

**Speech to Cambridge House Conference
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Good afternoon. It is an absolute pleasure to once again address the knowledgeable attendees I always encounter at Joe Martin's Cambridge Conferences. I would like to thank Joe and his associates for once again including me in the program, and I must compliment them on the wonderful conferences they run, conferences that I truly believe educate the attendees on a subject that is very badly distorted in the mainstream media. The misinformation that the public is subjected to on the precious metals front is almost criminal in my mind, and thus conferences like these are absolutely essential to enlighten those who are prepared to open their minds.

It is also a huge honour for me to appear in the company of such luminaries as James Turk, Dr. Jim Willie, and Ian Gordon to name but a few, individuals who I believe have done yeoman service in getting the truth out to a largely unsuspecting public. I would especially like to acknowledge my very good friend Bill Murphy, who has done an absolutely spectacular job heading up the Gold Anti-Trust Action Committee (GATA) for nearly a decade. What he has endured and what he has achieved are a testimony to his character and that of his associates at GATA, most particularly Chris

Powell. With the passage of time, it has become abundantly clear to all but the most dimwitted amongst us that virtually every single thing GATA has alleged over the past 9 years about the manipulation of the gold price is true. Great movements need great leaders and Bill Murphy is a shining example of this. A lesser man would have crumbled under the abuse, but Bill has forged ahead time and again. Make no mistake-it is largely due to his dogged pursuit of the truth that we are even talking about gold price manipulation today. At some point it will be conventional wisdom, widely acknowledged, but people should not forget that Bill has been instrumental in making market manipulation a serious issue to be discussed in the first place.

Turning to the subject at hand, I think many of you in this room know my views on gold and silver because I've done all but shout them from a mountaintop. However, as we move out to all-time nominal highs for gold and 28-year highs for silver, it is worthwhile to emphasize what I consider to be an absolutely key aspect to the gold story going forward. Simply put, this is one of the best, if not the best, supply-demand imbalance situations that I have encountered in my 45 years in the investment business.

On the demand side, I think it is instructive to highlight two quotes that have most assuredly stood the test of time. The first comes from the French philosopher Voltaire, who over two centuries ago observed that, “All paper money eventually returns to its intrinsic value-zero.” Remember his wisdom in conjunction with a comment from John Pierpont Morgan (better known as J.P.), the brilliant U.S. financier who essentially saved the U.S. financial system following the Panic of 1907. In 1912, one year before the establishment of the U.S. Federal Reserve, he succinctly stated that, “Gold is money and nothing else.” When you consider these two statements in the context of the current financial situation, it virtually ensures an explosion in the investment demand for gold in the upcoming years.

The well-documented financial issues in the U.S., keeper of the world’s reserve currency (at least for the time being), almost guarantee an ever-more rapid debasement of that currency. The combination of a sinking economy and crippling levels of debt ensure that the injection of truly excess liquidity lies ahead. For those who doubt me, contemplate the existence of \$43 trillion in notional value of credit default swaps (CDS’s) referred to by no less an authority than Bill Gross of Pimco as the most egregious example of derivatives excess. Then consider them in the context of the current travails

of the monocline bond insurers, Ambac, MBIA, et al. This alone should be enough to put the fear of God in any thoughtful person. Moreover, there is little doubt in my mind that the dollar's demise will drag every other fiat currency in the world down with it. We see evidence every day that the other countries can't tolerate their currencies rising sharply against the U.S. dollar due to competitive pressures, and thus they are forced to devalue their currencies to cushion the U.S. dollar's inevitable fall.

As this reality sinks in, more and more investors throughout the world are becoming cognizant of J.P. Morgan's stated wisdom and will increasingly seek gold (and silver for that matter) as alternatives to paper money. We have not even seen the tip of the iceberg of this coming phenomenon, so those pundits who are constantly calling for the end of the precious metals bull market anytime soon are sadly mistaken.

Gold bull markets occur when gold's role as money is firmly re-established and investors seeking refuge from paper money increasingly drive demand. The idea that jewelry demand is crucial is greatly overstated, in my opinion. It is only important in the sense that it establishes a floor price in times when investors are absent from the market. The historical record is clear: the

massive bull market that culminated in a spike high of \$850 per ounce in 1980 was not the result of gold's allure as an ornament. It reflected a time of serious inflation that caused the public to seek a safe haven. Seen in this light, the World Gold Council's recent program of massive expenditures to promote gold as jewelry was badly misguided, and an utter embarrassment to anybody with a historical understanding of the true role of gold. They may have partially redeemed themselves with their sponsorship of a gold ETF but I must confess that I even have my doubts about these vehicles. Every fibre in my body tells me that some of the gold being held in ETFs is mobilized when the cartel needs a little help. In any case, in my mind the demand side of the gold equation is baked in the cake and it is going to be explosive, to put it mildly. As they say, you ain't seen nothing yet.

