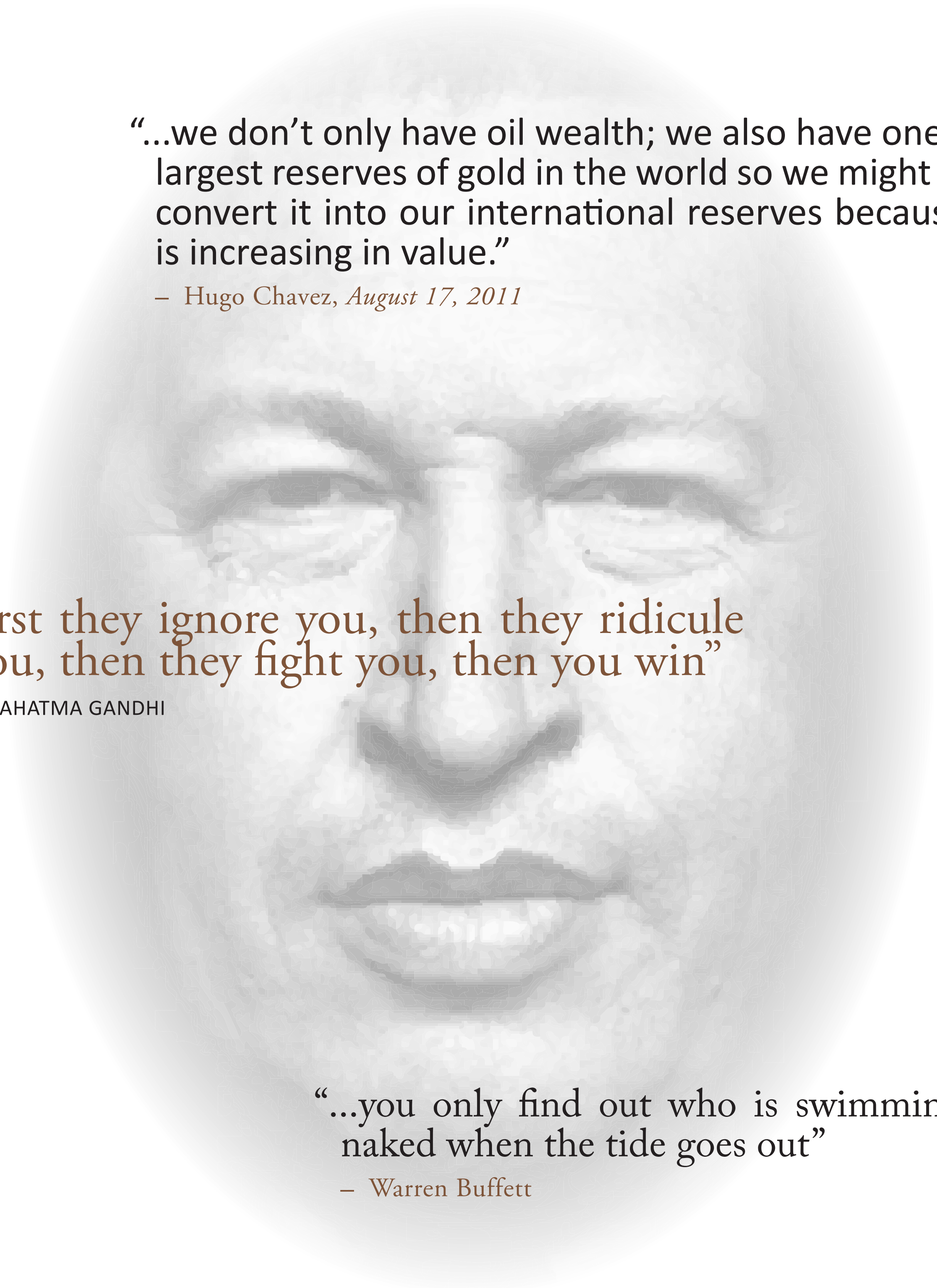
# THINGS THAT MAKE YOU GO Hmmm...

A walk around the fringes of finance



"...we don't only have oil wealth; we also have one of the largest reserves of gold in the world so we might as well convert it into our international reserves because gold is increasing in value."

– Hugo Chavez, *August 17, 2011*

"First they ignore you, then they ridicule you, then they fight you, then you win"

– MAHATMA GANDHI

"...you only find out who is swimming naked when the tide goes out"

– Warren Buffett

This week, without warning, the starter's pistol went off for what could turn out to be the race of a lifetime. For years, the entrants in the race have been waiting at the starting line, jumping up and down to stretch out their limbs while the crowd became distracted by events elsewhere, but on Wednesday, the gun sounded; and the trigger was pulled by none other than that nemesis of the United States of America, Hugo Chavez.

| Rank | Country/Organization | Gold (tonnes) | Gold's share of national forex reserves (%) |
|---|---|---|---|
| - | Euro Area | 10,792.6 | 60.7% |
| 1 | USA | 8,133.5 | 74.7% |
| 2 | Germany | 3,401.0 | 71.7% |
| 3 | IMF | 2,846.7 | - |
| 4 | Italy | 2,451.8 | 71.4% |
| 5 | France | 2,435.4 | 66.1% |
| 6 | China | 1,054.1 | 1.7% |
| 7 | Switzerland | 1,040.1 | 16.4% |
| 8 | Russia | 775.2 | 6.7% |
| 9 | Japan | 765.2 | 3.0% |
| 10 | Netherlands | 615.5 | 59.4% |
| 11 | India | 614.8 | 8.1% |
| 12 | ECB | 522.7 | 27.9% |
| 13 | Republic of China (Taiwan) | 466.9 | 4.6% |
| 14 | Portugal | 421.6 | 81.1% |
| 15 | Venezuela | 401.1 | 52.4% |
| 16 | Saudi Arabia | 322.9 | 3.0% |
| 17 | United Kingdom | 310.3 | 16.8% |
| 18 | Islamic Republic of Iran | 300.0[11] (Unofficial est.) | - |
| 19 | Lebanon | 286.8 | 27.6% |
| 20 | Spain | 281.6 | 38.6% |

SOURCE: IMF

Out of the blue, Chavez ordered his government to repatriate $11billion in gold that is being held on behalf of the Venezuelan government in overseas banks. For good measure, he then added that he was going to nationalize the country's gold industry.

The moving parts of this particular announcement are fairly complex so let's try to pick them apart and make some sense of what's going on and, more importantly, speculate as to what MAY happen now that the race has begun.

The first thing to understand is that, despite the fact that a race is now progress, we actually have no idea over what distance it is being run. It could be a long steady slog with Chavez acting as a pacemaker out in front - destined to fall back once we get to the business end of the contest or, worryingly for the rest of the field, it could be a straight sprint in which case Chavez is up and into his stride while the rest of the competitors remain frozen in their starting blocks.

According to the IMF's most recent numbers, Venezuela holds 401.1 tonnes of gold which equates to 52.4% of its reserves (I have seen numbers as high as 63%, but for the purposes of this discussion, let's stick to the IMF estimates (table, above)), but the vast majority of that gold is held in overseas vaults - far from Caracas (a description that isn't often used to describe Chavez himself).

The Venezuelan President has, apparently, contacted the Bank of England and asked them to make arrangements for the 99 tonnes of gold held in the vault beneath Threadneedle Street on Venezuela's behalf to be 'brought home' - a Bank of England spokesperson declined to comment. Also declining to comment was a spokesperson for the Bank for International Settlements, where Venezuela keeps a further $3.7billion of its cash reserves alongside 11.2 tonnes of gold that Venezuela carries on its balance sheet at $544 million. Someone who WAS prepared to comment was former Venezuelan Central Bank official José Guerra who confirmed that he had seen transfer documents and that they were authentic.

Chavez's long-time hatred of the United States is well-documented and he has, for many years, been a figure of some amusement on the world stage with his bombastic rhetoric, fist-pounding condemnation of capitalism and unrestrained loathing for the US dollar, but, after years of ineffective attacks against America, this time, he really may have started a chain reaction that could quickly spin out of control.

Chavez has announced that he will transfer billions of dollars held by Venezuela in such establishments as the BIS in Basel and Barclays Bank in London, to banks in 'safer' locations - 'safer' like Russia, China and Brazil. Estimates put the cash involved at $6.3 billion (give or take a billion or two), but it is the gold that lies at the heart of the potential maelstrom Chavez may have just stirred up.

According to a policy paper prepared by the Finance Ministry and central bank, Venezuela holds $18.3 billion in gold bullion in a number of locations worldwide:

| Institution | Country | Amount |
|---|---|---|
| Bank Of England | United Kingdom | $4.6 billion |
| Bank For International Settlements | Switzerland | $544 million |
| JP Morgan | USA | $807 million |
| Bank of Nova Scotia | Canada | $381 million |
| Barclays Bank | United Kingdom | $2.1 billion |
| BNP Paribas | France | $184 million |
| HSBC | United Kingdom | $1.4 billion |
| Standard Chartered | United Kingdom | $1.1 billion |
| Central Bank of Venezuela | Venezuela | $7.2 billion |
| | **Total** | **$18.3 billion** |

Chavez has indicated that he will be bringing the majority of that gold 'home' while storing the balance in the vaults of nations he considers to be 'friendly' - and that means the gold moving from West to East, a trend that has been in place for quite some time from individual investors right the way up to Central Banks. Everywhere we look, the signs are there that a transformational shift is taking place that will mean the West's preeminent place in the 'world order' (for want of a less evocative phrase) changes and, perhaps, disappears forever.

