"GOLD IS PALE BECAUSE IT HAS SO MANY THIEVES PLOTTING AGAINST IT"

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25 years ago I visited Comex at the World Trade Center, watching the feverish activity in the gold pit from behind the glass wall in the gallery. A gentleman standing next, unknown to me, remarked: "One day this make-believe charade will come to a bad end. All that these guys are doing down there is creating ever more claims to the same lump of gold — just as governments have been doing before they met their ignominious fate."

Later that day I went to see the Director of Research of Comex. During our chat that lasted about an hour he intimated that he was greatly disturbed by the mystery that the gold basis has been steadily declining year in and year out. Perhaps it was the fact that he could not solve the puzzle that bothered him so much that he quit his job a few months later.

I must confess that I could not solve that puzzle myself until the Twin Towers of the World Trade Center came tumbling down many years later. For me it was a symbolic event, conjuring up the unknown gentleman and bringing back his cryptic remark. We are watching a game of musical chairs. When the music stops, paper claims to gold will be dishonored, and the gold futures markets will tumble down just like the Twin Towers.

In my earlier article *The Dress Rehearsal for the Last Contango* I observed that "a very strange phenomenon has been manifesting itself during the past thirty-five years, since the inception of gold futures trading. The basis as a percentage of the rate of interest, rather than remaining constant, has been vanishing and, by now, it has dropped to zero." In the rest of that article I drew

* The title is a quotation from Diogenes Laertius (fl. 2nd century A.D.)
This was the favorite quotation of the late Chicago economist and gold expert Melchior Palyi.

attention to the apocalyptic consequences of the prospect of permanent backwardation in gold threatening the world, which is completely ignored by the makers of monetary policy, as I had opportunity to convince myself during my recent encounter with Paul Volcker, the Chairman of President Obama's Economic Recovery Advisory Board. As I see it, the Debt Tower will topple, just as the Twin Towers of the World Trade center have, when hit by permanent gold backwardation. The reason is that the availability of gold is absolutely indispensable for maintaining our system of irredeemable debt. Only then will bondholders, like the participants of the game of musical chairs, be satisfied that there is a goodly number of vacant chairs available, so let's get on with bond trading, gold futures trading, and let the music roar on.

But once permanent backwardation in gold establishes itself, gold is no longer available at any price. Bondholders will scramble to sell their irredeemable bonds before they lose all their remaining value. There is no other way to pacify bondholders than letting the game of musical chairs go on, that is, continue the charade of gold futures trading putting ever more claims on the same lump of gold.

The response to my article was overwhelming. I have never realized how many people out there are following my writings on the internet so closely. I want to thank every one of you and assure you that I take this responsibility most seriously. Even if I cannot answer every message I get from you individually, I will continue to do my best to explain the results of my research in simple, understandable terms.

Let me spell out for my readers what the vanishing of the gold basis means from the point of view of the puppet-masters of the gold futures markets. It means that they are fighting a losing battle. They are desperately trying to coax gold out of hiding by offering ever higher bribes — not in terms of the price but in terms of the basis. A low basis means that they offer to take your cash gold and let you have gold futures in exchange at a discount price. (The discount is contango minus the basis, so that the two are inversely related: as the basis falls, the discount increases.) This will allow you to invest an amount equal to the price of gold (less five percent, the margin on the gold future) in any way you want and, having paid the reduced contango, you can keep the profits. The point is that you will still benefit from any advance in the gold price, same as you would if you owned cash gold. *You can have your cake and eat it*. Remember, in a full carrying charge market, such as the gold futures markets were at inception, no such bribe money was offered.

But, lo and behold, people who are willing to take the bribe are few and far in between. So the pot is sweetened. The basis is lowered. Maybe at one point gold will be coaxed out of hiding, once the bribe is high enough.

No such luck. When the basis gets as low as zero, it means that the discount on gold futures has gone so high that it is equal to the opportunity cost of holding gold. Therefore, again, if you give up your cash gold in exchange for gold futures, you can invest an amount equal to the price of gold (less five percent) in any way you wish, but now they let you *keep your profit in its entirety.* And you can still benefit from any advance in the gold price, same as you would if you had the cash gold in your hands.

