenty of others there, too). So how the hell do they hedge it?

The only answer I can think of is that they hedge it by going long correlated (but not identical) assets. What's correlated with paper gold? Silver, copper, euros, crude oil, interest rates, yield curve spreads, whatever.

So now you have the mechanism for influencing the gold price. If you want to drive the price up, you just shift your hedge from correlated (but not identical) to actual gold investments.

Again, at this stage this is all speculation, and it needs independent confirmation that we are getting the liquidity survey right. In case this is correct, you can start thinking about how it will all blow up one day.

Victor

June 2, 2012 12:05 AM

victorthecleaner said...
Another remark on GOFO. You probably remember all the hiccups and hedge fund blow-ups during 1997-2001 reported during the original gold trail discussion. Each time, you can see GOFO spike towards negative territory (negative GOFO = backwardation in the OTC forward market indicates that someone desperately wants to borrow gold and is willing to pay a premium for this).

After 2002, there have been *no* significant GOFO events anymore. Not even November 2008 was as dramatic as the common disasters during 1997-2001.

(One thing, I think, that we know, is that the average numbers as reported on the LBMA website may be somewhat fudged - take a look at the 22,23 August 2011 example in my article)

But even with the few screenshots of the Reuters quotes that people kept, GOFO is rather tame these days. This may be because there is such a readily available reserve inside GLD. If you can easily and privately access GLD, why would you bid for a gold swap and let everyone with a Reuters data feed know that you are short of physical gold. The answer is you don't. You just take it out of GLD. What impresses me most is that they have always managed to replenish it - well, almost.

Finally, August 2011 might have been some sort of a panic. Perhaps some of the regularly buying giants were close to losing their temper. Hence the huge pukes. This may give you an idea of a threshold at which people become nervous.

Victor

June 2, 2012 1:05 AM

Edwardo said...
Thanks Victor, FOFOA and Costata for sharing.

So, the reserves of GLD peaked two years ago, and FOFOA conjectures that a large puke of 10% or more will amount to "game over".

It seems axiomatic, at least to me, that what we don't know far exceeds what we do. For example, and pardon the conspiratorial tone, but is it possible that there have been attempts to remove 10% or more of GLD's inventory that have been rebuffed via "negotiation." With that idea in mind I find it interesting that the two big pukes that occurred in August of 2011 happened near a major high (both temporally and in price) that nine months on remains unchallenged.

That action sits in stark contrast to the pukes that occurred at the major lows in 2008.

June 2, 2012 7:57 AM

FOFOA said...
Hello Edwardo,

"is it possible that there have been attempts to remove 10% or more of GLD's inventory that have been rebuffed via "negotiation."

I doubt it. You have to give physical to *everyone* who demands it to keep the game going. That's ***the*** key to the whole game!! If it's just one individual demanding 20 tonnes you can quell that threat with a Puke or a CB loan. I suppose it's possible to somehow talk someone out of their demand, but that would be a dangerous game to play. What you are powerless against is a run, a dramatic shift in physical demand. You can raise the price to stretch the flow, but you can't raise it too far too fast without actually causing that shift you most want to avoid. Remember this from ANOTHER?

"Gold has always been funny in that way. So many people worldwide think of it as money, it tends to dry up as the price rises."

On the other hand, you don't want it to fall too far too fast either because, apparently, there are some Giants out there who want the physical but who also know it is not in their best interest to run up the price. Like Victor said, *"There are some buyers of physical who effectively have limit orders quite a bit* *below the day-to-day fluctuations of the 'gold' price."* Another told us about something similar in the 90s:

"Well a funny thing happened right after the Gulf war ended. What looked like big money before turned out to be little money as some HK people, I'll call them "Big Trader" for short, moved in and started buying all the notes and physical the market offered. *The rub was that they only bought low, and lower and cheaper. They never ran the price and they never ran out of money.* Seeing this, some people (middle east) started to exchange their existing paper gold for the real stuff. From that time, early 1997 LBMA was running full speed just to stay in one spot! In other words paper volume had to increase to the physical volume on a worldwide scale, and that was going to be one hell of a jump. It could not be hidden from the news any longer.