That brings me to the supply side, which can be broken down into three parts: mine supply, scrap recovery and the availability of the very substantial aboveground inventory which has been accumulated for centuries, because very little gold is consumed in the conventional sense.

To simplify, I think you can dismiss scrap and aboveground inventory not in the hands of central banks as somewhat inconsequential, the former because

it is relatively small in the total context, and the latter because a strongly rising gold price tends to encourage individual ownership rather than leading to large-scale disposition. While some people may cash in their gold as prices surge, others will no doubt pile in.

Thus the status of gold mine production and available central bank inventories, most particularly *western* central banks, are the critical factors in supply. The good news for gold bulls is that both are in full retreat.

I have commented extensively in the past on future mine supply and nothing has changed so far. Mine supply will decline for at least the next three or four years irrespective of what the gold price does. The gold price could rise to \$2500 per ounce and the mine supply outlook would be virtually unaffected in that timeframe. This outlook relates to numerous factors, not the least of which is the fact there simply aren't many large, fully permitted projects ready to exploit. In reality, the low-hanging fruit was plucked many years ago, and gold mining companies are increasingly being forced to exploit lesser projects in more problematic geographical locations. And, this is happening in a much more hostile geopolitical climate when compared to the 1990s.

Arguably the most interesting project in the world belongs to Aurelian Resources in Ecuador. Yet the head of the government there, Rafael Correa, is a populist who is doing his best to discourage those who would be prepared to get involved and build the mine. I suspect the project's economics are too good to ignore forever, but with each day's delay the production gets inexorably pushed further out into the future. And the Aurelian experience is by no means an isolated example of this sort of problem.

However, that may not be the biggest issue facing the gold mining industry. I think the largest problem stems from an insufficient number of competent personnel to build and operate new mines and the ongoing sharp cost increases in all facets of mining. Capital costs, operating costs, and environmental levies have all risen dramatically, making projects such as Galore Creek uneconomic at companies' current long-term price assumptions.

On the labour front, we have essentially missed an entire generation in the mining industry and the chickens are now coming home to roost. A

significant proportion of skilled mining talent is old like me and our time is coming to an end. Staffing current operations is already problematic, so where are the people going to come from to build and operate new ventures in the near term? Will this problem be solved with time? Absolutely. Is there a short-term solution? Not a chance, in my opinion, and we will pay a stiff price in terms of supply.

As mentioned previously, costs also remain very difficult. My partner Eric Sprott and I are big believers in peak oil and think that oil prices are going to ascend to levels that will appear surreal to the petro-bears. I have always been an admirer of Matt Simmons, the author of the book *Twilight in the Desert*, which detailed the true state of the Saudi Arabian oil industry. I regard him as a man who truly understands the gravity of the world oil supply situation. He recently alluded to \$100 per barrel oil as being equivalent to a 15-cent cup of coffee. If Simmons continues to be prescient on the subject of the oil market-and to date his forecasting record has been the equal of anyone's- the viability of a number of low-grade open pit gold operations is suspect given the percentage of operating costs devoted to energy.

Eric Sprott, who has as fine an investment mind as I have ever encountered, has thought a lot about this subject and poses an interesting question:

“Should we use increasingly more scarce hydro-carbon supplies to exploit marginal gold properties? Gold is not an essential product in that most of the newly minted gold goes into jewelry. As a store of value, we can just revalue the existing aboveground stocks.”

That is certainly food for thought, and I can't say I strongly disagree with the sentiment. Ironically, this represents one of the very few instances in which my views aren't totally at odds with those of the environmentalists who would shut down all open pit mining if they could.

Thus, I am beginning to believe that as we go forward, we may be confronted with a situation where the industry will depend more and more on higher grade, underground mines in reasonably friendly locales. This is most certainly not a recipe for a dramatic increase in mine production anytime soon. Much like oil, for whatever divine reason some of the best

gold reserves are in parts of the world governed by dictators or environmentalists, and are going to be increasingly difficult to develop.

I have maintained for some time that current annual mine production, which is approximately 2400 tonnes and falling, is headed towards 2000 tonnes before production bottoms out. I see absolutely no reason at this time to change that view.

That brings me to the subject of western central bank supply, which is far more controversial and considerably more opaque than mine supply. I have been of the view for a considerable period of time that the amount of western central bank gold entering the market via direct sales, leasing and swaps has greatly exceeded that of conventional wisdom for at least the past decade, if not longer. The reason there is some debate relates to the lack of disclosure by most central banks of their gold lending activities, transactions in which the official sector parted with physical reserves for a mere 1% interest payment annually. The borrower, a bullion bank typically, then sold the gold and reinvested the proceeds at higher rates. The whole operation was known as the gold carry trade. It is my belief that this sort of activity

was far more widespread than ever publicly acknowledged by the central banks.

