

THE NATIONAL INVESTOR



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“For where your treasure is, there will your heart be also.”—Matthew 6:21

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OIL IS THE NEW GOLD...IN MORE WAYS THAN ONE!

*A Look at the New “Conspiracy” to Cap Oil Prices
(Part 1 of 2)*

We have commented quite a few times recently about the peculiar behavior of most of the asset markets. Some days more than others, one particular asset class--Treasury bonds, for instance--will strangely act in a manner contrary to how they *should*, given the news. We have explained a key reason for Treasuries' aberrational behavior by describing how much of the stimulus money that has found its way into the banking system has,



Will this apparent double top be enforced from behind the scenes?

in the end, been used to support the market for government debt, rather than being loaned to businesses and consumers.

Hopefully, our explanation of this a short time ago helped you to see how even strong fundamentals--or the lack thereof--can be overcome by the powers that be, as they use various means to achieve a desired end; in this

case, continuing low long-term yields. Now, you are ready for a *real* brainstorm of ours! You are

about to read something that we guarantee you have seen nowhere else. Maybe we're nuts, and more deserving of a straitjacket and rubber room over this than accolades. Time will tell; but, here goes.

Our position is this: a very broad and multifaceted effort is now underway, the object of which is to cap the recent rebound in oil's price.

Even before we finished “connecting the dots”

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on what we will present here, it had become obvious that the oil market was behaving strangely. In the case of the Treasury market, at least we had a solid idea as to why--despite, among other things, soaring deficits and verbal brickbats from abroad--bonds were so resilient. Where oil is concerned, though, there has been a mishmash of conflicting information, charges and counter charges over "speculation" and more. As with the bond market, oil as often as not has failed to move in a way in which the fundamentals suggest it *should*. And so changeable has been this behavior that it has had most traders and pundits confused.

Influencing all of this is the renewed idea that crude oil *has to* go up because of all the growth in China and elsewhere in the developing world. As we will repeat further along, this mindset has helped keep oil near recent highs in spite of what have usually been bearish inventory reports. In addition, a growing chorus has found it fashionable once more to publicly "pile on" the U.S. dollar. As has indeed happened more often than not since the great commodities bull market started several years ago, these trends of a declining dollar and corresponding strength in the *dollar price* of commodities like oil have been pretty reliable. But there have been exceptions; and it's a little bit eerie to see how quickly investors have forgotten the beating they took at the end of 2008 when they held on too long to their belief that oil and other commodities just *had to* go up.

With the benefit of hindsight, we now know that much of last year's spike in oil's price to near \$150 per barrel was caused by speculative buying of what some refer to as "paper barrels." This buying from hedge funds, *some* exchange-traded funds, *some* investment banks and others was for futures contracts. None of these entities ever planned on taking delivery of so-called "wet barrels." They were merely placing bets with parts of their significant war chests on this asset in the belief that they would generate profits for themselves and/or their investors. But much as when a 300-pound man does a belly flop into a "kiddie" wading pool, the consequences of huge amounts of money chasing pretty much any asset--in this case, oil--can be dramatic. Nobody now dares to suggest that a price of \$150 per barrel remotely reflected oil's true supply and demand fundamentals as a natural resource.

Then we saw the opposite happen. When buyers and holders of "paper barrels" did a sudden about-face and sold, prices crashed. Eventually, oil plunged to well under \$40 per barrel. In our view, oil's lows were not much more representative of where the price *should be* based on supply and demand than was the \$150 level. (For the record, and though some bears think we would be erring on the high side, we think a level closer to \$50-60 per barrel best reflects the *near-term* fundamentals.)

Also for the record, we will repeat here what we said in last month's regular issue, even as we were ratcheting up our near-term cautious stance on oil. **"Our long-term bullishness where energy is concerned has not changed.** However, in the near term, we will most likely continue to become incrementally more defensive..." **(Emphasis in original.)** For a variety of reasons, we believe that some *years* from now we are much more likely than not to see oil's price (in U.S. dollars) exceed the highs of last year. But a lot will transpire between now and then. Included in this will be considerable efforts on the part of, chiefly, U.S. policymakers to prevent such a thing from happening, whatever it takes.

ANOTHER PRECEDENT (?)