This was not far from the time that "Big Trader" said that "if gold drops below $370 the world would see trading volume like never before seen". The rest is history. Now the CBs will have to sell 1/3 to 1/2 of their gold just to cover whats out there. To use the Queens English "it ain't gona happen dude"!"

I'm not saying that all Giants are CBs. They aren't. But some CBs do play with the BBs. I have a reader who is a FOREX trader and she sends me gold-related info that comes across her screen from time to time. On 5/23, the day after the Puke she sent me this which I shared with Victor:

"Hey FOFOA,

I hear on the wire today that there is at least one Asian Central Bank with bids in the interbank market for spot gold at $1525"

These emails she sends me are very infrequent. To give you an idea of the frequency, the last time she sent me any item of interest that came across her FOREX "wire" was October. Anyway, I was about to share with Victor a couple of her emails in which she explained this info she gets. But since it is relevant to the discussion at hand, I decided to share them with everyone. I hope she doesn't mind! ;)

9/14/11
Hi FOFOA,

I realise I didn't bother to tell you much about myself, but I am a currency trader and that is how I came across your blog.

Sometimes info comes across my desk to do with Central Banks hitting bids or offers in various forex pairs, like "word is, Singapore Sovereign Fund on the bid EURUSD below 1.365", or whatever. Today, for the first time in ages and ages (maybe since the $1000 mark) I got a wire about gold:

Cont…

June 2, 2012 4:11 PM

FOFOA said...
2/2

"Interbank reports China bid spot XAU $1815 into NY close, further bid interest expected from

same $1725-$1750."

Sometimes the wire will mention the size of bids or offers but not in this case. I'm not sure if info like this interests you, but let me know if it does and I will pass it on as it comes to light.

9/26/11
Hi FOFOA,

The interbank is what we refer to as the aggregate price posted by a bunch of banks, same way the spot forex market works. There is no single exchange and no single posted price, rather a bunch of bank run ECNs which aggregate against each other to provide a "best bid/offer". The best/well known examples are EBS, Currenex and Reuters D3

http://en.wikipedia.org/wiki/Electronic_Broking_Services
http://en.wikipedia.org/wiki/Reuters_3000_Xtra

Usually, on big market days and even most days, at the end of the day (NY close) traders with access go back over the nights action and try to match executed volume against order flow which they executed for clients or saw their buddies on another desk executing for clients, to help get a grasp on who was doing what in the previous days action. Sometimes traders will put stop or limit orders into the market directly, so you can see volume waiting before it's executed.

So as Tokyo opens you will often see wires like "Confirmed 3 yards executed USDJPY during London afternoon fix at 85.5" or as London opens "Sovereign buy stops located just above 1.5 EURUSD, small size, bigger at 1.5525" or similar (I just pulled those ones out of my arse for example purposes). A yard is 1 billion.

It isn't often you see such wires about interbank gold transactions.

As mentioned, before $1815 the last time I saw such a line (admittedly they might have occurred and I missed them) was in 2009 around the $1000 spot gold price.

So to clarify what I meant specifically:

On the interbank gold market last night, which is the gold equivalent of spot forex, there was very little volume. Certainly not enough volume to attribute to a large player. Large players may have been positioning themselves in gold through other markets, but not on the interbank market. As rumors about $1650 bids from a cachet of Asian Central Banks had been floating around ever since the original $1815 China bid was spotted, after the NY close traders looked very hard at the overnight interbank flows for signs of order execution by these same parties and came up with nothing. $1815 was a real bid (although who knows how long it was held for), but no bids materialised under $1750 from sovereigns, certainly not below $1650, in the interbank market.

