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The Law of Supply and Demand Is Dead for Gold and Silver

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I'm going to preface this article by warning you that this is one of the longest and most important articles I have scripted in many months. During the recent gold and silver correction that began on July 14, 2008 and which perfectly coincided with the miraculous surge higher in the U.S. dollar, there was a massive story unfolding that should have been a lead story in every financial magazine, newspaper and website. Yet the media responded with silence. The story was so big, as a matter of fact, that every economics textbook should now have to remove the Law of Supply and Demand from their pages because if free markets still exist, the recent behavior in gold and silver markets strongly obliterates it.

Before I begin with that story, make no mistake that we have just experienced a steep correction and not the end of the gold and silver bull. Also make no mistake that this recent dollar rally is a miraculous rally because fundamentally nothing has changed about the U.S. dollar that could explain such a quick surge higher. In my last post, though I described calling the bottom of the gold markets a "sucker's bet" that was a waste of time when markets are so blatantly manipulated, I foolishly took the bet anyway and was wrong about predicting the bottom (I've now learned my lesson about taking a sucker's bet when I know it is one! Still, my subscription members well know my updated position about the short-term direction of gold and silver markets since this last public posting). But on to the meat of this article.

The Law of Supply & Demand is Broken: Demand Soars and Prices Plummet!

Consider the following. As gold and silver prices started to plummet on July 14th, surging physical demand for gold and silver continued to lead gold and silver prices markedly lower. **For the first time in history, record demand in a commodity was helpless to stem plummeting prices and in fact, contributed to further price declines.** In July, India bought 22 tonnes of gold. In August, according to Reuters, India increased its gold purchases by more than 350%, buying more than 100 tonnes of gold.

This figure also represented a 56% increase in purchases when compared to purchases during the same month from a year prior. In Dubai, demand surged as well.

"We are definitely witnessing a surge in demand for gold in Dubai and physical shortages have been reported by many dealers," said Ian MacDonald, the Dubai Multi Commodity Center's executive director for gold and precious metals. *"We are also seeing demand being driven by currency concerns in the region as many investors perceive the precious metal as one of the few strong currencies."*

Gold jewelry sales in Abu Dhabi soared 300 percent in volume and almost 250 percent in value in August from a year earlier after the metal dropped to nine-month lows, the emirate's industry group said on Monday.

"It was the best month the market has seen in almost 30 years and it compensated for any drops we have seen earlier this year," Abu Dhabi Gold and Jewelry Group Chairman Tushar Patni told Reuters. *"We had* ***never expected*** *(emphasis mine) that if gold fell below $800 an ounce we would see a 300 percent increase in volume and 250 percent in value, especially as many buyers are abroad on holiday."*

In the United States, the stories were the same. Many gold and silver bullion and coin dealers reported record sales in August and shortages of supply. I could quote fifty other stories similar to the ones above, but for the sake of brevity, I will not. Global sales of gold and silver would have to be at record levels in August for gold and silver prices to be pushed much higher for that month, and all preliminary indications are that global sales in August for gold and silver were indeed at record numbers. So how can it be that record demand and sales in the physical gold and silver markets would cause gold to plummet from a price of $910 an ounce at the beginning of August to less than $750 an ounce, and silver to plummet from a price of close to $18 an ounce at the beginning of August all the way down to almost $10 an ounce?

When this inexplicable anomaly was pointed out (at least inexplicable according to the supposedly irrefutable Law of Supply and Demand), gold and silver analysts employed by Wall Street to spread disinformation responded only to stories of shortages being reported in the United States and did not address record sales of physical gold in various countries in the Middle East and in Asia. They responded to reported U.S. shortages of bullion and coins by stating that dealers had supply but were simply not being honest about their supply numbers because they did not want to sell any more stock at

such depressed prices. This certainly could have been a very reasonable and logical explanation that adequately explains some of the shortages that were reported by gold and silver dealers. However, this was not "mystery solved" as these demagogues employed by Wall Street claimed.

