

GOLDMAN SACHS GOLD TRADING ON TOCOM – THE ACHILLES HEEL?

By Adrian Douglas

The trading positions of the major bullion banks are not available to the public on the Western Exchanges. However, the TOCOM in Japan publishes each day the position of all the houses that have a seat on the exchange. I have been following the position of Goldman Sachs by capturing the daily data for more than one year. Figure 1 compares the GS net short position (in red) with the gold price (in yellow) from 13th January 2006 to April 19, 2007.

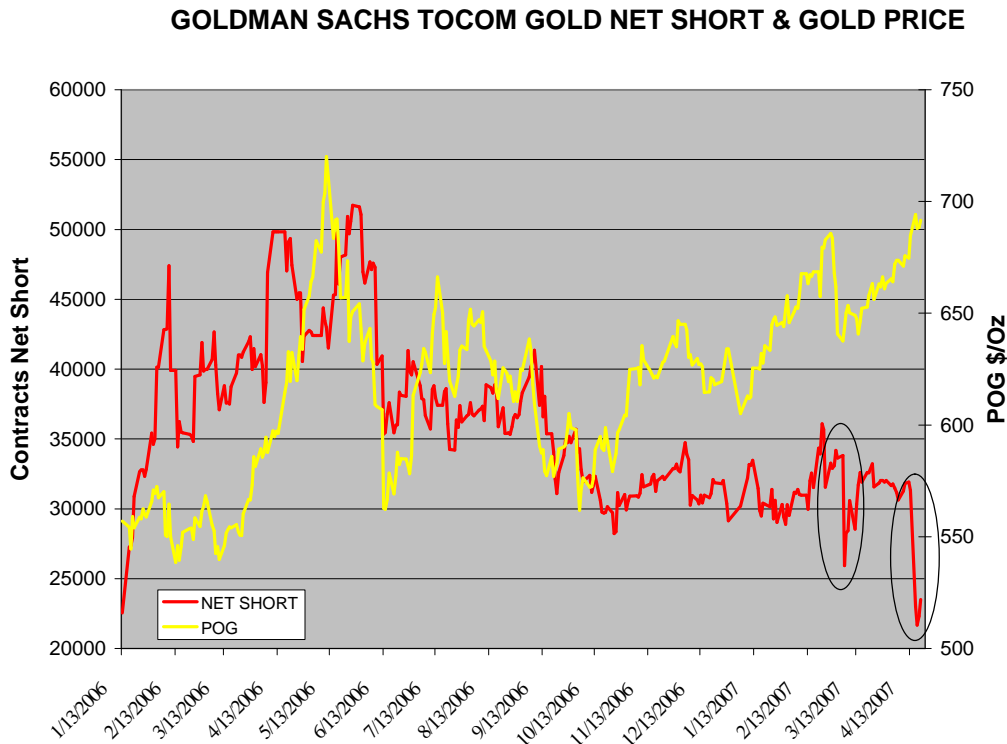


FIGURE 1

Goldman Sachs reported record profits in 2006 of 9.5 B\$ on 37.7 B\$ of revenue, paying their partners highly publicized rich bonuses. Such amazing results made me wonder if their clearly outstanding investment acumen extended to their short position in gold on the TOCOM. Are they making fat profits by being perpetually short gold?

I constructed what their profit and loss statement should look like. I have taken a short sale as generating immediate revenue equal to the number of ozs sold short multiplied by the gold price on the day of the short sale. This also creates a

liability to provide the gold or cover the short at some point in the future which we will deal within a moment. Covering short contracts is treated as an expense or negative revenue which is the number of ozs covered multiplied by the price of gold on the day of covering. Buying long contracts are likewise an expense and selling long contracts generate revenue. I have assumed that there are no commissions to pay or overhead costs to trade on the TOCOM, which is clearly not the case and would be additional actual expenses.

This covers the “cash flow” view of the trading position. But we need to consider the cost of closing out the short position or the credit from closing a long position. If we don’t do this it would be like saying I made \$300,000 by selling my house for that price, omitting to count that I have a \$290,000 mortgage that was taken to cover the purchase price which I have not yet paid off! The true liquidated value from the house transaction is \$10,000 net profit. Likewise Goldman Sachs has a liability of covering the short contracts which is equal to the cost of buying the equivalent amount of gold bullion or a credit of the value of selling the equivalent amount of gold of any long contracts. So as a next step I calculated the cost and/or credit of closing out all positions along with the cash flow gains or losses to yield the cumulated Liquidated Value (LV) of the Goldman Sachs TOCOM gold position at any time (referenced to 13th January 2006 as the start date).