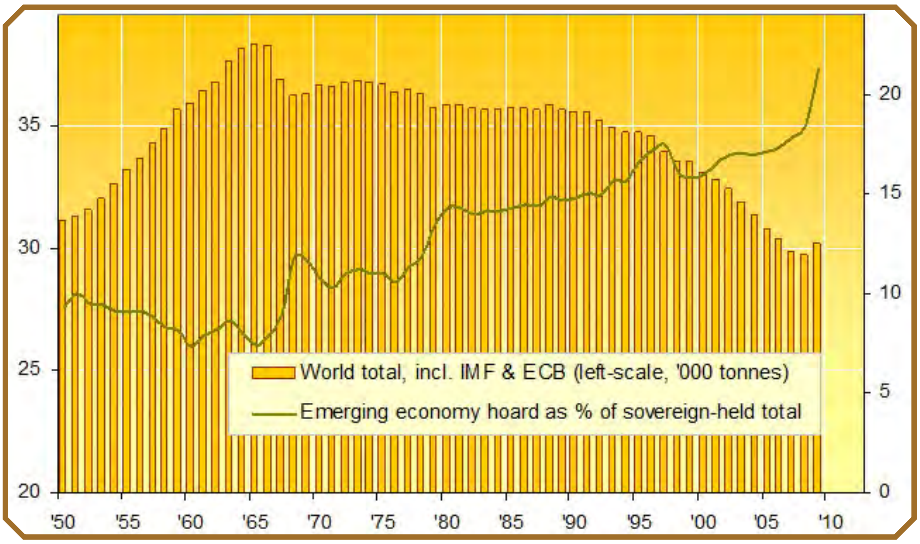
As the troubles in Europe have begun to ratchet up a notch these past couple of weeks, there was one interesting soundbite about gold reserves - almost lost in the madness of continuous press conferences, summit meetings and the resultant hot air - that may potentially shed light on this possible Eastward movement of gold. It appeared in the wonderful article, 'It's The Economy, Dummkopf!', by Michael Lewis that appears in the September issue of Vanity Fair:

> *If Greece defaults on its debt, the ECB will not only lose a pile on its holdings of Greek bonds but must return the bonds to the European banks, and the European banks must fork over $450 billion in cash. The ECB itself might face insolvency, which would mean turning for funds to its solvent member governments, led by Germany. (The senior official at the Bundesbank told me they already have thought about how to deal with the request. "We have 3,400 tons of gold," he said. "We are the only country that has not sold its original allotment from the [late 1940s]. So we are covered to some extent.")*

Signs that the Bundesbank are looking at their gold holdings as potential 'cover' signals (to me, anyway) one of two things:

*1: Germany feels that if it needs to pay a few bills it could sell some of its gold*

If this is the case, and Germany was considering selling some (or even ALL of its gold), the queue




SOURCE: WGC

of Central Banks lining up to buy it from them would, I suspect, have a distinctly Eastern flavour to it. As the West continues to decline, so the ascendancy of the East continues to pick up speed and at some point, the transfer of the world's gold from the Occident to the Orient will signify the final passing of the torch.

At left is a chart that shows the total gold reserves of the world's Central Banks along with the percentage of that hoard held by emerging market economies and the trend is both crystal clear and, for Western governments at least, alarming in the extreme.

In an article written in 2010, Adrian Ash of BullionVault had this to say about the transfer of gold when commentating on WGC data:

> *...given gold's critical role in world history, three telling facts are buried amongst the latest central-bank gold data compiled by the World Gold Council...*
>
> - *Central banks worldwide grew their physical gold reserves at the fastest pace since 1965 in 2009, adding bullion for the first time in two decades as a group;*
> - *Emerging economies added a near-record volume of metal to their official reserves, putting more than 21% of all the gold held by sovereign states outside the control of developed-world OECD members;*
> - *Western central banks, in contrast, shrank their reserves by more than 1% last year. Since the end of 2004, they have sold almost twice-as-much gold as non-OECD members have acquired (1881 vs. 994 tonnes)...*
>
> *Last year marked a "changing pattern" says the World Gold Council, pointing to slower West European sales and "accelerating" purchases by emerging-economy states.*
>
> *But even noting Moscow's frantic expansion of its gold reserves – primarily bought from domestic mine output, and taking Russia to 9th position in the sovereign league table –the WGC's comments underplay the political implications.*
>
> *In full-year 2009, emerging-economy states grew their reported reserves by 17.8%, adding 868 tonnes of bullion to build a new record hoard of 5738 tonnes. Yes, China's announcement in April that it had added 454 tonnes to its reserves over the previous six years accounted for a big chunk of that move. But Beijing isn't alone in buying gold. By the end of 2009, non-OECD members held half-as-much gold again as they did on average over the previous six decades.*

In 2010, the WGC were 'underplaying' the political implications, but those political implications - particularly in light of Chavez's move this week - look set to become far more important from this point on.

2. *Germany feels that - if necessary - they could launch a gold-backed Deutsche Mark*

Admittedly, this idea is potentially real pie-in-the-sky stuff. So many previously unthinkable things would have to happen for something as momentous as a German 'Geldmark' to be instituted. I mean, the current reserve currency of the world would have to be on its knees, there would have to be financial chaos in the world's markets and the currency union which Germany currently underpins - the Euro - would have to be on the verge of implosion. Clearly, none of those seismic events are likely to happen so we should probably stop thinking such fanciful notions and return to the real world.

Before we do, though, let's quickly return to March of 2000 when Christopher Story, a former adviser to British Prime Minister Margaret Thatcher, wrote in the Economic Intelligence Review:

> *"...The Bundesbank suddenly acquired massive gold reserves, just as the euro was launched in the first quarter of 1999. The gold amassed, both in terms of its physical size and of its value is more than enough with which unilaterally to introduce a gold-backed 'new Deutsche mark'—in contrast to the U.S. dollar, which is not backed by gold"*

Crazy idea.

But let's leave Germany and the year 2000 for the moment and get back to the present, and Chavez's Power Play.

It has long been recognised that the amount of paper gold that trades on a daily basis is of an order of magnitude far, far grater than the amount of physical gold that exists in the world to back it, but in 2010 this theory became hot news when CPM founder, Jeffrey Christian made something of an admission during testimony to a CFTC commission chaired by Gary Gensler:

> **"***The CFTC, when it did its most recent report on silver, used the term that we use, "the physical market." We use that term as did the CFTC in that report to talk about the OTC market -- in other words, forwards, OTC options, physical metal, and everything else. People say, and you heard it today, there is not that much physical metal out there, and there isn't. But in the "physical market," as the market uses that term, there is much more metal than that. There is a hundred times what there is. If I look at the large short positions on the Comex, my question is: Where are the other shorts being hedged? Because the short position that I believe the bullion banks use to hedge their physicals is larger than their short position on the Comex, and the answer is that they hedge it in the OTC market in London"*

GATA board member Adrian Douglas had this to say about Christian's testimony:

> *This is a stunning revelation. Christian confirms that the "physical market" is not in fact a physical market at all. It is a loose description of all the paper trading and ledger entries and some physical metal movements that occur each day on behalf of people who believe they own bullion in LBMA vaults but in fact don't. They are told they have "unallocated gold" or "unallocated silver," but that does not mean the LBMA has physical metal set aside for those customers and has just not given specific bar numbers to the customers...*
>
> *Christian confirms what many analysts and GATA have been alleging -- that there is not much REAL physical metal -- but testifies that there is actually 100 times the REAL physical metal being sold based on the much more "loose" definition of what "physical" means to the bullion banks.*
>
> *The last sentence of his statement is mind-blowing. He says the "physical" positions of the bullion banks are so huge that they are much bigger than the Comex short position. He says the "physicals" are hedged on the OTC market in London!*

At the risk of letting Douglas do all the heavy-lifting for me, I will allow him to sum up his own thoughts rather than me take a stab at doing so because in his conclusions lies the beating heart of the matter under discussion today:

> *The bullion banks are selling what is supposed to be vault gold, but it is just a ledger entry if the customer never asks for delivery. The bullion banks must balance their exposure with a ledger deposit entry. This has to be some paper promise of gold from a third party, or some derivative, or even some real gold bullion. If all the ledger entries balance out, then the bullion bank has no net exposure in exactly the same way the futures market works with a short offsetting a long.*
>
> *So the giant Ponzi trading of gold ledger entries can be sustained only if there is never a liquidity crisis in the REAL physical market. If someone asks for gold and there isn't any, the default would trigger the biggest bank run and default in history. This is, of course, why the central banks lease their gold or sell it outright to the bullion banks when the bullion banks are squeezed by high demand for REAL physical gold that cannot be met from their own stocks.*

Bingo! There it is.