I also noticed today there is a note from Goldman Sachs floating around the net about the recent price action in gold, and I will quote the appropriate section below:

"What we are seeing in the market place is high volume turnover on the exchange but extremely low liquidity and huge activity on the screens rather than in the OTC discretionary space where most of our counterparties have had very little risk in gold for several weeks. Interbank flows are almost extinct."

Sincerely,
FOFOA

June 2, 2012 4:14 PM

Michael H said...
Regarding 'synthetic hedges':

If the hypothesis that the BBs effect a gold price rise by replacing synthetic 'gold price correlated' hedges by actual paper gold, wouldn't this action cause losses for the BBs?

Example: BB has XXX short exposure to gold price so as part of the hedge they buy XX long oil price exposure. They need the gold price to rise so they sell X oil price and buy X gold price.

By selling X oil price, do they begin to break the correlation between the remaining XX in oil hedges and the gold price?

I.e. by unwinding part of their hedges are they eating losses on the remainder of their hedge.

June 2, 2012 7:47 PM

FOFOA said...
Hello Michael H,

Earlier Gary asked about the "needing/wanting issue". It's the dollar/BB side that *needs* the $PoG (paper gold) to rise so as to manage the flow of physical. Short exposure is a slam dunk to the BBs. They don't fear it one bit. As I said, it's more of a wonder (i.e. mystery) when the $PoG rises than when it falls, which is why it doesn't make sense to think that anyone is intentionally suppressing the $PoG. Here's some FOA from "A Clear Path" (3/2/00):

"From a Euroland viewpoint, the dollar no longer needed to be supported by a low gold price. With the Euro in place and holding a large portion of the world's new, non-currency "reserve asset" for support, ***they no longer had a reason to buy at $280 or sell at $480****. Indeed, they told the world they were backing out of the paper gold game with the Washington Agreement."*

So you're a BB, Michael, and you no longer have official support for a low (managed) price for *physical* to keep it in line with the price of your paper product, the $PoG. The other way to look at this is as if you are a bank who has just lost its CB backer, its lender of last resort. A bank with a lender of last resort doesn't need to manage the flow of reserves itself as its CB just steps in and floods the market with reserves when needed. Here's a bit from my post The View: A Classic Bank Run to set up this analogy:

"A bank can be "populated" with unallocated gold accounts in two primary ways. It can either be done as a physical deposit by a silly person or by another corporate entity, or else it can occur completely in the non-physical realm as a cashflow event whereby a customer with a surplus account of forex calls up and requests to exchange some or all of it for gold units, whereupon the bank acts as a broker/dealer to cover the deal – occurring and residing on the books as an accounting event among

counterparties rather than as any sort of physical purchase. No bread, no breadcrumbs, only a paper trail and metal of the mind. This is how the LBMA can report its mere subset of clearing volumes averaging in the neighborhood of 18 million ounces PER DAY. Just a whole lot of "unallocated gold" digital activity as an ongoing counterparty-squaring exercise.

It is here that I offer the eurodollar market as a very good parallel to the bullion sector of banking. While not a perfect parallel (for all the most obvious reasons) it provides a remarkably good bridge to help anyone who has a good footing on modern commercial banking to successfully cross over to that seemingly unfamiliar territory of "bullion banking". In fact, they need do little more to successfully cross over than to simply think of bullion banking ops as though they were eurodollar banking ops – the difference being that whereas eurodollar banking makes extra-sovereign use of the U.S. dollar as its accounting basis in international banking activities (thus outflanking New York's purview and restrictions), bullion banking engages in similar "extra-sovereign" use of gold ounces within its operational/accounting basis (thus outflanking and overrunning Mother Earth's domain and tangible restrictions)."

Cont…

June 3, 2012 12:09 AM

FOFOA said...

2/2

There's really no risk of paper gold rocketing to the moon. Unlike the real thing, paper gold can be quantitatively eased (expanded in volume) to meet demand, kind of like the dollar. The risk is an uncontrollable shift in demand from your paper to your reserves. To manage that risk, you must manage the flow of reserves.