Government--together with allies of various sorts in the financial marketplace--regularly seeks to work its will where markets are concerned. Sometimes it wins (as now, with the Treasury market) and sometimes it loses. Whatever the outcome, we must never underestimate this factor: that the government or, in the alternative, the private Federal Reserve will attempt to move a particular market in *their* desired direction.

Undoubtedly the most infamous example of this in the eyes of some is the past--and, according to some, ongoing--"conspiracy" to keep a lid on the price of gold. Though we have relatively little in the way of disagreement ideologically with the purveyors of this particular conspiracy theory, we have in the past disagreed on both factual and practical grounds.

The gold conspiracy theory that has been championed chiefly by some of the higher profile "gold bugs" out there--and led most visibly by the Gold Antitrust Action Group, or G.A.T.A., which

can be found at www.gata.org--essentially is as follows:

Central banks the world over have become increasingly desperate to protect their respective fiat currencies. No country in the world any longer has a currency *redeemable* in gold or any other specie. For that matter, no country in the world as a practical matter has a paper currency *even backed* in any meaningful way by gold.

Given this, and pretty much everybody's monetary inflation (with attendant rising deficits) over time, policymakers have sought to remove any visible sign that their currencies are deteriorating in value. Thus, it is imperative for central banks--led by the Federal Reserve--to prevent, if at all possible, a dramatic rise in the gold price. Such a move would reveal paper money for what it intrinsically is: worthless on its own, save for the blind faith of a populace to believe in it and its creators/protectors.

Especially during the 1990s, this conspiracy theory gained a lot of adherents. It seemed a fairly easy case to make; after all, gold was quite underwhelming as an investment during most of this time, slowly ratcheting downward for pretty much the entire decade (pretty much all commodities followed the same pattern, but that's a fact conveniently forgotten by the theorists.)

At times it really did seem like there was a bona fide conspiracy to keep gold from rising. The yellow metal would start to rally, some bullish prognostications might get issued, and then WHAMMO! Some news would come out that, say, the Swiss National Bank had sold 50 tonnes of gold. The next time, it might be Germany's turn. Or the I.M.F. And to show just how skittish the gold market chronically was, forever looking over its shoulder in fear of the *next* announcement, it was always interesting to watch traders' reactions to this news of, usually, something that had *already taken place!*

You read that right: most of these kinds of announcements for *years* came AFTER said sale had occurred, and presumably factored into the spot price of gold. Some say that this proved their conspiracy theory, as--they claimed--some "insider" would trigger renewed selling.

We never quite bought into this particular conspiracy theory in its broadest sense, though we were (and remain) sympathetic and friendly toward

some of its proponents. Instead, we *generally* took the view expressed in a great May, 2001 piece by Doug Casey that remains archived on the "Other Experts" page of our website, entitled "An Unlikely Conspiracy, An Entirely Likely Swindle." -- which can be read at <http://www.nationalinvestor.com/Experts-Casey.htm>. That is, that most of what passed for a government-run conspiracy to keep gold in check was instead little more than a handful of prominent players managing to corral and then manipulate a relatively small, thinly-traded market for their own benefit. Eventually, the *Financial Times* published a lengthy and revealing exposé confirming this, identifying Goldman Sachs (who'd-a-thunk it?) as the ringleader.

There was, however, at least one notable occasion when "the government" DID involve itself in this swindle. It remains both the most memorable and most financially rewarding event for *The National Investor* and its subscribers. A few of you out there who were with us at the time will undoubtedly have a smile on your face as we continue our walk down Memory Lane...

The time was the late summer of 1999. The gold price remained mired well under \$300 per ounce. Previously, the Bank of England had embarked on a series of regular auctions of gold designed to liquidate most of its holdings.

A couple things happened in quick succession that got gold bulls stirring. First, just after Labor Day, the International Monetary Fund shelved a planned sale of some of its gold. Following this a bit later, the September sale of 25 tonnes of gold by the U.K. was marked by very heavy demand, including by at least two major mining companies who for a while were able to buy gold on the market like this cheaper than they could mine it. Gold, which had threatened to dip below \$250 per ounce prior to all of this, instead was inching its way upward. *All of this and some related technical factors caused us to recommend some very aggressive trades into call options tied to some of the major gold mining companies' stocks.*

Then, all hell broke loose.