> ***"If someone asks for gold and there isn't any, the default would trigger the biggest bank run and default in history."***

Chavez's move this week could set in motion a chain of events whereby Central banks who store the bulk of their gold overseas in 'safe' locations scramble to repossess their country's true 'wealth'. If that happens, the most high-stakes game of musical chairs the world has ever seen will have begun.

One would imagine that a country's gold would be stored onshore in their own vaults rather than be entrusted to a foreign power - after all, if tensions WERE to rise between the two sovereigns, amongst the first casualties would be said gold.

The obvious exceptions to this thesis would be countries that are inherently more unstable than others - I don't know, countries such as Venezuela, perhaps? Or Lebanon? Or even Libya?

Interestingly enough, all of Libya's 143 tonnes of gold is supposedly stored within its borders - and under the direct control of Colonel Qaddafi/Gadhafi/Gaddafi - while tiny Lebanon , whose 286 tonnes of gold is enough to secure 19th place on the table on page 1 of today's *Things That Make You Go Hmmm.....* stores half its gold in the safe confines of Fort Knox - supposedly.

Based on the paper prepared for the Venezuelan Finance Ministry and Central Bank (table, page 3), Chavez is about to ask a group of Western banks to hand over some $11.1 billion in gold bullion and, despite the obvious logistical nightmare that the transportation of this bullion presents, he will be expecting it to be delivered either to the Venezuelan Central Bank vault, or that of a 'friendly' nation such as China or Russia. Soon.

This week, Zerohedge cast an eye over the gold holdings at the CME of, amongst others, one of the banks at which Venezuela appears to hold a significant amount of its gold - JP Morgan and they found a potential problem:

CME Group

COMMODITY EXCHANGE, INC.

METAL DEPOSITORY STATISTICS

GOLD
Troy Ounce

Report Date: 8/17/2011
Activity Date: 8/16/2011

| DEPOSITORY | PREV TOTAL | RECEIVED | WITHDRAWN | NET CHANGE | ADJUSTMENT | TOTAL TODAY |
|---|---|---|---|---|---|---|
| **BRINK'S, INC.** | | | | | | |
| Registered | 454,397 | 0 | 0 | 0 | -699 | 453,698 |
| Eligible | 58,598 | 0 | 0 | 0 | 699 | 59,297 |
| Total | 512,995 | 0 | 0 | 0 | 0 | 512,995 |
| **HSBC BANK, USA** | | | | | | |
| Registered | 465,436 | 0 | 0 | 0 | 0 | 465,436 |
| Eligible | 3,526,483 | 30,067 | 29,264 | 803 | 0 | 3,527,286 |
| Total | 3,991,919 | 30,067 | 29,264 | 803 | 0 | 3,992,722 |
| **JP MORGAN CHASE BANK NA** | | | | | | |
| Registered | 338,303 | 0 | 0 | 0 | 0 | 338,303 |
| Eligible | 2,808,208 | 0 | 63,719 | -63,719 | 0 | 2,744,489 |
| Total | 3,146,511 | 0 | 63,719 | -63,719 | 0 | 3,082,792 |

CLICK TO ENLARGE

SOURCE: ZEROHEDGE/CME

*(ZeroHedge): What could well be a gamechanger is that according to an update from Bloomberg, Venezuela has gold with, you guessed it, JP Morgan, Barclays, and Bank Of Nova Scotia. As most know, JPM is one of the 5 vault banks. The fun begins if Chavez demands physical delivery of more than 10.6 tons of physical because as today's CME update of metal depository statistics, JPM only has 338,303 ounces of registered gold in storage. Or roughly 10.6 tons. A modest deposit of this size would cause some serious white hair at JPM as the bank scrambles to find the replacement gold, which has already been pledged about 100 times across the various paper markets.*

*Keep an eye on gold in the illiquid after hour market. The overdue scramble for delivery may be about to begin*

For the longest time, conspiracy theories about the amount of gold actually held in the various depositories have abounded - in fact, we have discussed many of them in these pages over the past couple of years - but now we may finally find out just what does lie beneath, as Venezuela's grab for their gold could potentially start a landslide of demands for delivery that could unravel a web of deceit years in the making.

Or it may not. Either way, we MIGHT just find out who was right and who was wrong and be able to put the matter to rest once and for all.

To quote Vizzini, it would be 'inconceivable' to think for a second that Central Bank governors the world over are blissfully unaware of the rumours about empty vaults, massive leasing programs and fictitious allocations held on their behalf at places like Fort Knox, the Federal Reserve and the Bank of England, so one can reasonably imagine that quite a few of them are sitting uneasily in their chairs waiting to see what the response is to the Venezuelan demands.

Personally, if I were a Central Bank governor, I know I would want to be absolutely certain that my gold was a) exactly where it was supposed to be, b) held in the amount advertised and c)....well..... made of gold, ideally - as opposed to tungsten.

If there is *ANY* delay in repatriating Venezuela's gold, it could potentially start a frantic scramble by Central Banks to claim their physical gold and, if that happens, you can be assured that a fire will be lit under the gold price the likes of which we haven't yet seen - even as gold has appreciated from $250 to $1850 over the past 11 years.

Of course, those Western countries that DO keep their gold at home - the big holders like the US, Germany, Italy and France, will doubtless have nothing to worry about (extensive leasing programs notwithstanding of course) except...

The gold in Fort Knox hasn't been independently audited since President Eisenhower was in the White House - despite Ron Paul's recent attempts to have both the Kentucky depository's contents AND those of the Federal Reserve accounted for (incidentally, if you haven't seen Jon Stewart's hilarious skewering of US Media coverage of Paul, do yourself a favour and click HERE ), and Germany? Well not ALL of Germany's gold is held at home either - at least not according to a letter from the Bundesbank to Rob Kirby of Kirby Analytics dated 24 August, 2009:

> *...The Deutsche Bundesbank keeps a large part of its gold holdings in its own vaults in Germany, while some of its gold is also stored with the central banks located at major gold trading centres. This has historical and market-related reasons, the gold having been transferred to the Bundesbank at these trading centres. Moreover, the Bundesbank needs to hold gold at the various trading centres in order to conduct its gold activities. It is common practice for central banks to keep part of their gold reserves abroad.*

Common practice indeed. Up to a point.

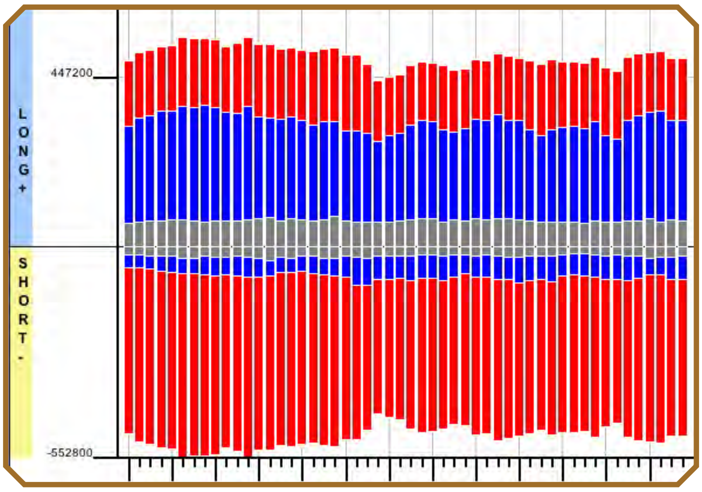
But what of the 'large part' of Germany's gold holdings held 'in its own vaults'? In a recent piece by James Turk - a man who knows a thing or two about gold - he posed the same question:

> *One of the most important assets of the German people is the gold that has been accumulated over the years through their hard work and savings. Individuals hold some of this gold, but much of it is kept with the Bundesbank as an essential rainy-day reserve, held just in case monetary turmoil requires its use to re-establish a stable currency.*
>
> *This gold has been entrusted to the Bundesbank and provides peace of mind knowing that it is there. But where is it really? And just as important, how much is there? Unfortunately, we do not know the answer to these questions.*

Turk's digging through the Bundesbank's most recent Annual Report only succeeded in throwing up more questions:

> *The Bundesbank's latest Annual Report states: "As of 31 December 2009, the Bundesbank's holdings of fine gold (ozf) amounted to 3,406,789 kg or 110 million ounces. The gold was valued at market prices at the end of the year (1 kg = €24,638.63 or 1 ozf = €766.347)." The total value therefore reported by the Bundesbank on its balance sheet is €83,939 million. There have been, however, repeated claims suggesting that the Bundesbank's gold vault is empty. The reporting by the Bundesbank in its Annual Report does nothing to disprove these claims.*
>
> *The Annual Report states that the Bundesbank owns €83,939 million of "Gold and Gold Receivables". Surprisingly, it does not distinguish between these two fundamentally different assets, nor does it report how much of each it owns.*
>
> *Section 26(2) of the Bundesbank Act states: "The accounting system of the Deutsche Bundesbank shall comply with generally accepted accounting principles." By reporting "gold in the vault" and "gold out on loan" as one item, the Bundesbank is not reporting its two different gold assets according to generally accepted accounting principles.*
>
> *There have been reports that the Bundesbank believes the way it accounts for gold is required by International Monetary Fund rules, which they contend supersede Section 26(2) of the Bundesbank Act. But if so, one can reasonably ask, who controls the Bundesbank? The German people or the IMF? Until these questions are answered, the public may never learn how much gold the Bundesbank has stored safely and securely in Frankfurt, and how much it has loaned, thereby perpetuating the rumour that the Bundesbank's gold vault is empty.*
>
> *Given the ongoing monetary turmoil and the growing worries about the inflationary impact of rising commodity prices, those rainy-day gold reserves may soon be needed. So when will the Bundesbank provide an accurate accounting of Germany's gold reserves?*

When indeed.




