One more sell-off in the gold and silver before we will take off, the weak hands are getting out

The surprise “no tapering” decision of the Fed basically means that the economy is not growing whilst Pimco’s Gross believes it is a handoff to Yellen. If Gross is right you have to wonder what is more important the economy or Yellen! Anyway if is Yellen she will need it! The no tapering confirms my view that the economy is fragile, it doesn’t have any traction, there is no sustainability, the stimulus has no effect, in fact it is becoming counter productive. In short the Fed is #$@%&* scared what higher rates could do to the economy. And as a result of the unexpected Fed’s decision we saw the ultimate risk assets move strongly, gold surged $61.70, or 4.7%, to settle at $1,369.30 an ounce on the New York Mercantile Exchange, marking its highest close since September 9. The gains were the largest for a single session since early 2009. Silver posted its biggest rally in almost five years with its climb of 8%.

It's not so much the fact that the Fed is continuing QE. It's the message that's being sent, which is that the underlying economy is so bad that we can't taper $10bn or $15bn. In my point of view the no tapering forcing interest rates lower momentarily will give (foreign) bondholders a great opportunity to get out. Moreover how much more can you dilute the currency or reduce its purchasing power. Watch the 10y interest rates in the next couple of days, if rates rise again back to the 2.9% area you will know!

Don’t forget the Fed has purchased and now holds 49% of all US Treasury bonds outstanding with a maturity of 10-15 years. The question thus begs for how long can this artificial situation go on before something is going to give in a very severe way.

That means that you want insure yourself owning physical gold and silver, financial assets without counter party risk, to protect yourself for when the chickens are coming home to roost. People justifying a PE expansion for the record US stock market, in an economy that is not improving, being the investment asset class of last resort doesn’t give me a good feeling.

As hedge fund pro Stanley Druckenmiller told CNBC the Federal Reserve lost its chance for a "freebie" by deciding not to begin scaling back its $85-billion-a-month bond-buying program because the markets had already factored in the taper.

The stock market move to record highs on the Fed's inaction is great for the rich, but the wealth effect of quantitative easing bond purchases will be negative after the exit, he argued. "This is the biggest redistribution of wealth from the middle class and the poor to the rich ever. Who owns assets—the rich, the billionaires."

But for now, "it's great for gold on an intermediate basis," he predicted. "And it's great for risk assets. At some point it will end, 1999-2000 ended. I don't know when this will end. I think the risk-reward is pretty good for risk assets."

Here below I will elaborate my line of thought favoring gold and silver.

The pressure on Central Banks to come clean on their gold holdings is increasing

If the Libor manipulation could be continued for 15-20 years, orchestrated by the major banks, why wouldn’t it be possible that the gold and silver are influenced with the backing of the Treasury and the Fed in order to try to demonetize gold. Hence why the Western central banks, with the BOE (Bank of England) as the most sheepish example, have been selling gold whilst the central banks of the emerging countries have been accumulating gold. It is established world versus the new emerging world, it is debt laden countries vis a vis surplus countries, it is paper money which is printed ad infinitum versus real money that has to be mined. By the way next to the Germans (2020 delivery from the NY Fed) and the Polish there seems to be now also a movement developing in Finland to repatriate their 49.1tonnes of gold stored for the most part at the BOE (Bank of England). Anyhow it is clear to me that we could soon see that "The emperor (BOE) has no clothes" with all its consequences. Imagine what will happen if the central banks don't have the gold they have been warehousing for other countries! Think what that will do to the credibility of the monetary institutions and system! In that case wouldn't it be ironically that the central banks (who need to supervise the banks and the financial system) could cause the next financial disaster instead of the commercial/investment banks! Thin how "precaire" this situation potentially could be.

The central banks that are demanding their gold back are probably rebuffed with the statement that if they want to have it back immediately that they will create a financial Armageddon which would result in a severe worldwide depression which would also affect their country with all its consequences. So what are the options left but to accept the conditions dictated by the central banks that have "stored" the gold. Does the 2020 delivery of the Bundesbank's gold sound familiar! Though be aware that you just need one "rogue" player who doesn't buy the BS they get to hear and all the trust in the central banks would be gone.

