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Despite Europe's problems, central banks on both sides of the Atlantic intervened to prevent gold from becoming an alternative currency

Machinations to blame for end-of-year slide

For the 11th consecutive year, gold comfortably sailed to a higher year-end close.

John Embry

This was no mean achievement, being unprecedented in any asset class, notes Richard Russell, publisher of the *Dow Theory* letters.

But in reality, it was a very difficult time for gold bugs.

Gold had been consolidating near US$1,700 an ounce following its vicious takedown after Labour Day when yet another European summit — in the first week of December — ended in total failure.

And that summit did fail. Not only did it yield no viable solutions, but the Brits opted out, thus creating further problems.

Gold, which hit US$1,760 during the summit, then fell more than $230 over the next three weeks.

To say this was counterintuitive would be an understatement indeed. Just before the summit, gold leasing rates went negative which meant that anybody lending gold — that is the western central banks — was willing to pay borrowers to take the metal off their hands.

To pull off a paper raid — one of great magnitude — there has to be a source of physical supply to meet increasing physical demand at the lower prices. The leasing rate maneuver would have sufficed.

In the absence of any palatable solutions to their many problems, the Europeans undoubtedly knew they'd have to announce various rounds of quantitative easing— that is unfettered money creation.

So, it was essential that gold not be seen as an attractive alternative to fiat currency.

Not surprisingly, attempts at quantitative easing emerged almost immediately. In fact, the U.S. Federal Reserve arranged "a temporary U.S. dollar liquidity swap" with the European Central Bank.

In effect, the Fed was helping to bail out the European banking system in a more covert way than in 2008 when it loaned money directly European banks.

It's very important to realize that the U.S. can't risk a European implosion. America's banking system, despite constant denials, is massively exposed to Europe through credit default swaps, as well as other exotica.

And the U.S. economy, which is fragile enough in its own right, would be hit hard by an economic meltdown in Europe.

Given that we're now in a U.S. election year, the Americans will move heaven and earth to prevent such a development.

So what did the Europeans do? They announced a $489 billion Euro bailout for their own beleaguered banking system, calling it a long-term refinancing operation.

That this was almost immediately deemed to be a failure when the commercial bank beneficiaries began depositing a big chunk of the proceeds with the European central bank was downplayed.

While all this was happening, gold came under enormous pressure. Particularly galling was the price action between Christmas and New Year's, typically the quietest week of the year.

In seven of the past eight years, gold posted small gains in the last week of the year, which isn't surprising given that the metal has been riding a powerful bull for over a decade.

But in 2011, gold plunged precipitously despite the absence of anything remotely resembling a negative fundamental connotation.

From a pre-Christmas close of more than US$1,600 an ounce, gold fell five per cent in three trading sessions before rallying sharply on the last day of 2011.

All this has been trying for those who correctly see gold as the true safe haven in a world awash in debt, monetary excess and currency debasement.

Yet, it's just the same old drill and, as such, will be followed shortly by dramatically higher prices in both 2012 and beyond.

We've had declines as deep as those of the past four months several times during this bull market. And they've always signalled a move to new highs.

This time will be no different. Without the overt interference in the market by the usual suspects during the last four months of 2011, gold would have likely closed the year comfortably above US$2,000.

The price smash during that time — over 20 per cent from top to bottom — probably will have no material impact on my original price expectations for 2012.

As a result, it's likely we'll have the largest annual percentage price gain since the bull started running at the outset of this century.

An advance of at least 60 per cent, putting gold in the neighbourhood of US$2,500 an ounce, is a reasonable expectation.

My optimism on this subject stems from many sources. But the crux of the matter can be boiled down to "too much debt in the financial system."

As confirmation, I could quote any number of stats. But one that recently caught my eye was that the G-7 nations alone will need to re-finance a staggering US$7.3 trillion, of which both Japan and the U.S. now account for 80 per cent.

And this doesn't even take into account the trillions of dollars of new debt that have to be raised to

cover the outsized budget deficits throughout the western world.

The obvious question is that given interest rates that don't come close to reflecting inherent risks, who out there will buy all this paper of increasingly dubious merit?

The equally obvious answer, if one thinks about it for more than a nanosecond, is simple.

That which can't be foisted off on unsuspecting buyers will be bought by official sources using money dutifully printed by the central banks.

This process will accelerate the debasement of all fiat currencies. But it will also cause investors to realize they need more real money, preferably in physical form.

This will have a remarkable impact on the price of the metal — so much so that my price prediction might prove conservative.

That most of the western world doesn't yet grasp this reality is wildly bullish for gold.

Indeed, the amount of money that can — and will — be redirected into the yellow metal will simply overwhelm the physical supply.

This phenomenon might also cause those holding most of the supply of paper gold to realize that they don't, in fact, enjoy the protection they now think they have.

That's because there's remarkably little physical gold behind many exchange-traded funds, pooled accounts, gold certificates and the like.

Any big move from paper gold into bullion will have a healthy impact on the price.

Meanwhile, back at the equities ranch, the financial repression in gold shares continues, with most gold miners finding it hard to get out of their own way.

The good news is that the value of these stocks, even at current gold prices, is beyond outstanding. And, in the event of the much higher prices I anticipate, their potential return dwarfs any competition in equity markets worldwide.

Take, for example, **Wesdome Gold Mines Ltd.** (WDO $1.53, TSX). In the wake of a disappointing third quarter, Wesdome has performed dreadfully. It also appears deeply undervalued.

But Wesdome, whose market cap is now $165 million, has several things going for it.

For starters, its physical plant is worth a lot. Indeed, in current dollars, it would cost about $400-$500 million to replicate its infrastructure and underground workings.

This doesn't even take into account what it would cost to acquire its extensive land holdings.

Second, as a result of opening the Mishi mine this year, Wesdome will now be operating three mines in Ontario and Quebec. And both provinces are mining friendly.

Third, following a bad grade cycle which hurt its operations in 2011, Wesdome's grades are expected to improve, particularly at the Eagle River/Mishi complex in Ontario.

And lastly, Wesdome, which has already produced over one million ounces of gold, is logging major exploration success in both Ontario and Quebec.

Not only, then, will the company have a growing production profile, but it will likely remain in operation for years to come.

In sum, Wesdome is just one of many deeply undervalued gold stocks which, along with others, will likely turn in exemplary performances when gold prices rise.

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