True state of economy not grasped by the public

By John Embry

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In the face of widespread skepticism, gold continues to battle its way higher, despite considerable resistance from the anti-gold cartel. Mounting physical demand from around the globe is relentlessly consuming all the gold being mined, recovered from scrap and disposed of by central banks.

I must confess that it beats me as to why sentiment isn't dramatically more bullish than it is currently. I suppose it can be attributed to the investing public's unfortunate gullibility when it comes to assessing the true state of the economy, and more importantly, the financial system.

The mainstream view peddles the notion that inflation is moderating, the U.S. housing bust is bottoming and any deceleration in economic growth is transient, soon to be followed by renewed robust growth. In my opinion, nothing could be further from the truth.

The out-of-control financial side of the equation has become so dominant that it is now dictating what happens in the real economy, the antithesis of what has traditionally been the case and representative of a classic "tail wagging the dog" scenario.

More and more liquidity is being pumped into world finances in an increasingly frantic effort to keep the system intact and the world economy moving forward. The result has been a series of bubbles and the absolute necessity of recurring liquidity injections to paper over the growing number of cracks.

If a deflationary episode is to be avoided, one of the costs will most assuredly be accelerating inflation in a textbook case of ever more paper chasing a limited amount of real goods and services.

I thought that one of the more interesting observations to emerge from the Davos get-together of the world's financial movers and shakers came from the president of the European Central Bank, Jean-Claude Trichet. Acknowledging that financial markets were potentially unstable, Mr. Trichet suggested that, "investors need to prepare themselves for a significant repricing of some assets."

Clearly, this remark was directed at the remarkably low credit spreads and risk premiums that have been spawned by unrestrained liquidity and nearly exponential increase in derivatives (the most recent number bandied about at Davos was $450 trillion and counting).

All of the foregoing is not just bullish for gold but spectacularly bullish because it speaks to an unavoidable, ongoing debasement of paper money.

In the face of this, I find it fascinating that many pundits acknowledge the longer-term attractiveness of gold, but persist in trying to call short-term corrections.

In a market as seriously manipulated as gold with the incredibly powerful fundamentals that it possesses, trying to be cute on corrections strikes me as a real mug's game. The good news on the manipulation front is that it has become so blatant that it is revealing distinct signs of desperation, a necessary precursor to its eventual cessation.

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Also, the GATA (Gold Anti-Trust Action Committee) arguments are gaining more adherents, while those who do not acknowledge central-bank management of the gold price have been embarrassed into silence on the subject.

In addition to the standard practice of capping all substantial gold rallies at key technical points and then knocking gold down hard in slow-market periods, the antigold cartel's modus operandi includes the requisite negative gold story at the appropriate moment.

In late January, as gold was rallying, it resorted to the same stale canard, IMF gold sales, that has been trotted out umpteen times in the past. To give this one added authenticity, it emanated from a panel that included such luminaries as the aforementioned Trichet and former Federal Reserve Chairman Alan Greenspan.

It suggested that the IMF sell 400 tonnes or roughly $6.6 billion worth of gold to place its deteriorating finances on a more stable footing. However, it also recommended that it be co-ordinated with Central-Bank gold agreements and should not add to the announced volume of sales from official sources.

This defused the impact by confirming suspicions first raised last year that central banks are no longer going to come close to meeting their annual 500- tonne sales quota, announced under the second Central Bank Gold Agreement (formerly known as the Washington Agreement).

However, make no mistake: this wasn't about improving the IMF's finances; it was aimed solely at discomfitting gold buyers.

The great news is that it failed miserably. After pausing momentarily, the gold price shrugged off the IMF threat and surged upward, leading to even more blatant capping activity. That reaction was just one more indication that we are getting closer to the end of the western central-banks' ongoing suppression efforts.

A longstanding definition of human stupidity is to do the same thing over again and expect a different outcome. The western central banks can be accused of undertaking just such a course of action. I must, once again, point out the sordid beginnings of the last great gold-bull market, when the London Gold Pool, a co-operative effort between major central banks to maintain the fixed price at US$35 an ounce, was in operation.

Initially, the Gold Pool was successful in its mission, but in the late 1960s, the scheme fell apart as private-sector demand overwhelmed the central banks. On its last day of operation in 1968, the Pool is said to have lost 400 tonnes of gold defending the official gold price.

Twelve years later, amidst a speculative frenzy, the price of bullion peaked at US$850 an ounce, capping a remarkable decade in which the folly of central banks was revealed for all to see.

In today's world, where the financial and geopolitical issues dwarf those of that era, the central banks have attempted exactly the same ploy. I have no doubt that it will result in precisely the same outcome as last time.

John Hathaway, a gold-fund manager at Toqueville Asset Management in New York and the author of a series of brilliant essays on gold, perhaps summed it up best in a recent letter to shareholders. He stated that, "we are still in the early stages of a bull market in gold. When it has completed its course, we believe the duration and magnitude will exceed any historical precedent."

On that happy note, let's switch focus to stocks. **Tri Origin Exploration Ltd.** ($1.05, TOE-TSX/VEN, $1.05, 905-294-9942, *www.triorigin.com*) is a fascinating situation that is not particularly well-known but possesses an intriguing combination of value and significant exploration potential.

The company owns 54 per cent of a publicly traded Australian company, Tri Origin Minerals, which at its current market price is worth roughly $1.50 to Tri Origin Exploration. The Australian entity controls the Woodlawn Mining District, 200 km west of Sydney.

This area produced 13 million tonnes of polymetallic ore prior to 1998, and today, the measured and indicated reserves at Woodlawn are 8.58 million tonnes, grading 10.37 per cent zinc, 4.07 per cent lead 1.87 per cent copper, 84 grams of silver and 0.54 grams of gold. That represents a substantial asset.

The Canadian company, in addition to its holding in an Australian subsidiary, has a 23,000-acre land package in Red Lake, located 10 km south of Goldcorp's Red Lake and Campbell mines.

This is the largest, unexplored gold property on the prolific Red Lake Greenstone Belt and funds have recently been raised to conduct a serious drilling program in the near term. The company is headed by Bob Valiant, a seasoned mining veteran, and the stock appears to represent a very timely opportunity.

John Embry is chief investment strategist at Sprott Asset Management. Sprott funds may hold above-noted securities. For Sprott fund holdings , see www.sprott.com. *The opinions expressed in this article are those solely of the author.*

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