BUILDING WEALTH IN CHANGING TIMES

The Solari Report

JULY 11, 2013

Precious Metals Market Report

with James Turk
& Franklin Sanders

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C. AUSTIN FITTS: It's my pleasure to welcome to the *Solari Report* a gentleman who many of you know and have heard before, and that's James Turk, who is the proprietor, the founder and the chairman of *GoldMoney*, a company that provides access to owning and depositing gold and silver in a variety of places around the world. You can access it at *goldmoney.com*. James is a well known commentator on the precious metals market and, in fact, is the gentleman who introduced me to the one-and-only Franklin Sanders, whom I have the pleasure of joining at his Top of the World Farm here in Tennessee. So Franklin and James, welcome to the *Solari Report*.

We've had an unprecedented three months in the precious metals market, so let's dive in. If we could get a recap from James about what's been happening since April, for the second Quarter. Then I'm going to invite all of us to talk about how much of this has been market forces at work. Or are we seeing some sort of central management and regulatory forces? Let's begin with an update. James, I'll start with you.

JAMES TURK: Well, I think there are two dominant themes that we have to focus on as we look back over the past few months. One, is that we have to distinguish between the *physical market* for precious metals and the *paper market* for precious metals. They're entirely different. The physical market is a *tangible* asset; the paper market is a *financial* asset. The physical market, being tangible, has no counterparty risk and the paper market does have counterparty risk. The promise of that financial asset is only as good as the counterparty's ability to deliver on whatever promise they happen to be making.

You know, although the gold market and silver market for physical metals is related to the gold and silver market for paper, in reality they have different supply and demand characteristics. You own the physical metal in order to have a safe haven with no counterparty risk – to have money completely outside the banking system. But there are a lot of people around the world who, at this moment in time, aren't really that concerned about it. Or, if they are, they own the physical but they're also trading in the paper market. You trade in the paper market in order to try to profit from fluctuations in the gold price both up and down. And here I'm talking about the hedge funds, the professional traders, the day traders, the scalpers, and the locals on the floor of the commodity exchanges.

The supply and demand of these two different markets are fundamentally very different because, in contrast to paper (which can be created out of thin air from a bookkeeping entry), physical metal only comes from mining. And there's only a limited amount of physical metal compared to an unlimited amount of paper. And what we've seen over the last several months is the paper market *driving* the physical market, which brings me to the second theme I think we have to focus on.

It's not really considered often, but it is critically important in anything related to a portfolio, and that is: there's a difference between the *price* of an asset and the *value* of an asset. You know, assets can be overvalued or undervalued. And gold has been undervalued and it remains undervalued. And the fact that its price has fallen only means that it's more undervalued than it was three months ago. And it has become more undervalued because of what's been happening in the paper market in terms of driving down the price.

To focus on one more thing related to this overvaluation and undervaluation, I look at it using two specific mathematical formulas in order to eliminate the emotion of making a decision about whether gold is undervalued or overvalued. These are my *fear index* and my *GoldMoney index*. Both of these are indicating that gold is undervalued. And so, as a consequence, I'm going to take the same view since starting *GoldMoney* back in 2001: you should view the precious metals as a form of savings. It doesn't make sense to save national currencies because of the risks, particularly in the zero interest rate environment in which we operate. And every month or every quarter or whenever you feel comfortable, just continue accumulating the precious metals. These are your savings, and you'll be happy that you're saving these when this bull market is finally over.

The bull market will finally be over at some point in the future when my fear index and Gold Money index become overvalued. We're a long way from that. So what we need to do in focusing on this price and value relationship is basically ignore the price, focus on the value, and have a strategy to continue to accumulate the precious metals. And sometimes it's tough to do when you pick up the newspaper and you see that gold prices have been hit for $25.00.

But, I always come back to something Warren Buffet wrote in one of his annual reports years and years ago. He remarked that he was always confused when people got excited when the stock market rose and stock prices got high. And he compared it to a guy who only ate hamburgers his entire life. And if that guy only ate hamburgers, would he be happy if the price of a hamburger were high or if the price of a hamburger were low? You know, it's the same thing when you're accumulating and saving money. You want to save things that are undervalued, and that's what precious metals are at the moment. So, I guess that's a summary as to where we are.

The only other thing I would add, Catherine, is that it pretty much came as a surprise to me that the price dropped the way it has. But when it comes to markets, the old adage is "anything is possible" and that's clearly what we've seen over the past few months.

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C. Austin Fitts: Now, James, because you're running a fairly significant physical operation, what has happened to physical demand in the face of the tremendous drops in the paper price?

James Turk: Well, the major thing is that metal is moving from West to East. That's the big theme. Gold and silver are not appreciated or not valued as highly in the West as they are in the East. So you've had tremendous flows of metal going from North America and Western Europe over to Asia, Russia, China, India and pretty much all of the Middle Eastern and Asian countries where they recognize the importance of gold. They recognize that gold is undervalued. I mean, that's the big driver. Gold goes to where it's more highly appreciated or, as some people say, "Gold goes to where the wealth is being created." And in Asia, a lot of wealth is being created. And people acquire gold and silver as a form of savings to protect their wealth in dealing with the uncertain future we all have to deal with.

