# MORE DRESS REHEARSAL
# FOR THE LAST CONTANGO

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I have received a deluge of mail from readers of my latest article on the gold basis and the threat of the coming permanent backwardation in gold. I truly appreciate the interest of my readers in learning my thoughts on the subject. I regret that it is not possible for me to answer these letters individually; I make an attempt here to answer one or two, where the questions are general enough so that my answers may benefit all readers.

Hello Antal!

I have questions about your "Dress Rehearsal for the Last Contango".

(1) Will not gold at $1,000+ per ounce restore gold holdings registered at Comex warehouses? If not, why not?

(2) When the gold basis goes negative, could it not subsequently go back to positive, assuming the price rises to over $1,000? If not, why not?

(3) Why must gold backwardation, once established, become permanent?

I should like to hear your reply to these questions. I am really very interested in understanding fully the implications of the vanishing basis for gold, and I hope you can provide me with your answers to my questions.

With warm regards,

Victor

Dear Victor,

For a full discussion on the gold basis and the permanent backwardation in gold you must come to Canberra, Australia, where the Gold Standard Institute will have a Seminar in November. This Seminar is second in a row, devoted exactly to these topics. Last year's Seminar was a great success; this year's will be an even greater one. I am confident to say that Canberra is the only place in the world where you may get scientific information on gold contango, gold basis, gold warehousing, bimetallic arbitrage, and the prospects of permanent gold backwardation, as well as answer to a host of tantalizing questions that arise from these. We shall have an expert on hand from the Perth Mint. And, as an absolute first, the manager of Masters Fund, a unique gold fund just coming on stream, will be in attendance to answer questions. I am proud to say that I have been associated with this Fund from inception throughout the incubation period. The Masters Fund is offering exclusive features not available from any other fund, such as:

(1) The guiding star of the Fund is not the dollar price of gold, but the gold basis which is much less open to manipulation, and much more relevant to an accumulation plan;

(2) The gold in the Fund bears a return in gold, so profits are measured not in terms of the U.S. dollar but in terms of gold itself;

(3) Any appreciation of the Fund's value in U.S. dollar terms is additional, but the maximization of dollar value is not a prime objective;

(4) The gold in the Fund is never put out on lease or on loan, nor can it be pledged as collateral, but stays on the premises at all times under the full control of the Fund. It has never happened before that you could collect the return on capital unless you were willing to relinquish temporary control over it and thereby assume the risk of losing it. This could be important at a time when wholesale defaults on paper gold contracts may engulf the world;

(5) The principle on which the Fund operates is valid whether the monetary metals are in a bull market or whether they are in a bear market;

(6) The Fund is especially recommended to those individuals who are in the habit of measuring the value of their assets and their own net worth in gold units, rather than irredeemable paper units such as the US dollar;

(7) The Fund is structured in such a way as to take full advantage of the coming permanent gold backwardation, when all other gold funds will be grounded.

Of course, false alarms can and do occur, and it is possible that gold goes into backwardation and then promptly comes out of it. It has happened before. But here we are looking at a 35-year trend, embracing the entire history of gold futures trading. The trend has been that, as a percentage of the prevailing rate of interest the basis has been falling from practically 100% to practically 0%.

You and I know the reason for this: it has to do with the vanishing of all newly mined gold into private hoards at an accelerating pace; the insatiable appetite in the world to snap up all available gold by well-heeled governments and individuals who no longer believe in the tooth fairy residing in the Federal Reserve.

You have to remember that the basis is widely used as a guide in the huge arbitrage operations between gold holdings and dollar balances and in the gold carry trade. To participate in this arbitrage you must have gold on deposit in Comex warehouses. But with the vanishing of the gold basis the profitability of this arbitrage as well as that of the gold carry trade has been drying up, which explains the dwindling of warehouse stocks.

Another consequence of the vanishing of the gold basis is that it makes the risks involved in the gold/paper arbitrage rather lopsided, as far greater risks are assigned to short positions on gold and long positions on the dollar, than on long positions on gold and short positions on the dollar. The arbitrageurs are very much alive to this lack of symmetry, and are increasingly unwilling to put their gold in harm's way. They are fully aware that we are approaching an historic milestone, one that has never been passed before: the milestone marking the last contango. As a consequence of this lopsidedness the gold futures markets can no longer coax gold out of hiding. In vain do futures markets promise risk-free profits for taking over the carry from the individual.

Here is the deal they offer you: give us your cash gold in exchange for gold futures that we'll let you have at a deep discount, so that you can pocket risk-free profits. The offer is increasingly declined. There was a time when a drop in the basis would pull in gold from the moon, figuratively speaking. No more. Arbitrageurs no longer believe that gold futures are fully exchangeable for cash gold.

Gold backwardation is virtually inevitable and when it comes, it will be irreversible. Why? Because it signifies a crisis of the first magnitude: the general disappearance of gold from trade for reasons of lack of confidence. No one will give up gold, because one is no longer confident that he can get it back on the same terms. Vanishing confidence is like a runaway train. The only thing that might turn this runaway train around is a steep rise in US interest rates. However, this is not in the cards. It would ruin what is left of the US economy.

It would also cause the bond market to collapse, sending the dollar down the drain.

I do not see the collapse of the bond market happening anytime soon. The US Treasury and the Federal Reserve can muddle through this crisis, and possibly beyond, by making bond speculation risk free in order to maintain demand for Treasury paper.

Having said that, I don't think the guys at the US Treasury and at the Fed understand the gold basis and the seriousness of the threat of permanent gold backwardation. They are just trying to hold the line at $1,000 for whatever psychological value it may have, for as long as they can. It's the same old tug of war, they think.

It is not. Once the $1,000 level is breached, there may be some 'profit-taking', to be sure. But, because of the zero basis, those who take profits will look rather foolish. Last contango — last profit taking.

Be prepared for a great wave of defaults on paper gold obligations. Certainly, the lessees of central bank gold will default. Comex will close its gold pit for good, and outstanding contracts will be settled on a cash basis. I will be surprised if any gold ETF shareholders will see a grain of gold coming their way out of the rubble left by the default. Comex gold certificate holders will be lucky if they can get a fraction of their gold back from the warehouses — after a lengthy wrangle. Too many claims have been issued on the same lump of gold.

Under these circumstances it is difficult to see how anyone could wish to deposit gold in a Comex warehouse to restart gold futures trading. The market for slaves has disappeared after emancipation never to come back again. The gold futures markets will disappear, utterly (and deservedly) discredited. Like the slave markets, they will never come back.

Yours faithfully,

Antal

August 26, 2009.

**References**

*Dress Rehearsal for the Las Contango,* August, 2009

*The Last Contango in Washington*, June 25, 2006

*The Vanishing of the Gold Basis* and its implications for the international monetary system, June 23, 2009

*Remobilize gold to save the world economy!* An open letter to Paul Volcker, Chairman of the Board of Governors of the Federal Reserve, 1979-1987; Chairman of President Obama's Economic Recovery Advisory Board; July 6, 2009. See: www.professorfekete.com

**Calendar of Events**

University House, Australian National University, Canberra: first week of November, 2009

*Peace and Progress through Prosperity: Gold Standard in the 21$^{st}$ Century*

This is the first conference organized by the newly formed Gold Standard Institute.

For further information, e-mail: feketeaustralia@gmail.com ,

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

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

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