Market Manipulation and the Second Great Depression

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“Market Manipulation, Fraud, Corruption, and the Second Great Depression“

‘The Matterhorn Interview’ – October 2011

In an exclusive interview for Matterhorn Asset Management, Lars Schall discusses with financial journalist Nomi Prins from the United States and fund manager Wesley Legrand from Australia issues related to the precious metal markets, central bank policies, and the parallels between our days and the age of the Great Crash / Great Depression. Unfortunately, “we’ve just haven’t learned.”

Nomi, why should people pay attention to the precious metal markets?

Nomi Prins: Right now, in particular as the second Great Depression is in progress, many investors, banks, governments, and regular people look to the precious metal markets, especially gold, in order to have an alternative to the currency markets. What we’ve seen in the last couple of years in the money markets in general has been chaotic, volatile, and screwed up because governments have been creating money through printing it, as well as extending substantial loans to banks, which hit national economies as debt, in order for these banks to navigate their own problems; as the crisis they created and perpetuated wreaks havoc on the rest of the planet. Gold and silver offer a way that lies slightly outside of the chaos that’s occurring in that printed currency market.

Do you think that gold is an adversary to the currencies of Western central banks?

Nomi Prins: Again, as an alternative to printed, debt-backed currency, it is certainly viewed by investors and also by individuals as having more intrinsic value, with the potential of more appreciation as well, given our current environment, than Western currencies. There is a physical nature to it as opposed to the vapid printing machine nature of central bank created currency. On the other hand, every tradable entity in the global markets has a political underpinning and has the potential to be manipulated; in that respect, even physical gold is something that can be acquired or sold or leveraged in the futures and options markets, in large quantity by banks, central banks and governments far more easily than individuals can, which gives gold trading the potential for manipulation by these larger factions. Nonetheless, it is a viable currency alternative and given the chaos in today’s markets, there remains a value to having a kind of independence that printed currencies don’t necessarily have, from debt-based national economic policies.

Wesley, what is gold’s pivotal role in global politics and finance?

Wesley Legrand: Gold has always been the purest and oldest form of sound money. It really is now the barometer of faith in the fiat monetary system. It is very hard to measure confidence and faith, but that of course is what the whole system is dependent on. Gold is the best measure of that faith. There is no counterparty risk to gold, it is pretty much the only monetary asset in the world where there is no counterparty risk.

Why has the suppression of the gold price been a prime directive of the establishment and central banks?

Wesley Legrand: Effectively the underlying reason is to mask and therefore facilitate monetary inflation, which is simply money printing. They are stealing purchasing power away from the masses, it’s a stealth tax. Obviously all fiat paper currencies have lost significant purchasing power since the gold standard was abandoned in 1971, and the US dollar as the world reserve currency has lost more than 90 percent of its purchasing power in that time. So that is the underlying reason – to facilitate and mask the inflationary tax.

Do you think, too, that the suppression or “managing” of the gold price has been a prime directive of the establishment and central banks?

Nomi Prins: I think there is this fear. The central banks and the national economic establishment, first and foremost, want to maintain control over monetary policy with respect to rates, and thus, to the printing of money. This serves the purpose of backing the risk that banks dumped into the market through faulty assets, derivatives and excessive leverage. They seek to retain influence, to be able to offer debt in return for austerity measures in Europe, or debt in return for conversations about different kinds of austerity measures in the United States like cutting socio-economic programs like Social Security and Medicare. Suppression of the price of gold, as an alternative currency, is a way to keep that control and influence.

How important is short selling in the precious metals markets seen from the perspective of a fund manager?

Wesley Legrand: It’s of paramount importance, because this is the main tool that the bullion banks use in their price suppression scheme. The JP Morgan’s and HSBC’s are in effect the expansion arms of the Federal Reserve and the US government. They can create paper gold, which is obviously different to physical gold, and they can create as much paper gold as they like to short sell. They short more gold and silver than actually physically exists.