I think this was amply demonstrated by the fact that gold dropped to \$252 per ounce in mid-1999, in the face of the English gold auctions. This was a price that was totally uneconomic and made no sense in the context of conventional analysis looking at traditional demand versus mine and scrap supply and disclosed central bank sales. I believed then and continue to believe now that had the central banks not seriously oversupplied the market with gold in their support of the noxious carry trade, which incidentally greatly enriched their bullion bank allies, gold probably never would have traded below \$400 per ounce.

I think this view was vindicated when gold staged a furious rally in the wake of the first Washington Agreement in 1999 limiting European central bank sales and leasing. This occurred as a result of classic central bank stupidity that clearly indicated that the left hand did not know what the right hand was doing: individually the gold loans were probably not problematic, but collectively they had dramatically oversupplied the market. The short squeeze that the Agreement ignited nearly bankrupted Ashanti Gold and

Cambior, and occasioned then-Bank of England Governor Eddie George's famous comment, as recounted in Reg Howe's courageous gold-price fixing lawsuit:

We looked into the abyss if the gold price rose further. A further rise would have taken down one or several trading houses, which might have taken down all the rest in their wake. Therefore at any price, at any cost, the central banks had to quell the gold price, manage it. It was very difficult to get the gold price under control but we have now succeeded. The U.S. Fed was very active in getting the gold price down. So was the U.K.

So much for free markets. This action led to even more aggressive price capping subsequently, facilitated by the mobilization of more and more central bank gold which created the eventual double-bottom in gold at the outset of 2001.

At that point, gold began its inexorable ascent, which is ongoing today despite the western central banks' continuing efforts to restrain its advance.

No one knows for sure how much western central bank gold has been dumped in the market in this increasingly sordid endeavour, but I can assure you it has been substantial. There were very credible estimates made several years ago by the likes of James Turk, Frank Veneroso and Reg Howe, all highly skilled analysts of great integrity, that suggested at that point approximately half of the central banks' 31,000 tonne stash of gold was gone. If that were the case, and I have seen no subsequent evidence that would dissuade me from that view, then subsequent dispositions would put the western central banks' available inventories at critically low levels today. For many years, these huge clandestine central bank activities, carried on through leasing and swaps, masked a growing deficit between natural demand and mine and scrap supply. I strongly suspect that anywhere from 1000 to 2000 tonnes of central bank gold has been entering the market annually which is remarkable considering mine and scrap supply at present barely exceeds 3000 tonnes.

Now, demand is on the cusp of an explosion because gold is reasserting itself as money. Mine supply is falling and scrap supply is relatively static. Thus the only possible offset to an increasing shortage of physical gold is the maintenance of continued large supplies of central bank gold. This flat out

isn't going to happen because this has been their modus operandi for far too long and has essentially emptied the vaults. As a result, the jig is nearly up.

However, the problem runs much deeper than a shortage of physical gold. There was a remarkable release recently by the Bank for International Settlements, the central banks' central bank. They published their triennial survey on Over The Counter derivatives, which is much more informative than their ongoing semi-annual surveys in that it encompasses a much wider universe of banks. It highlighted a near tripling in the notional value of outstanding gold derivatives in the past three years to over \$1 trillion. This is fascinating for several reasons, not the least of which is the fact that there are derivatives written on roughly 35,000 tonnes of gold, which represents nearly one quarter of the gold ever mined. However, it is even more bizarre that this virtual explosion in gold derivatives in the past three years would have occurred at a time when the gold mining industry was aggressively de-hedging.

In the past, bearish apologists attributed the relatively large amounts of gold derivatives outstanding to producer hedging. We now know this was not true. In my opinion, the remarkable proliferation of gold derivatives has

simply been another tool in the anti-gold cartel's arsenal to manipulate the price. As a result, there is going to be a day of reckoning on this front, and those on the wrong side (i.e. the short side) of the gold market are going to have a religious experience.

Returning to the subject of central banks, I have already made the case that western central banks are rapidly running out of gold to fill the steadily widening gap between burgeoning demand and falling mine supply.

However, the issues on the central bank front are far more complex than just the dwindling inventories. There are numerous central banks in the Far East and Middle East as well as the Russian central bank that are awash in U.S. dollars. To date they have been content to maintain the status quo by holding onto these dollars. However, the unending flow of U.S. dollars as the result of the U.S.'s continuing massive current account deficit is leading to unrest. It is becoming apparent that a number of these countries have reached a saturation point on the greenback. As a result, some of the central banks are already clandestinely buying gold, though a more transparent vehicle is receiving materially greater emphasis: the sovereign wealth fund. Hardly a week goes by without the announcement of a new entity in this field, with Saudi Arabia being the latest to enter the fray. And by no means are these

insignificant pools of capital. A recent estimate put the assets of these funds collectively at more than \$3 trillion and Morgan Stanley, in a recent study, suggested that they could grow to \$12 trillion by 2015. Their express purpose is to allow the various countries to more easily diversify their mountains of currency, primarily U.S. dollars, into more tangible assets. Thus far equity investments have grabbed the headlines, but I believe precious metals are on the radar screens of these entities.

