Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Alasdair McLeod
Goldmoney

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Dennis Tubbergen:

Welcome back to RLA radio, I'm your host, Dennis Tubbergen. Joining me again on today's program is returning guest, Mr. Alasdair MacLeod. Alasdair is the head of research at Goldmoney, you can check out his work at goldmoney.com. And if you click on the Insights tab, you'll get Alasdair's articles, it's one of my go-to sources for news about metals and economics, and I would encourage you to check it out as well. Alasdair, welcome back to the program and thank you for joining us.

Alasdair MacLeod:

It's very much my pleasure, Dennis.

Dennis Tubbergen:

So Alasdair, let me just start, because you were on the program in December, so we'll just say about five to six months ago, and it was your thought then that given monetary policies that we could see hyperinflation by the end of 2021. And it seems that we have inflation now emerging, we're seeing prices of groceries, lumber, copper wire, everything going through the roof, is this the beginning of the end? Are you maintaining that view?

Alasdair MacLeod:

Yes, I am maintaining that view, and this was very much what I expected. It's going to be very interesting to see how it pans out. I think the underlying problem is that the Fed, and this is not the only central bank doing this by the way, they're all doing this. The Fed is using quantitative easing basically to keep the financial asset bubble inflated. The one that they're really concerned with obviously, is the government bond market, US Treasuries, in the case of the Fed. They want to keep the yields of those as low as possible because one of their prime tasks basically is to ensure that the government deficit is funded, and as we all know, that government deficit has enlarged very substantially over the last 18 months. So they do have a problem that they need to satisfy that funding, that's the first thing.

Alasdair MacLeod:

The second thing is that central banks have got this idea in their heads that if you have a bull market in stocks, then that creates wealth, if you like for the people that you sort of typically think as the ordinary person who is probably middle class, rather than let us say the average person on the high street. Creating that wealth also creates confidence in the overall economy, and they think that confidence is the thing which is most important. Now there is a fallacy in all that argument, in so far as actually what they're doing is they are diluting the purchasing power of the currency in the process. But they've managed to cover this up to a large extent by changing the way in which the consumer price index is constructed.

Alasdair MacLeod:

And just to show you how they have changed things, John Williams at shadowstats.com currently reckons that on the old basis, by which the CPI was calculated, and he's going back to 1980, the current rate of price inflation is running at about 11 to 12%. Now that's an awful long way from 2%, as you can see. But the Fed insist that the rate of inflation is struggling even to get to 2% and they see that prices will rise probably beyond that, but they think it will come back down.

Alasdair MacLeod:

So the story that's coming out of the central bank is very much at odds with what's going on, because as you rightly pointed out, Dennis, I mean, we've got, particularly food prices, the raw materials that feed into what we eat, energy, things like lumber, even copper, all these industrial materials and raw materials have just been going through the roof. And this is not because there's sort of wonderful demand is going to happen from everywhere, it is because the purchasing power of the currency is going down. And this is the basis, really of what I think is inevitably going to turn into hyperinflation.

Dennis Tubbergen:

Alasdair, I was struck as you were talking that John Williams, who is actually going to be a guest on my program in a couple of weeks, that when you look at 11 to 12% inflation, that is '70s style inflation. And I believe it was in 1980, then Federal Reserve Chair, Paul Volcker to subdue inflation, raised interest rates to approaching 20%, and certainly it worked to subdue inflation. But it seems that given the level of debt that exists today on a national level, on a worldwide level, that's really not an option now.

Alasdair MacLeod:

I would agree, I would agree with you entirely. And so in that sense, without that escape route, it seems to me that the Fed is boxed into a corner. But now let us imagine that interest rates start rising in the summer. In fact, it's very hard to imagine a situation where interest rates will not rise in the next two or three months. But let us assume that they do rise in the next two or three months, now that would unsettle, obviously, not just US Treasury prices, but it also unsettled the stock market.

Alasdair MacLeod:

Now, what does the Fed do then if it appears that we've entered a bear market? Well, what they do basically is they need to raise interest rates somewhat to try and take the steam out of expectations on the interest rate front, but then what they will do is they will probably have to increase the level of QE in order to support markets, the stock market's going down. Now, this then is getting into real craziness and it's very difficult to see how they can stop it. But what it amounts to is that they will have to continue to print dollars in order to keep the stock market bubble inflated.

