

Gold is the true refuge for the current crisis

By John Embry

Gold strengthened dramatically going into the 2008 year-end and, in so doing, posted its eighth consecutive higher yearly close (as defined by the final afternoon fix on the London market).

To say that this is a very impressive performance would rank as a considerable understatement in a world which has recently seen dramatic attrition in the prices of most other assets.

However, gold, although well off its highs earlier in the year in U.S. dollars and Japanese yen, was at or near all-time highs in many other currencies at year-end and was still higher in the strongest currencies than it was at the beginning of the year. This, in my books, qualifies as exceptional performance and once again confirms gold's status as a true store of value in difficult times.

Nevertheless this wasn't good enough for the venerable *Wall Street Journal*, which, on Dec. 26, ran an article entitled *Gold, Not so Golden in 2008*, in which it quoted the usual suspects denigrating the yellow metal. The overall gist of the article was that with all the bad things occurring on the financial and economic fronts, gold should have done so much better than it actually did.

I have two rejoinders to that line of thinking. First, in a vicious deflationary environment when virtually everything came under enormous selling pressure, gold was certainly not immune as black box technical funds and overleveraged hedge funds were forced to disgorge their not insignificant paper long positions. Thus, to have posted a positive annual return, as gold did, is exemplary.

In comparison, consider the following developments in 2008:

The major stock indexes in the developed world were down over 40 per cent and smaller more illiquid stocks often did even



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worse, as did the equity markets in the developing world. In total, world equities fell in total by more than \$30 trillion.

Real estate values were imploding in virtually every country on the planet.

Most fixed income products (bonds, mortgages, structured products, etc.) came under tremendous selling pressure and saw their spreads with the very safest triple-A-rated paper blow out to record levels.

Commodities, other than gold, were savaged in the second half of the year with some reaching such low levels that it almost seemed like an illusion.

In such an environment, anybody criticizing gold's performance is wildly off base.

Secondly, and perhaps more importantly, gold faced an enormous headwind throughout the year due to unrelenting pressure from the anti-gold cartel.

The central banks and their bullion-bank cronies became increasingly more desperate as the year progressed due to the increasing scrutiny being directed towards the pure fiat monetary system that they are trying to pressure.

Major financial institutions teetered on the edge of bankruptcy, sovereign countries became suspect (Iceland was the poster boy for this development, but the Baltic states and several Eastern European entities weren't far behind) and the world economy began to come apart at the seams. In addition, the large, concentrated short positions in the paper gold market, utilized primarily for market suppression, became increasingly more toxic as actual physical gold became harder to acquire.

I would say that, all things considered, gold had a terrific year and the ones to follow should be even better.

Albert Einstein was reputed to have once said that, in his mind, only two things in the universe were infinite, space and human

stupidity, although he wasn't totally sure about the former. I have to believe that the great man must have been very familiar with financial history when he made that cogent observation.

Who can forget such historical absurdities as the tulip mania in Holland, John Law's South Sea Bubble, the preposterous prices that equities and real estate commanded in Japan in the late 1980's and the recent dot-com experience in the U.S. These are just but a few of the innumerable examples of the public's collective folly in financial affairs through the years.

However, we may very well be experiencing the latest saga of this type at this very moment in history. Unquestionably, one of the best, if not the very best performing assets in 2008 were U.S. Treasuries which saw their yields plummet to minuscule levels as investors worldwide undertook a classic "flight to safety" to escape a deflationary environment. This phenomenon also contributed mightily to the sharp counter-trend rally in the U.S. dollar.

When one actually takes the time to look at the true fundamentals behind this, it makes no sense whatsoever. The theory advanced to support it is that because the U.S. dollar still remains the world's reserve currency, it somehow represents a true store of value and thus a refuge from the current storm. In my mind, nothing could be further from the truth.

To lend money to the U.S. government for virtually zero return on the short end of the curve and considerably less than three per cent at the long end, to me represents the absolute apex of human stupidity.

The U.S. economy and financial system are at the very epicentre of the world's seemingly intractable problems and, as a result, what is currently unfolding in the U.S. is truly historic.

Several months ago, I advanced what I thought to be a radical opinion that the U.S. federal government deficit could reach \$1 trillion on an annual basis in the

not too distant future.

I must confess I was wildly off the mark. A combination of plunging revenues due to the rapidly weakening economy, the ongoing substantial bailout of financial institutions, the aggressive spending initiatives announced by the new president, the continuing war expenses and the activation of automatic stabilizers virtually assures open-ended annual deficits materially above \$1 trillion as far as the eye can see.

I expect that this will ultimately trigger a dramatic debasement of the U.S. dollar, and when this reality sinks in, I believe that the U.S. government will find it increasingly more difficult to borrow the money to fund its mounting deficits. Domestic savings in the U.S., while on the rise, are still minimal, and with interest rates at rock-bottom levels, the incentive for foreigners to continue to fund U.S. financial profligacy will wane. Facing this predicament, the U.S. will have little choice but to resort to using the printing press to get the required funds.

At that point, all the investors currently flocking to U.S. Treasury paper as a refuge will realize the error of their ways and the panic to dispose of this increasingly worthless asset will be somewhat akin to a herd of elephants trying to get through a key hole simultaneously.

The true refuge in the current circumstance, in my mind, is gold, as it has been through all the past financial and currency upheavals. I think this will become increasingly apparent in 2009 and, as a result, I expect that many of the truly aggressive price targets that have been banded about for years will finally be realized.

I anticipate that good quality gold stocks that are either in production or possess a very legitimate ore body that can be put into production in a reasonable time frame will enjoy dramatic rises in price.

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