THE SAGA OF THE NAKED BOOGIEMAN

Exploding the Myth of Unbacked Silver Certificates and Phony Silver Storage

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Executive summary

Analysts put their own construction on facts coming out of the class-action suit between Morgan-Stanley and 22,000 of its clients involving costs associated with the storage of precious metals. They jump to the conclusion that metal supposedly backing outstanding silver certificates does not exist and never has. Storing silver on clients' account is a farce. From this they conclude that the net short commercial interest in silver on the COMEX, allegedly naked, must further be increased by adding the amount of unbacked silver certificates and phony storage, which they conservatively estimate at one billion ounces.

Analysts and the 22,000 owners of silver certificates ask the wrong question. The question that should have been asked before the Court is this: "By what right has Morgan-Stanley been using silver belonging to clients for covered writing, and to whom do the bounteous profits flowing from that activity rightfully belong?

Earn interest on your funds without transferring control

Once more, analysts have fallen victim to their own propaganda, and thereby continue to play the role of the stooge to the large concentrated commercial short interest in the silver market. Because of their obsession with price manipulation and naked short selling of silver, a magnificent opportunity has been missed to expose the best-kept secret of the regime of irredeemable currency: *monetary metals are capable of earning a return to capital consistently while the owner need not relinquish physical control of his metal.* In other words, a strategy of adroitly using covered writing can generate a risk-free income. "Miracles" of risk-free gains are made possible through the courtesy of the regime of irredeemable currency. By contrast, under a metallic monetary standard you must give up physical control in order to earn interest on your money. The metal is at risk. In case of a default you will never see it again. The significance of the difference is enormous. The choice between freedom and slavery is involved.

Symbiosis between the "naked bear" and the "insane bull"

It is interesting to watch commercial interest as it throws the pursuers off scent. It leads the analysts by the nose. Morgan-Stanley freely admits to the charge of selling unbacked silver certificates of which it is not guilty, and gladly refunds storage and insurance charges which it has rightfully collected — as long as the secret of the trade need not be revealed, and a much larger income to which it is not entitled can continue to be concealed: the consistent flow of risk-free profits from the ongoing covered writing.

Your certificates are fully backed, and the short sales are not naked. Your silver is safe: physical control is not released for one moment by the service-provider. Yet silver is being traded continuously according to the demands of the market: sold high and bought back low. Question: to whom do the profits from this trade belong? This is exactly the issue that the Court should have decided. But the service-provider succeeded in derailing the legal process. It did not want to disturb the existing symbiosis between the "naked bear" and the "insanely bullish".

Fabulous jackpot

From the point of view of the service-provider it is just as well that people do not understand that its activity merely mimics the power plant harnessing the ebb-and-flow of the oceans. The misguided analyst plays a symbiotic role in assisting the large commercial shorts. He fosters the belief in a fabulously large jackpot at the far end of the rainbow: the overnight doubling of the silver price. He believes it will happen when the naughty naked shorts are finally forced to cover. The jackpot makes people "insanely bullish" on silver. It makes them play the role of the "useful fool". Without it, the task of fleecing the silver sheep would certainly be harder. A lot of silver is held on margin by the insanely bullish. Silver in weak hands is easy picking for the large commercial shorts.

Waiting for Godot

Practically all analysts are devout believers in the miracle of the coming price explosion in silver, and they are doing their best to prepare their following for the field day. They admit that the large commercial shorts have a higher tolerance for financial pain than most, but when they do panic, they panic big. Analysts even divulge the trigger price: $45. This sounds familiar, except for the figure. When silver fetched only 5 dollars, cheer-leaders were talking about a trigger price of $15. Fifteen dollar silver came and went, yet no explosion took place. Fifteen dollar silver is around the corner once more, but the trigger has been moved up to 45. We should not be surprised that, when forty-five dollar silver arrives, cheer-leaders will make the trigger recede farther still into the misty future.

Waiting for the explosion in the silver price is tantamount to waiting for Godot. (In Samuel Beckett's play the characters keep waiting for a man named Godot who never arrives.)

Phoenix rising from its ashes

I am a monetary scientist. My interest in silver is keen because it is the "most misunderstood monetary metal," with far-reaching consequences for the overthrow of existing social order by the regime of irredeemable currency.

Some analysts brag that in their opinion silver is not a monetary metal. Yet the fact is that you cannot understand silver if you do not at least consider the possibility that it is on the way to become a monetary metal once again. A kind of phoenix, rising from its ashes. This would guard you against making the mistake of assuming that silver consumption is hand-to-mouth. In fact, you will never understand silver on the basis of supply/demand analysis alone. If you want to make a half-decent prognostication about the price of silver you must assume that hoards of monetary silver do exist, here and now, out of which silver will be released gradually as the price advances. In addition, there will be profit-taking by those holders of silver who follow a different strategy involving a shorter time-horizon. Short squeezes will occur, too, but it is most unlikely that you will ever be able to squeeze the large commercial shorts. They are not suicidal. They are not naked. They have a strategy far superior to naked short selling. They take advantage of risk-free profits available to holders of silver.

Canary in the mine

Most importantly, silver is the canary in the coal mine that will sing just before the lethal seepage of poisonous gas, warning miners to escape. But the miner must have ears to hear silver sing. It sings the song of basis, the song of the last contango, the song of permanent backwardation. If you don't believe that silver is the junior monetary metal, then you have no ears to hear the songs silver may sing, and may not escape from the mine disaster.

Analysts *add* whereas they should *subtract*. They should subtract what they call the "unbacked silver certificates and phony storage" from "naked short interest". It never occurs to them that the first aggregate is merely a subset of the second. They ignore the possibility that the large concentrated short commercials offer a service to smaller service-providers who hold the silver for customer account, and profitably trade it for a fee. This explains the inordinate size and concentration of short interest in silver — without conjuring up the naked boogieman.