Alasdair MacLeod:

Now, this is exactly the situation that John Law had in France in 1720, and he failed. The Mississippi Bubble, basically burst, and it took the currency down with it. The currency incidentally, which shares the characteristic of the dollar of being completely unbacked by any precious metals. So really, I think what we're seeing central banks doing today, really led by the Fed, is that just doing what John Law did 300 years ago, they haven't learned the lesson. But what it does mean, as far as we're concerned, is the purchasing power of these paper currencies will go down towards zero.

Alasdair MacLeod:

Now, hopefully they won't get to zero, but we can see the purchasing power is going to fall very, very substantially. And the only way in which they can get out of this is to mobilize their gold reserves and turn Fed currencies into credible gold substitutes. I think eventually that is something that will happen, but it's difficult to see that they have the understanding of knowing what is involved in that. Because it also involves not just setting up a credible gold exchange system, which must involve coins rather than bullion incidentally, because it's got to be at every level throughout the economy, for ordinary people as well. But the other problem is that governments need to cut their intervention in the economy. And by that I mean, they need to reduce their involvement in GDP to less than 20% of the total. That's going to be a very, very different scenario for our current crop of politicians who only know about warfare and welfare.

Dennis Tubbergen:

Alasdair, as you were talking I was thinking, ironically, rising interest rates and massive inflation designed to keep the stock bubble going, could ultimately be the catalyst that brings it down. Isn't that rather ironic?

Alasdair MacLeod:

I think it is inevitable. Yes, I mean, it seems ironic, but it is in effect inevitable. And I just can't see how they can get out of this trap, because in order to get out of the trap, they would just have to stand back and say, "Our policy has failed, we've obviously got it wrong. We're just going to be hands-off and let the market sort itself out." I rarely find it impossible to see that policy being followed before a crisis, bringing on the crisis is not what bureaucrats are employed to do.

Dennis Tubbergen:

So how do you see this crisis playing out?

Alasdair MacLeod:

I think basically it's, we need to study the John Law situation. And what'll happen, if this current situation follows that playbook, and I can't see how it cannot, what will happen is that rising interest rates, which I think will be as early as this summer. So in a matter of a month or two, we will start seeing rising interest rates, or alternatively, we will see the Fed trying to prepare markets for the potential, for a small rise in interest rates, that's what they would hope would contain it, and maybe some tapering. I'm sure that that's what they will try and do. That won't succeed. The rises that we're seeing in prices, particularly of essential goods such as food and energy, I think puts the whole lie on the CPI statistic, and everybody realizes this. The foreigners will find that the dollar is not giving them returns. You have got roughly 10.7 trillion, current estimates, 10.7 trillion of foreign owned investments in the US stock market.

Alasdair MacLeod:

Now, so far, that's worked extremely well for the foreigners, but the moment the market turns down, which is really what a popping bubble is, they're going to flee the scene, and they'll have to leave quite quickly otherwise their losses, they're just going to mount. So you can see there's got to be pressure at the same time on both the dollar and also the stock market. So the two bubbles as it were, the valuation of the dollar and the valuation of the stock market are inextricably linked, and I think they will go down together.

Dennis Tubbergen:

Alasdair, we have just a couple of minutes left in this segment, there may be some listeners out there that are not familiar with the work of Goldmoney, could you take a minute and just explain a bit about what your company does?

Alasdair MacLeod:

Yes, certainly. I'd be very happy to. Goldmoney was set up in 2002 by James Turk, we were acquired by a Canadian company which changed its name to Goldmoney. But basically what we do is we store precious metals on behalf of our customers in vaults around the world. I think we've got 11 different vaults which we can offer our customers.

Alasdair MacLeod:

The storage is outside the banking system, which is crucial, because if you have the banks involved, then if you get bank failures you've got counterparty risk, so obviously we don't want our customers to have that. And our customers can choose where they store their gold and silver, which very often... I mean, I think we've got a lot of American customs for customers, for example, who remember or recall reading about the confiscation of gold back in 1933, and just want to make it a little bit harder for the government to confiscate their gold. So typically they will store that gold away from America, we have British people like me who will store it away from London. And it's all about ensuring that you protect yourself against the demise of fiat currencies, and that's basically what we do.

Dennis Tubbergen:

Well, our guest today is Mr. Alasdair MacLeod. He is the head of research at Goldmoney, and I'll continue my conversation with Mr. MacLeod when RLA radio returns, stay with us.