Do you think those short positions are illegal, because they are naked, not backed by anything physical?

Wesley Legrand: Correct, yes, I do, as there is simply no bona fide financial reason for these investment banks to be involved in precious metals or commodity markets in this way. Naked shorting is blatantly manipulative and should be banned completely.

What’s your take on short selling in the precious metal markets, Nomi?

Nomi Prins: We have to consider short-selling which is legal vs. naked short-selling which isn’t. The issue of simple short selling is when banks – or private equity and hedge funds – take a position that the price of gold will fall for some particular period. If they back that position with extreme leverage, they are effectively suppressing the value of gold. But this is legal. By naked short selling, banks – investments banks, private equity, hedge funds, etc. – can illegally manipulate the gold price by their short sell without even necessarily having a stock of physical gold to back their short, which is technically illegal. But because there is no real global reporting mechanism or requirement for indicating gold naked shorts, or silver for that matter, there is no real transparency for the banking system in terms of who is short or by how much and thus, how much they would have to possibly get in the form of physical metal in order to fill that short. And this goes for the Federal Reserve and European Central banks as well. It is difficult to trace that manipulation absent true transparency, and that becomes an even bigger problem.

What would you suggest should be done about this, Wesley?

Wesley Legrand: The bullion banks should be banned from the short side of the market. There is no genuine economic reason for these bullion banks to be involved. The LME and the COMEX were originally created commodities companies who used to operarate and hedge themselves in those markets. There is no room for Wall Street and asset banks to distort and control the markets purely for speculative gain . This is just not free market capitalism, as GATA famously says: “There are no free markets, only interventions.

Do you consider the entire gold and silver paper markets as fraudulent?

Wesley Legrand: Yes, as there is a hundred times more paper gold traded than is physically in existence and it’s similiar for silver. And again, these banks have no genuine role economically to be short. So yes, they’re fraudulent.

Would you invest in ETFs?

Wesley Legrand: No, I wouldn’t. I think a lot of the physical gold in bank bullion vaults is the subject to double claim. We know that central banks account for gold on their own balance sheets, but then when they lend that gold out the gold is also counted on the balance sheets of the institutions they lend it too – so it’s subject to multiple claim. I certainly think there is not nearly enough physical gold in the world to cover all the ETF paper claims in the world. A lot of people will get a rude shock one day when they will go to claim their physical gold with their paper entitlements.

Will the new Pan Asia Gold Exchange (PAGE) be a game changer?

Wesley Legrand: I’m not sure if it will be a game changer per se, but it will certainly help re-monetize gold and unmask the price suppression scheme, because it opens the physical gold markets up to the Asian economies much more readily. China and India have a culture of savings and a culture of encouraging their populations to swap their paper money for a physical store value like gold.

Since we've used the words "legal" and "fraudulent," do you perceive the accounting practices of central banks related to their gold reserves as accounting fraud?

Nomi Prins: Since they effectively make their own rules, it's difficult to classify the reticence of information with respect to gold as actually illegal. Again, there haven't been publicly available records recently of how much gold is in reserve at various central banks, and because there is no true information there can be all sorts of accounting manipulation, fraudulent or not, that we can't track. But certainly manipulation on price, on availability, on the amount of physical gold in storage, and so forth should be classified as a component of securities fraud. Before the real gold standard was dropped during the Great Depression, there used to be much more mechanisms, not only related to the accounting for the value of gold which was pegged to the value of various currencies, but also for the amount of gold in storage. Today, we don't really have that aspect. Therefore, any time there is no real transparency, whether it's in gold reserves at central banks or in governments, or in subprime mortgages, there is the potential for fraud.

Is a return of the gold standard realistic in your point of view?

Wesley Legrand: Well, I don't know if it's realistic, but I would argue that anything would be better than the current system and it seems as if the only thing that can impose the necessary discipline on governtments and central banks to stop them from printing money without limit and generate never-ending more debt is to have some form of gold standard. The best solution would be to abolish all central banks at the same time as returning to the gold standard, but sadly this is not realistic!