When the weak hands are out we will see the mother of all rallies

Especially since the bear raid on gold in April physical demand has taken off and in particular in the Far East. Whilst the West is mainly characterized by short-term gold speculation/trading using futures (paper gold and silver) China, India, Indonesia and other Far Eastern countries are mostly interested in the long-term or physical gold. It is the difference between the so-called weak hands and strong hands. It is the difference between investors that are not really committed to holding gold and silver for the long term and are just interested in making a paper profit or that will sell or have to sell their gold and silver when the markets move adversely. The strong hands will hold on to their physical gold because of what it represents, an insurance against the irresponsible monetary policies and the potential consequences for the financial system. They don't buy paper gold because of its counter party risk, which defies the real purpose of holding physical gold and silver in the first place.

My points is that these bear raids are making the case for a sustained rally, the strongest we will see so far, more and more likely. Because more and more strong hands, convinced investors (long-term and thus physical investors) are buying physical gold and silver because they regard the gold and silver prices as very cheap. And what is their yardstick for cheap? It is their conviction, intuition that things don't add up n'importe quai what Governments and their statistics are saying. So when most of the gold and silver is in strong hands short sellers will be easily taken to the cleaners because there will be hardly any supply.

Next to that most likely the Western central banks will have to restock their inventories in order to deliver the gold to the central banks they have been a custodian for. Surely under these circumstances of a tight gold market and the risk that you can't get your hands on the physical gold Germany, Poland and Finland will not be satisfied with paper money. Next to that the Chinese, and other emerging countries, are continuing to increase their gold reserves at an accelerated pace. Chinese imports for the first half were up 54% to 706 tonnes whilst for July alone they were up 70% to 129 tonnes totaling 835 tonnes for the first 7 months. China consumed 832.18 tonnes in all of 2012. China's government has urged national gold producers to boost the development of overseas resources in neighboring countries and Africa and Latin America, according to its 12th Five-Year Plan, which ends in 2015!

Goldman's forecast of gold at $1,000 or less makes them no less eager to accumulate physical gold

According to a report on Bloomberg, Goldman's head of commodities research, Jeffery Currie suggested that gold could see further declines as the U.S. Fed gradually withdraws stimulus (tapering) , which it didn't, and as economic data is seen to improve, which is doesn't, which would result in higher interest rates. I believe the higher interest rates will happen anyway because it offers bond investors a way out. Bloomberg quotes Currie as saying "While we agree with the mid-cycle price somewhere around $1,200, we believe that at least near term it can overshoot to the downside, which is why we have $1,050 as a target... It clearly could trade below $1,000." This could put about 60% or more of the world's gold mines into the red! All-in costs per ounce of gold are believed to be between $1,100 and $1,300.

The state of affairs with forecasts from mega players like Goldman Sachs is that their prophecies can become self-fulfilling given their dominance of the investment-banking sector. Goldman's infamous "sell gold short instead of just sell" call in April just before 400 tonnes of gold were sold in the futures market on the lightest moment of trading on a Sunday evening was what could be interpreted as possibly one of the best "calls" in gold.

Though what do we see when the full details of Goldman's holdings were released for Q2, Goldman Sachs added 3.7 million GLD 'shares'. As Paulson dumped his GLD, Goldman used the opportunity to amass the GLD ETF to become the ETF's 7th largest holder. And thus from the sequence of events it could be concluded that Goldman Sachs despite its negative forecast for the gold price probably favors gold. Don't forget gold futures are for short-term investors whilst physical gold is accumulated by long-term investors.

Anyway different from Goldman HSBC Global research has a different forecast for the gold price. The global bank points rightly to physical demand for gold as a key driver in the months ahead and has lifted its gold price prediction for the current year to $1,446 an ounce from its prior forecast of $1,396 and is looking for an unchanged forecast of $1,435 for 2014.

Do gold futures still have the right of existence, a raison d'etre, if the Comex warehouse is empty?

Paper gold and silver are losing their right of existence by the sheer fact that the inventories in the Comex are being depleted at a rapid space as a result of futures investors requiring physical delivery. The difference between the paper gold futures contracts with inherent counter-party risk (the ability of your counter-party to deliver the physical gold) will become very obvious versus the no counter party risk bearing

back up the delivery demand in kind from the exercise of a future contract. In general it could be argued that the value of a paper contract on the Comex (future) is derived from or backed by an underlying tangible commodity.