This is where we are now. Indications are that the game fish still does not bite. What now? Where do the futures markets in gold go from here? Well, the pot can be further sweetened. The basis can be pushed down into negative territory. Gold could be forced into backwardation. Let's see what that means. It means that you can sell cash gold and *buy it back for future delivery at an outright discount.* Somebody wants your gold so badly that he is willing to pay you for the privilege of holding it for a few days, few weeks, few months paying your storage and insurance fees. You get your gold back at a cheaper price. *You make a risk-free profit on this deal.* If the gold price goes up in the meantime, you benefit fully, just as if you have held on to the cash gold.

Now risk-free profits are a promise of *unlimited* profits because, if you are nimble enough, then you can make any number of round trips. However, opportunities to earn risk-free profits from arbitrage do not last. Other nimble speculators would jump in and their unlimited action would close the spread that gave rise to the risk-free profit in the first place. Yet I predict that, after a period of initial vacillation between backwardation and contango (due to action by misinformed traders) gold will settle in permanent backwardation.

Wouldn't that be loverly? Risk-free profits galore. No need to bother with storage charges and insurance premiums. Just sit back and enjoy the ride to riches.

But hey, wait a minute! Is the arbitrage *really* risk-free? You give up your cash gold, but what if your gold futures contract expires and they refuse to return your gold? Commodity markets can change the rules of the game mid-stream. They just declare 'cash settlement only' for outstanding contracts. Unsaid and unstated, not even mentioned in small print, is the fact that the trap door may be slammed shut. The investor who has taken the bribe is neatly separated from his gold when the hairy godfather waves his magic wand. "*Gold is pale because it has so many thieves plotting against it*." There are all too many trap doors, sprung wide open, ready to devour gold belonging to the unweary.

That's it. That's why more people do not fall for the bribe even when tickled with promises of risk-free profits. The promise is mendacious. There is a risk: the risk that you lose your gold and you may *never be able to buy it back at any price*. There is no other explanation for the fact that the promise of risk free profits does not eliminate the discount on the futures price of gold. This is the true explanation for the coming permanent backwardation in gold.

Gold futures trading is clearly a con-game, but it is in a symbiotic relation with the regime of irredeemable currency and irredeemable debt, on which our 'democracy' is based. So we have a double con-game. We have a smaller con-game of gold future trading inflicted upon gullible people who want to have their cake and eat it and, then, we have the much bigger, all-embracing con-game of irredeemable currency, inflicted upon the rest of us, innocent bystanders. It is inflicted by the United States government that stoops so low as to trample on the Constitution mandating a metallic monetary system for this country precisely in order to outlaw all Ponzi-schemes. The government could never muster the moral courage to propose an Amendment that would make the Constitution conform to its monetary system — as it would open Pandora's box. Rather, it would live with the onus of being in contempt of the Constitution. The government of the United States had looted gold from its own subjects in 1933. It looted even more gold from people not under its jurisdiction in 1971. It continues to operate in the same tradition.

The larger con-game of the irredeemable dollar could not have gone on so long, but for the smaller con-game of gold futures trading from which it takes its strength. Historically, every regime of irredeemable currency has met its Nemesis in no more than 18 years. The present experiment with irredeemable currency has been going on for twice that long. Of course, gold futures trading is a relatively new invention that was not available to the managers of the assignats, mandats, or the Reichsmarks. Nor was it available to the managers of the most recent experiment with the Zimbabwe dollar. But, as the relentless fall in the gold basis clearly shows, people cannot be conned forever. The clock is ticking. Sand in the hourglass keeps dropping. When it runs out, the present experiment with fiat dollar will also meet its Nemesis, as all the earlier experiments have. That's the good news.

The bad news is that the government of the United States persists in continuing the double con-game and Ponzi-scheme through thick and thin. It is callous to the economic damage it is causing world-wide, and it disregards the danger of permanent gold backwardation that would inflict utter economic pain on the innocent people of this country, to say nothing of the people of the rest of the world. As explained above, it would make the runaway debt-tower of Babel topple, burying people under the rubble as the Twin Towers of the World Trade Center buried people working inside.