As a result of this flow of metal from West to East, we've seen some unusual things. There have been a lot of bottlenecks. And I guess the way to explain this, Catherine, is that there are two different aspects to the market we have to consider: the *retail* market and the *wholesale* market. The retail market is where you have coins and small bars, and the coins and small bars, for a period of time, were in short supply. And that was principally because of the fabricators – there was a limited capacity to make coins and bars. We saw how the U.S. Mint had run out. The Canadian Mint has also run out.

Over the past few weeks, some of these fabricators have been catching up and the supply of coins and small bars has, I think, more or less caught up with the demand. But on the other side of the equation, the wholesale market has not only been tight, it's becoming *even tighter* than it was previously. And, as an indication of how tight the wholesale market is here, I'm talking about 400-ounce gold bars that are traded internationally between the central banks, bullion dealers, and major participants in the bullion market.

Recently, the London Bullion Market Association started reporting the gold forward rate and it showed that gold is in *backwardation*, which is pretty much an earth-shaking event because it very rarely happens. But, it's an indication of how tight the metal is at the wholesale level. In fact, the week before last, there were no 400-ounce bars in Singapore and nothing available for immediate delivery. And they were waiting for bars to come from Switzerland. But there's been so much physical metal moving through the market from West to East that all of the transport arrangements have been locked up in advance and backlogged. They couldn't get the 400-ounce bars to Singapore as quickly as they wanted.

C. Austin Fitts: It's funny…I have one dealer in Dubai who keeps warning me that he can't get planes. All the planes are taken because he's got so much going out. I never know whether to believe him or not.

James Turk: Well, that's probably true. You know, another thing that's happened is that the refiners in Switzerland have been working 24/7 now for several months simply because they're so backlogged with demand, particularly for kilo bars. And another thing, a couple of these refiners have stopped producing the 400-ounce bars so that they can produce the kilo bars. The fact is that they only have a limited capacity and the kilo bar is a higher-margin product for them than the 400-ounce bar.

It's also an indication that they were having difficulty getting hold of a lot of gold to go for the high-margin products, which are the kilo bars. These are all being shipped out, most of them going to the East, but there is accumulation in the West as well by people like the three of us who understand that gold is good value and that we're in a major bull market.

C. Austin Fitts: Franklin, you're managing the physical market at the *Moneychanger* here in the United States. What have you seen in the physical market since April?

Franklin Sanders: Well, at first we saw a big burst in demand as the seasoned buyers saw that big drop and said, "Oh, oh, this is my chance to buy some more!" And then that was exhausted and that exhaustion shows both in the level of business that we do and in the premiums on what are really quasi-numismatic $20.00 gold pieces. And I watch that premium all the time – the premium actually started declining after an initial surge in April. You know, I publish a commentary, and if I say, "Well, I'd rather wait to see where the price is going to settle," people don't buy as much.

We saw huge premium increases in silver products and there was actually more demand for silver than there was for gold. And wholesalers reported the same thing. When they start raising those premiums, it's because they don't have it. And then all of a sudden, they run out because the supply pipeline is extremely thin and there are not that many refineries. And for them to mint up even 100-ounce bars, let alone one-ounce rounds, takes a long time and the pipeline quickly empties when there's a big surge in demand. So, I've seen some of the same thing.

But, I'd like to comment on two things James said. He said gold is undervalued and he made the point that we have to keep value in mind over price. Historically, it's hard to overstate how undervalued gold is when 140-150 years ago, 20 ounces of gold a year was a large income; sufficient to live on and to live *well* on – even allowing for changes in the cost of living. You know, the standard of living has risen considerably, and both gold and silver are just monumentally undervalued in historical terms. And it's also interesting that the flow of gold and silver is from West to East, because for centuries the East had products that the West wanted more than they wanted gold or silver. And so, gold and silver flowed from West to East, and then it flowed back the other way when that balance of demand changed. So, what we're seeing is simply the East recapitalizing itself with gold and silver, in a sense. I mean, maybe I'm abstracting too much, but that's what it looks like. So finally back to your question about demand: in the last two weeks or so, demand has really kicked up and we've got more and more people coming into the market to buy. So, I see strong retail demand. Those people are not going away.

C. Austin Fitts: One of the things I wanted to talk about was the extraordinary regulatory efforts we've seen over the last couple of months that would be suppressing of the price. I know Franklin has heard this, but James may not have – there's a story of a well known brokerage house that has traditionally encouraged people to buy gold and silver. I got a call from them sometime in April or early May saying, "FINRA is coming in to do an audit and any account with more than 20 percent precious metal has to sell down to 20 percent or leave within the next two weeks. We want them all out because more than 20 percent is a violation of the suitability rule in Dodd-Frank."

I'm not used to having somebody kick out good clients who've been there for many years. That is a regulatory push and, not surprisingly, (I just checked yesterday) you see Central Fund of Canada trading at a 4.8 percent discount to melt value, which is extraordinary given the quality of the organization. I can only presume that this is part of a "war on paper." Any thoughts or comments?

JAMES TURK: Yes, I think you're right, Catherine. If you look back historically, Central Fund of Canada does trade from time-to-time at a discount to its net asset value. And when it does, it's usually when sentiment in the West is low or at very rock-bottom levels. In other words, nobody's paying attention to gold. Nobody's recognizing how good a value it is. So I'm not surprised that Central Fund is at a discount to its net asset value at the moment. But again, looking at it from a historical perspective, it's usually a good indication that this is probably as low as prices are going to go.