Do you think a return of the gold standard is realistic?

Nomi Prins: I don't think it is realistic given that we don't have that transparency in our central banking system and we do have this potential undercurrent manipulation of the market by the private banks, central banks, and investment community. A return under that scenario to a gold standard would be difficult for several reasons. One is that these institutions don't want it, and would fight against it. They want to be able to manipulate the gold price in order to hedge the possibility of it ever becoming a standard, sure, and therefore retain the power of accumulation and evaluation to be in control of that possible process. But there is no real incentive for the central banks that have the gold or retain the control over what happens to it to go into a gold standard. It's much easier in this environment, in this second Great Depression, to have money printed for banks if there is a chaotic financial crisis.

The Federal Reserve can print trillion of dollars of currency. The US Treasury department can issue trillion of dollars of Treasury debt at a whim.

So can the ECB. So can any of the stronger governments and central banks – in order to supposedly facilitate a smoothing of this crisis when in fact what happens is that all they do is create an inflation of the crisis, because they are inflating debt, they are not dealing with the causes, and they are then sitting back assuming because they did this, that somehow things are better when they are actually not. So they don't have the incentive for a gold standard that would reduce their power over this situation. What we are dealing with here is that the people who are most powerful and most able to influence currency, the financial system, the global economic system, the exchange of debt for austerity requirements – just have no interest in changing that easy ability that they have.

Wesley, do you think the financial crisis goes now into full gear

Wesley Legrand: It's probably not going to be a case of a sharp, disastrous fall as we had in 2008/09, but I suspect it's going to be deeper over a longer period of time, which is actually worse. You had really a liquidity crisis in 2008, governments worldwide bailed out their private sectors, and now you have a solvency crisis where the world's governments actually can't afford to service their own debts without resorting to trickery like suspending 'mark-to-market' accounting rules or printing money to buy their own bonds (effectively a ponzi scheme). So this global delevaraging process is by no means over, it gets a lot worse before it gets better. I am a naturally optimistic person, but you got to look at the facts and take the only logical course of action, and that's to hope for the best, but be prepared for the worst, and I can't see any other way how this bursting debt bubble isn't going to be the most painful in history.

Do you think it is scandalous that the private banks transferred their debt to the populations?

Wesley Legrand: "Scandalous" is one of the more gentle words I have heard to describe the banks. Obviously, when you look at the advisors in government and the managers of the regulatory bodies, they're all ex-Wall Street and all the centralbankers are ex-Wall Street, it really is a filthy cess-pool of corruption. When you print money (physically or electronically), only the parties that receive that money first actually benefit from the monetary inflation, and these parties are of course the elite, the establishment, the Wall Street bankers, etc. The rest of the world has the same amount of money as before, but has to deal with higher consumer prices (i.e. lost purchasing power). The establishment is kicking the can down the road, as obviously they want to retain their power for as long as they can, so they try to maintain the status quo and leave the problem for the next generation. But I think the end-game is fast approaching for these guys.

Nomi, you publish during this month a book on the Great Crash / Great Depression. Given that we are talking about some financial institutions here, could it be that those institutions back then are the same today like some member banks of the New York Fed?

Nomi Prins: Well, the book is actually a novel. Usually, as you know, I write non-fiction, but this time it's a historical novel about the Great Crash of

1929, and as a novel it has many dramatic elements to it – romance, desperation, heroism in the face of great odds, and all that. The main character, Leila Kahn, does not start out to be a fighter against the big banks at all. She's a girl in love, trying to figure out life in general. It is with great reluctance and internal conflict that she comes to take on that role. But the historical elements of Black Tuesday, very much focus on research I was doing around a group of six bankers that got together in a room five days prior to Black Tuesday, Oct 29, 1929, in order to put money into the markets, buy certain stocks (of their main corporate clients), and to give this false sense of confidence to the markets so that individuals would continue to invest their money and borrowed money. Those six bankers were sort of seen as saving the day by the media then, when in fact they were saving themselves, because their own stocks were involved, their own debt was involved and everything else. Of course, that only worked for a short period of time. The markets ultimately crashed anyway.