When that happens, the government of the United States will not have the excuse that it has not been warned. I have delivered the message in person to the Chairman of President Obama's Economic Recovery Advisory Board, Paul Volcker, when we met at the Santa Colomba Conference last July. I also consider it my moral duty to warn all the people who are willing to listen of the danger lying ahead. It is incredibly naïve to believe that gold can be removed from the international monetary system with impunity at the stroke of a pen, as they pretended to do it in 1973. The gold corpse still stirs. When it rises from its prostrate position it will, like Gulliver, dust off the Lilliputians who like ants have been scurrying all over his body. The day of reckoning will have dawned.

Keynesian and Friedmanite economists bear a special responsibility for the disaster. They dug in and monopolized their positions at universities and research institutes. They never allowed a free discussion on the gold standard. They did everything to aggrandize and perpetuate their own power as the sole advisors on government policy. They will not be able to live down this shame in a thousand years.

Masters Gold Fund

In my previous article *More Dress Rehearsal of the Last Contango* (see References below) I mentioned the unique Masters Gold Fund, soon to come on stream, structured to take advantage of the permanent backwardation in gold when it comes, which would ground all other gold funds. I have acted as advisor from inception and during the incubation period. In that article I listed seven exclusive features spelling out how the Masters Gold Fund would operate in these perilous times. It would take its clues, not from the gold price that is open to manipulation, but from the gold basis which is a pristine indicator telling you about the willingness of gold holders to carry on in playing the game of musical chairs and putting their gold at stake.

In response to subsequent inquiries that I have received, I provide the name and e-mail address of the manager of the Masters Gold Fund, who will be happy to send the prospectus to interested parties upon request:

Sandeep Jaitly (Sandeep.Jaitly@soditic-cbip.co.uk)

If you come to our Seminar in Canberra, Australia, in November, then you will be able to meet Mr. Jaitly in person, and ask him questions directly.

Disclosure

I have not been paid by Masters Gold Fund or its parent company for writing this article, or any other article representing it. My interest in the project is purely intellectual. I want to demonstrate that, under the regime of irredeemable currency, it is possible to have gold locked up in a vault and still make it bear a return *in gold* — to disprove Aristotle's dictum: *pecunia pecuniam parare non potest* (gold does not beget gold).

What we have here is an historical anomaly. Never before could one earn a return on gold in gold *unless* one surrendered control, thus incurring a risk. The risk in investing in the Masters Gold Fund is that the gold price stabilizes, that is, the world willy-nilly goes back to a gold standard. However, this is a risk that anybody should be glad to take.

August 29, 2009

References

More Dress Rehearsal for the Last Contango, August 26, 2009

Remobilize Gold to Save the World Economy! An open letter to Paul Volcker, Chairman of President Obama's Economic Recovery Advisory Board;
July 6, 2009. See: www.professorfekete.com

Calendar of Events

University House, Australian National University, Canberra: first week of November, 2009:
Peace and Progress through Prosperity: Gold Standard in the 21st Century

This is the first conference organized by the newly formed Gold Standard Institute. For further information, e-mail: feketeaustralia@gmail.com ,

On the Gold Standard Institute, e-mail philipbarton@goldstandardinstitute.com

Professor Fekete on DVD: Professionally produced DVD recording of the address before the Economic Club of San Francisco on November 4, 2008, entitled *The Revisionist History of the Great Depression: Can It Happen Again?* plus an interview with Professor Fekete by the President of the San Francisco School of Economics. It is available from www.Amazon.com and from the Club www.economicclubsf.com at $14.95 each.

DVD's of the Gold Standard University, Session 3 (Adam Smith's Real Bills Doctrine and Its Relevance Today); Session 4 (The Bond Market and the Markey Process Determining the Rate of Interest); Session 5 (A Primer ont he Gold and Silver Basis) **are now available**, and so is Session 6. For details, see the announcement on the website www.professorfekete.com