During this Correction, Gold & Silver Steady or Much Higher Many Days in Asia, Down Markedly Lower by Close of New York Markets

How can record sales, the strongest in 30 years, and shrinking supply in other regions of the world like the Middle East and India, cause prices of gold and silver to plummet steeply as well? Clearly, since price is a function of supply and demand, rising record demand for gold in India and the Middle Eastern markets should have stopped the downward slide in gold and silver markets dead in its tracks and led the price higher again. And indeed this is exactly what happened. But it happened only in the futures markets in Asia. Last week MarketWatch reported a story that gold experienced one of its worst months ever in this bull run because August had not one day where gold closed higher in price; however, this article only told half the story as the media so often does. Gold experienced many days in August were it closed higher in Asia and significantly higher, often piling on gains of $5 to $10 an ounce. These gains were only lost once London markets closed and New York markets opened; only then, were gains quickly sold off and then transformed into deep losses within a span of 24 hours.

If one constructs the 24-hour gold and silver charts for every day during this correction, one will discover an overwhelming amount of days when gold and silver were significantly higher in futures markets in Asia, but then were sold off harshly at nearly the exact same time (within a 30 minute time frame) when London markets closed and New York markets opened. How could this have happened? Simple. The price for gold and silver that you see plastered all over financial tickers everyday is established in the paper futures markets and not in physical markets where REAL gold and silver actually exchange hands. In the futures markets, only 1% of all futures contracts are closed out with actual delivery of the physical commodity. Instead 99% of all futures contracts are closed out with the purchase of another paper contract. In the case of gold and silver, futures contracts represent digital bytes of gold and silver flying around in a paper market, not real ounces of gold and silver that exist in the physical market. Thus it is entirely possible to utilize this discrepancy to create two entirely different prices for the same commodity. **In other words, if not properly regulated, futures markets provide a gateway to manufacture massively fraudulent prices non-reflective of the buying and selling volumes that are occurring in the physical markets!**

Two Parallel Markets For Gold & Silver: Paper Markets & Future Markets

Thus, the world can end up with two parallel markets that act differently: a papers market for gold and silver and a physical markets for gold and silver that establish significantly different prices for the same commodity over short periods of time, odd as this may seem (I say short periods of time because unless perpetually manipulated, free markets will eventually work out such massive distortions over time). The recent actions that were coordinated in the futures markets for gold and silver beginning on July 14th would most likely have been impossible to replicate in the physical world of gold and silver. To any veteran investor in gold and silver, the manufacturing of this correction was as plainly transparent as a two-ton boulder falling out of a clear blue sky. Though I won't discuss the other mounds of evidence that explain how this correction was manufactured, these other specifics deal with large U.S. institutions that piled on huge short positions in the futures markets for gold and silver in an incredibly compressed period of time around July 15th.

Again, the gold and silver analysts paid by Wall Street to spread misinformation spoke out against the manipulation theories, simply stating that the dollar was overdue for a bounce and gold and silver markets were overdue for a correction. I have stated multiple times myself over the years that bulls never rise straight higher and will correct, and that bears never plummet straight downward and will experience bear market rallies. This much is true. Still, what transpired starting this past mid-July was far beyond the realm of a free-market inspired U.S. dollar bear market rally and a free-market induced gold and silver bull market correction. The meteoric rise of the U.S. dollar since July 15th and the panic inducing slide in gold and silver prices reeks of manipulation and not a natural free-market rally and correction for many reasons.

For instance, try explaining this. I know for a fact that certain gold coins that were selling in the low $700 range when the price of gold bullion was at $680 an ounce a couple of years ago were still being priced at more than $1,100 by gold coin dealers even when gold slid all the way down to $750 an ounce during this current correction. When I inquired as to why the prices of these gold coins had not also slid to $780 or so (as would have been dictated by the spot market price of gold), but were instead still selling for well over $1,100 a coin, the dealers answered that demand, not the spot price of gold in the futures market, was setting the prices of these coins. Since demand was off the charts, the prices did not reflect the monumental drops in price in the futures markets. When I checked the market for silver coins, I discovered the same massive disconnect between prices set in the physical markets for silver and in the silver futures markets (that only comprise "paper" silver). Silver coins were selling at prices sometimes 60% to 70% higher than what would have been indicated by the spot price of silver determined in the futures markets.