As the merits of gold as an escape from paper money become more widely appreciated, I expect an increasing proportion of the Sovereign Wealth Funds' portfolios to be devoted to precious metals. Given the relatively small size of the gold and silver markets, the lack of available inventory and the existing huge supply/demand imbalance, this phenomenon alone should have a salutary impact on gold and silver prices.

For the foreseeable future, I don't think anybody will be constrained in their buying of gold because of the perception that it is overpriced, and we can credit that attitude to the effectiveness of the anti-gold cartel's price suppression scheme over the past decade. By their cumulative actions, they

have restrained the gold price to the extent that it is currently dramatically under-priced by virtually any metric you care to use.

For a considerable period of time, I have contrasted the price of gold with that of oil. Since gold became allegedly free trading in 1971 when Richard Nixon severed the last link to the U.S. dollar, an ounce of gold has on average been able to purchase 15 barrels of oil. With oil currently pushing \$90 per barrel, this metric obviously suggests that gold is under-priced by at least \$400 per ounce.

Similarly, for many years gold and platinum traded at roughly the same price before the cartel horse collared gold. In fact, in times of financial stress, gold, the monetary metal, commanded a premium. With platinum currently trading comfortably over \$1500 per ounce and the financial crisis arguably worsening by the day, the price of gold seems ridiculously low by this comparison.

When one contemplates the unconscionable amount of paper money and credit that has been created worldwide since gold peaked at \$850 per ounce in 1980, it almost seems surreal that it has taken almost 28 years to reach

that level again. To amplify that point, a gentleman named Ron Rosen recently noted in his “Precious Metals Timing Letter” that in the 28-year period that gold round tripped from \$850 to \$252 and back to \$850, the national debt of the U.S. grew by more than 10-fold from \$900 billion to \$9.2 trillion. Now tell me, in the face of that statistic, would you rather own gold or U.S. dollars at this point?

Not to beat a point to death, but if the previous peak price of gold were adjusted by the official U.S. inflation rate in the intervening period to establish an equivalent price in today’s dollars, that number would be in the neighbourhood of \$2200. So to think that gold has accomplished much by regaining its old nominal peak is naïve. Heaven forbid that we should use a more realistic inflation rate for that period, minus hedonic manipulation, substitution, bogus imputed rents and all the rest of the distortions. That would suggest the previous peak in today’s dollars would be closer to \$5000.

Before I close, I feel the need to comment on a recent article on gold that appeared in the venerable *Financial Times* of London. After all the times that I have abused the *Times* and its sister publication *The Economist* for their pathetically misguided coverage of gold, I feel the need to compliment

them on one of the first articles I have ever read in their paper that has given, in my opinion, a fair evaluation of the gold outlook. Both the *Times* and the *Economist* are mainstream establishment publications that I read faithfully and find most informative on most subjects other than gold, so it was a delight to read an accurate assessment of the yellow metal. In the article entitled, “Gold is the New Global Currency”, the *Times* correctly criticized the U.K.’s appalling decision to sell 60% of their gold reserves right at the bottom of the market, acknowledged the vulnerability of the U.S. dollar due to the necessity of having to cut interest rates irrespective of any inflationary implications, and drew attention to the rapid rise in money supply globally.

However, in the last line of the article, they essentially blew the establishment’s cover by saying that it is in the interests of business and consumers that gold’s most bullish fans are proved wrong.

That remark highlights one of the primary motivating factors behind the anti-gold cartels’ long campaign to restrain the price. The theory goes that if the gold price is behaving, then everything in the financial world is fine. If I had ever thought that creating a bogus gold price to convey a false message would lead to good things ultimately I would have gladly kept my mouth

shut. But this fantasy has led us into the mess we are currently in, with bubbles bursting everywhere and more to come. If we had had an honest gold price from the outset, acting as the so-called canary in the coal mine, we might have run a much more rational monetary policy and avoided the current nightmare we are now facing.

Finally, to bring this harangue to an end, I would like to draw reference to an observation by one of the great stock and commodity traders of them all, W.D. Gann. Gann noted many years ago that the longer it takes following a decline from a high to better that high again, the more powerful the ensuing recovery move will be. Given that it took gold almost 28 years to make that journey, the next few years should see some spectacular price action if Gann's adage proves accurate. In my opinion, the fundamentals couldn't be much better and the technicals look great. Ergo, I will once again reiterate my long held opinion that gold is going to trade at multiples of the current price before this bull breathes its last.

Thanks for being a wonderful audience.