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C. AUSTIN FITTS: I don't ever remember seeing it that low. You know, typically it's at a premium. Well, we've also seen an increase in margin requirements and I think one of the questions is how much can they raise those margin requirements in addition?

JAMES TURK: Yes, you know the Chicago Mercantile Exchange (or the Futures Exchange) controls the margin requirements. And throughout the entire price drop there was no change in the margin requirements. But, when gold finally got to its low price, they increased the margin requirements making it difficult for anybody who wanted to come in to buy the market – they would now have to put up more margin.

It's just another indication that governments and the powers-that-be do everything in their power to try to keep gold and silver out of the hands of people or to make gold and silver look risky compared to other alternatives. Because the government's power rests upon keeping people caught in the dollar system or the euro system or the British pound system and staying out of precious metals. And I always like to go back to what happened in the 20th century because it's just so clear from history that gold was confiscated by Lenin in Russia, Mussolini in Italy, Hitler in Germany, and Roosevelt in the United States.

Now, it might seem strange to put those four politicians in the same grouping, but they all had the same objective: it was to increase their power by taking money out of the hands of the people and putting the control of money into the hands of the government. This is the system in which we've been operating. Throughout the 20th century, governments through propaganda and interventions in the markets have tried to distort the free market process and the return to sound money as is constitutionally mandated and as this country has existed for the first 150 years or so.

C. Austin Fitts: I think, James, it's hard for many people to understand the nature of a *confiscation process*. If you look at the letter the Treasury sent GATA, they said, "We reserve the right to confiscate everything." But if the government said, "Okay, we're going to have a confiscation process," that would take much longer and be much more expensive because they'd have to compensate people at the market price. It would take longer and be more expensive to bring in lots of gold than by doing it in this way.

In other words, if you drive down the price and you do it with the ability to short the market and make money doing so, you can bring in a lot more gold a lot faster. You know, this is confiscation by a market management scheme.

Franklin Sanders: I agree with you completely, Catherine! I think this has been an opportunity for the insiders to load up!

C. Austin Fitts: I just have to tell you that I drove from Tennessee to California via Nebraska, Colorado, and Oregon in April and then back again in the last week or two. And I constantly asked my subscribers around the country the same question: everywhere I went, in every pawn shop and in every jewelry store there was a big sign saying, "**We buy gold.**"

There were no signs saying, "We *sell* gold." It was all a giant sucking sound. And what it said to me as the price was dropping was that everybody is buying, buying, buying.

And nobody's selling. It's very interesting.

JAMES TURK: Another thing it represents, is that it really points to what gold and silver *are*. They are your savings and the economy in the States is still crawling along. Unemployment is still high. We've not reached the employment levels that we reached prior to the crash. We haven't reached the average income levels that we reached prior to the crash. So, people are still having a tough time and what they do is draw on their savings. So, it's quite natural that a lot of people have been selling gold or selling silver to a lot of these shops around the world, or around the States, in order to get by.

But this isn't just happening in the States. You see this elsewhere, as well. People who are having a tough time are relying on their rainy-day money, which is of course gold and silver.

C. AUSTIN FITTS: I know there's been reports that the VAT tax has increased in Europe.

JAMES TURK: Yes, that's just one of many taxes they're increasing to try to fund these deficits they're running. But it's not helping. All it's doing is making economic activity suffer even more. Europe is heading into a recession. It's probably already in one. The only question mark is Germany. But I was just reading that German exports are down, meaning Germany is probably on the border of going into a recession, as well. The politicians there, like the politicians in the States, don't understand that taxes kill economic activity. If economic activity is killed, revenue to the government falls accordingly and the deficits get bigger. And what's happening in Europe is also happening in the States.

You just have these huge deficits and the mountain of debt continues to grow.

C. Austin Fitts: Let me ask you both this question: could any of the drop in the gold price relate to the fact that the economy is slowing and that we have deflationary forces at work as well?

James Turk: Well, we do have some deflationary forces at work, but crude oil is at $103.00 a barrel. Gasoline prices are up. The government lies about what the true inflation rate is. Prices are going up all the time. Some assets that have been overvalued like houses and other assets like stocks are overvalued. But stocks are an alternative to having liquidity in a currency that's always being depreciated. So, you have debt destruction. A lot of debts are being reneged upon, but that's not deflation. The money supply continues to increase and prices continue to rise.

C. Austin Fitts: That's right, although commodities as a general group were trading with the U.S. equity markets until late last year. And then there was a huge divergence between U.S. equities and all commodities. So Starbucks has been having a party as coffee fell and their stock price rose. But, they seem to have de-linked and that's been part of what surprised the market.

James Turk: Crude oil hasn't de-linked. You know, it's $103.00. And, in my view, crude oil hasn't de-linked because it's responding to inflationary pressures; whereas most commodities have been flat or down because economic activity is poor. But crude oil is an essential commodity regardless of whether the economy is doing well or not. That's why crude is going its own way.

Franklin Sanders: Well, regarding a deflationary tendency in the economy, you have to go back to what Bernanke said in November of 2002: "I've got all these tools against deflation and I'm going to use them." And he has! I mean, it's like reading Adolf Hitler's *Mein Kampf*. This is what my program is, and I'm going to do it, and *he did it*. And I don't think you can understand this outside the context of the central banker mentality.