What nobody saw coming--something which, in an instant, caused what was merely the latest technical rally for gold to turn into a buying panic--was the unveiling of the first central bank

agreement on gold. First dubbed the “Washington Accord” due to its having been unveiled there by then-European Central Bank President Wim Duisenberg following a bankers’ meeting, it put an identifiable lid on new gold sales and leasing activity by central banks. This was a sea change for the gold market, removing perhaps the biggest obstacle gold bugs had faced. Within days gold’s rally was accelerating, and the price had pushed well over \$300 per ounce. Gold traders were giddy with excitement. *But there was a problem.*

Some key players--engineers of and profiteers from gold's long bear market and its periodic swings--had been caught “offside.” To this day, we've never read anything that definitively identified anything close to the specific amounts involved; but suffice it to say, some of these folks were short *massive* amounts of gold. They faced ruin; and the entire financial system was quickly in every bit as precarious a predicament as it had been in the year before due to Long Term Capital’s implosion.

We, of course, were enjoying this lucrative ride. But thankfully, we were not as “married” to this sudden change of fortune for gold as were the more religious types among the gold bugs out there. After the first big push to around \$325 per ounce, one day brought sizable *selling* pressure which--given the timing and circumstances surrounding it--raised some red flags for us. Over the course of mere days such a thing happened three times, with the third of those being on October 5.

A couple phone calls to a loyal and well-connected friend of ours revealed the party involved in trying to beat back gold’s surge: the


Federal Reserve Bank of New York, via J.P. Morgan. Notably, the Fed was *not* a party to the new Washington Accord. And all it knew was that if it did not act quickly, a number of key financial houses would go bust--and take God knows who with them--due to their short positions in gold.

We quickly exited our recently entered positions at the top, for huge profits. The Fed's efforts were successful; and, by early in the year 2000 (just as we predicted at the time) gold was

fluttering back down and would eventually retest its bear market lows the next year (2001). During this time, the Fed worked with those of its closest allies who had nearly been destroyed, to see that they incrementally extricated themselves from their lopsided short positions. *Later--when, as we wrote at the time, it served the Fed's interests for gold to go up--nobody was in any danger.*

(NOTE: All of the above is barely a Cliff Notes version of this incredible story; one worthy of a movie! For those of you who are interested in a longer, more detailed and exciting read we have copied onto our web site’s front page the entire first section of our October 1999 issue.)

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THE NATIONAL INVESTOR 
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NUMBER 39 For where your treasure is, there will your heart be also.—MATTHEW 6:21 OCTOBER, 1999

WOW!

As predicted in these pages in the last two issues, gold stages a monster rally--prowded by welcome (and largely unexpected) good news on central bank gold sales and leasing activities.

GOLD - London PM Fix 1985 - present
\$100/oz.

GOLD AND SILVER SECTOR INDEX (XAU)

After dropping again to near \$255 per troy ounce, gold surges to \$330--and then \$340--before pausing for breath.

Already anticipating better news--and under apparent accumulation by certain institutions--gold shares quickly jump

Recommended call options	Purchase Price	Price--October 5	2 Week Gain
Newmont Mining --Nov 20	2 9/16	9 1/4	+ 261%
--Dec 22 1/2	1 13/16	7 1/2	+ 314%
Barrick Gold --Nov 20	1 1/2	5 1/4	+ 250%
--Jan. 20	1 7/8	5	+ 167%
Placer Dome --Jan. 12 1/2	7/8	4 7/8	+ 457%
Homestake Mining --Jan. 10	1/2	1 3/16	+ 138%

And...my September 21 Hotline, fax and e-mail recommendations on the above-listed call options on these mining shares have to date resulted in average gains of 264.5%, translating into a current value of \$36,450 for each \$10,000 invested--
IN JUST TWO WEEKS!

IS THIS THE LONG-AWAITED BULL MARKET LONG PREDICTED BY GOLD BUGS?

A POTENTIALLY CATAclysmic SHORT-COVERING RALLY?

OR...ARE LATE-ARRIVING GOLD INVESTORS ABOUT TO BE SUCKERED AGAIN, AS IN JANUARY, 1996?

READ INSIDE FOR THE SCINTILLATING DETAILS...

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OIL IS NOW THE SUBJECT OF CONCERN

We have all heard the old adage of how history tends to repeat itself; and the corollary truth that *this* is caused by people refusing to learn from history. It makes us alternately laugh and shudder to recall that--similarly to what we've heard in recent days in relation to the oil market--those brief but wild gyrations in the gold market were the fault of shadowy “speculators.” This was technically true, as it is now, on a certain level. But this claim is also an overly simplistic dodge of broader and more sinister truths.