Last month it was clear that the Law of Supply and Demand was dead for gold and silver markets. Soaring physical demand for gold and silver were not factored at all into the prices set in the PAPER gold and silver futures markets. Incredibly, soaring physical demand created a greater acceleration of losses in the prices in the PAPER gold and silver markets. One way to interpret this disconnect between physical and paper gold and silver markets that clearly happened last month is this: If a bushel of corn were selling in the September futures market for $1.40, but if you were to go to a farm

in Anytown, USA and had to pay $3.10 for a bushel of corn, what would you conclude was the REAL price of corn? This is how you can determine the real price of silver and gold today. Look to the physical markets, not the paper markets, for the real price of gold and silver. **Who cares what the paper futures markets are stating as the spot price of silver, if I still have to pay 60% more than this price when buying silver coins in the real world? The price is simply what I have to pay for the real physical silver, period.**

The Usual Suspects

The most likely culprits of this manipulation are all members of the U.S. President's Working Group on Financial Markets (the SEC, the Commodities Futures Trading Commission, the U.S. Treasury, and the U.S. Federal Reserve). A massive disconnect between the price of gold and silver in physical markets and the price in paper futures markets, of the extent that happened last month, either means that the Law of Supply and Demand has just been proven to be invalid, or that massive fraudulent manipulation just occurred. I will let you make this conclusion. However, let me be clear that the evidence of manipulation was so overwhelming this time that it was not just the usual suspects, including yours truly, voicing these opinions. It must have greatly dismayed the mainstream analysts that try to cover up evidence of manipulation in commodity markets, particularly in gold, silver, and oil, that a member of the mainstream investment community attributed the recent gold and silver decline to manipulation.

It also must have dismayed these same analysts that four U.S. Senators who are key members of Congressional energy committees recently stated that the Commodities Futures Trading Commission "**obviously knew** that underlying data used to prepare the interim report was **seriously flawed**." (emphasis mine) (The report referenced by the Senators was a key report distributed to U.S. Congress days before a legislative vote to close commodity trading loopholes that allow massive manipulation of commodity markets. The report stated supply and demand was solely responsible for the recent run up in oil prices to $147 a barrel. The seriously flawed data that was contained in the report, after it was corrected, demonstrated that manipulation was responsible for the run up in oil prices. Based upon the deliberately falsified data provided by the CFTC (the Senator's words, not mine), Congress voted to keep the loopholes open. Read the whole story here).

Don Coxe, chairman and chief strategist of Harris Investment Management in Chicago, one of the top respected investment groups in the United States, called this recent manipulation of gold and silver markets that broke the Law of Supply and Demand a "brilliant" plan executed by the U.S. Federal Reserve and U.S. Treasury. My reply to Mr. Coxe? Let's not get carried away. If I was in charge of the U.S. Treasury and could direct the CFTC, the SEC and various Wall Street firms through the President's Working Group on Financial Markets, I could have pulled this plan off in my sleep. If the plan was executed in the manner that Mr. Coxe speculates, there was nothing brilliant about it. Let's call the plan for what it was. Fraud and a shameful dismantling of free markets and capitalism. Plain and simple.

But in today's world fraud is the name of the game. When the Law of Supply and Demand was broken in the gold and silver markets in August, for a comparable story of similar magnitude to exist in the scientific world, the Law of Gravity would have to be disproven. If it was reported that in California, a man ran down the street, threw his hands in the air and flew for a length of 200 meters while 10 meters from the ground, don't you think that reporters would be scrambling to report this story? Yet gold and silver markets just proved the Law of Supply and Demand to be no longer relevant in August 2008, and ZERO members of the mainstream financial press deemed this story to be newsworthy.

Fannie Mae (FNM) and Freddie Mac (FRE) committed fraud for years and nearly triggered the collapse of the entire U.S. housing market. When their bailouts finally became necessary, people that ingested the force-fed spin that this bailout was "for their own good" and don't understand the implications, cheered the fraud that allowed the Fannie Mae and Freddie Mac CEOs to retain their tens of millions in salary and bonuses they collected from engineering this fraud. Furthermore, for their roles as architects of this fraud, Freddie Mac CEO Richard Syron and Fannie Mae CEO Daniel Mudd are to respectively receive a severance payout of approximately $6.3 million and $7.3 million, respectively. When Stan O'Neal and Chuck Prince were respectively ousted from Merrill Lynch (MER) and Citigroup (C) for their terrible leadership and participation in creating the most massive financial crisis the U.S. has seen in decades, what were their rewards for leading investors of their stock into financial ruin? A $160 million and a $40 million golden parachute, respectively.

