



Gold, The Ultimate Insurance Policy?

We believe that Gold may be the solution

The global economy continues to slow and markets are dropping under the increasing weight of soaring inflation and a credit contraction. We're facing an outright bear market in financial assets so where should we as cautious investors be looking?

From its all-time high in April, spot gold prices have declined 8%. Even though gold has soared over the last few years, the spot price of gold is still 55% below its inflation-adjusted high since January 1980.

Global gold production has been declining since 2005 with South African and Australian output virtually stagnant in 2008. Net supplies are approaching deficit as production fails to meet rising demand.

We've seen a booming demand mainly from exchange traded funds and a dramatic asset allocation shift among investors. Retail investors are selling dollars and other currencies for the relative safety of gold. Unlike many other “commodities” such as Oil, Gold is viewed as a currency by many and can behave distinctly differently to other metals. Indeed while oil has fallen from its recent \$147 peak gold has suffered, but not nearly to the same extent percentage wise. Once this current malaise passes we expect gold to continue its upwards march to \$1,000 later this year.

What if the US Dollar Rallies?

“Gold moves in the opposite direction to the dollar as bullion is seen as an alternative asset and as an inflation hedge.” The US Federal Reserve’s Charles Plosser said only last week that rising inflation could force the Fed to start raising rates even before labour and financial markets recover and possibly giving a big lift to the dollar. If the US does raise rates and the dollar strengthens will gold tumble?

Even if the U.S. dollar does recover and posts a cyclical bear market rally, gold prices can still rise. This occurred in 2005 as spot gold prices climbed 18.3% while the dollar rallied 12.8% against the euro. There's no steadfast rule that gold must decline if the dollar strengthens, especially in a counter-cyclical bear market rally.

Provided investor demand remains strong for gold and global interest rates remain historically low, gold prices can climb to new highs as the dollar strengthens. As can be seen from the graph above gold price appreciation has been substantial whichever currency you are based, however both Sterling and Euro based investors have underperformed their dollar base counterparts over the last eight years as their respective currencies have rallied. However TAM are of the opinion that any further currency strength will be muted and the dollar may well have a renaissance. Should this happen non-dollar investors should profit by holding dollar denominated assets.

In Summary

As the global economy continues to deteriorate, central banks, despite their rhetoric, will find it necessary to cut interest rates and stimulate economic growth. As some point even the Bank of England will have to focus on growth and not inflation; allowing inflation to rise higher. To maintain purchasing power investors will continue to turn to gold. Add to this jewellery demand (we are now entering the buying season particularly in Indo-Asia) and expect to see higher prices this quarter and next.

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