James, you knew John Exter very well. He was very, very kind to me when I was going through all my legal problems. He came down and testified for me in court twice and did a lot of other things. But, I remember talking with him on the phone one time – he went to Harvard in the late '30s when deflation was such a problem in the economy. And I'll never forget talking to him and he said, "Oh,that deflation." And his voice dropped and I knew he was about to make a very important point. And he said, "When that deflation takes hold, there's nothing you can do."

"There are generations of central bankers who have grown up with that mentality and who are still reacting to the experience of the Great Depression in their fear of deflation."

And right there, there are generations of central bankers who have grown up with that mentality and who are still reacting to the experience of the Great Depression in their fear of deflation. And of course, they're right. Once that takes hold, there's nothing they can do. You can't inflate your way out as the New Deal proved. You can't inflate your way out of an economic depression – it just won't work. A war will work, but who wants a war to get out of a depression?

James, I'd like to go back to something you said a few minutes ago about the increase in the Value Added Tax in Europe. Germany recently passed an increase taking the Value Added Tax on silver from 7.5 to 19 percent (effective the first of next year). Now there's no VAT on gold in Germany but there *is* a VAT on silver and that's the one they're increasing. At the same time, there were news reports that the French postal service announced you could no longer use the post office to make shipments of gold, silver or currency. And then I read the same report that UPS and FedEx had also announced they would not make those shipments. I know the part about the French postal service is correct because there was a link to the actual regulation. But what's up there? What's going on?

JAMES TURK: I think it's just more government control – government trying to keep gold and silver out of the hands of people. And what you say is true: Federal Express did stop. But they are once again shipping metal in Europe. We use Federal Express in Europe to ship gold and silver bars that Europeans buy from us. But, there was some uncertainty as to whether or not they were going to continue. The governments are doing everything they possibly can to make gold and silver look unattractive because they have to keep this phony system in which we operate alive. They have to keep propagandizing against gold and silver. They have to keep intervening to make gold and silver appear to be risky assets, when in fact they're the world's safest assets with 5,000 years of history as money.

FRANKLIN SANDERS: Well, that leads me to believe that what we've seen this year in gold and silver is simply a replay of what the government did from the beginning of 1974 through August of 1976. There were repeated gold auctions in which the government literally waged war on gold by selling. And, don't you think that that's the same thing we're seeing now? I mean, the greatest competition to the U.S. dollar, the euro, the yen – all of those fiat currencies – is gold and silver.

JAMES TURK: Yes.

FRANKLIN SANDERS: So it simply makes sense that they want to trash them.

C. AUSTIN FITTS: But, you guys are making it sound like they don't *like* gold and silver. To me, it looks like they're doing everything they can do to accumulate and *acquire it*.

FRANKLIN SANDERS: When I say that, I mean that they don't want *public demand* for the metals to go up. But, they may know themselves. Although the central bankers garble about how gold is a "barbarous relic" and all that sort of stuff, they still hold 15 percent of their reserves in gold. I mean, maybe the number is a little smaller now, but when the euro was floated they had a 15 percent reserve as measured against their currency issue in gold.

C. AUSTIN FITTS: But aren't central bank stores in gold rising right now?

FRANKLIN SANDERS: Yes, they are. And I don't disagree with you that they're playing a two-faced game. But if you look at it, they're sucking the gold away from the public and towards themselves while they're telling the public, "Oh, you don't need that gold. That stuff's no good, and we're not going to ship it by postal service, and we're going to lay a larger tax on it."

C. AUSTIN FITTS: Well, it sounds to me like they're talking their book.

FRANKLIN SANDERS: Sure – absolutely – yes, talking their book! No question about that!

JAMES TURK: There is a good example in history of the exact same thing. When Roosevelt was elected in 1932, before he was inaugurated in March, there were all kinds of rumors that he was going to go off the Gold Standard, and he kept denying it and denying it. But there was this massive outflow of gold from the United States to Europe. Then he devalued the dollar and revalued gold, and all of this gold flowed back into the States. So it was clear that the insiders had prepared themselves for what they knew was coming, which was gold confiscation and the devaluation of the dollar. Because gold outside the United States was not confiscated by Roosevelt.

C. AUSTIN FITTS: Let's turn to the bond market for a moment. The West has been the beneficiary of a long-term bull market in bonds for many decades. We've seen interest rates come down, down, down. You know, every month I get on *Coast to Coast* and say, "They can't possibly go any lower," and then they go lower. But we've now seen a struggle at the beginning of the year as interest rates started to sneak up. They came back down, not unconnected perhaps to the slam-down of precious metals in April. And now we've just seen them sneaking back up again. Could we talk a little bit about what's happening in the bond market and what the relationship is between interest rates and the precious metals markets: what the outlook for interest rates could mean to gold and silver over the next 12 months?

JAMES TURK: I think we reached a tipping point back in May and it was confirmed in June. After the May meeting, when the Federal Reserve Open Market Committee met, interest rates jumped even though the Fed said they were going to continue their quantitative easing program. Then in June, the same thing happened after their meeting: interest rates jumped. This was different from what had happened in the past. When the Fed announced quantitative easing, interest rates had been declining and the Fed was buying more government paper than was being demanded by the market or was available to the market.