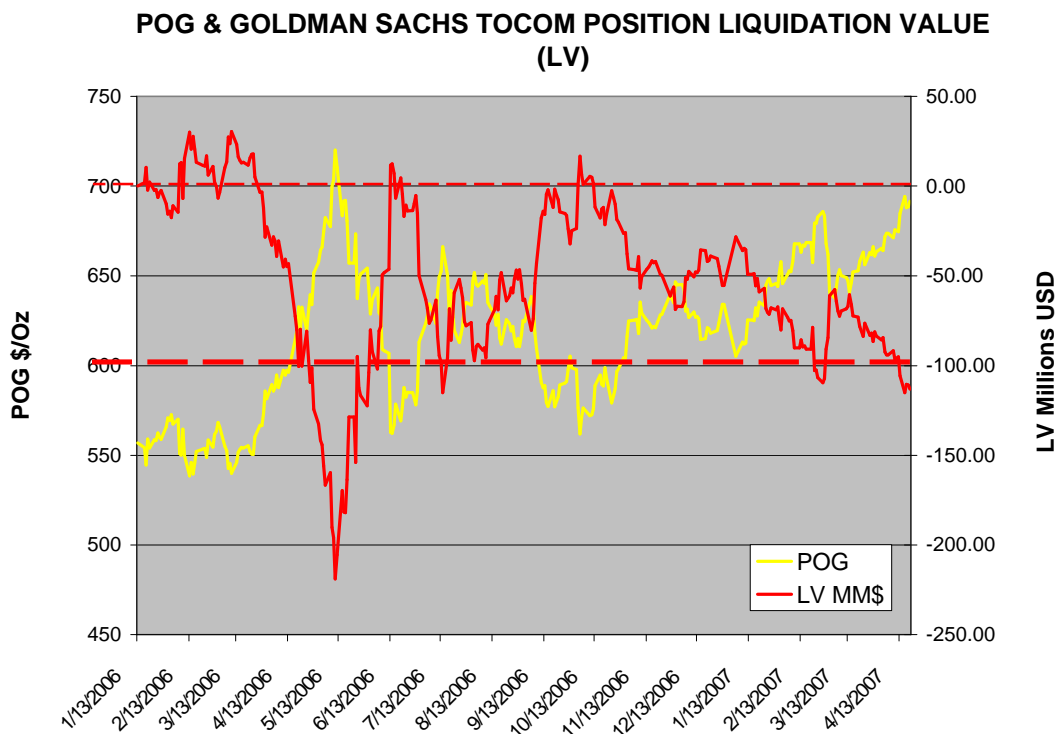


FIGURE 2

In figure 2 this total Liquidated Value is shown from Jan 13th, 2006 to April 19, 2007. It can be seen that the Liquidated Value of the Goldman Sachs TOCOM gold position is nearly always a net loss! Last May when the Gold price soared to \$740/oz their net liquidated loss soared to \$220 million. When the Cartel called in help from the Official Sector gold hoards they were able to cover on the correction to bring their net loss to zero again.

The net loss of their LV has been slowly growing since last October. The gold price has risen inexorably \$130/oz from its October 2006 lows. Recently GS has been making massive short coverings. In just two sessions this week they covered 9,645 short contracts, they also had a massive covering on March 6 (see circles in figure 1). Why did they suddenly run for the hills?

There is a clue in this graph of what is going on. I have drawn a line at \$100 Million net loss. Notice that every time the net loss reaches this point action is taken to reduce the net loss. The only exception was when the gold price soared to \$740/oz in May 2006 when the gold price clearly escaped from the Cartel capping scheme and was only brought back under control by enlisting help of official sector physical gold to dump on the market. But if you look carefully before the net loss soared there was an attempt to bring down the gold price just when the net loss touched \$100 million. The attempt, however, failed.

It would appear to me that the GS traders on the TOCOM have a standing approval from their credit committee that their liquidated net loss can not exceed \$100 million. This is what has likely triggered the recent panic short coverings (and a similar one in March) because it is bumping up against this level. What can be seen from the graph is that even after covering almost 30% of their short contracts their LV is still sitting around negative \$100 Million! If this is their limit it would seem that they don't have any spare ammunition to attack the TOCOM market without asking the credit committee for more. Credit Committees exist to prevent traders from bankrupting a company such as Nick Leeson did with Barings Bank. It is unlikely that the Credit Committee would be willing to approve more credit to increase a losing position! Is this their Achilles Heel? Are they having to cover to keep within their Credit Committee guidelines of approximately \$100 Million net loss and are not free to short further to suppress the gold price without more credit being approved? I don't know, but it bears watching and could be a dynamite discovery. If the position is closed out immediately the paper loss will be realized at around \$113 million. If the gold price continues to rise the losses will increase.

If their credit is extended and GS attacks the gold price by increasing their short position at this point they are extremely vulnerable to the longs with deep pockets.

Considering that the Goldman Sachs LV on TOCOM of their gold position has almost never been in a net profit it would appear that their motivations have not been related to making a profit! Their operation has been run as a loss but in a controlled manner. We know that keeping a lid on the gold price has been the key to making big profits in the currency, stock and bond markets, which is probably why the \$100 million loss on TOCOM gold has been allowed.

We are at a critical juncture. Is GS going to be forced to cover their short position or will they attempt to a dangerous gamble and try to bring down the gold price? Or will the market escape from the chains of the gold Cartel suppression as it did for a short while last May? Considering that the ECB dumped 57 tons of gold on the market last month, only to see the gold price continue to rise must have the Cartel sweating. It is no wonder that they want to get their hands on IMF gold.

From my proprietary analysis work all the key commodities of gold, silver, oil and copper are synchronously at BUY points and the dollar has broken key support. The Cartel has now an Achilles Heel and the bulls have the high ground.

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