Frankly, it has been the increasing drumbeat over “speculation” as the cause of oil’s crazy gyrations that stirred our memory banks and

almost single-handedly motivated us to study and then write this story. After all, think about it for a minute. When the stock or bond markets move wildly higher, seemingly in defiance of the underlying economic fundamentals, the bulls not only receive the benefit of the doubt but praise for being so capitalistic and patriotic as to buy *financial* assets. But when some folks do the same where, say, oil is concerned, there is something wrong and unpatriotic about *that*.

Hmmmm.....

As was the case with gold for a while, policymakers--especially in the United States--loathe the thought of a new, sustained rally in the oil price. Of most concern is the fact that newly rising energy costs would assuredly short-circuit any chance of arresting the current economic contraction. As you'll read further along, some consumers have now been reduced to buying such relatively trivial things as back-to-school supplies on layaway, of all things! The last thing that any of us needs is gasoline going back to \$4 a gallon and everything that goes with that.

The trouble is--as we have described numerous times in the past in this and related contexts--the Fed and other policymakers are fighting a monster of their own making. It is the Fed and other central banks that are drowning the world and its markets in waves of fiat money. All of that dough has to go *someplace*; and it stands to reason that--especially with much of the world bringing itself into the modern era--money managers of *any* persuasion would deem it prudent to buy natural resources, including oil.

The trick now for the Fed and others is-- in spite of their drowning the markets with cheap and plentiful "money"--to *prevent* too large a portion of it from going into oil. Whether they will all succeed or not remains to be seen. We believe that in the *very* long run, they will not.

For a while, though, they will.

First, they will be helped along by oil's own present fundamentals. As most of you have no doubt read repeatedly in recent months, oil demand has been noticeably curtailed by the present recession. 2008 and 2009 will be the first time that global oil consumption has had back-to-back annual declines in two generations. According to the International Energy Agency, oil demand will register little more than fractional gains for several

years to come. In fact, says the I.E.A., the demand picture's recent weakness has pretty much removed any possibility of a near-term supply crunch. Indeed, at the present time, it is not too much exaggeration to say that the world is awash in oil.

The recent move back to the 2009 recovery highs for oil has come about to a great extent due to markets' overall belief that the nearly 2-year-old recession is over, and the "recovery" is underway. Underscoring *this* notion is one that sees no risk to the renewed growth story in China. We would place a 100% certainty on the first of these--at least, where the U.S. and virtually all the rest of the developed world is concerned--soon being proven overly optimistic. As for China, that's a coin toss. The net result, though, is that too much optimism exists at the present time as reflected by the current oil price.

But policymakers are not sitting idly by and hoping that *The National Investor's* economic predictions come true. They have a lot of other irons in the fire on this cause, running the gamut from mere jawboning to both legal and financial impediments:

-- The well-respected I.E.A. itself has warned that an oil price of over \$70 per barrel represents danger. "If we go one step further, if we see prices go much higher than that, we may see it slow down and strangle economic recovery," said the agency's Fatih Birol in a recent interview.

-- In Europe, the screws are being put to oil traders over there. An effort was launched at last month's G-8 meeting in Italy--led by U.K. Prime Minister Gordon Brown and French President Nicolas Sarkozy--ostensibly calling for "better scrutiny" of energy trading markets in order to curb what they derisively call "damaging speculation."

-- An aversion to oil prices any higher than current levels is not confined to both sides of the Atlantic. A key and growing new consumer--China--also has something to say. The average investor--let alone the average American--*still* is unaware of the fact that China re-pegged its currency to the U.S. dollar a year ago. Unlike in the couple of years prior when the rising price of oil was blunted for the Chinese when they were allowing the Yuan to rise against the dollar, China is once again as susceptible as we are to a higher oil price. We can assume that some of their behind-the-scenes cajoling of U.S.

“leaders” includes demands to “do something” to keep oil in check. And another thing is certain: oil (and other commodities) will *plunge* if/when China officially acknowledges that its outsized buying/stockpiling of the first half or so of the year is over with.