So the net purchases from the Federal Reserve actually caused interest rates on government paper to decline. What's happening is that people are beginning to see that there is a dark side to quantitative easing. There's a dark side to all of this money printing, and capital is responding by demanding higher interest rates. So we've reached a tipping point. Even though the Fed is continuing to expand its balance sheet by buying government debt, interest rates are going *up*. The Fed can't stop that. What we're at is the beginning of a hyperinflationary blow-off…or the federal government has to stop spending money.

You either destroy the currency with hyperinflation or the federal government stops spending money to save the currency. We're at the stage where rising interest rates are going to worsen the budget deficit of the federal government, causing it to borrow more money – more than the market has the capacity or the willingness to lend it. The federal government, therefore, either has to stop spending or turn to the central bank to buy that paper and turn it into currency. And that's how you essentially get to hyperinflation. I don't think the federal government is going to stop spending money. So, I think we really are heading to hyperinflation, which has been my view for some time.

It's just taken longer to reach that moment than what my expectation was. Although I've always felt the 2013-2015 timeframe was when everything was going to come together. We're now in that timeframe and I think we're heading toward hyperinflation of the dollar.

C. Austin Fitts: James, this is one place, one of the *few* places, where you and I disagree. Because I think they'd always rather have a war than have hyperinflation.

JAMES TURK: It's possible. My view is that to fight hyperinflation they're going to impose *capital controls*. You know, dollars outside the United States cannot be remitted back to the U.S. and spent there. Meaning that the international dollars held by China and all the other central banks around the world are going to go to a *huge discount* to a domestic dollar. I think they'll impose capital controls before they go to a war, but I don't disagree with you, Catherine.

You know they're going to fight it. I don't know if they're going to fight more wars. I mean, they're already fighting *some* wars. Whether more wars are on tap, who knows? They'll do everything possible to maintain their power, but it's inevitable that they have to stop spending money. Otherwise, the currency is going to hyperinflate.

"They'll do everything possible to maintain their power, but it's inevitable that they have to stop spending money."

C. AUSTIN FITTS: Do you think this is one of the reasons why they're targeting the tax havens? I mean, six weeks ago we saw the G7 get together and agree that they're literally going to target tax havens. Then the G8 met and they reaffirmed it. Many of the subscribers on the *Solari Report* are worried that they're going to target IRAs and 401Ks, but there's a lot more money in the tax havens.

JAMES TURK: Well, there is a lot of money in tax havens, but that's hard to get at. The easy money is the pension money and if you look at what's happened in other countries around the world when they hit the wall, Argentina went after pension funds. Ireland, when it collapsed, went after pension funds. Spain, when it collapsed, it went after pension funds. So yes, I think pension funds are the target they're going to go after. They'll go after pension funds before they go after gold.

C. AUSTIN FITTS: Well, that's where the money is. The pension funds have much bigger holdings, as Franklin has always said.

JAMES TURK: Yes, and they're easy to get at because it's all recorded in the banks' and brokerage firms' books. They'll just say, "Okay, we're taking control of your 401K because this is an emergency situation. We'll take those assets and we're going to give you a 100-year zero-coupon bond in return.

C. AUSTIN FITTS: Actually, one of the things they've proposed, James, is an annuity. So they'd convert it.

JAMES TURK: Something like that.

C. AUSTIN FITTS: Franklin, what do you think the the outlook for interest rates is and what will it mean to the gold and silver market?

FRANKLIN SANDERS: Well, you know, a lot of people try to give a simplistic answer to this relation between gold and long-term interest rates. And it's true that in a free market there would be a negative correlation. I mean, the higher interest rates go, the more it would cost you to hold cash, which is gold.

But what they're doing, in effect, is discounting interest rates for the *expected* inflation. For instance, let's say interest rates went to 16 percent. Well, anybody would be crazy not to buy government bonds. But, if the expected inflation rate is 20 percent, then what that 16 percent means is that you're going to lose 4 percent a year. And so, as that manner of thinking begins to enter the public mind, it won't matter where interest rates are. The people won't be interested in holding currency or currency-denominated assets.

We looked at a chart that shows how interest rates are negatively correlated with gold. We looked at the last few years and, while that's true in the long term, once you break confidence in a currency or *begin* to break confidence in a currency, then the interest rate doesn't matter because people want out of the currency.

C. AUSTIN FITTS: Right.

FRANKLIN SANDERS: And the only way they can get out of the currency is to get into some other currency. Namely, gold and silver.

JAMES TURK: I think Franklin is bringing up a good point and I agree with him entirely. There's one other thing to keep in mind: are we talking about *nominal* interest rates or *real* interest rates? Remember what Volker did back in 1980? He took interest rates up to 16 percent, but that was because the inflation rate was 10 or 12 percent. So you had interest rates higher than the inflation rate. Right now you've got interest rates *lower* than the inflation rate – you have negative real interest rates. As long as you have negative real interest rates, the gold price is going to continue to rise.

One other thing to keep in mind is that the U.S. government's debt is now approaching $17 trillion. Every one percent rise in interest rates means an additional $170 billion a year in interest expense. The government is running a trillion-dollar deficit. And $170 billion *on top* of that, with just a one percent rise, raises the deficit by 17 percent. If you bring rates up to a more normal level – you know, eight percent or something like that – you're talking about another $1 trillion of interest expense. And that's when you get on the treadmill and you can't get off, because you're borrowing in order to pay interest expense. And that's what leads to hyperinflation.