CLICK TO ENLARGE

SOURCE: CFTC

So, to sum up:

- *It is common practice for most Central Banks to hold part of their gold reserves overseas in 'gold trading centres' (read London and New York)*
- *One of those Central Banks - that of Venezuela - wants its gold back*
- *That means that a group of banks (mainly in the UK and the USA) who are supposed to have that gold in their vaults need to GIVE it back...*
- *...which in turn could potentially trigger a race to re-patriate national gold holdings*
- *Neither Fort Knox nor the Federal Reserve (the world's two biggest gold depositories) have been independently audited in recent times*
- *The status of the gold held in the Bundesbank (home to the world's third-largest hoard) is somewhat unclear*
- *The practice of leasing gold by Central Banks has been going on so long that it even predates the time when Alan Greenspan advocated sound money.*
- *The gold 'physical market' is approximately 100 times the size of the amount of actual under-lying metal by which it is purportedly backed*
- *The top four bullion banks, or 'commercials' on the COMEX continue to run what we shall po-litely call 'significant' short positions (chart above)*

In the three trading sessions since Chavez made his announcement on August 17th, gold has added almost $100, coming within a whisker of $1,900 before settling back at another record weekly close.

Henri Cartier-Bresson: Shanghai Gold Rush, 1949

Market weakness? Maybe. Fear of further problems in Europe? Quite possibly. Continuing disgust with the world's fiat currencies? Highly likely.

The beginning of a race amongst the world's Central Banks to grab physical gold? Now THAT would be something to see...

In today's edition of *Things That Make You Go Hmmm.....* the good folks at Sprott Asset Management tell us all about the greatest trade of all time, Matt Taibbi lays out a damning case against the SEC whom he accuses of some pretty underhand behaviour and Michael Pettis explains why China slowing down their US Treasury purchases won't be hugely disruptive.

Alasdair Macleod weighs in on an issue that has been at the forefront of my own thoughts recently - namely the $1.76 trillion in non-borrowed reserves sitting on deposit at the Fed and wonders what they might mean in the context of QE3, another whistleblower steps forward - this time from Moody's - and it's fair to say he pulls no punches and Ambrose Evans-Pritchard sees Europe AND the US turning Japanese.

Felix Salmon sees Hewlett Packard pull the old bait-and-switch, little Finland once again rock the Eurozone boat and in a familiar show of a united European policy and a common front, Herman van Rumpuy and Wofgang Schauble both announce to the world that there will be no 'Eurobonds'. Sigh...

Dan Norcini takes a look at gold stocks versus the metal itself, we chart the US' credit card bill as well as 200-point moves in the Dow and see just how tenuous the EFSF is, courtesy of Der Spiegel's wonderful graphic designers.

Lastly, we hear from Bill Fleckenstein, Jim Rickards warns about the possible perils of asking for your gold back and we head back to 1965 for a visit with a prescient Charles de Gaulle.

Is it me, or is it getting hot in here?

## Housekeeping:

I am delighted to announce that, as of this week, I have joined Vulpes Investment Management here in Singapore where I will act as advisor to the Vulpes Testudo fund.

Vulpes was founded by the former managing partner of Artradis Fund Management, Stephen Diggle in April 2011.

The Testudo Fund is an unconstrained, long-term endowment-style fund that seeks to generate steady but safe real net returns after inflation. It holds a blend of listed and private equities, commodities and debt instruments selected purely on their own merits and is one of three funds currently on the Vulpes platform. The other Vulpes Funds are the LAVA Fund, a negative correlation fund that aims to provide outsized returns in falling markets through long volatility strategies, and the Russian Opportunities Fund, a fundamentals-driven stock-picking fund that focuses on Russia and the CIS. For information on these funds, please visit the Vulpes website:

VULPES INVESTMENT MANAGEMENT

www.vulpesinvest.com

As a result of my role at Vulpes, it falls upon me to disclose that, from time-to-time, the views I express and/or the commentary I write in the pages of *Things That Make You Go Hmmm.....* may reflect the positioning of one or all of the Vulpes funds - though I will not be making any specific recommendations in this publication.

I am working towards hosting *Things That Make You Go Hmmm.....* at the Vulpes website so please watch for details on that transition going forward

Grant

# Contents

21 August 2011



## The Gonnie, Gonnie Banks

| # | Bank | Assets ($m) | Deposits ($m) | Cost ($m) |
|---|---|---|---|---|
| 65 | Public Savings Bank, Huntingdon Valley, PA | 46.8 | 45.8 | 11.0 |
| 66 | Lydian Private Bank, Palm Beach, FL | 1700.0 | 1240.0 | 293.2 |
| 67 | First Southern National Bank, Statesboro, GA | 164.6 | 159.7 | 39.6 |
| 68 | First Choice Bank, Geneva, IL | 141.0 | 137.2 | 31.0 |
| | **Total Cost to FDIC Deposit Insurance Fund** | | | **374.8** |

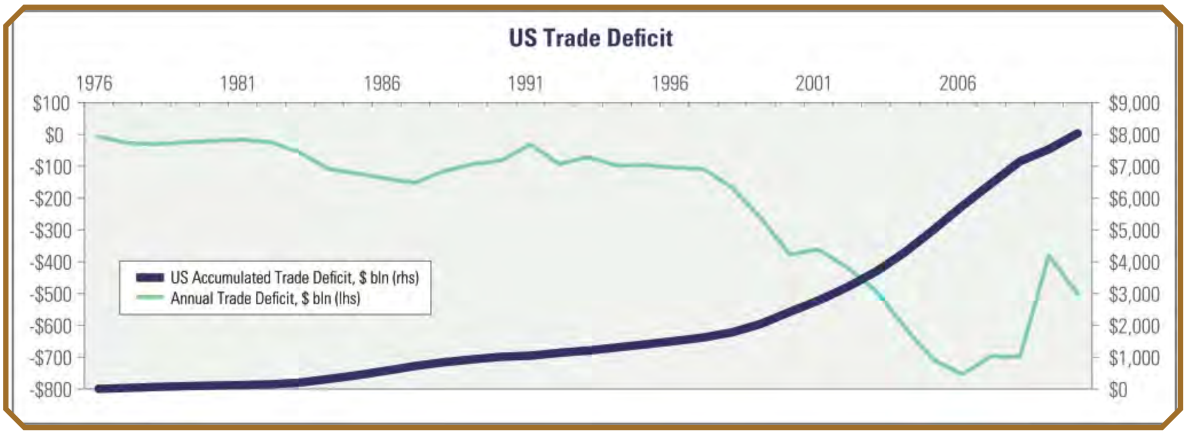
On its way to becoming the world's greatest superpower, the United States pulled off some truly remarkable trades. Two notable transactions come to mind and were both outstanding bargains.

• The Louisiana Purchase (purchased from the French)

• Alaska (purchased from the Russians)

For a mere $15 million, America instantly doubled its size with the 1803 purchase of the Louisiana territory. Sixty-four years later, oil-and mineral-rich Alaska was obtained for a paltry $7.2million. Even adjusting for inflation, the combined value of these deals in today's dollars would be very small.

However, these two transactions pale in comparison to the greatest trade of all time, one which remains ongoing. This particular trade has allowed the US to exchange more than $8 trillion worth of paper for an unbelievably enormous amount of real goods and services over 36 straight years. We're referring, of course, to the United States trade deficit. As Chart 1 shows, imports have exceeded exports every year since 1975. For much of the past decade, America's annual trade deficit has soared past the $600 billion mark, while the accumulated trade deficit has moved relentlessly higher.




SOURCE: US CENSUS BUREAU/SPROTT AM

Back in November 2003, Warren Buffett penned an article for Fortune magazine warning that America's trade deficit could no longer be ignored. He felt that America's "net worth" was "being transferred abroad at an alarming rate." At the time, the accumulated trade deficit had only reached a few trillion dollars, but it has grown over the last seven years by an average of over $600 billion per annum. As Buffett wrote at the time, "our national credit card allows us to charge truly breathtaking amounts. But that card's credit line is not limitless." Makes you wonder what he must be thinking now.

*KEVIN BAMBROUGH* / LINK

Panic flight to safety has pushed the yield on 10-year US Treasuries below 2pc for the first time in modern American history, exceeding the extremes of the Lehman crisis and the banking crash of the 1930s.

Investors scrambled to buy the bonds of strongest industrial states on Thursday on fears of a double-dip recession on both sides of the Atlantic and a European banking crash, driving down their returns to investors. German yields fell to 2.08pc and Switzerland's 3-month rates have turned deeply negative.

Markets were stunned by a plunge in the manufacturing index of the Philadelphia Federal Reserve to minus 30.7 in August from plus 3.2 in July, one of the most violent falls ever recorded.