-- The Federal Reserve fired a shot across the bow of oil “speculators” after its most recent Federal Open Market Committee meeting. In its statement following the meeting, the Fed said, in part, “The prices of energy and other commodities have risen of late. *However, substantial resource slack is likely to dampen cost pressures, and the Committee expects that inflation will remain subdued for some time.*” (*Emphasis added.*)

The Fed has previously used language such as this at times when it does not wish to see *its* monetary inflation translate into rising prices for commodities; translated, the central bank means, “There is no reason on this earth for commodities to be going up in price. Something is wrong if they do.”

-- O.P.E.C.--just as often as not a target itself of those wishing to keep oil prices low--is currently singing from the same songbook, judging by its latest pronouncements *and actions*. The oil cartel has recently cited both the \$60 and \$70 levels as acceptable for its product. And so zealous are the preponderance of members to lend us a hand that they may have sown the seeds themselves for a drastic drop in the oil price. With all of the evidence lately of a *glut* of oil in the physical market, O.P.E.C. has not only *not* cut production, but for some reason recently saw fit to point out that it was producing more than 1 million barrels per day *over* its stated target, with output having increased now for four straight months through July.

For those oil traders who either can't or won't read between the lines, some friendly “persuasion” might be in order:

-- The Federal Trade Commission said a couple weeks ago that it would begin policing the petroleum industry with penalties for anyone trying to “manipulate energy prices.” It announced a new rule, to take effect in November, aimed at anyone dealing with crude oil, gasoline and petroleum distillates. As stated by a wire service report, the rule “prohibits market distortions through false or misleading statements about stockpiles, prices or

crude and fuel output.” As to what this means, your guess is as good as ours. But with *an agency of the federal government* being the umpire who determines that, we suspect that some of the more aggressive players in the energy markets will be watching their P's and Q's a little more closely.

-- For its part, the Commodity Futures Trading Commission has announced that it will redefine the various participants in oil trading markets. Currently, the C.F.T.C. labels traders as either “commercial” or “noncommercial” entities, based on their own nature and the purposes for which they are buying futures contracts, for example. While it remains undefined, it is expected that the Commission's goal is to more starkly identify any activity in the oil trading pits that *does not represent physical demand*. This greater isolation of investment--and even hedging--activity as opposed to physical usage will serve to make all of that a bigger target for regulators and Congress, if it comes to that once again.

-- *Currently, there appear to be no bigger targets of this whole campaign to remove some speculation from oil (and other commodity) markets than exchange-traded funds.* Led by efforts of the C.F.T.C., a variety of energy and other commodity-related E.T.F.'s have in recent days been the subjects of increased scrutiny, limits on trading activities and share issuance, and much more (this has also affected shares of the **U.S. Natural Gas Fund E.T.F.**, a subject we will discuss toward the end of this issue.) Undeniably, E.T.F.s' rapid growth has been an element in pushing the prices of *most* commodities higher. Policymakers *really* want to put this genie back in the bottle. Here again, though, the magnitudes of these moves would never--*could never*--have happened without the massive monetary inflation on the part, primarily, of the Federal Reserve.

LONGING FOR THE GOOD OLD DAYS

We have to believe that, at least for the foreseeable future, a combination of all of the above with the ongoing sick state of the overall economy will bring success to these efforts. In fact, not only do we think the price of a barrel of oil is unlikely to exceed its recent peaks (with the possible exception of a brief spike due to a weather or geopolitical event), but we would characterize as

a better-than-even-money bet that oil will be closer to \$50 per barrel by year-end.

At the same time that our rulers want to keep their excessive monetary inflation *out of* oil and other commodities, they have a corollary objective. And that is--in case you had not already guessed or turned back the clock a little bit in your mind--to direct their monetary inflation *into financial assets*.

Such diverging moves are not without precedent. Indeed, for most of *two decades*--the 1980s and the 1990s--stocks and bonds rose in value while commodity prices generally declined. To be sure, a lot has changed in the world since then. But what has decidedly not changed is the instinct of a central banker to do all in his power to keep his fractional reserve system and the banking system which implements it on a daily basis afloat and, preferably, healthy.

You and we might think they're crazy; but policymakers have convinced themselves that they can repeat this environment of the 80s and 90s. We have already described above how they are seeking in various ways to take some of the starch out of commodities; most notably, oil. In part two of this analysis in the next issue, we will go on to describe the ways in which they will do the opposite with stocks and bonds, and drive their monetary inflation once more primarily into *those* assets.

Last but not least, we will describe for you the risks facing policymakers as they travel down this road and--most importantly--how to measure their success (or lack thereof) and, therefore, how we should respond as investors.