The reason this current story is so important is the following: The very acceptance and nonchalant reactions to this fraud by billions of people worldwide poses an equally serious threat to the health of the U.S. and global economy as the actual perpetrators of these fraudulent actions. Though I've never asked any of my readers to take action before, I urge you this time to email the link to this article at my investment blog, theUndergroundInvestor, to every single person that you know that has ever had so much as a ruble, a dollar, a peso, a real, a Swiss franc, a Euro or a pound invested in stock markets. Knowledge is power, and only knowledgeable persons can prevent these same shenanigans from happening in the future. **As this financial crisis deepens and we have only seen the very beginning of it, the intensity of disinformation campaigns will increase at an exponential rate. To solve the crisis will require aware and knowledgeable investors, and masses of them.** Thus, we must begin spreading awareness today and not a day later.

The Likely End Game: Re-Capitalization of the U.S. Financial Sector at the Expense of the Individual Investor

I'll conclude this article with my theory of why this manipulative scheme was executed in the gold and silver markets, for I have not seen another analyst give any credence to this theory as of today's date. This sell-off in gold and silver and the U.S. dollar rally wasn't engineered just to stem the record rate at which foreign central banks were dumping U.S.

Treasuries (another huge story that somehow the entire mainstream financial press somehow missed). Furthermore, this scheme wasn't hatched solely because it was a necessary step to save the global financial markets as Don Coxe speculated. Both are fine reasons, but ultimately, unlikely to fully explain why this scheme was hatched in July. With the failure of Fannie Mae and Freddie Mac, the failure of Merrill Lynch (just announced Monday), the likely failure of Lehman Brothers (LEH), and the likely failure of a huge U.S. financial institution on the imminent horizon, all these failures are about to place a serious squeeze on the already hemorrhaging balance sheets of some of the world's largest financial institutions. With foreign interest in increasing ownership in these institutions quickly dissipating and weak share prices unable to translate secondary offerings of stock into significant amounts of capital, some of the largest financial institutions were absolutely desperate to find a channel in which to raise significant amounts of capital (not hundreds of millions, but billions of dollars) very, very quickly. What just happened in the gold, silver and oil markets accomplished this goal, and thus may have been integral in preventing a global financial collapse.

Let me explain. During this recent gold and silver correction, gold and silver markets were higher, and significantly higher in Asia before drastically turning significantly lower in New York almost on a daily basis. The creation of these huge arbitrage opportunities could have been exploited by large financial institutions to reap billions in profits in an incredibly condensed period of time. The type of arbitrage opportunities that existed during this recent correction in gold and silver was absolutely enormous. Unprecedented 2% to 5% swings in the price of gold and silver bullion from their highs in Asian markets to their lows in New York markets happened time and time and time and time and time and time and time again during this recent correction (if you were unaware of this action or don't believe me, simply search out the 24-hour charts for gold and silver for the entire month of August and you will be absolutely dumbfounded from what you will discover). These swings in prices were so enormous that daily swing trades in futures markets, given these arbitrage opportunities, could have produced hundreds of millions of dollars of profit in a single 24-hour trading day. During the past few weeks, these arbitrage opportunities may have produced profits in the tens of billions of dollars, if not more, for just a small handful of firms.

If I were a large financial institution with a critically hemorrhaging balance sheet due to massive losses created from insane foolish and risky bets on MBS (mortgage backed securities) and CDOs (collateralized debt obligations), and I wanted the quickest way to recapitalize my balance sheet, how would I do it? Through gross manipulation of commodity markets, in particular the gold, silver, oil and agriculture markets. Of course, I would need the help of certain regulatory agencies to achieve this and wouldn't be able to accomplish this on my own, but I'm going to speculate that this is exactly what just happened. This correction was not only just about shoring up the U.S. dollar and U.S. Treasuries, but also about recapitalizing Wall Street and huge banking institutions. Though I haven't covered the oil and agriculture futures markets, there is more than ample evidence that the same thing has occurred in these markets as of late as well (and again, the evidence is blatant enough that U.S. Senators have demanded investigations into much of the curious behavior I have delineated in this article). Again, if you are someone interested in putting an end to the regulatory and government schemes that continue to reward CEOs for their incompetence, dishonesty, and disloyalty to shareholders, and you care about the future of the United States, I urge you to forward this article to everyone you know.