C. AUSTIN FITTS: Well, I still think they have enormous capacity to keep the *slow burn* going. I just think it's going to be very violent.

Now, let me ask one other question because I always try to look ahead to see what's coming around the bend and to see what the risks are. When I met you, James, you were extraordinarily helpful in helping me understand the opportunity in precious metals. So, I was able to get in very early. And the people I recommended precious metals to were able to get in very early thanks to your good work. Then I remember coming into 2008. I saw the danger in the equity markets and the bond market and I was able to shift people out.

But, I didn't see this one coming and that bothers me because I pride myself in being able to side-step these big moves. This one got me. One of my favorite quotes – I just used it in one of our newsletters – is from Mike Tyson. He says, "Everybody has a plan until he gets punched in the face!" The question for me is, what did I do wrong? What did I miss? Why didn't I see this coming? How can we make sure that we see these things coming? I know you can't *always* do it, but this one was a big surprise.

FRANKLIN SANDERS: Catherine, if you don't mind, I want to add to that. I watch charts all the time and one of the charts I watch closely is the Dow measured in silver and the Dow measured in gold. I've been watching it since 1996 and it never gives a false signal. It's slow to move sometimes, but it just *never* gives a false signal. Well, in August and September of 2012, I had been watching that chart very closely since January because it had been forming an up-pointing wedge – a rising wedge – which normally breaks out to the downside.

And sure enough, in late August it broke out to the downside, and then it kept on going to the downside and kept confirming to the downside until November. At which point it turned and went 180 degrees up – just completely negating the previous 10 months of technical activity. So I finally concluded that what I saw in that chart was Ben Bernanke. Because charts *just don't do that*. I mean, they don't make that kind of contradiction. So, I just wanted to add that. I got fooled, too. I got punched in the face big-time.

JAMES TURK: I was surprised as well. If you'd asked me on the 31st of March where gold was going to be on the 1st of July or something, I would have probably said higher. But I would also have said that there's a ten percent possibility that anything can happen, and anything *did* happen. Then it surprised me. You know, anything can happen when it comes to markets. What we don't know is the reason *why* we saw that price decline. We only see the impact and the results and the consequences of it. I think the reason may ultimately prove to be that the Bank of Italy and maybe the Bank of Spain – the central banks of those countries – actually sold some gold or loaned it into the market in order to raise liquidity to bail out insolvent banks in those countries.

You know, 100 tons of gold is $20 billion in dollar terms and, as a consequence, you don't have to sell a lot of gold to raise the liquidity to bailout banks. Given the amount of metal moving through Switzerland at the time, I think that may have been the reason. But the consequences are what we should be focusing on and what we're seeing is unusual circumstances in the market. You know, the huge demand for physical product in Asia, the backwardation that we're seeing in gold – all of these things suggest that the gold price has to go higher from these levels in order to bring some kind of balance back into the market.

"The consequences are what we should be focusing on and what we're seeing is unusual circumstances in the market."

But I think the important point, Catherine, is that you really need a strategy to get through an uncertain future and to deal with the *noise* that occurs from time to time. And I keep going back to my dollar-cost-averaging plan. Regardless of what happens on the 15th of the month or the 25th of the month or the last day of every quarter, you know, you're saving money. If you're saving $100 or $1,000 or $100,000, it doesn't matter. Just buy on that day, regardless of what the price is doing, regardless of what the news is saying. Because we're in a major bull market and precious metals are going to go much, much higher before this bull market finally ends.

One thought that came to mind when I talked about valuation – and it relates to something Franklin was saying earlier – I'm bullish on gold, but I'm even *more* bullish on silver because gold is overvalued relative to silver. Or, silver is undervalued relative to gold. So, at the moment, silver is by far the better value than gold. But silver comes with risks you don't see with gold. It's much more volatile and you see that volatility in the gold/silver ratio. You know, in the year before last, the gold/silver ratio got down to 30 ounces of silver to 1 ounce of gold. And a few months later it was 58 or 60 ounces of silver to 1 ounce of gold. A lot of people can't handle that kind of volatility. But if you're in for the long haul, you should have some silver in your portfolio, too.

C. AUSTIN FITTS: James, to what extent do you think the *bail-in* fears are happening? I'm a great believer that we have excess capacity in the financial system and that we're ultimately going to have to shrink that capacity. We know at the end of last year that the Fed and the Bank of England came out with their bail-in policy. And the EU just announced a bail-in policy. Are bail-ins coming, and what could that do to the supply and demand of gold at the wholesale level?

JAMES TURK: That's a really good question, Catherine. And it's the only potential deflationary force out there. What a bail-in basically implies is the same thing that happened back in the 1930's when you had that massive deflation. A bail-in means the destruction of money; it *requires* the destruction of money to have a deflation. I've been pondering the implications of whether the price decline in gold since the Cyprus bailout is the market aside from the intervention issues, responding to the potential deflationary implications of a bail-in.

But we also have to remember that in the 1930's the price of gold *rose*. Gold will rise in an inflationary environment or in a deflationary environment for different reasons. In an inflationary environment, it rises to maintain the purchasing power. In a deflationary environment, it rises to avoid counterparty risk. So the bail-in thing is what we should really be focusing on going forward.

