

# The Quadrillion Dollar Derivative Debt and the “Bail-in”: When you Deposit Funds in a Bank, it Becomes “Their Money”

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*The world is awash with “promises”. Nearly everything we think of as having “value” is because of a promise behind it. A few examples; your bank accounts, retirement funds, bonds and even the dollar bills in your pocket. Your bank account for example, once you deposit the money it is no longer yours. You can argue this if you wish but we now know this is true for sure after recent “bail in” legislations passed throughout the west. When you deposit funds into a bank, it then becomes “their money” held for you ...they “owe” it to you.*

*Do not take this lightly, lawmakers around the world have made this the new reality. A little known fact, in 1845 Britain passed banking law that made depositors (unsecured creditors), this is still precedent to this day. When you deposit money you “accept a liability” from your bank and are classified as an unsecured creditor. In other words, “get in line with everyone else”!*

Same thing with many retirement accounts. Think about Social Security. When you get your annual statement form, it comes with an asterisk. This is to inform you they “might need to reduce benefits”. With any retirement account you are relying on the custodian to make payments to you upon retirement. Think about state and municipal retirement accounts promising the good life, they are nearly ALL underfunded. Meaning there is not enough money in there to make (promised) future payments unless some sort of magically higher returns are realized. These are underfunded by the TRILLIONS of dollars!

Bonds are an obvious asset class where a “promise” is relied on. Dollars on the other hand seem the most misunderstood by the public while being the biggest leap of faith in all asset classes. Dollars rely on the “full faith and credit” of the U.S. government (a bankrupt entity) yet the populace sleeps through the night secure knowing they own dollars. ALL non backed, fiat currencies in the past have failed. The dollar is the widest spread and widely owned fiat the world has ever known, its failure will be spectacular upon arrival!

I wanted to point out the above “promises” as a basis to speak about trust or confidence. The financial world turns on the axis of “trust”. This trust was nearly broken in 2008 and is the reason the Federal Reserve needed to secretly lend \$16 trillion all over the world. If the Fed had not come up with these funds, failures would have spread and trust would have been broken amongst the banks/other financial institutions and even between the central banks themselves! The Fed’s largesse worked and trust was maintained.

Now, I believe we are set for another “test” of trust. We have gone five+ years with QE this and QE that, the reality being outright monetization. In fact, central banks today are buying

more sovereign bonds than are even being issued. The public and even the professional funds have backed away from the debt markets, you can't blame them because the interest received does not even cover inflation not to mention a risk premium. Globally the pace of trade and business activity is slowing or even declining which will bring to a head the difficulties in meeting debt service and other "promises".

I ask, what will happen when inevitably "trust" begins to wane? Or even fully break? It is at this point the system goes into "The Great Call". Margin call? Of course, because nearly everything financial has leverage behind it but there is more to it than this. The "call" I am speaking of is for contracts of all sorts to "perform". In particular I am thinking "derivatives" contracts will be called on to perform their contractual duties.

All in all, there are over **\$1 quadrillion** worth of derivatives outstanding. The problem with this is the "tail" is bigger than the dog. In other words, the amount of derivatives outstanding dwarfs the total amount of money outstanding and thus the ability to "pay" and make good on the contracts. The other side of this coin are contracts promising to deliver something. Here I am thinking both gold and silver. There are far more (100-1 or more) obligations outstanding than there are ounces or kilos available to deliver. This is a default just waiting to happen.

If you listen to the Harry Dents of the world, the dollar will be the safe haven and where all fear capital will go. In a world based on nothing but trust and promises, will fear capital really pile INTO a currency based ONLY on trust and promises ...when "trust" is exactly what is come into question. Actually, it can be said the dollar was originally set up in 1971 on a "never pay" model. The dollar (and bonds) only promise to pay "more dollars" and nothing else. This game worked for many years, now it looks like the Saudis after doing many deals with both Russia and China may be set to transact in currency other than dollars. Are they displaying confidence?

The Chinese are now net sellers of U.S. Treasuries. Ask yourself this question, if China could sell all of their Treasuries and turn it all into gold, silver, oil, copper and other real tangible assets (without destroying the Treasury market or making gold and silver go no offer), would they? I say yes, they absolutely would love to be out from under their Treasury position. Apologetic others might say China is comfortable, we will soon see.

Because confidence is the only thing at this point holding the game together ...and its fickle nature, it is important for you to think this through. What will be standing when confidence breaks? Can banks globally survive "runs" when depositors come calling? Can commodity exchanges deliver all they promise? Can borrowers "borrow more" if they cannot redeem past issues with new debt? This is where we are headed both systemically and globally!

Before finishing I want to tie two connected thoughts together. First, the great Paul Craig Roberts said last week he feared precious metals could be suppressed forever. I received MANY fearful e-mails regarding this thought process. Mr. Roberts would be entirely correct if it were not for one small detail, REAL gold and REAL silver must be available to deliver. Otherwise the game comes to an end and the fraud is exposed. He is entirely correct, "price" can be jammed or rammed with enough "margin" posted. Dan Norcini once upon a time had it correct when he said, nothing will unnerve the shorts more than the longs standing for delivery ...and making a call for the product. I would like to remind you, COMEX currently has only 11.7 tons of gold for delivery. This is roughly \$400 million. If I were short,

this paltry sum would not add to my confidence.

Another thought going hand in hand with this is where we are now versus 2008. Back then we were within overnight hours of the entire system coming down, this is fact. What has changed since then? “Nothing”, but in reality quite a bit. Nothing has changed from the standpoint of “tools used”. We have not altered or changed anything that “got us to the brink”... only done more of it! We have far more debt and more derivatives outstanding now. In fact, central banks and sovereign nations have even sacrificed their balance sheets to prolong the game. It has worked ...so far. The only problem is the entire arsenal of the central banks have already been tried and failed to provide the real economy with any stimulus. The result has been capital pushed into financial markets and blowing the bubble(s) far larger than they were. Now, we have far larger markets with far more leverage than 2008. These will need to be met with central banks and sovereign treasuries with weaker balance sheets and almost no ability to borrow in an effort to reflate. It is a recipe for disaster.

We already know the sovereign debt markets are very thin on the bid side as liquidity has dried up. We also know equity markets are displaying horrible internal breadth. China is actually nearing a 1929 scenario and will be there shortly if they cannot steady. Confidence is a fickle girl, if it breaks, then we go back to the 2008 scenario and we’ll find out just how powerful the central banks really are. I believe the coming “Great Call” cannot nor will be met and only then will we see what is left standing. It is imperative here and now to position yourself in assets that do stand on their own, everything else will be a broken promise!

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### **About the author:**

Bill Holter writes and is partnered with Jim Sinclair at the newly formed Holter/Sinclair collaboration. Prior, he wrote for Miles Franklin from 2012-15. Bill worked as a retail stockbroker for 23 years, including 12 as a branch manager at A.G. Edwards. He left Wall Street in late 2006 to avoid potential liabilities related to management of paper assets. In retirement he and his family moved to Costa Rica where he lived until 2011 when he moved back to the United States. Bill was a well-known contributor to the Gold Anti-Trust Action Committee (GATA) commentaries from 2007-present.

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