Dennis Tubbergen:

Welcome back to RLA radio. I'm Dennis Tubbergen, and I am chatting today with one of my favorite guests. He is the head of research at Goldmoney, Mr. Alasdair MacLeod. If you're just joining us, you can learn more about Alasdair's work at goldmoney.com. I would encourage you to click on the Insights link where you'll see many of Alasdair's articles published.

Dennis Tubbergen:

And Alasdair of late you have been writing about, just this past week in fact, the article was titled The End of Paper Gold and Silver Markets. And I think a lot of our listeners out there that understand that they should own some precious metals in their portfolio, but they have no idea as to the difference between paper gold and silver and physical gold and silver, so can we start at a very basic level and explain the difference?

Alasdair MacLeod:

Yes, of course. I mean, physical is very easy to understand in that you can probably go into a specialist store and you can buy say a silver coin, and that is silver. And assuming the coin is, let's say, a US coin or a British coin or whatever, it will be solid silver. And so you have got the predetermined weight of that coin in silver, that is physical metal. You can also buy it in bulk bar form. And what is true of Silver is also true of gold, so you can buy gold either in coins or alternatively ingots . And the standard bar, if you like, is a one kilo bar refined to 99.99% gold, and that's actually the Chinese standard. And you've got the London Bullion Market standard, which is the 400 ounce bar and that's refined to 95 and a half percent minimum. So that's physical gold, and I think that's quite simple to understand.

Alasdair MacLeod:

But there is also what we refer to as paper gold. In other words, substitutes for gold, which aren't actual gold, and they may be deliverable in the form of gold. For example, if you look at the futures market, the COMEX futures market, the gold contract is ultimately deliverable in gold. But very, very few people who buy and sell futures, either take delivery or deliver gold, so that is in essence a paper market. By far the largest paper market in the world is the London Forward Market. Now Forward deals for more than two days, I mean the normal settlement cycle is you would go into the market, you would buy gold and it would be delivered against payment in two days time, that is a standard physical deal, if you like. But in London you can deal for settlement forward for longer times. So typically someone might hedge a position by buying gold forward for delivery in one month's time. And they would look to close out the position by buying back for the same settlement date at a later time when they no longer need that price cover.

Alasdair MacLeod:

So you've got two basic forms of derivative there. There are also options and you can buy an option, buy a call option, or a put option, or you can sell a call option or sell a put option. Those again are all derivatives, ultimately deliverable in gold, but very rarely done so. The reason that they are effectively meant to be deliverable in gold is because that is the way in which the value of the options or the value of the futures or the value of the forward are tied to the gold spot price. So you've got those two big markets, you've got the real stuff, if you like, physical delivery and you've got the synthetic stuff, which in practice is very rarely ends in the delivery of physical metal.

Dennis Tubbergen:

So Alasdair, a couple of things I guess I'd like you to chat about, one, it seems that these bullion banks can literally create gold out of thin air by simply creating more contracts. And then the second thing I'd like you to talk about is how leveraged are these markets, how much physical gold is actually backing these derivatives?

Alasdair MacLeod:

Yes. I mean, basically you're right. The banks operating in these markets with the bullion bank trading desks, can literally print the money to buy contracts or to take a position out of thin air. It is an extension on the creation of credit if you like. So if we look in the London Forwards Market, that is dealing on what the London Bullion Market Association describes as unallocated gold. In other words, the deals do not involve physical gold bars of specific weights, specific fineness, because they're all different, but it is if you like a sort of a general assumption that if you do a forward deal, say in one 500 LBMA bar, then it is 100% gold for the purpose of the contract. But of course, it's not gold, this is just paper.

Alasdair MacLeod:

And the way in which the bullion bank creates a position is that it creates for itself the credit for it's dealing desk to actually go out and buy a contract or indeed sell a contract short. So it is something that has made out of thin air if you'd like, that is the best way to describe it.

Alasdair MacLeod:

In the case of futures contracts, it's exactly the same process. A bank has the ability to create credit out of thin air, and it uses that to finance its dealing desk. It just so happens that both futures and forward deals, instead of them being done, let us say in straightforward dollars where deposits are in the bank, let's just say it has a credit from the bank, in other words, the bank has a liability to the depositor measured in dollars, it is just measured in gold. But it's purely synthetic, the gold isn't there, the gold is the reference price in effect. So that's the way in which these things are actually created.