You're a bank, so you never have any exchange rate or price exposure. You hired some Harvard PhD geeks to take care of that. You might have "short exposure" according to those annoying little gold bugs (why can't someone come up with an effective gold bug lamp?), but you're a bank, a master of the known and unknown universe, so you know better. Whatever your momentary exposure may be in that minute after one of your minions hangs up with a client, your black box takes care of it.

Most of your job is just "netting out" everyone else's transactions and then counting (and subsequently rolling around in) all the transaction fees. And your nifty black box nets these things out six ways to Sunday. If someone buys a dollar from you exposing you as short one dollar, that can be netted out against someone else selling you a dollar… or an almost infinite amount of other ways! A small part of your job is managing your net-exposure at the end of the day, and the even smaller, most annoying part is managing the flow of those stupid shiny rocks the dirty miners and blue-collar workers at the refinery ship to your vault.

Any net short exposure your black box spits out means you have net cash of one kind or another with which you can quickly eliminate that exposure by picking from the menu of choices your box spits out at the same time. If there's a net inflow of $5.4B with short gold exposure as there was in Q1 2011 according to the LBMA survey, there's no need to unwind anything that you already own. You just pick where you want to channel that inflow of cash. Some to the "gold" market (to manage the flow of physical) and the rest into whatever your black box says has a strong correlation.

If there's a net outflow of cash (or other stuff) leaving you with a net long exposure to shiny rocks, you could either short the "gold" market or simply unwind some other correlated long hedges. But if you want your precious $PoG to rise for those ever-annoying "reserve management" reasons, you obviously won't choose to short the "gold" market! You will instead be unwinding your other long hedges. And if you really want to give the "gold" market a boost (because of a Puke), why not unwind more than you need and pour that extra cash into COMEX?

You've just unwound your leveraged long in that other item which will now be temporarily less-correlated with gold because of your *UPWARD* manipulation of the (quote-unquote) "gold" price. And the best part is that since you are a master of the universe and you knew that gold would unexpectedly bounce up $70 (give or take) on Friday, you were able to let your black box know about it and he/she/it made the appropriate adjustments. All in a day's/week's work, and now back to rolling around in those fees.

Sincerely,
FOFOA

PS. Your Harvard PhD geeks never heard of Another, FOA or Freegold at Harvard, so that particular phat tail never made it into your unfortunate algorithm.

Tuesday, August 20, 2013

My Candid View – Part 7

Actual GLD Vault

> Hi FOFOA,
>
> Another question that I think has a decent chance of getting asked is something related to the repatriation of German gold.
>
> We are, of course, standing in a different place from the tidal wave whose narrative is "They don't have the gold and so they crashed da Market" to get their hands on cheap physical to replace that which they didn't have.
>
> My line in response to the conspiracy perspective would be that while a seven year delay for a return of one's gold does seem rather strange, there was no diplomatic furor from The Germans as a result. And if it was the intent of "the manipulators to sidestep some sort of catastrophic market event, driving the price of gold down below the cost of production amounted to swimming through croc infested waters in order to get out of the heat. Could "they" be that stupid? Possibly, but to paraphrase Victor, I don't like any theory that rests on such a premise.
>
> Cheers,
> Edwardo

Hello Edwardo,

What a mess these kinds of stories are to deal with. First of all, the price decline has nothing whatsoever to do with German gold repatriation, obviously.

As you know, I don't think anyone is actively trying to suppress paper gold. Short term price manipulation can happen in anything, and in any direction, but that's done for short term profits and not for ideology. And as you point out, the current price decline is probably not producing any extra physical because it is stifling the mines and probably increasing the flow to the East in weight terms. The suppression of gold was systemic and due to the expansion of the supply of paper gold backed by central bank guarantees from ~1983-1999. The suppression was for the purpose of buying time, and not for some CB anti-gold ideology. (For more on this, please see 'The View of the Rocket Man' video at the bottom of Part 3.)