If you don't have the physical gold you don't have anything!!! That depends of course of the phase of the disintegration of the markets we will be in if the paper money is still worth the nominal value or purchasing power it represents. Paper money and physical gold are each other's opposites. Therefor we have to ask ourselves when gold goes to $2,500-$3,000 and silver goes to $150-$250 what the value of the US dollar is and if this "benchmark" of valuation, the US dollar, is worth the paper it is written on. What I am trying to say is that at one stage the expression of gold in dollars doesn't have any relevance anymore and gold and silver owners will not sell their gold and silver for US dollars any longer. Why would you sell gold and silver for something that is perceived to have no value or purchasing power no longer! In other words the label of general accepted currency has moved on from the US dollar to gold.

There is no reason for gold to go up in price if the US dollar is strong hence its inverse correlation

Gold represents the ultimate manifestation between the value of paper money and the value of real money. As mentioned in earlier blogs there is no reason for gold to go up in price if the US dollar is strong and visa versa hence its inverse correlation. Gold will only shine in the limelight when there is something wrong with reserve currency. And "we all know" the US dollar and the state of the US economy are not strong next to that the debt levels are getting out of control and have passed the tipping point. As a result the spill or anchor currency, **the paper (US dollar) tiger**, is losing purchasing power (very difficult to register or acknowledge when it happens gradually) hence the increases in the gold and silver prices. The recent price declines in gold and silver in my point of view can therefore be interpreted as purely a temporary action to prevent showing the weakness, devaluation and demonetization of the US dollar. And in my opinion this view is strengthened by the fact that this has and is continuing to trigger strong physical buying despite increasing interest rates. The 10y interest rate before the tapering decision was 2.90% which fell to 2.67% after the “no tapering” decision has since then climbed back to 2.77% on Friday morning September 20!

That historically low interest rates don’t pose a threat doesn’t hold ground!

I would like to emphasize a point here that I think is often misunderstood. On CNBC we often hear the argument that interest rates are still at historically low levels of approximately 3% and therefore shouldn’t represent a big threat to the economy. Though in my point of view this doesn’t hold ground because as usual a lot of people don’t put things into context. The factors that here are overlooked are: **(1)** that when the 10-y yield will break out of its 32 year downtrend at 3.75%-4% violent upward movements in the rates can be expected because the whole world holds 10 y treasuries and everybody would want to get out treasuries at those levels. Imagine the massacre! **(2)** Next to that the debt levels in 2013 are much higher than in 2007, the world debt levels ($200trn+) can’t afford higher interest rates. See what happened in India because of a perceived tapering. **(3)** There is hardly any economic growth worldwide. The emerging markets have run into the limits of what their infrastructure can tolerate. Whilst the economic growth of the developed markets is being held back by their debt levels and entitlement payments that have passed the tipping point. (4) Next to that one of the cornerstones of the economy, the housing market, is not improving!! How can 50% cash buying, house flipping (buy/sell within 6 months) following price rises of 15%+, homeownership at 18 year lows and private equity firms buying home portfolios for securitization be regarded as a healthy stable housing market?

For me the artificial housing market in the US brings similarities with the Chinese GDP calculation to the fore, which uses production/construction instead of sales as final measurement for GDP contribution. In other words, for example condos when they are constructed, mainly done by the Government, are considered GDP instead of when they are sold!! Hence why we have all these empty ghost cities in China, which “boost GDP growth to 7.5%”. Anyway you get the gist real estate is a contentious area in many places in the world. By the way Europe is not in a much better place with respect to the state of its real estate. And be aware how important real estate is for the whole economy in terms of the wealth effect, lending, consumer spending etc etc.

Anyway I believe we are getting in the phase of whereby it is not the return on your money you have to be concerned about but the return of your money. It is not any longer an issue of what your assets yield (you can hardly speak of yield except perhaps for equities) but the preservation of your capital or purchasing power unless you believe in fairy tales. Forget about yield this concept is long gone! Investors have to change their conceptual thinking.