"It is a catastrophic collapse," said Rob Carnell from ING. "Markets are in a fearful state right now, and data like this gives them plenty of excuses to panic."

Andrew Roberts, credit strategist at RBS, said investors are haunted by fears that European banks may have lost full access to America's $7 trillion markets, leaving them at imminent risk of a dollar squeeze.

"... The Bank for International Settlements said German, Dutch, Swiss and British banks together have a US dollar funding gap of around $1 trillion. The global dollar gap is $5 trillion...

An unidentified European lender had to tap $500m from the European Central Bank's (ECB) swap line with the Federal Reserve, indicating that it had been shut out of the markets. US investors have brought down the guillotine since the EMU debt crisis spread to Italy and Spain, and Germany vetoed any form of eurobonds or fiscal union. "This is what has kicked [off] the latest turbulence," Mr Roberts said.

Ewald Nowotny, Austria's central bank governor and an ECB member, told newspaper Wirtschaftsblatt there was a "growing reluctance" within US money market funds to finance the Europeans, though he blamed the cut-off on a change in US banking regulations.

Mr Nowotny said a global double-dip recession was unlikely but said nobody should be complacent because "we have learned painfully from history" that a global slump can strike unexpectedly. His personal fear is an insidious slide towards "Japanese" stagnation in Europe.

The Bank for International Settlements said German, Dutch, Swiss and British banks together have a US dollar funding gap of around $1 trillion. The global dollar gap is $5 trillion, reflecting the continued use of the greenback as the base for international finance. This means that severe market stress sets off a scramble for dollars, akin to a global margin call.

"It won't take much for the interbank market to collapse," said Lars Frisell from Sweden's Riksbank. "It is extremely important that we don't see a repeat of the situation in 2008."

★ ★ ★ *AMBROSE EVANS-PRITCHARD* / **LINK**

A former senior analyst at Moody's has gone public with his story of how one of the country's most important rating agencies is corrupted to the core.

The analyst, William J. Harrington, worked for Moody's for 11 years, from 1999 until his resignation last year.

From 2006 to 2010, Harrington was a Senior Vice President in the derivative products group, which was responsible for producing many of the disastrous ratings Moody's issued during the housing bubble.

Harrington has made his story public in the form of a 78-page "comment" to the SEC's proposed rules about rating agency reform, which he submitted to the agency on August 8th. The comment is a scathing indictment of Moody's processes, conflicts of interests, and management, and it will likely make Harrington a star witness at any future litigation or hearings on this topic.

The primary conflict of interest at Moody's is well known: The company is paid by the same "issuers" (banks and companies) whose securities it is supposed to objectively rate. This conflict pervades every aspect of Moody's operations, Harrington says. It incentivizes everyone at the company, including analysts, to give Moody's clients the ratings they want, lest the clients fire Moody's and take their business to other ratings agencies.

Moody's analysts whose conclusions prevent Moody's clients from getting what they want, Harrington says, are viewed as "impeding deals" and, thus, harming Moody's business. These analysts are often transferred, disciplined, "harassed," or fired.

In short, Harrington describes a culture of conflict that is so pervasive that it often renders Moody's ratings useless at best and harmful at worst.

Harrington believes the SEC's proposed rules will make the integrity of Moody's ratings worse, not better. He also believes that Moody's recent attempts to reform itself are nothing more than a pretty-looking PR campaign.

We've included highlights of Harrington's story below. Here are some key points:

- Moody's ratings often do not reflect its analysts' private conclusions. Instead, rating committees privately conclude that certain securities deserve certain ratings--but then vote with management to give the securities the higher ratings that issuer clients want.
- Moody's management and "compliance" officers do everything possible to make issuer clients happy--and they view analysts who do not do the same as "troublesome." Management employs a variety of tactics to transform these troublesome analysts into "pliant corporate citizens" who have Moody's best interests at heart.
- Moody's product managers participate in--and vote on--ratings decisions. These product managers are the same people who are directly responsible for keeping clients happy and growing Moody's business.
- At least one senior executive lied under oath at the hearings into rating agency conduct. Another executive, who Harrington says exemplified management's emphasis on giving issuers what they wanted, skipped the hearings altogether.

*BUSINESS INSIDER* / **LINK**

Since the FOMC meeting, there has been a noticeable silence over the Fed's monetary policy following QE2. But there is some evidence that the funding of government debt at low interest rates will shift to the repo market, rather than a new round of quantitative easing.

"...High levels of NBRs reflect the reluctance of banks to lend and bankable borrowers to borrow: they are symptomatic of an economy that refuses to expand.

The silence on this subject may be partly explained by the monetary focus shifting to Europe. However, it is likely that the Fed has no intention of introducing QE3, given that the expansion of narrow money so far has led only to a degree of price inflation, without much benefit to asset prices. And with the ECB still reluctant to print euros, QE3 would probably collapse the dollar/euro rate and propel gold considerably higher, putting unwelcome strains on the financial system. The Fed also finds itself having dramatically expanded the monetary base for little economic benefit: against all its expectations, the economy is sliding into recession again. Perhaps it is a case of all the people being no longer fooled all of the time with respect to what QE actually is. No, another approach is called for.

To the Keynesian mind the obvious alternative must be to expand bank credit, particularly when there is an accumulation of non-borrowed reserves sitting on the Fed's balance sheet. The NBRs represent the excess capital owned by the commercial banks, which have not been drawn down for use as the capital base for the expansion of bank credit. They currently stand at about $1.76 trillion while in normal circumstances NBRs would be no more than a few tens of billions. High levels of NBRs reflect the reluctance of banks to lend and bankable borrowers to borrow: they are symptomatic of an economy that refuses to expand.

It is against this background that Ben Bernanke announced at the recent post-FOMC meeting press conference that interest rates would be held at current levels (close to zero) for the next two years. This could be the basis for shifting the funding of government debt from printing raw money to expanding bank credit. The public do not understand the inflationary implications of expanding bank credit as easily as they do that of printing money: switching to bank credit as a funding route for government debt allows the Fed to fool all of us a while longer.

★ ★ ★ *ALASDAIR MACLEOD* / **LINK**

"... For the past two decades, according to a whistle-blower at the SEC who recently came forward to Congress, the agency has been systematically destroying records of its preliminary investigations once they are closed.

Imagine a world in which a man who is repeatedly investigated for a string of serious crimes, but never prosecuted, has his slate wiped clean every time the cops fail to make a case. No more Lifetime channel specials where the murderer is unveiled after police stumble upon past intrigues in some old file – "Hey, chief, didja know this guy had two wives die falling down the stairs?" No more burglary sprees cracked when some sharp cop sees the same name pop up in one too many witness statements. This is a different world, one far friendlier to lawbreakers, where even the suspicion of wrongdoing gets wiped from the record.

That, it now appears, is exactly how the Securities and Exchange Commission has been treating the Wall Street criminals who cratered the global economy a few years back. For the past two decades, according to a whistle-blower at the SEC who recently came forward to Congress, the agency has been systematically destroying records of its preliminary investigations once they are closed. By whitewashing the files of some of the nation's worst financial criminals, the SEC has kept an entire generation of federal investigators in the dark about past inquiries into insider trading, fraud and market manipulation against companies like Goldman Sachs, Deutsche Bank and AIG. With a few strokes of the keyboard, the evidence gathered during thousands of investigations – "18,000 ... including Madoff," as one high-ranking SEC official put it during a panicked meeting about the destruction – has apparently disappeared forever into the wormhole of history.

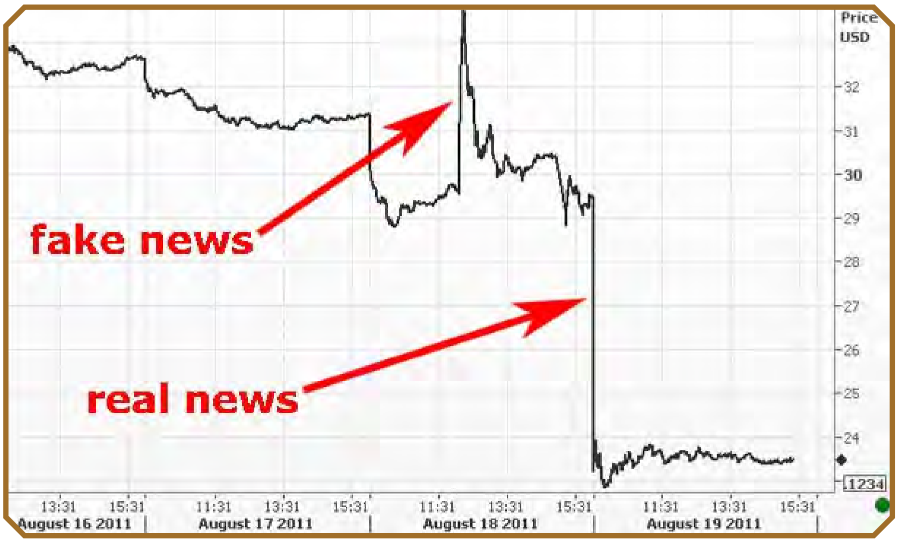
Under a deal the SEC worked out with the National Archives and Records Administration, all of the agency's records – "including case files relating to preliminary investigations" – are supposed to be maintained for at least 25 years. But the SEC, using history-altering practices that for once actually deserve the overused and usually hysterical term "Orwellian," devised an elaborate and possibly illegal system under which staffers were directed to dispose of the documents from any preliminary inquiry that did not receive approval from senior staff to become a full-blown, formal investigation. Amazingly, the wholesale destruction of the cases – known as MUIs, or "Matters Under Inquiry" – was not something done on the sly, in secret. The enforcement division of the SEC even spelled out the procedure in writing, on the commission's internal website. "After you have closed a MUI that has not become an investigation," the site advised staffers, "you should dispose of any documents obtained in connection with the MUI."