In terms of "active suppression," I do think the BBs have control of how quickly paper gold rises given overwhelming demand. In other words, they have no problem handling high demand for paper gold. They can simply create more of it. They can expand the supply. So the rate of rise can be easily managed as long as there's strong market demand for their product, paper gold. It gets quite a bit more difficult to control the price, however, when there is low market demand for their product, especially with so much of it already out there. Kind of like dollars. ;D

I think this may be partly why "the top" in 2011 looked the way it did. The LBMA survey was coincidentally released ***right before the top***! The survey was released in August of 2011 and gold topped at $1,896 on Sept. 5, 2011, just days later. I wonder if they would have even released the survey if they had known that demand for their product was about to reverse trend.

The survey was conducted in Q1 of 2011 and it appears to show an expansion in paper gold during that quarter. This would be newly-issued paper gold amounting to more than 7,600 tonnes during a quarter in which the price of gold barely rose $35. Since this was near the top of the decade-long bull run, I can imagine demand being high and that some of it was met with new supply rather than old supply. Perhaps in Q3 demand was instead met entirely with old supply which is why we saw the price spike from $1,492 to $1,896 in one quarter. Then demand dropped out from under the massive supply and the BBs lost control.

It's kind of like the printer who has control of the rope as long as demand is pulling. Remember the tug-of-war analogy in 'Big Gap'?

"The printer controls supply and the marketplace controls demand. A tug-of-war is actually an apt analogy. When demand for a currency spikes its price, the printer just eases his grip on the rope, releases more rope and the whole demand side just falls on its butt. [...] But in the same way that the marketplace has no control over the supply side, the printer is powerless on the demand side."

Anyway, the point is that any kind of "active manipulation" talk is a non-starter for me unless the talker can demonstrate an understanding of what's actually possible and not simply parrot the conspiracy theories. When you understand what went down and what went up over the last year and a half, that was not manipulation. It was some kind of a massive shift in trader sentiment that has nothing to do with physical gold.

Sorry, enough about manipulation/suppression. Let's talk about German repatriation.

Only simple minds imagine that CBs share the same transitions concerns as we shrimps. I, on the other hand, understand that while "gold in your physical possession" is the best transition policy for shrimps, that is not the case even for private Giants, let alone CBs. At the Giant level, properly allocated physical is the best way to store the bulk of your hoard. I have a hard time imagining anyone with 20+ tonnes stored in a home safe.

For CBs, there are many reasons why their gold is where it is. During WWII Germany stole a lot of gold. A good deal of the European gold that wasn't stolen by Germany was moved to New York for safekeeping, so that it wouldn't be stolen by Germany. Then, after losing WWII, most of that stolen gold was taken away from Germany.

Since WWII, Germany has been a net-producer accumulating a lot of gold. And most of that accumulated gold was accumulated in New York City through Bretton Woods. That's why it's there. Nations generally keep at least some of their gold in the financial centers because that's where it is most useful. And under the auspices of the BIS, that's normally the safest place for it, especially for small countries.

If the gold is all kept at home, then it can disappear whenever there is a violent transfer of power. The gold obviously doesn't belong to the ruling party, it belongs to the people of the country, but that doesn't mean it cannot be physically stolen. However, if it is kept in London or NYC, it is much more difficult for the deposed party to make off with the loot.

There are, however, good reasons for Germany to want to repatriate some of its gold. First of all, it has a lot of it. And it certainly has more than necessary stored externally. But transporting gold is risky and dangerous. So it is always done in secret. Germany is probably doing more business with countries other than the US these days, more business in Europe and the East, so it doesn't make sense to keep so much of its gold on the North American continent. It is potentially more useful if it is physically in Europe.

But more than any of these reasons, the repatriation talk was simply a response to the gold bugs demanding to know where Germany's gold was being kept. So BUBA released a complete list of where it is, and since an inordinate amount was shown on that list to be in NYC, they accompanied the release with the repatriation talk.