So the question begs where should investors park their money to preserve their capital when we see interest rates breaking out (interest rates are rising again after the no tapering decision)?

A lot of investors are divided if we will face inflation/hyperinflation or deflation. **Inflation** reduces the real value of money (reduced purchasing power) over time (inflation is hardly recognizable and only visible looking backward); conversely, **deflation** increases the real value of money (increased purchasing power) allowing one to buy more goods with the same amount of money over time. Deflation also increases the real value of debt (of which we, governments and households, have too much), and is likely to aggravate recessions leading to a deflationary spiral, which in turn results in a depression, which amongst other things ensues in more deleveraging. And deleveraging leads to the selling of assets, which puts downward pressure on prices and so forth. Next to that a lot of people hold off on purchasing goods in anticipation of lower prices. **Hyperinflation** occurs when a country experiences very high and usually accelerating rates of inflation over a short period of time. The general price level of goods and assets within an economy increases rapidly and recognizable as the official currency quickly loses its real value i.e. the purchasing power of the currency is getting reduced so quickly that citizens are basically forced to hold tangible assets. This often leads to barter trade because the currency has lost its function as a medium of exchange next to having lost its function as a store of value.

Deflation is most likely

Well in any case at present we probably have a combination of inflation and deflation and time will tell who of the two will win. And in general gold and silver should do well in both situations. We know that gold is an inflation hedge but it also is a deflation hedge especially if and when the currency of country becomes worthless as a result of a debt implosion and the inability of a country to meet its debt payments (Argentina).

As we have been witnessing the QEs are not working, there is no velocity of money as we have run into the limitations of what our societies can bear. Taking everything into account deflation, in my point of view, is the most likely scenario, with no economic growth of any magnitude, following the $3trn+ QE, to account for in a situation where probably $15-$20 of stimulus is needed to generate $1 of GDP growth. Clearly counter-productive!

When we have deflation cash becomes worth more but so does debt so what happens to the currency?

When we experience a collapse everything goes down but some assets go down more in price than others. When interest rates rise (which is the more likely when interest rates are at historical lows) the debt market will implode as a result of which asset values will collapse. As mentioned before in general it is best to hold cash especially in times of deflation. Though the key question begs: what kind of cash and in which form? And the main issue that comes to the fore here which we have to address is the issue of counter–party risk especially considering the enormous unsustainable debts. And we know what will happen to debt, the opposite of cash, in a deflationary spiral. Cash becomes worth more but so is debt! And in a shrinking economy (low or negative velocity of money) with increasing unemployment these debts will lead to massive write-downs, bankruptcies and BANKruptcies!

For instance, one could hold its cash in bank deposits though one should be aware that the moment you deposit cash in a bank your status changes from owner of cash to a creditor of the bank. We just witnessed Cyprus as an example of what can happen. Although different banks have different ratings we shouldn’t forget that all banks are interconnected through all the bonds and corporate debt they hold as well as all economies are interconnected through their currencies. In other words the whole world has never been as intertwined as before. And thus don’t be surprised if a lot of banks would fall over because a 5-9% equity ratio is not going to do the trick in preventing failures. The ripple effect, accelerated by the astronomical amount of derivatives outstanding, will hit everybody's bank account. In other words whilst you might think you have millions of dollars in your account, and that applies to individuals and corporates ($1.5trn+ in cash), but if the bank falls over you are one amongst many other creditors! Don't forget. Anyway the main question is "why have a bank account" when the $#@%*& hits the fan, you could lose everything or you will get a strongly reduced currency in return? Does holding physical gold or silver or gold or silver mining companies start to make sense?

With the US dollar losing its purchasing power China is accelerating its gold purchases

Although the US dollar seems to be holding up I pointed out in this article and more specific in my two last articles **"Part I and II: Chinese gold purchases, in preparation for the adoption of the gold standard, are starting to have a dramatic impact on the gold price."** that the purchasing value of the US dollar is rapidly losing its value in favor of gold and silver. Who has the gold has the power (you can have aircraft carriers but you still have to pay the Navy). It is the loss of purchasing power of the reserve currency why the Chinese and other emerging country central banks (mainly in the Far East) and their citizens are accumulating gold as never before thereby challenging, "the unrealistic lower gold and silver prices caused by futures maneuverings in the West"!