Dennis Tubbergen:

And then as far as leverage goes, Alasdair, you would know better than I, but some of the research that I've done shows that these markets are highly leveraged. So for example, I think it was May six, seven, and 10, If my memory serves me, that there were short gold contracts created by bullion banks that really amounted to the equivalent of about a third of all the gold even registered to COMEX, so that's really highly those facts are a little bit off.

Alasdair MacLeod:

No, you're right. It is very highly leveraged, and even more so in London. The last figures we have are actually compiled by the Bank of International Assessments and including London, there are a few other smaller centers, but including London, they reckon that the total value of outstanding contracts is in the region of about $550 billion. I mean, this is huge. We're looking at about... If you take both, the COMEX gold contracts and the forward derivatives, we're looking at about 11 and a half thousand tons of gold equivalent, just in those two markets.

Alasdair MacLeod:

Now, in terms of the liquidity in the markets, which is the other thing we've got to look at, we don't know what the figure is in London, but just by taking out ETF owned gold, making an allowance for central bank owned gold and also for gold held by private individuals, and that is something we can only assess at, it's very difficult to see how those can be more than three or 400 tons of liquidity in the London market, and probably not even that.

Dennis Tubbergen:

So that's extreme.

Alasdair MacLeod:

Yeah.

Dennis Tubbergen:

So Alasdair, in the time we have left you, you wrote an article this past week titled The End of Paper Gold and Silver Markets, so hopefully we've laid a bit of a foundation maybe for this next question. Can you explain the premise of the article and what that's about and why you're concluding that?

Alasdair MacLeod:

Yes. After the great financial crisis, the Basel Committee, which is a subset of the Bank of International Settlement, was given the task of coming up with new regulations that would prevent a bank risk, if you'd like, escalating throughout the banking system. And this is the whole basis behind the new Basel III set of regulations. Now, the regulations must be adopted, certainly in principle, by all the banking systems around the world. And we have in Europe the European Banking Authority which regulates the Eurozone banks, and banks, if you like, in Europe which aren't in the Eurozone. They are introducing these new rules at the end of June, which is the end of the second quarter.

Alasdair MacLeod:

Now, basically what it means is that there is a penalty for banks. It's a balance sheet penalty in effect for banks holding derivative positions in gold. I won't go into it in great detail, but what it basically means is that it is no longer economic for banks to run bullion desks with uneven positions. And there are probably problems in some jurisdictions of just even running a balanced position. But anyway, we won't go into that. The point is that the European Banking Authority is introducing its rules at the end of June. The Bank of England has finished its consultation period and has said that it will introduce these rules on the 1st of January, 2022. In other words, at the end of this calendar year. Now, that means that all the members of the London Bullion Market Association, whatever their ownership, will have to comply with these rules. And again, it's going to be uneconomic for them to do so.

Alasdair MacLeod:

Now the problem from there is that we can see how this is effectively going to shut down the unallocated gold market in London, but the problem is that as far as COMEX is concerned, you've got the same players in London as you have on COMEX. So substantially the business in COMEX, which is meant to be hedging the London position, though very often it's taking naked position, that position, that business is also going to be cut out. So the COMEX gold and silver contracts are going to see a very substantial withdrawal of liquidity.

Alasdair MacLeod:

Now not only that, but the bullion banks on COMEX have short positions valued roughly at around about $30 billion. And that's between the total of about 17 long and 27 banks being short. So the question is how are they going to manage to close those positions? And they're going to have to close them effectively by the end of this calendar year. So you can see that there is some pressure for banks to withdraw from the market ahead of that end date that the British are putting on the London Bullion Market Association. And that could have the effect of transferring unsatisfied demand from the paper markets into the physical market. So what I would expect to see is the availability of physical metal being very restricted with a market which specifically for allocated gold and allocated silver is increasing because of the demise of the unallocated markets.

Dennis Tubbergen:

Well, fascinating. We're going to have to leave it there. My guest today has been Mr. Alasdair MacLeod. He is the head of research at Goldmoney. You can check out his work at goldmoney.com, click on the insights link, and you'll get access to all of Alasdair's articles. So Alasdair, thanks so much for joining us today. Always a pleasure to chat with you, and thank you for taking time out of your busy schedule to chat with me and my audience.

Alasdair MacLeod:

That was very much my pleasure, Dennis. Thank you for having me.

Dennis Tubbergen:

We will return after these words.