We don't know if they really want their gold moved. And if they do, we don't really know if the US refused immediate delivery or if they asked for the 7-year plan. And even if they wanted and were to receive the gold within one year, it would make sense to say it was happening over 7 years. It's safer to transport a pre-announced shipment if you distract potential pirates with a bogus timeline. In any case, we really don't know all of the facts. We only know the theories of conspiracist gold bugs for whom this release was made in the first place. So, whatever.

I care about this story about as much as I imagine the Bundesbank does. It's more of an annoyance to be quelled than anything else.

Sorry if that doesn't help you much for the interview, but I had to get it off my chest since you asked. ;D

Sincerely,
FOFOA

> This article approximates quite well the "other" view:
>
> What If? by Grant Williams

Edwardo,

FWIW, I wrote that last reply before I even saw this email, let alone read the 'What If' article in it.

So the GLD drain is to get back the gold for German repatriation, and the price suppression is so the Fed doesn't have to pay too much for that gold? Something like that? ;D

How about this? Something else happened right around the middle point between those two lines. And that is the marginal paper gold bug, as represented by my bellwether, turned his back on the gold market and declared the end of the bull run and the beginning of a secular bull market for the dollar (aka deflation).

As each marginal gold bug throws in the towel, a new marginal gold bug is created, and then it's only a matter of time before he throws in the towel creating another new marginal gold bug. And so on and so forth. And the marginal gold bugs that don't throw in the towel simply get squashed because there are just too many commodities heading lower and dragging paper gold down with them.

These guys really must think that gold moves in isolation. Well, at least he admits he's inclusive when he adds the gratuitous "and silver" while quoting analysis by Maguire and Silver Doctors. ;D

There are a few redeeming ideas and charts in that article, so let's play with his scenario a bit and see if it makes any sense in the big picture without enlisting any conspiracy theories.

The main premise that he relies on is this CB leasing of physical gold that the CBs now want back. In order to have leased gold, you must also have a borrower of that gold. That is, someone who carries the short-side price exposure. In the 90s that borrower was the mines and the hedge funds. And they both took it in the keister when gold started rising in 2001. So from 2001-2011 there was not really a market for leased gold other than the small bit for fabrication, unless the CBs were acting as the lender of last resort for the BBs in providing actual physical reserves needed for the subterranean flow. This would imply a tight flow during that whole period. This would also have left the BBs with the short-side price exposure which they would have hedged going long futures or other correlated asset derivatives. This BB long hedging could have possibly been partial support for the decade-long commodity bull.

If this situation is in the process of unwinding right now, as the article proposes, then as the BBs return the physical to the CBs (taken out of GLD, Comex or wherever), they are relieving themselves of that price exposure and must consequently sell the off-setting long-side hedges, which would have been Comex futures and other correlated commodities/currencies, adding downward pressure to any otherwise organically-emergent bear market.

Let me just pause here to say that, even if this was the case, I would still say categorically that it has absolutely nothing to do with BUBA's repatriation request. At least it's not a response to BUBA. BUBA's announcement may, however, have been BUBA's way of telegraphing the ongoing unwind to anyone who might be paying attention.

One problem with this view is that somehow there was a surplus in the subterranean flow that amounted to at least 1,300 tonnes—the gold that went into GLD. Did the BBs borrow that gold from the CBs in order to corral some of the demand coming from the West? Perhaps, but it seems to me that that particular Western paper gold demand could have been met with fractional paper rather than fully-reserved paper. So this logic tells me that, somehow, the 1,300 tonnes that was accumulated between 2004 and 2010 (when GLD inventory plateaued) actually was surplus to the required physical flow. And if so, then it doesn't make sense to me that the BBs would be borrowing physical from the CBs between those years.

