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Subject: Another Systemic Dislocation - The International Banking System again on the Brink

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Another Systemic Dislocation: The International Banking System Again on the Brink

September 25, 2011
By [Asher B. Edelman](#)

The Banking System has suffered a collapse (then revived by the American taxpayer). It is, once again, on the cusp of collapse.

With the help of the taxpayer the International Banking community survived the mortgage and mortgage derivatives' crisis. It survived the steep decline in equities. A huge effort is contemplated to save the banks from Sovereign default (so far only contemplated).

AND NOW:

On Friday the gold market declined 6%, the silver market 18%. Margin required on gold futures contracts (derivatives), as of Friday, was \$7,000 per contract, or 4% of the value of the contract which leaves most futures contract holder accounts in deficit at the close of business Friday. These margin requirements are even lower in many of the banks and exchanges in the rest of the world.

Silver margins were \$15,500 per 5,000 ounce contract worth about \$180,000 at Thursday close and \$150,250 at Friday close, leaving many silver derivative futures contract holders with a \$15,000 deficit plus a \$25,000 margin requirement to pony up Monday morning or be sold out.

Copper and platinum have similar stories.

Banks not only will have to collect margin from clients or sell the clients out, but also absorb the usual losses from their own speculative derivatives' positions (larger than at any time in history, including the pre mortgage derivatives' crisis).

This week will be telling. Certainly we will see an attempt to rally the commodities markets and soothe the fears of Sovereign defaults. It will be difficult for the American government that cannot even agree to a temporary budget bill to be of assistance; even more difficult for the Europeans, who can't decide default now or later, to assuage the fears of collapse.

For some background I have attached two previous letters I have done on commodity derivative systemic risk.

Silver and Derivatives Dislocation

May 3, 2011

By Asher B. Edelman

In the past couple of days I have received a number of calls about currency weakness and commodities volatility - especially that of Silver.

The aggressive policies pursued by the American government and other debtor nations to debase their currencies have awakened speculation in "hard assets" such as silver, gold, other precious metals, oil, etc. As the prices of these commodities are fear driven, not demand driven, there is no analytical case to be made for either boom or collapse.

There are, however, technical reasons to be cautious. Historically, when currencies become worth less and less, politicians try to offload the blame on the "speculators." Nixon put currency controls in effect. Roosevelt prohibited gold ownership. Currently delivery of the ten ounce bar of gold has ended and is replaced with a "dollar settlement" substitution. When in enough trouble the political "saviors" institute confiscatory treatment against those left with some form of assets. History is replete with such activity.

Another observation often made is that these markets have little to do with the underlying asset as the derivatives markets in these assets constitute many, many fold the availability of the "underlying" asset. We saw in recent history what happens when one or more of the derivatives bankers, brokers or speculators are improperly capitalized or hedged. Witness the mortgage crisis! Witness the Hunt silver bubble and subsequent debacle!

To sum up, the recent run-up in hard commodities has little to do with demand for productive economic consumption. It is driven by fear or simple trading exuberance. Whether the run-up has discounted the likely continued depreciating value of most currencies is not measurable. Politicians punish the winners in times of extreme. The winners are the scapegoats. Their capital and capitalistic rights are often trod upon. The banks, brokers and many speculators are never well enough capitalized or hedged in these volatile derivatives markets. The system is at risk at times of high volatility.

It would not be a surprise but would, indeed, be sad to see the "hard asset" derivatives markets as the source of the next economic emergency.

Wow!

March 31, 2009

By Asher B. Edelman

Dear Friends,

In January of this year I wrote a letter: "Reflections on the Art Market." Within that letter was a short analysis of the gold market and its risks, which follows:

Gold- the traditional safe haven in times of contraction and inflation. The risk here is that of the system. Most gold transactions take place in the form of derivatives. The banks, brokers and commodities exchanges guarantee the counterparty responsibility of these derivative trades. At the time of the Hunt silver debacle, the exchanges and the important commodities brokerages were unable to deliver physical silver, and, to a lesser degree, gold against contracts which required delivery. The system was saved by a clever commodity trader who convinced the Hunts that he and the exchanges would go broke and not live up to their contracts unless the Hunts provided the physical commodity to the market. Fearing for the disappearance of their gains and capital they foolishly filled the need of the brokers and exchanges, put up physical silver and eased the pressure on the market at which time the gold and silver markets collapsed! The Hunts lost all! The system was saved. The proportions of the current physical/derivative relationship are far beyond what any group (government included) could be called upon successfully to "save" the system. There simply is not enough physical gold stock to satisfy the future and option markets should physical be demanded. Were the exchange and counterparties to collapse, investors who held derivative gold positions will have lost their "safe" gold positions, no gold! Whether or not this is a long shot remains to be seen but keep in mind the system is funded by the same crowd who brought us the mortgage crisis. Once burnt, their

fault, twice, our own. A solution could be to buy physical gold or coins. The premiums, cost and simple practicality of this approach makes it an unworkable solution for a substantial investor.

Since January it has become more and more apparent that the commodities exchanges, commodities brokers and banks are running "short" or even running "out" of physical gold for delivery. The delivery rules have already been amended, albeit quietly, and the likelihood of further amendments is high. I think it likely that in the near future there will be little, if any, physical gold to deliver against derivatives such as futures and options.

What does this mean?

First, it may result in the collapse of the commodities derivatives markets backed and guaranteed by financial institutions such as banks, brokers, exchanges, insurance companies, hedge funds and the like. The financial counterparties will simply be unable to make good on their commitments to deliver physical gold. At first there will be a rejiggering of these contracts to provide for substitutes to gold deliveries. Substitutes will be unacceptable to the investors who will clamor for their contractual rights.

Then, in comes the Economic Team of the Obama administration. To no one's surprise a system is devised to "save" the financial institutions from yet another disaster created by these same institutions. In some form or another, the "contracts" will be abrogated in a manner advantageous to the financial institutions and disadvantageous to the investor. Possible regulations could ban the ownership of physical gold, require owners of physical gold to turn it back to the institutions for "paper gold" or similar restrictive combinations which will disadvantage the gold investor in order to "save" the financial institutions.

As the magnitude of the gold shortage versus derivative products is extraordinary, and as it will spill over into the entirety of commodities derivative markets, the Obama team could finally fold on the banks in the same manner as it has on the auto companies. Wow!

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