The EU just announced (I think it was the week before last) that bail-ins are part of the remedy they'll use to deal with insolvent banks. That's now part of the EU official policy and I've seen other countries around the world accepting this, as well. And it suggests to me that perhaps the bankers aren't going to destroy the currency. Instead, they're going to deal with the 1930's type of inflation by de-leveraging the banks by destroying depositor money. That's one of the most plausible ways to get money out of the banking system.

C. AUSTIN FITTS: My theory is that a lot of what we've been seeing in the gold market is an effort by the G7 central banks and the big member banks to cover their shorts before the bail-ins happen. So they're battening down the hatches. If they're going to work their way through the bail-ins without contagion, then they can't afford to have shorts on the gold side in their trading positions or unallocated pools. So, I think a lot of what's happening is that they're sort of "spiffing themselves up" for bail-ins.

JAMES TURK: Yes, I don't disagree with you. I think that's a very good possibility.

FRANKLIN SANDERS: But why would they do that? There are two drawbacks to that. First of all, they'll switch the economy into a deflationary mode for sure because they'll be decreasing the money supply – and at the worst spot, where it's available to consumers. So, they'll be curtailing consumer spending.

And second, they'll be overthrowing what was done and has been done around the world since the 1930's: offering government insurance like FDIC to depositors to create confidence and faith in the banking system. So, if they did what you're talking about, the bail-ins will imply that something *huge is up*. Otherwise, it appears they're committing suicide.

C. AUSTIN FITTS: Well, they would write down the uninsured, not the insured. But they could do it in a way that drives the deposits into their lead member banks. So this would simply be a consolidation that makes the lead member banks stronger.

JAMES TURK: Exactly. And if they own the gold, Franklin, which is what I think the insiders have been loading up on during this last price decline, they're going to be protecting themselves.

Their survival is what they're really focused on. They want to continue this fiat currency scheme whether it's at an international level or at country levels. Who knows? But, they want to continue this international fiat currency scheme because that's what their power base is based on.

C. AUSTIN FITTS: Right, and if you talk to the small banks and credit unions around the country, the regulatory policies (at least in this country) have been feeding off of that negative interest rate that James was talking about. Every effort by the regulators has been to make sure that banks are buying long treasuries and *not lending locally*. So they have cut off credit on Main Street in many different ways. It's quite extraordinary and it has kept a damper on inflation because people are hurting.

FRANKLIN SANDERS: Well, I'm not nay-saying what you're talking about. But I'm just asking this question in my mind: why would they kill themselves? I mean, it seems to me that the policies we just discussed would turn people away from the system and drive them to even greater desperation than the years since 2008 have driven them away already. So what you're talking about is running your ship dangerously close to the wind of public repudiation – you know, public revulsion.

C. AUSTIN FITTS: Right, but I think this gets into another topic, which is the NSA story. I believe they think they have enough control to continue to squeeze the middle class. And they can maintain that control because so many people are dependent now on federal credit. If you look at the percentage of people in any place (such as a county in Tennessee) who are dependent on food stamp money, on Social Security, on Medicare, on disability checks, you know they've got as much as 50 percent or more on the dole. And that means 50 percent of the people have a vested interest in the dollar system *continuing to work*. So it's an ugly picture, but I think this gives them enormous constituent support for the squeeze.

Now, James said that he would recommend averaging. And Franklin, should someone who's looking to buy be a buyer now, or should they wait for the primary trend to reassert itself? What do you say?

FRANKLIN SANDERS: Well, Catherine, I've been nursing my bruised feelings and my punched face since April …

C. AUSTIN FITTS: Join the club!

FRANKLIN SANDERS: And so I've been very cheery about telling people to get back in, because every time I thought it was time, they would engineer another waterfall collapse. But what we saw on Friday, which is typically the time that they hit a market where the trading is thin – either they do it early in the morning or late in the day or sometime where the trading is thin and there's not many traders around – and that's always the 5th of July because all the folks in New York have gone out to Long Island and are drinking their martinis. So they hit the market on the 5th. Gold closed at $1,252.50 on Wednesday. They hit the market on Friday, but they couldn't drive it below $1,206.00. And then on Monday, it came back, closed higher at $1,234.00, and that's a key reversal. That's when you break into new low ground for a move and then close higher the next day. It's not exactly a key reversal, but it certainly has two of the components. And then we're higher again today. So today being the 9th, my mind has changed about gold and silver. I think that the low that we saw in June when you had all that concentrated fund selling at the end of the quarter – in addition to all the other pressure on it – I think we've seen the bottom of it.

"That's when you break into new low ground for a move and then close higher the next day. It's not exactly a key reversal, but it certainly has two of the components."

Now, if it goes below $1,206.00 and silver goes below $18.70, then I'll say, "No, I was wrong again." But right now, for my own part, I've turned from being a bystander into being a buyer.

C. AUSTIN FITTS: Okay, so I have folks say to me, "Well, these guys can raise the margin requirements, and they can change the brokerage rules, and they can play games – you know, they can force central banks around the world to sell in the tax havens. Or they can change the mailing rules and do all of this and there's so much more they can do…and *I don't want to fight city hall.*" How much tougher can they make it? How much more can they drive it down? What do you say to that?

JAMES TURK: My guess is that they've driven it down as far as they can and that's why gold is in backwardation. There's just not enough metal down here. You have to remember that gold is basically an interest rate play. Interest rates are a reflection of the risk of the currency. You know, the interest rate of the South African rand or the Indian rupee is higher than the interest rate of the U.S. dollar because the central banks in those countries are more likely to inflate those currencies. And they have, in fact, been inflating those currencies. But gold's interest rate is the lowest interest rate of all the different monies out there. And it is the lowest because you can't just create gold out of thin air.