One of those fellows in that room also happened to be a Class A Director at the New York Fed. Likewise today, one of the Class A Directors in that same slot is Jamie Dimon, CEO of JPMorgan Chase. Back then the fellow's name was Charles Mitchell, the CEO of what became Citigroup, at that time it was called National City Bank.

He had that front row seat to work with the New York Fed on keeping rates low into the speculative bubble leading up to the crash that lead to the Great Depression, because it served his own purpose and bank. So there was a lot of that going on then, and that is certainly going on now with what we see is taking place with people like Dimon and banks like Citigroup and Bank of America. These banks are largely insolvent in many areas, yet they have been able to navigate this crisis colluding with the New York Fed and the Federal Reserve and the Treasury department of the United States to effectively get cheap money that hasn't found its way into the general economy in the United States or in Europe. And so the parallels between the type of men and their positions in the late 1920's that lead to the stock market crash in 1929 and the Great Depression are very similar to today. In my novel, "Black Tuesday" I look at what was going on behind the scenes and how it impacted real people. Many people were really struggling economically even before the crash and didn't have access to loans and everything else to grow their businesses after the crash, which was one of the reasons for the Great Depression, as is happening now with banks receiving cheap money and not lending it out.

Is it depressing to observe the similarities?

Nomi Prins: It makes me so angry. (Laughs.) It's like we've just haven't learned. I give you another example of a man in that room of six bankers, who was influential in creating the Bank for International Settlements, BIS, and that was a fellow by the name of Albert Wiggins, who at that time was the CEO of Chase. While he was working with those others bankers in October 1929 to pump money into stocks (his depositors money), he was sitting there and shorting his own bank's stock, even though he was trying to get the market to buy it, because he knew his bank was unhealthy. And that is very reminiscent of today with Goldman Sachs shorting against their clients, and it really is sad that this kind of crime continues unabated and our governments in the US and Europe really don’t seem to get it. So yes, that is depressing and frustrating. Hopefully my novel, “Black Tuesday,” will provide a different way of seeing a story that centers around people and what they did and how they were impacted, without all the general statistics and numbers that I put into my non-fiction work. It’s a different way of looking at similar times, the human side of things.

Back to gold. Wesley, Nomi mentioned the word “bubble.” Can you as an equity trader give us your reasons why gold is not anywhere near bubble territory?

Wesley Legrand: There are several reasons. Of course, the mainstream likes to say that because gold has gone up for the last five to ten years in a row it is a bubble, but obviously things aren’t bubbles just because they go up in value. The all-time high in 1980 of the nominal gold price, I think, was $850 per ounce. We have surpassed that now, but when you look at the all-time high price for gold in 1980 adjusted for the Consumer Price Index (CPI) the way the US government measures CPI now, then the 1980 high was $2300 an ounce, and we are fast approaching that now. However, if you look at the all-time high for gold in 1980 adjusted for CPI the way the US government measured CPI in 1980, then the all-time high is closer to $7.500 an ounce. So this is one metric illustrating that gold is still very cheap. And if you equate the global gold stock to the global money supply, which has grown in unprecedented fashion in recent years, or to the level of debt in the world, also grown unprecedented, then it is very easy to make the case for gold in the five-digit range, so $10.000 plus per ounce. And even from a percentage of global assets and investments point of view gold is very under-owned across the world by asset managers and pension funds etc., particularly in comparisson to the level of ownership that existed back in the 1980s when gold was hitting nominal highs back then.

And how would you argue related to silver?

Wesley Legrand: Silver will outperform gold. Gold will go higher, but silver will go even higher in percentage terms. I think James Turk very correctly pointed out that we’re only entering stage two of the secular bull market in gold and silver now, and there are genuinely three stages of a bull market. We’re entering stage two now and that tends to be the longest and strongest.