Many of the destroyed files involved companies and individuals who would later play prominent roles in the economic meltdown of 2008. Two MUIs involving con artist Bernie Madoff vanished. So did a 2002 inquiry into financial fraud at Lehman Brothers, as well as a 2005 case of insider trading at the same soon-to-be-bankrupt bank. A 2009 preliminary investigation of insider trading by Goldman Sachs was deleted, along with records for at least three cases involving the infamous hedge fund SAC Capital.

*MATT TAIBBI* / **LINK**

The death of the M&A scoop is going to happen slowly, but frankly it should happen as quickly as possible — and the past 24 hours in the history of Hewlett-Packard is an excellent indicator of why.

Yesterday, just after noon, Bloomberg found itself in possession of some market-moving news about HP: it was engaging in a major strategic shakeup, closing its WebOS division, buying UK company Autonomy for about $10 billion, and putting its PC business up for sale. (Bloomberg has since updated its story to reflect HP's formal announcement, so I can't link to the scoop itself.)



**SOURCE: REUTERS**

The markets, suffering through a massive down day, loved the news, in its leaked-to-Bloomberg form. HP shares were trading about $29.85 before the news came out; a few minutes later they were as high as $34. That's a rise of 14%, or, to put it another way, an increase in market capitalization of some $8.5 billion.

One blogger, at least, was unimpressed. Zero Hedge, in an astonishingly prescient post entitled "Hewlett Packard Leaks Good News Early, To Mask Bad News Later," explained exactly what was going on:

With less than 5 hours until the company's official earnings release, Hewlett Packard just leaked to by Bloomberg that it would spin off its PC business and purchase British software developer Autonomy PLC. This is the oldest trick in the book to get a stock to drop from a higher level in the hopes that staggered releases of news, first good, then bad offsets each other, instead of having the good news be overwhelmed by the bad... We very much doubt this surge will sustain itself for more than a few minutes after the scam is understood. We also very much doubt that today's earnings release will have anything good to say about the future.

By the end of the day, HP was back to its pre-report levels, in anticipation of a weak earnings report. But no one guessed just how weak the earnings would be...

*FELIX SALMON* / **LINK**

It sounds like this time the PBoC might be pretty serious about diversifying their risk away from USG bonds, right? Let's leave aside the fact that every six months we have heard the same thing for the past several years, and nothing has happened, shouldn't we nonetheless be worried? Won't reduced PBoC purchases be hugely disruptive to the US economy and to the US Treasury markets?

"...If the PBoC decides that it no longer wants to hold USG bonds, it must do something pretty drastic. There are only four possible paths that the PBoC can follow if it decides to purchase fewer USG bonds.

No, they won't. There is so much nonsense still being said about this, even by economist who should know better, that I thought I would try to address what it would mean if the PBoC were actually serious and not simply making noises aimed at domestic political constituents.

First of all, remember that the PBoC does not purchase huge amounts of USG bonds because it has a lot of money lying around and doesn't know what to do with it. Its purchase of USG bonds is simply a function of its trade policy.

You cannot run a current account surplus unless you are also a net exporter of capital, and since the rest of China is actually a net importer of capital, the PBoC must export huge amounts of capital in order to maintain China's trade surplus. In order the keep the RMB from appreciating, the PBoC must be willing to purchase as many dollars as the market offers at the price it sets. It pays for those dollars in RMB.

It is able to do so by borrowing RMB in the domestic markets, or by forcing banks to put up minimum reserves on deposit. What does the PBoC do with the dollars it purchases? Because it is such a large buyer of dollars, it must put them in a market that is large enough to absorb the money and – and this is the crucial point – whose economy is willing and able to run a large enough trade deficit.

Remember that when Country A exports huge amounts of money to Country B, Country A must run a current account surplus and Country B must run the corresponding current account deficit. In practice, only the US fulfills those two requirements – large financial markets, and the ability and willingness to run large trade deficits – which is why the PBoC owns huge amounts of USG bonds.

If the PBoC decides that it no longer wants to hold USG bonds, it must do something pretty drastic. There are only four possible paths that the PBoC can follow if it decides to purchase fewer USG bonds.

- The PBoC can buy fewer USG bonds and purchase more USD assets.
- The PBoC can buy fewer USG bonds and purchase more non-US dollar assets, most likely foreign government bonds.
- The PBoC can buy fewer USG bonds and purchase more hard commodities.
- The PBoC can buy fewer USG bonds by intervening less in the currency, in which case it does not need to buy anything else.

★ ★ ★ *MICHAEL PETTIS* / **LINK**

The delivery of Greece's €109bn (£95bn) bail-out package agreed last month could be delayed amid a rush of demands from countries wanting "Finnish-style" individual collateral agreements in return for their support.

European Union members, including Austria, The Netherlands, Slovakia, Slovenia and Estonia, have spoken out against Greece's agreement to pay Finland around €1bn collateral if the Nordic country backs the bail-out.

In the wake of the deal, which was announced on Tuesday, they want similar agreements too.

Ivan Miklos, Slovakian finance minister said: "I consider it unacceptable for any country not to have collateral when other countries have it."

He added: "Because if this is a loan, and that is what everyone is calling it, the debtor should have no problem offering collateral for the loan."

"... Yesterday Greece's finance minister warned the country is sinking deeper into recession, with revised forecasts indicating negative growth of close to 5pc this year

The Austrian Finance Minister Maria Fekter told reporters: "The Finns have negotiated with the Greeks that they get 20 percent of collateral in cash from the other member states. If every country demanded 20 percent, the entire package would blow up."

The collateral issue "is something that goes against the logic of the whole bailout package," said Marius Daheim at strategist at Bayerische Landesbank in Munich. "It has the scope to result in a conflict and to topple the whole second bailout package."

Raoul Ruparel of Open Europe, the London-based think-tank, said: "Such demands threaten to derail the whole package as Greece is unlikely to be able to afford to offer guarantees to numerous states."

The deal still has to be approved by Brussels, but experts warned that the worsening economic outlook in Greece may lead to other countries demanding individual collateral agreements too.

Yesterday Greece's finance minister warned the country is sinking deeper into recession, with revised forecasts indicating negative growth of close to 5pc this year - far below the 3.8pc shrinkage forcast by the EU and IMF.

Evangelos Venizelos told an Athens radio station: "There's now a range of forecasts suggesting growth could shrink by above 4.5pc – and we have yet to see where it will stop."

★ ★ ★ *UK DAILY TELEGRAPH* / **LINK**

On August 10th, after years of secretive work, the Chinese navy launched its first aircraft-carrier on its maiden voyage. The Chinese media hailed the vessel as a sign of China's emergence as a sea power, one they insist has only peaceful intent. Its neighbours are not so delighted.

State-controlled media had been predicting the ship's imminent launch for weeks, prompting Chinese military enthusiasts to converge on the north-eastern port city of Dalian in the hope of seeing it set out. One newspaper said a fire escape on a nearby IKEA store was a good vantage point, but the Chinese navy kept quiet about when the date would be.

It has reason to be diffident. The ship is hardly a symbol of China's prowess in technology. It was bought in 1998 from Ukraine, where it had been rusting half-finished since its first launch a decade earlier. The Ukrainians were told it would be used as a floating casino (they sold it without weapons or engines). But unlike two other ex-Soviet carriers in China that ended up as theme parks, this one was taken to a navy shipyard where, in 2005, it got a telltale coat of Chinese military paint. It was not until July that China confirmed it had been refitting the ship.

China has been mulling plans to build an aircraft-carrier since at least the 1970s. Officials debated how useful one would be in a conflict over Taiwan, the military planners' main preoccupation until a few years ago. Land-based aircraft and missiles could be deployed easily across the Taiwan Strait. But in the past decade China has become more focused on acquiring the means to project power farther afield, the better to defend shipping lanes, it says, and to help relief efforts.

Other countries in the region believe China also wants to assert territorial claims in the South China Sea more vigorously. Vietnam and the Philippines have been complaining in recent months about what they see as a more aggressive posture by China in that area. There had been speculation that the aircraft-carrier would be launched in time for the Communist Party's 90th birthday on July 1st. It is possible that its leaders decided that a lower-key affair a few weeks later might avoid stoking the neighbours' suspicions.

For the time being the region's pre-eminent naval power, America, is showing little sign of concern. The Chinese carrier's actual deployment might yet be years away. China will take longer still to gain the expertise needed to deploy a carrier-based battle group, with all its supporting vessels. It is reportedly building two more aircraft-carriers (from scratch, this time). But the Americans worry more about other bits of China's rapidly improving arsenal, from carrier-busting missiles to submarines and land-based fighter jets.