Physical gold comes out of mining, and this above-ground stock grows consistently year after year at about 1.8 percent per annum.

So gold has this very low interest rate. Now, because dollar interest rates have been forced low, they've had a period of time where they were actually saying gold's interest rates were negative. The only reason they did that was to prevent gold from actually being reported as being in backwardation. But in reality, gold's been in backwardation for some time. Now they're even reporting through the LDMA web site that it's in backwardation. I don't think they can drive gold any lower.

Again, I'll add my ten percent: anything can happen when it comes to markets. But to me, this looks like it's just a real steal down here at these levels.

C. Austin Fitts: Well, I just have to say two things in closing. I think the hardest thing in the world is to look at the world and say, "Something is deeply wrong and I'm going to *do something* about it. In fact, I'm going to go create a business that helps people succeed and survive in this environment despite that." And both of you have done just that and you've done a tremendous job. It's taken many decades and I think it takes great courage and competency.

And the other thing I would love to say in closing is, James, you introduced me to Franklin. You sent me an email in 1999 or 2000 and you said, "You know, there's another guy in Tennessee who's had an even harder time with the federal government than you have, and you ought to go check him out." And I did. And one of the things that's important for us to do today – James probably doesn't know this – today is the day that the *Moneychanger* is closed for a special holiday that no one (certainly not the New York Stock Exchange) celebrates. It's July 9th, which is a very special day here at the *Moneychanger*. It's a day that reminds us that anything is possible and that miracles can happen to those who work hard and are faithful. Franklin, maybe if you could share with James and the audience why today is such a special day at the *Moneychanger* and what we're celebrating today.

FRANKLIN SANDERS: Well, today is the 9th of July, and James, maybe you remember that on the 9th of January, 1991, I was arrested along with my wife and 22 other people on charges that my starting a gold and silver bank a few years earlier was a conspiracy to delay and defeat the IRS. And I was also charged in a 72-page indictment with willful failure to file. *And* they charged my wife. And that trial lasted exactly a year and a half. And on the 9th of July, 1991, we were all acquitted. And it really made the judge mad because she was just doing her best to put us in jail, and they just folded up their tents and slinked off into the night.

And honestly, if you know anything about federal prosecution, the investigation lasts a long time. In my case, they started in June of '86, and they do everything they can to destroy your morale, your business, your marriage. And by the time most people are indicted, they're so broken that they'll plead guilty to anything. And the U.S. attorney, who was just the most venomous person I've ever run across, actually told somebody that she had a bunch of people in a case who wouldn't plead guilty if she had them on videotape.

And she was absolutely right, because we had *done nothing wrong*. But this is how great a threat silver and gold is to the present financial and governmental system. So, I think there's an institutional instinct to try to crush gold and silver anytime they raise up their head. But they can't do it. Over time, the trends, the overwhelming move by people to protect themselves just can't be resisted. So this is a great day for us. This is the 22nd anniversary of that day.

C. AUSTIN FITTS: Now, I always have to say one other thing you didn't mention, Franklin. And it's the most amazing thing about this whole story.

You swear – and James, this is a testimony to one of the happiest marriages I've ever seen – that Susan never once criticized you for getting her into this.

FRANKLIN SANDERS: Well, I would have been tempted to turn around at some point and say, "You know, this is all your fault." And she literally never even got close to saying that the entire time. And she would have been right. It was all my fault.

JAMES TURK: Well, you know, Catherine, it's been great for me to be friends of both Franklin and Susan for as long as we have been friends. I don't really remember when we first met, but it must have been in the early 1980s if not the late 1970s. But, it's been an honor to be your friend over this period of time and I will celebrate July 9th with you today.

FRANKLIN SANDERS: Good! Well, I've got to say it's been my honor, too, to be friends with both of y'all, and I have been tremendously inspired by James' perseverance at *GoldMoney* because I watched it all through the early '90s and watched everything you did. And I think what it proves is that it is possible. It's possible to create businesses and institutions in the teeth of the opposition of the financial structure – the system, the elite, whatever you want to call it – and still succeed. *It is possible.*

C. AUSTIN FITTS: Yes, and that's what *we* have to do, and you guys have proven it can be done. So anything else you want to add in closing? Any message to the subscribers?

JAMES TURK: Well, I'd like to thank you, Catherine, and Franklin as well. This has really been a great opportunity to talk about current events in the market as well as the big picture. And it's been a real pleasure for me to participate in this conference call.

FRANKLIN SANDERS: Well, same for me. I don't know if y'all have ever noticed this in your lives, but when I get around some people, I think they put out vibrations or emanations that heterodyne your brainwaves. In other words, they jam your ability to think. And you come away from them and you're thinking, "What was wrong with me? Why wouldn't my brain work?" And then there are also the other kind of people who must put out emanations of clarity or something.

But you all are always that way around me and I really appreciate it because you make me think more clearly.

C. AUSTIN FITTS: Well, "where two or more are gathered in my name, there am I. " So James and Franklin, thank you again on behalf of all the subscribers at the *Solari Report*. Thank you for joining us today on the *Solari Report*.

JAMES TURK: Thank you, Catherine.