Gold is replacing the US dollar as the standard and capital gains and losses of gold are replacing interest

Another way of looking at the current situation is to start acknowledging gold as the standard, the benchmark against which you measure everything else such as risk and valuation. In that case when the gold price in dollars is down it would mean that the dollar is up and visa versa. In other words the US dollar and its interest rates are no longer the ruling standard but gold. Interest paid on treasuries can in the case for gold be translated in price rises (inflationary) or price declines (deflationary) of the gold price. Yield is being replaced by capital gains.

Moreover gold and silver are the only currencies that are not or cannot be diluted. Gold and silver can't just be printed out of just thin air, unlike the US dollar, the Euro and the Yen, and because their real value is being determined by the mining costs, efforts made by miners digging every ounce of gold and every ounce of silver out of the ground. In other words the idea of looking at gold as the standard is not so far fetched or outlandish. My point is that investors might have to look at gold in a different way. As previously mentioned gold would not have gone up so much if the US dollar and the US economy would be strong. Investors have to get off the idea that gold doesn't generate a return it delivers a return in the form of capital gains of the underlying gold price.

Next to that it should be well understood that gold only comes to the fore when it needs to "rescue" the financial system, in other words under very special circumstances. Gold doesn't need to generate a return because it is real money it corrects for inflation by showing capital gains and losses of the underlying gold. Paper money yields interest because it doesn't has intrinsic value and needs to be “corrected” for inflation hence interest payments. The value of the paper money and the level of interest rates are mainly determined by the strength and weakness of the economy and credibility of the monetary and political authorities. Though at present the circumstances are not normal, as stated before we are at the end of an era, which will mean that we are in for a huge transformation of our societies, as we know them.

Conclusion: the current gold and silver price declines will offer the buying opportunity of a lifetime preserving your capital

Concluding, many people believe that cash and bonds are unattractive and that the US stock market is the only place left to invest in. Though going forward help me, where is the growth going to come from? China is not growing at 7.5%, Chinese statistics, as portrayed by its rulers, are known to be highly unreliable. Neither are the other BRIC countries showing the growth figures they showed over the last 5 years. Europe hasn’t seen the worst yet although a lot people believe so. And we know that the South American engine has also stalled. The US is believed to be growing at 2%+ though company top line growth figures are disappointing to say it at the least. Forecasts are being downgraded continuously.

Next to that interest rates are clearly on the rise because investors are selling, ask Pimco how many redemptions it has seen recently, because investors don’t want to wait till the 32 year decline in interest rates is over and interests brake out of their long term range. Beside that the Syrian standoff is definitely not over. You have to ask yourself is someone who uses gas against his own people will suddenly listen to the demands and conditions of the US, their arch enemy. Think again; would you if you would be in Assad’s position? He is asking the West, the US, for $1bn to destroy the chemical weapons. I didn’t know he had a sense of humor!

On another note China’s purchases in July were 129 tonnes 70%!!! higher than the 75.8 tonnes in the same month last year, according to the data from the Hong Kong Census and Statistics Department. I should be emphasized that Mainland China doesn’t publish such data. In the first six-month China’s gold purchases were up 54% to 706 tonnes. 2013 worldwide mine production is forecast at some 2,750tonnes. China, India (citizens) and Russia could account for 80% of global mine production in 2013.

Anyway I believe that there are a lot of factors indicating that we are getting very close to a very strong rally of gold and silver. Look at the MACD of the monthly charts for gold and silver and imagine what could happen when the MACD turns positive again.

Like the Chinese, the Indians are buying more and more gold (now also silver as the proxy of gold) as a hedge against inflation and the weak economy. Gold and silver are shifting from weak hands (the West) to strong hands (the East). Comex inventories are being depleted. Central banks want their gold repatriated (Germany, Poland, Finland).

Whilst gold and silver are declining again despite the no-tapering, gold could chart technically go to $1,050 and possibly $700 and silver's support can be seen at $15, they will offer the investment of a lifetime because I don't exclude that we could see gold at $2,500 and silver at $100 next year. Most investment options are looking to be exhausted. We are entering the phase of preserving capital!

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