★ ★ ★ *THE ECONOMIST* / **LINK**

European Union President Herman Van Rompuy ruled out issuing common bonds as a cure for the debt crisis, saying any joint borrowing should wait until European economies and budgets are better aligned.

With three countries drawing financial aid and national debts ranging from 6.6 percent of gross domestic product in Estonia to 142.8 percent in Greece, this is the wrong time to set up a single borrowing agency, Van Rompuy, 63, said in an interview broadcast on Belgium's RTBF radio today.

"... Van Rompuy said unwarranted panic sparked the selloff of Italian and Spanish bonds that led the European Central Bank to intervene earlier this month..."Markets aren't always right," Van Rompuy said

"We could have euro bonds on the day when there is genuine budgetary convergence, the day when everyone is in balance or virtually in balance," he said.

Pledges of 365 billion euros ($526 billion) in official loans to Greece, Portugal and Ireland, and 96 billion euros of bond purchases by the European Central Bank have failed fix the finances of those countries or prevent speculative attacks on Spain and Italy.

Van Rompuy sided with Germany and France in damping down the euro bond debate, saying the answer to the crisis lies in executing plans like last month's decision to give more flexibility to the bloc's 440 billion-euro rescue fund. He urged governments to quickly ratify the plan so the fund can buy bonds in the secondary market.

French Prime Minister Francois Fillon wrote in Le Figaro newspaper today that common issuance would "increase the cost of servicing French debt and might even put its credit rating in doubt."

Van Rompuy said unwarranted panic sparked the selloff of Italian and Spanish bonds that led the European Central Bank to intervene earlier this month. He praised both countries for enacting further budget cuts.

"Markets aren't always right," Van Rompuy said. He cited purchases of the Swiss franc, which jumped 14 percent in value this year, as an example of investors overreacting to European debt concerns and the U.S. credit downgrade by Standard & Poor's.

"If the Swiss franc becomes a safe haven currency, it's because something fundamentally disproportionate is going on in the world's markets," he said.

While European growth is slowing from the first half of this year, the continent enjoys healthy economic fundamentals and will escape recession, he said.

Van Rompuy said a six-part package of laws to strengthen Europe's rules on national deficits is likely to be passed next month.

Europe's next move will be to streamline its communications policy to defuse public disagreements between governments that undermine market confidence, Van Rompuy said, previewing proposals he will make at an October summit.

★ ★ ★ *BLOOMBERG* / **LINK**

The euro region would become an "inflation community" if member countries decide to sell bonds jointly without unifying their fiscal policies, German Finance Minister Wolfgang Schaeuble said today.

"Unless there is a single financial policy in the euro area, there won't be a single rate of interest" on debt sold, Schaeuble said at the finance ministry in Berlin.

"...Unless there is a single financial policy in the euro area, there won't be a single rate of interest" on debt sold

Selling common bonds with a single interest rate would spark inflation and destabilize the currency as long as the euro area doesn't have a single budget policy, Schaeuble said in his first public engagement since returning from a summer break.

The European Commission said yesterday it may present draft legislation on joint euro-area bonds after completing a feasibility report. The commission, the EU's regulatory arm in Brussels, earlier this year opposed such a step because of German-led objections.

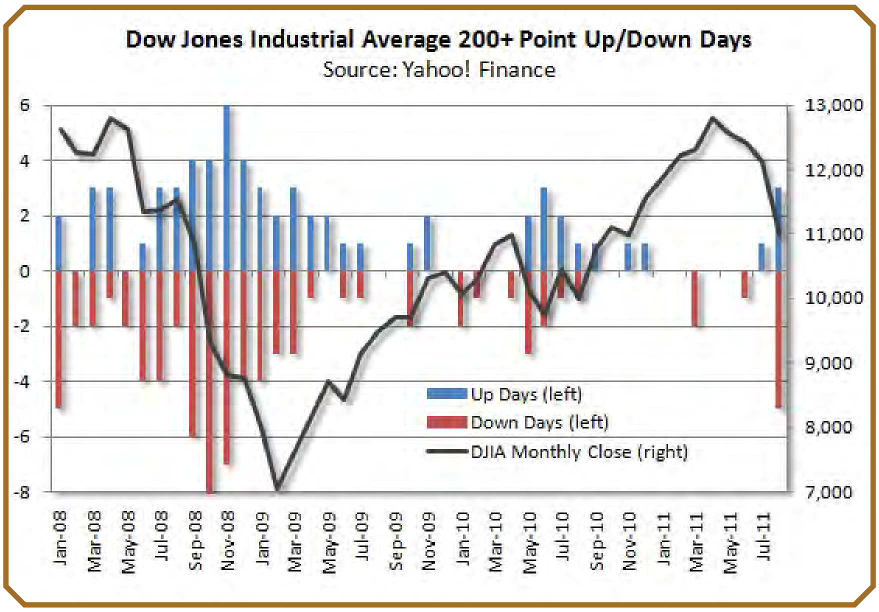
Hyperinflation in Germany between 1921 and 1923 has influenced policies at the Bundesbank since it was created in 1949 to safeguard the stability of the deutsche mark. Inflation in Germany, Europe's largest economy, rose to 2.6 percent in July, outstripping the ECB's reference rate of 2 percent.

Chancellor Angela Merkel yesterday told members of her Christian Democratic Union party that she opposed a "collectivization" of debt that would leave the bloc's members worse off. Merkel's party faces two state elections in September, the same month in which her coalition aims to win a parliament vote for a second round of financial aid to Greece.

A majority of German voters oppose joint euro-area borrowing to quell the debt crisis, a poll published Aug. 18 showed. Seventy-six percent of respondents said they were against euro bonds and 15 percent in favor, according to the Emnid poll for broadcaster N24.

Germany would face extra costs of 47 billion euros ($67.6 billion) annually if it aligns interest rates with nations that pay more to borrow, the country's Ifo institute said on Aug. 17.

★ ★ ★ *BUSINESSWEEK* / **LINK**

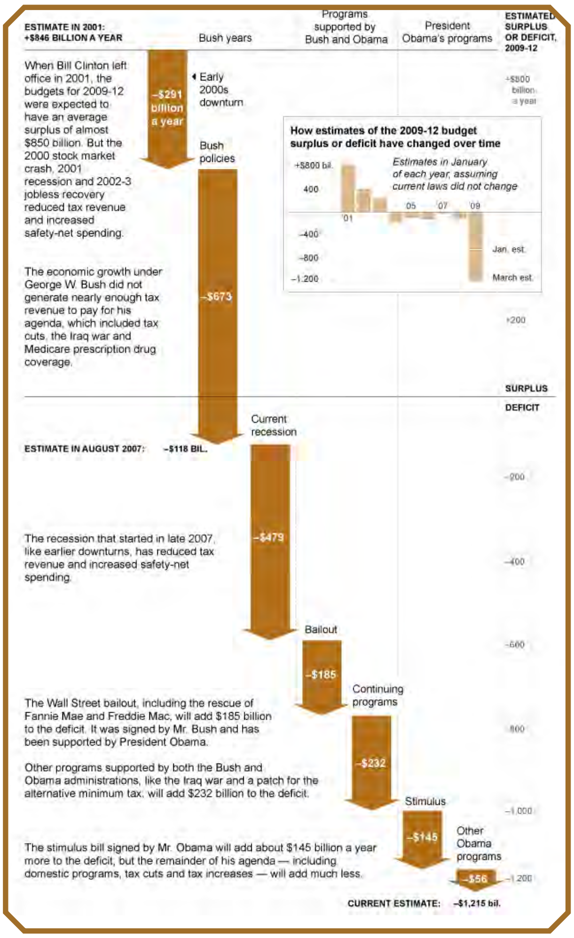



**SOURCE:** TIM IACONO

The chart [left] would be far less terrifying if August were almost over, but, since we're only about half way through and have already seen the most 200+ point days for the Dow in a single month since December of 2008 (when it looked like the global financial system might not survive) many stock investors are probably reaching for the Maalox right about now.

Based on an extrapolation of the 14 days of trading that are already in the books this month, August will equal the volatility seen in October and November of 2008, back when TARP was being debated and implemented, voters were casting their votes to elect a new president, and 200+ point swings for the Dow were the rule, not the exception.