I can't explain the existence of that surplus during those years, except to say that it existed and therefore there must be an explanation. So I am left with imagining plausible explanations to show that it was possible. One such plausible explanation is that the BIS successfully kept the biggest interests out of the flow through some sort of deal-making like Another wrote about. But that kind of deal-making must have had a finite timeline which I wrote about in Think like a Giant 2. This coincides with Ari's 2010 "target" which then got pushed to 2013 after the GFC in 2008. This correlates with GLD inventory plateauing in 2010 and then declining in 2013.

Again, it's merely a plausible explanation to show that the surplus reserves required to build up GLD were possible even though the physical gold flow was technically "cornered" as far back as 1997. The alternative is the view in the 'What If' article that the CBs were leasing out more than just their good name all that time. I suppose it is also possible that, rather than leasing the physical to the BBs, the CBs could have actually ponied up the 1,300 tonnes for GLD directly. That way no one is carrying the short-side price exposure implicit in a lease during an obvious bull market. The CBs could have done that to "corral" the Western demand, but I think it is too much of a stretch to believe the source of that gold being the CBs could have been kept quiet. So I think it is more likely that it was BB gold that was checked into the coat-check room rather than CB gold. And if the BBs had that much gold to spare (that much slack in the flow rope), then why would they have been borrowing physical from the CBs?

The consensus view is that the gold in GLD was "purchased at market" to meet the demand from investors. Well, the BBs ***are*** the market in LGD bars so even if they "bought" the gold to put in GLD, they bought it from themselves. Ergo, coat-check room. No matter what, GLD represents a place to put gold that would otherwise be part of the BBs' physical reserves if it were not in GLD. And that's why the coat-check room view is the correct view.

The main difference in the conclusions drawn from the consensus view is that there is no shortage of physical and never was. There's plenty of it to always meet demand. But even in that view of plenitude, it would still be correct to view it as a coat-check room. Just that the checked coats (in that view) would represent only a small fraction of the *total* coats (physical reserves). And in order to maintain that view of plenitude even in light of the present drain on GLD, redemptions must be a necessary or obligatory part of the arbitrage that keeps GLD in line with "gold", which, of course, makes no sense.

Sorry to meander here, but I thought it would be worthwhile to think through a few ideas out loud, and, yep, turns out I'm still happy with my view. ;D

Sincerely,
FOFOA

> How is it the case that in order to have that view (of plenitude) redemptions must be obligatory?

Because in my view the massive redemptions reveal the opposite of plenitude. Redemptions are a choice made by someone, not a necessary part of the arbitrage "mechanism" as it were. "Obligatory" might be the wrong word as it implies that the APs must actively manage GLD so that it tracks "gold". The consensus view would argue that they are simply "arbing" to make a profit off of the stupid GLD investors who don't watch the NAV (the price of GLD relative to "gold"). So (they would say) it's not so much obligatory as it's simply a way to make money.

My answer would be that I used the term "obligatory" (or compulsory) to cover both "the AP actively managing scenario" as well as "the arb requires redemption scenario" which is the crux of the consensus view. That's really what the difference boils down to. Would GLD track "gold" if it weren't for the arbs creating and redeeming shares to skim a profit off of the stupid GLD investors? The answer is of course it would. I does!!! Kind of like silver tracks gold. GLD is not an actively managed fund. Instead, it is an **exchange traded fund**. That means participants in the exchange arb the correlation between GLD and everything else.

Arbitrage is natural. It mostly happens automatically. A dedicated arbitrageur probably wouldn't even mess with GLD because it tracks everything else so well. He's looking for ratios that are technically exploding past fundamental differences so that he can make a profit. If hundreds of thousands of people are trading GLD and "gold", then the ratio between the two should be self-correcting over a reasonable amount of time… **AND IT IS!!!** This graph of the intraday premiums and discounts shows it self-correcting repeatedly during the day, every day!

We have evidence in the data that creations and redemptions of shares are not necessarily a part of this mechanism. Logically they are not, because GLD could theoretically trade at $500/oz. gold or $5,000/oz. gold with the same amount of inventory. It has an objective or indicated value, and to the BBs the shares are literally "as good as gold." Think about that.