"Bulls in bear's skin"

It is understandable that those who draw an income from their control of silver (whom elsewhere I have called "bulls in bear's skin") are edgy. They wish to keep a low profile. They might even encourage speculation that they are naked sellers, and no silver to speak of exists above ground as all monetary silver "has been consumed". These people are already using silver as a monetary metal drawing a silver income from their holdings through covered short selling, or through writing call options, or any other of the more exotic dynamic hedging techniques available. They want to guard their trade secret even at the pain of being duplicituous. Spreading the gospel of silver as a monetary metal is not in their interest. Bulls in bear's skin have preference for a controlled increase of the price of the silky metal. They prefer evolution to a cataclysmic revolution.

Fraud cannot be proved by the fraudster's own admission of guilt

I have no expertise in law and cannot pass judgment on the contract Morgan-Stanley has with its clients. It is possible that it has been drawn up with fraudulent intent, but if so it has to be proved. I would suspect that there is plenty of small print and technical language in the contract making it opaque, designed to provide an excuse for the service-provider to use swaps and swaptions, futures and derivatures, or other exotic instruments to generate an income on silver which would otherwise lay idle. Fraud cannot be proved by referring to the fraudster's own admission of guilt, which is a red herring. After all, the fraudster may be covering up an even bigger fraud by admitting to the smaller charge. I have no sympathy for Morgan-Stanley's apparent attempt to pocket all the gains as a service-provider, to the exclusion of principals. I would wholeheartedly welcome an initiative to regulate the allocation of profits from covered writing between the principal and service-provider. Above all I want to see obscurantism and the use of smoke and mirrors in the silver trade dispelled which, I believe, would decisively show that in silver we behold a nascent monetary metal.

The poison of *lasting* risk-free profits

While on the subject of fraud and morality, we must name the real culprit, the regime of irredeemable currency making, as it is, risk-free profiteering possible. Note that under a metallic monetary standard the opportunity to earn risk-free profits could never last longer than a fleeting moment. As long as it is ephemeral, risk-free profit plays a positive role in the economy. It is the driver of economic progress. It is the reward reserved for the most progressive entrepreneurs for tracking down misalignments in economic relations, and for anticipating sea-change correctly. The problem is with the *perpetuation* of risk-free profits. Then they become poison that is injected into the body economic by irredeemable currency.

Exotic derivatives such as higher-order hedges would not be possible under a metallic monetary standard. First-order hedging would, but *only for risks given by nature*, as in the case of the price of agricultural products. Risks created by man would be confined to gambling casinos where they belong. Under a metallic monetary standard, tricksters could not gamble with the savings of people or with the funds of widows and orphans.

Analysts have gone wrong because of their dogmatic insistence that silver is not a monetary metal. The important fact to keep in mind is that under a metallic monetary standard lending is never risk-free. It involves the transfer of physical control, and the borrower may default. By contrast, under the regime of irredeemable currency it is possible to draw an income from the possession of monetary metals *without* surrendering physical control. It is this that makes the social poison of *lasting* risk-free profits possible.

Nature has provided a prophylactic against this poison that makes the beneficiaries of lasting risk-free profits into slave-drivers, and the rest of society into slaves. The prophylactic is: a metallic monetary standard. The regime of irredeemable currency is incompatible with stable social relations based on the system of division of labor. It allows the concentration of the monetary metals in a few hands, conferring unlimited power upon those in control. This is the main reason that militates against embracing irredeemable currency. It is a great historical tragedy that this socio-economic danger was not investigated before the official adoption of irredeemable currency by every country in the world in the wake of the U.S. default on its international gold obligations in 1971. The world then made its fateful U-turn back to slavery.

Self-destruction of the regime of irredeemable currency

The regime would have come to an inglorious end already in the twentieth century but for the possibility of lasting risk-free profits, lending the parasitic regime exceptional staying power. Through the linkage between the rate of interest and the price level (a.k.a. Gibson's Paradox) it may be able to rein in runaway inflation.

Paradoxically, it is precisely lasting risk-free profits that will bring about its downfall — but not without extreme social pain. As the monetary metals get concentrated in ever fewer hands, the rest of society is being condemned to slavery. Ultimately, slaves will rise and overthrow the tyranny of the slave-drivers.

These remarks put my disagreement with the analysts into high relief. We all see the menacing concentration. Analysts warn of dangers inherent in the concealed concentration of *short* interest. I warn of dangers inherent in the concealed concentration of *long* interest, a combination far more threatening to social peace.

References

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GOLD STANDARD UNIVERSITY LIVE

Session Three of Gold Standard University Live (GSUL) will take place in Dallas, Texas, from February 11 through 17, 2008. The program is in three parts:

> (1) a course on *Adam Smith's Real Bill Doctrine and its Relevance Today*, consisting of 13 lectures, from February 11 through 14;
>
> (2) a debate on the *Economics of Gold Mining: the failure of Barrick Gold's hedging program*, with industry participation;
>
> (3) a panel discussion entitled *Gold Profits in Troubled Times* where paraphernalia such as the basis, gold and silver lease rates, the NAV of gold and silver ETF's and the variation of these will be discussed with invited experts.

Program (2) and (3) are scheduled for the week-end February 15-17. The registration fee covers participation in these debates during the week-end. It is possible to register for the week-end program separately at a reduced fee. Participation is limited; first come first served. Participants pay their own hotel and meal bills. The cost of the closing banquet and refreshments during breaks is included in the registration fee.

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