*TIM IACONO* / **LINK**



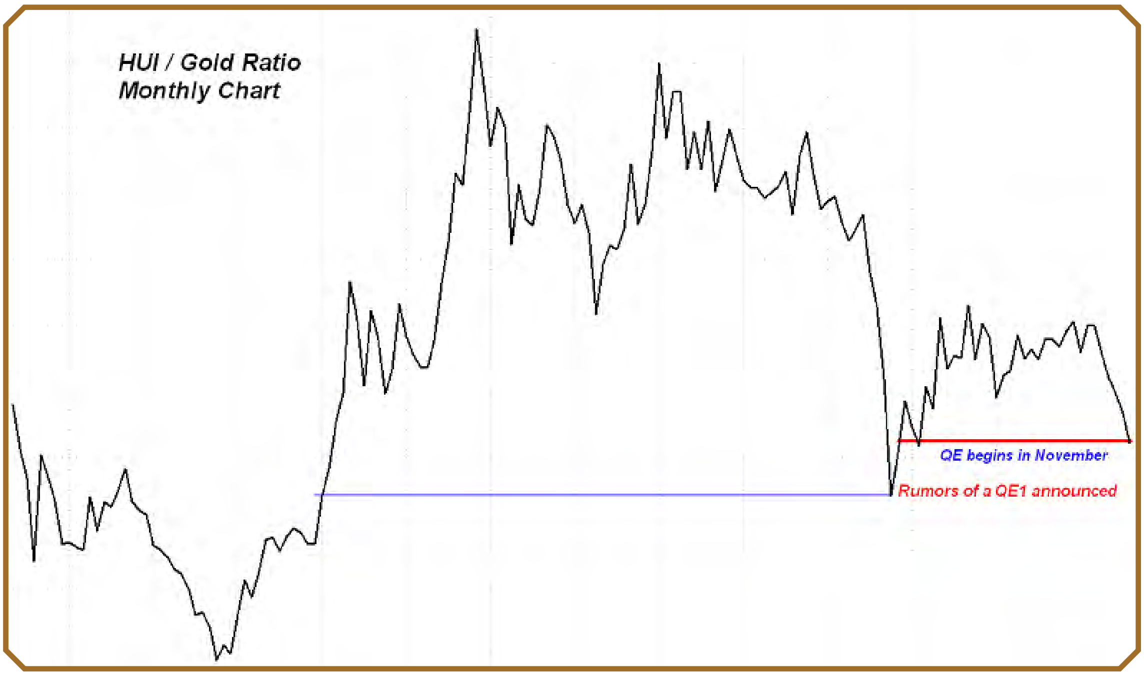

**CLICK TO ENLARGE**

**SOURCE:** NY TIMES

If you want to know how the US maxed out it's credit card this fascinating graphic from the NY Times (via Vizualizing Economics) lays it all out for you....

The following ratio chart says in a picture just how severely undervalued the gold stocks are in relation to the price of bullion.

You might recall that as the credit crisis erupted in the summer of 2008 with the failure of Lehman Brothers and subsequent meltdown of other large financial firms, stocks and commodities plummeted as the Yen carry trade unwound and deflationary fears escalated.




**SOURCE:** **DAN NORCINI**

The rumors began to circulate as the crisis deepened that the Federal Reserve was getting ready to implement some unorthodox policies in an attempt to stave off the deflation and prevent a credit market lockup. That was when the phrase, “Quantitative Easing” first began making the rounds in the markets.

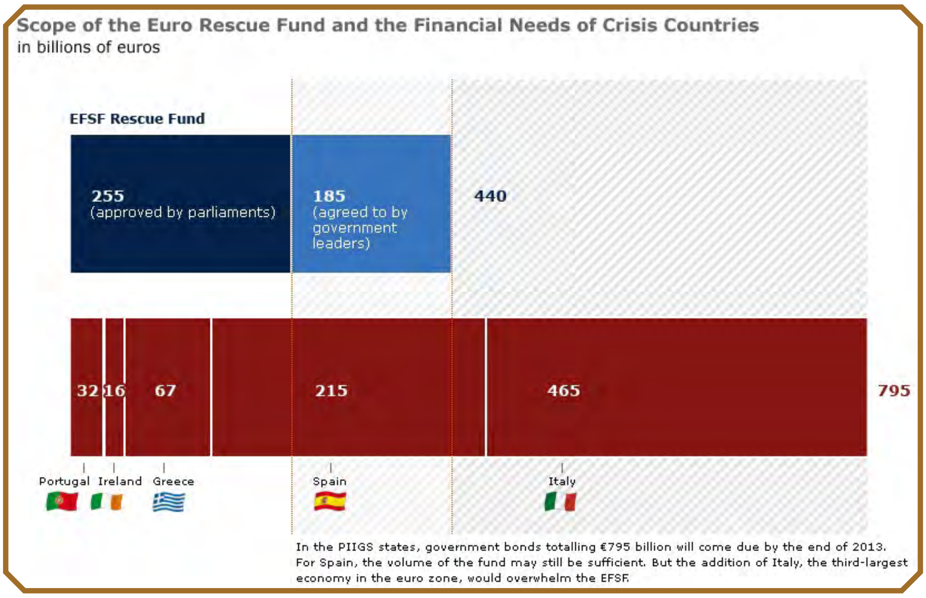
So confident were traders that the Fed was not going to sit idly by while the entire US financial system imploded that they began covering shorts and bidding up the price of equities and commodities ahead of what was then announced with certainty in November of that year.

Look at the chart and you can see that while the HUI/Gold ratio is not at the depths it reached during the peak of the credit crisis, after today, it is now at levels last seen just before the QE1 was actually implemented.

If you look across the chart to the left and note the blue line reaching back to the end of 2001, you can see that the mining shares relation to gold had actually plummeted to levels last seen near the VERY BEGINNING of the now decade + long bull market in gold. That is how cheap the shares had become to gold bullion in the third quarter of 2008.

Quite frankly, we are not all that far off from levels seen at that time with today’s round of selling across many of the mining shares. This has occured in spite of the fact that we have spent more than $2.5 TRILLION between QE1 and QE2 and seen the gold price leap from $700 in November 2008 to over $1800 as of today’s close.

*DAN NORCINI* / **LINK**

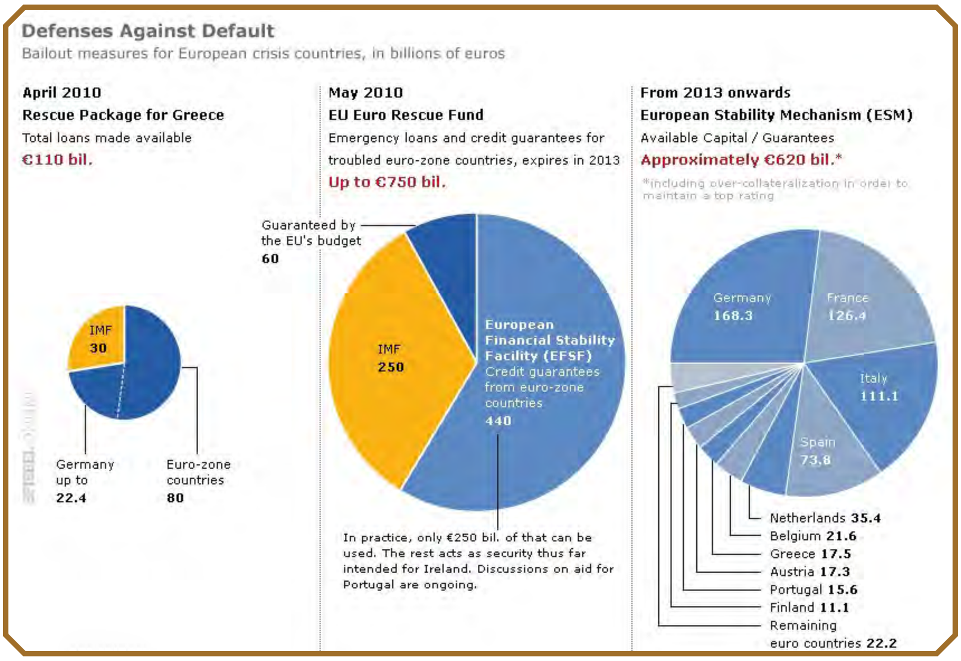



CLICK TO ENLARGE

SOURCE: DER SPIEGEL

The EFSF is very much the centre of attention at the moment. Der Spiegel has a series of excellent charts that offer a great perspective on some of the nuances of a hastily-assembled scheme that looks to be Europe's last hope.

Let us pray...




CLICK TO ENLARGE

SOURCE: DER SPIEGEL

**CLICK TO LISTEN**

Regular readers are well aware of the high regard in which I hold Bill Fleckenstein of Fleckenstein Capital and today, Fleck talks to Eric King about the usual suspects in gold and silver, but also the Banking Crisis Part II, the cooking of books and what he feels may be the endgame.

As always, listening to Fleck's thoughts is a very worthwhile way to spend ten minutes of your day...

Apropos of our discussion today, Jim Rickards, another frequent visitor to these pages, had a few interesting things to say about what the US might do with the gold held in its vaults when he was interviewed by CNBC last week:

> *"If I was Germany, I would want to move some of the gold back to Berlin. Why do they keep it here? Sometimes you don't ask the question because you don't want the answer. If Germany called up and said, "we're sending a vessel, we want to ship our gold back", the answer might not be pretty."*

**CLICK TO WATCH**

**CLICK TO WATCH**

In 1965, Charles de Gaulle sat before a packed press conference and proceeded to gaze into the future... (my thanks to Jesse)

*Hindsight is the time machine*
*You will live certain perils*
*Over*
*And*
*Over*
*But the second time around*
*Will be more painful than the first.*

- David Jonathan Newman, *Pure Luck*

The majesty of Double Arch in Arches National Park is captured in a stunning 360º panorama.

This is just one of a series of incredible photographs you will find if you click on the image below.

(Thanks AZ!)

CLICK TO VIEW

*Hmmm…*

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