

# Investor's Digest

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## Expect gold to gain more than 30% this year

By John Embry

**G**old ended 2009 on a disappointing note as a sharp correction resulted in by far the worst December performance since the bull market began in 2001.

The yellow metal, nevertheless, posted its ninth consecutive higher year-end close and enjoyed its third best year out of the past nine by appreciating 25 per cent. However, what transpired in December deserves closer examination.

Gold made an all-time high at the outset of the month, briefly trading over US\$1,220 per ounce, as a combination of central bank gold purchases, U.S. dollar weakness, and inflationary fears exerted a positive influence. This capped a five-month period in which gold rose by more than US\$300 per ounce amid widespread mainstream skepticism.

At that point, it fell precipitously in the face of a better than anticipated U.S. jobs report (i.e., there were fewer job losses than forecast) which came out of left field in that it was not corroborated by any other economic data. The U.S. dollar rally sparked by this development prompted the algorithm-driven traders to pound gold, driving the price down US\$60 in less than two days.

What, however, did not occur was a sharp retrenchment in open interest on the Comex. This



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was highly unusual in that, in the past when the large speculators were shaken out of their long positions by a sharp price drop, the open interest dropped noticeably as the anti-gold cartel covered their extensive short positions. In

this instance, in what I view as a very positive development, new buyers emerged to contest the cartel as the blackbox traders and momentum players retired to the sidelines.

This was followed by an even stronger rally in the U.S. dollar, propelled by a sharp drop in the euro attributed to the revelation of the depth of Greece's financial problems. In essence, the Greeks were forced to confess that their fiscal condition was dire and infinitely worse than previously acknowledged. This was greeted by a spate of downgrades of their sovereign paper by the much maligned rating agencies. The euro weakness led to further aggressive selling of gold by those misguided souls who continue to believe that strength in the U.S. dollar must equate with weakness in the gold price.

What I find vaguely amusing, in this instance, is that if one were to deconstruct the U.S., state-by-state, and then examine the condition of California, Michigan and New York, to name but three, the problems of Europe's weak sisters would seem almost trivial in comparison. So the idea that

Greece's problems should crater the euro seems like a bit of an over-reaction to me.

The final indignity of the month occurred during the last four trading days on the Comex where, irrespective of the news backdrop, gold was driven relentlessly lower during Comex trading hours. This occurred despite considerable price strength overnight that related primarily to strong physical buying in Asia. This was highlighted by the gold premiums in important markets like India and Vietnam that demonstrated serious buying interest. This did not deter the paper gold sharks on the Comex who persisted in selling and achieved their objective of a closing price under US\$1,100 an ounce on the final day of 2009.

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***Urban myth: the idea that the U.S. dollar and, by extension, U.S. financial assets continue to represent a safe haven***

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All of the foregoing is just noise and standard behavior by the usual suspects who have been messing with the gold market throughout the price rise from US\$252 per ounce to the high over US\$1,220. By creating a false closing price in 2009, they have just helped to ensure a tenth consecutive higher year-end price in 2010 and, quite frankly, I will be greatly disappointed if gold's price appreciation in the coming

year doesn't exceed the best annual gain seen in the past decade (31.3 per cent in 2007).

I think it is important to remember that bull markets continuously climb a wall of worry and then experience violent corrections which serve to clean out the nervous Nellies, the latecomers and the momentum investors. Gold has once again experienced just such a phenomenon and I expect it to be the precursor to yet another strong up leg early in the year.

Last month, in this column, I went to great lengths to refute the notion that gold is in a bubble phase. This month, I would like to deal with another urban myth and that pertains to the idea that the U.S. dollar and, by extension, U.S. financial assets continue to represent "a safe haven." In my mind, nothing could be further from the truth.

In the past, when the U.S. was undeniably the strongest nation in the world economically, financially and militarily and was in an unassailable position of providing the world's reserve currency, that status was unquestionably justified. Things, however, have changed dramatically.

In the past 20 years, the U.S. manufacturing base has been devastated, the country has gone from being a significant creditor to the dubious position of being the world's most obscene debtor nation, its fiscal position has been devastated with trillion-dollar federal budget deficits, now seen

as the norm, and its military forays have been disastrous, unending and extremely costly.

At this point, I firmly believe that its status of being the sole provider of the world's reserve currency is in considerable jeopardy, as the budget conundrum is insoluble and the dollar is now nothing but a hollow shell. The only justification for running to the U.S. dollar seems to be the perception that the problems of the world's other major currency blocs are worse.

Whether this is true or not is a moot point. The U.S. interest-rate policy of zero-based short rates is, in my mind, unsustainable and raises the serious question as to why any clear thinking investor would accept no return on a currency that is being systematically debased at a time when it is massively overowned throughout the world.

One issue that I believe is underestimated is what significantly higher interest rates throughout the whole curve would do to the U.S.-federal-budget deficit, let alone the economy as a whole. It is a remarkable fact that despite a massive rise in total

debt outstanding in fiscal 2009, U.S. debt service costs actually declined because the average interest rate on new U.S. borrowing was under 1.0 per cent, the lowest ever recorded.

When inflation rears its ugly head, and I suspect that will be sooner rather than later, the market will force interest rates higher in the U.S., and it is within the realm of possibility that an annual increase in U.S. debt-service costs, at some point in the not-too-distant future, might end up exceeding any total U.S. budget deficit prior to fiscal 2009.

So those optimists who think a better economy will bail the U.S. out of its fiscal woes should probably reconsider, and while so doing, they should also disabuse themselves of the notion that the U.S. dollar represents "a safe haven."

### *Time's outrage*

In the "don't they ever learn" category, I was appalled to see that *Time* magazine selected Fed chairman Ben Bernanke as its Person of the Year for 2009.

This is an individual who mid-

way through 2008 assured the public that the economic and financial problems were contained and the Great Moderation, a phrase he coined several years earlier, was still in effect. When his prognostications proved to be disastrously wrong and the economy and financial markets were on the verge of total collapse mere months later, he flooded the system with money, bailed out the perpetrators of the whole debacle at the expense of the greater public, totally undermined the Fed's balance sheet by replacing U.S. Treasuries with massive amounts of junk mortgages and other toxic waste and then had the unmitigated gall to suggest that there were no inflationary implications to his actions.

In my opinion, *Time's* laudatory recognition of this outrage is akin to rewarding an arsonist who ignites a raging blaze and then returns to the scene to help extinguish the blaze, and for his efforts, is deemed a hero. Why not Tiger Woods for Husband of the Year, if we really want to deal in inappropriate recognition.

However, it is worth remembering that this is the very same

magazine that put Robert Rubin, Alan Greenspan and Lawrence Summers on the cover in 1999 in the aftermath of the Long Term Capital Management fiasco and called them the saviors of the financial world. Subsequent events certainly proved the folly of that judgment and I expect future developments will similarly impugn Mr. Bernanke's reputation. One only has to recall the virtual deification of Alan Greenspan and his designation as "the Maestro" during his tenure as Fed chairman to realize how truly misguided the mainstream press really is.

I expect 2010 to be a banner year for gold and silver as the true depth of the world's financial malaise is more widely acknowledged. In this environment, I anticipate that gold, in particular, will garner increasing recognition as the only real money and the true safe haven as the slow motion trainwreck of the world's fiat currency system begins to accelerate.

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*John Embry is chief investment strategist at Sprott Asset Management.*