Do you think that gold could go into permanent backwardation?

Wesley Legrand: Yes, I do. At some point, when the confidence, that intangible quality that we were talking about before is lost and you start to approaching hyperinflationary scenarios, where there is no faith in the paper money that people use, then absolutely gold will go into permanent backwardation.

Would this have dramatic implications?

Wesley Legrand: Yes, it would. As we’ve said the whole system is held together by faith, by confidence. It’s intangible and you can’t measure it. So a backwardation signal is the trigger or the canary in the coalmine that says the confidence has been lost.

Nomi, the final question goes to you. If you could choose three things to change – what would it be?

Nomi Prins: Well, I would first of all go back in time, when the crisis was unfolding, and when we were seeing firsthand that banks across the world, especially lead by the Wall Street banks, were engaged in fraudulent activity in creating assets that became toxic and leveraging those assets. I would have decreased the ability to manufacture $14 trillion of such assets, no the back of just $1.4 trillion worth of subprime loans, and instituted a separate evaluation mechanism to oversee the quality of those assets, independent from the rating agencies that rated them 'AAA' while collecting fee for that service.

If I ran the Fed, I wouldn't have allowed the bigger banks to become bigger, n the fall of 2008. I would have denied rather than approved those mergers of Bank of America and Merrill Lynch, JPM Chase and Washington Mutual, Wells Fargo and Wachovia. I would have segmented – and would still segment – as the Glass Steagall Act did in 1933, the facilities of banks to engage with the population through regular lending and deposit taking and renegotiating things like business loans and refinancing mortgages to help individuals – from their asset creating and speculative activities. That would reduce banks' ability to "pillage," as I say in my book, "It Takes a Pillage," people's money into risky deals and trades. In that way, I have to be pumping up debt to the extent the Fed and other Central banks have, in order to sustain all the investors and the banks and their mistakes to such an extreme extent. Instead, I'd seek to repair, with less extreme forms of funding and strict requirements of the banks, the Main Street citizens get back on their feet, because that ultimately propels the rest of the economy.

Also, if I ran the Fed, I wouldn't have allowed rates to become so low through QE, QE2 and what probably will be QE3, to basically sustain a flawed financial system where banks get all the benefits of cheap money, and don't share them with ordinary customers. Unfortunately, what we have now, is continued economic Depression for the general population, as banks give the illusion of health through fuzzy accounting standards, which should be changed, and speculate with the free or cheap money that they continue to receive, on the backs of the citizenry.

Thank you very much for taking your time, Nomi and Wesley!

Nomi Prins, who grew up in the US state of New York, worked after her studies in mathematics and statistics for Chase Manhattan, Bear Stearns in London and as a Managing Director at Goldman Sachs on Wall Street. After she left the financial industry, she became a prominent financial journalist who has written four books including the highly recommended: "It Takes a Pillage: Behind the Bailout, Bonuses, and Backroom Deals from Washington to Wall Street," that was published in September 2009 by Wiley. Her most recent book, the historical novel "[Black Tuesday](),“ is out now (and also available for the Ipad). Furthermore, she is a Senior Fellow at "Demos" (http://www.demos-usa.org/) in New York City, gave numerous interviews to international outlets such as BBC World, BBC, Russia TV, CNN, CNBC, CSPAN and Fox, and her articles appear in the New York Times, Fortune, Newsweek, the

Nation, The American Prospect and the Guardian in Britain. The website of Nomi Prins can be found at: http://www.nomiprins.com/. She lives in Los Angeles.

Wesley Legrand, who was born in 1979, is a fund manager at Grand Private Equities in Adelaide, Australia. He studied Economics, Finance and Law at Adelaide University and has worked now for 13 years in the stock broking industry. In 2008 he set up with his father Grand Private Equities as a boutique advisory firm servicing high net worth private clients, with a particular focus and expertise on emerging miners in the precious metal space.