So if there's plenty of gold reserves in the LBMA, then why are the BBs draining GLD? The consensus view says "because they need to redeem the shares to book the profit on the arb that maintains the correlation between GLD and "gold"." Nonsense!

Sincerely,
FOFOA

> *"So from 2001-2011 there was not really a market for leased gold other than the small bit for fabrication, unless the CBs were acting as the lender of last resort for the BBs in providing actual physical reserves needed for the subterranean flow. This would imply a tight flow during that whole period."*
>
> Well, we have a pretty good idea that there was a tight flow then. I remember discussing this with JR on the forum and him saying the constantly rising price was evidence of gold not flowing well, ergo the ever rising price being required to keep the flow going.

Well, the prices of silver and other commodities went up too. But we know that physical gold is in a league of its own, so I think it might have been a mistake to think that the "gold bull market" was a symptom of the shortage of physical gold (or silver or anything else). It probably helped the physical gold shortage, but it might not have been *because* of it.

I'm not saying there wasn't a shortage of physical. I think that, because the flow of physical has been "cornered" for at least 16 years, obviously there is a shortage until there is a revaluation. But I'm also saying that something *other than* the price rise must have delayed the inevitable because obviously there was a "surplus" in the flow of at least 1,300 tonnes from 2004-2010—enough to populate GLD with physical gold.

That's not a huge "surplus" in the big scheme of things. If we think about a roughly 4,000 tonne-per-year flow from mining and scrap during those six years, 1,300 tonnes total amounts to only about 5% of that "new" flow. That's a marginal percentage, so whatever took care of the threatening physical demand could have easily overshot enough to fill GLD with or without intention.

BTW, I hope you realize that I am discussing speculative issues at the "cutting edge" of Freegold that are not fundamental nor foundational to Freegold. I am simply using my "view" or "lens" to tease out the best explanation, or at least a non-contradictory one. That's why I use the term "plausible" instead of the occasional "certainty" I show toward Freegold. Certainty doesn't extend beyond the gold revaluation or dollar hyperinflation. Beyond those two topics I'm venturing into analytically speculative topics trying to apply that in which I have high degree of confidence to those things which are obviously unknown, in the attempt to discover a plausible and non-contradictory explanation.

Some people mistakenly apply my "certainty" toward Freegold to anything I comment on. And then they think that if they can disprove me on any small detail then my macro view must be wrong as well. This reveals poor understanding of what I'm discussing, but it is rampant in my arena, which is why I don't spend much time speculating publicly about things other than what is covered in the A/FOA archives.

> Yes, I understand. The naysayers are always on the lookout to catch anyone else who has the temerity to do what you are doing.

Funny, I read this article that someone called "straight out of Freegold" and, to me at least, his choice of words and phrases revealed just how far away from Freegold he really is!

http://dailyreckoning.com/your-personal-gold-standard/

He's clearly not expecting a gold revaluation:

*"And gold at the levels I'm talking about would mean that you've now verged into hyperinflation, or something close to it, because **nothing happens in isolation**."*

He's clearly talking about an inflationary spike that will occur in all commodities and not exclude paper gold:

"It will have a kind of a slow grind upward… and then a spike… and then another spike… and then a super-spike. The whole thing could happen in a matter of 90 days — six months at the most."

I find it a little funny that people want so badly for someone like him to be a secret Freegolder that they are blind to how different his analysis actually is.

It reminds me of XXXXXX. He, like Rickards, expects the dollar to devalue and gold to fill the hole. But neither one seems to have thought it through far enough to realize that nothing fills the hole without at least one thing being revalued in isolation.

Rickards: ***nothing happens in isolation.***

I'll have to remember that one! ;D

> I completely agree. Good catch with the isolation language. He was wrong before the words ever escaped his

mouth since we've already had a revaluation (isolated move higher) (1933) albeit a vastly less spectacular and meaningful one than what lies ahead.