



The Gold Rush!

“Buy Gold! Buy Gold. It’s the only way to combat what is happening in the markets.” This is the view of some analysts. And perhaps this is the reason why gold prices have surged in the recent past. Since 28 May, gold futures have been trading between the \$860-\$910 range. As the dollar slumped in value following the Fed’s announcement, gold prices rose to \$920. Even though gold has lost 10% after it hit a record high of \$1,030.80 on 17 March, bullion is still up 10% year to date, compared with a 12% decline of the broad-based global equities, MSCI ACWI, index.

Citing ‘diminished downside growth risk’ and ‘upside risk to inflation’ the Federal Open Market Committee (FOMC), on 25 June, left the benchmark policy rate, the Federal Funds rate, at 2% following a cumulative 150 basis points for the year so far. Over the past few months, investors would have noticed the heightened credit crunch facing banks and investment firms as a result of the subprime losses in the US. In light of this, there was a noted decline in the growth rate of the US market and a subsequent depreciation of the US dollar. With the constant increase in the inflation rate, the investor is left wondering where to place personal investments in order to preserve its value? Gold seems to be the solution.

The Federal Reserve had the option of increasing interest rates in order to protect the dollar. However, a rate increase would have meant that servicing of the high debt levels would be unmanageable and could possibly sink the economy into further decline. With not much choice, the FOMC left the rate unchanged in order to stave off inflationary pressures. On the flip side, this could ultimately lead to a further fall in the greenback’s value.

As a precious metal, gold has the ability to retain its value over time because of its durability and limited quantity. During periods in which financial markets are in turmoil, for example the current tightening of credit markets in the US, falling interest rates, escalating commodity prices and the falling of the US dollar, the intrinsic value of gold continues to increase (see Figure 1).

Figure 1



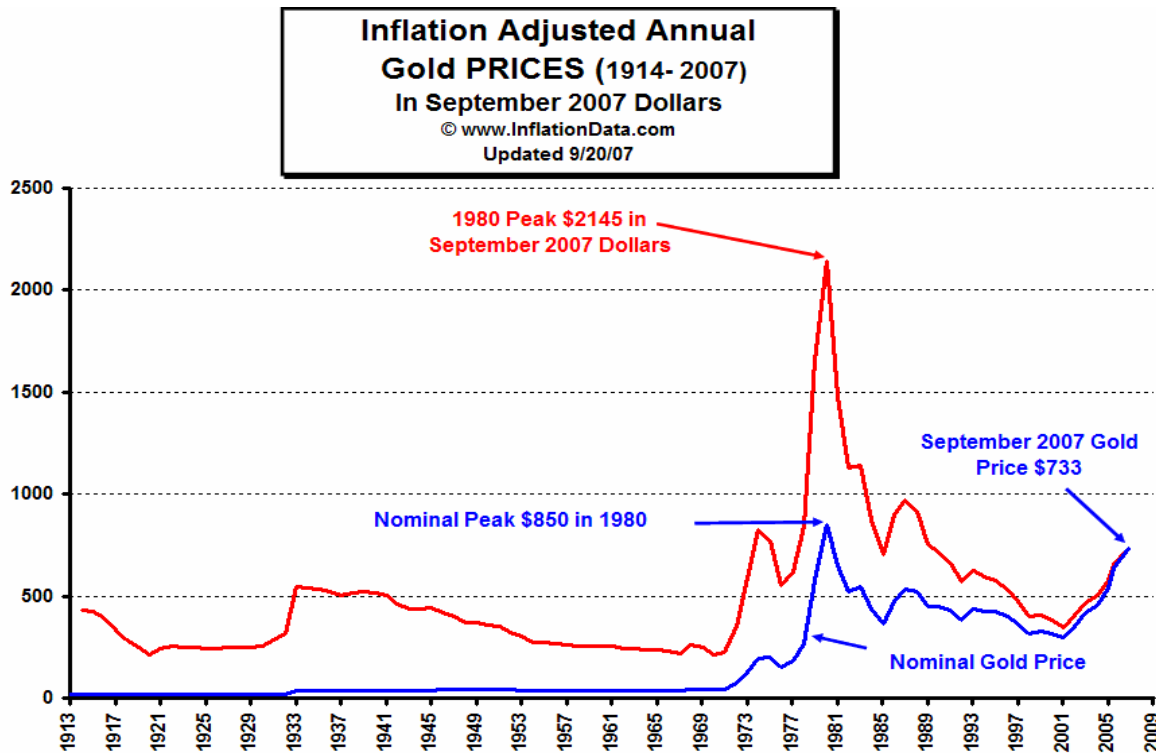
Given the current crisis in the global financial markets, investing in gold now is preferred to investing in the stock market. This is because the value of a stock is determined by the rate of return due to the growth potential of a company, its sector and the economy. Hence, with talks about a US recessionary period, a surge in oil prices to US\$143 per barrel, a weakening US dollar and a plunging global stock market, investing in hard assets like gold seems to be an important component in weathering a recessionary period.

Can gold be used as a hedge for inflation?

Gold does not have a great track record of being an inflation hedge. As inflation rates increase, governments tend to increase interest rates. When this happens the value of their currency tends to appreciate in value, thus, resulting in a decline in gold prices.

In January 1980, gold reached a record high of US\$850 an ounce. If gold was a hedge against inflation, the spot price of bullion, which is supposed to have kept pace with the US inflation rate, would have been selling for about US\$2,145.00 as of September 2007. Instead, gold was trading at a price of US\$743.60, only about 35% of what it should be if it was really an effective hedge (See Figure 2).

Figure 2



According to Goldman Sachs, since 1988 the correlation between the price of the bullion and US inflation expectations has only been about 36%. This means that the price of gold moves in the same direction with inflation only about 36% of the time. This relationship worsens when the price of gold is compared to the US Consumer Price Index. This is only about 23%. When further compared with US core inflation, which excludes food and energy costs, the relationship is lower at about 7%.

Although gold is not a very good hedge, it is still a good investment. This is because of strong demand for jewelry in countries such as China and India, a worldwide shrinking of mine production, reduced net central bank gold sales, and the growth of gold exchange traded funds which makes investment in gold easier. It is recommended that investors hold only about 1.5% - 2% of their portfolio in gold.

Investors seeking protection from inflation are better off investing in the stock market. On 30 January 1980, Standard and Poor's 500 Stock Index (S&P 500) stood at 115.20. If the index is adjusted to compensate for the increase in the Consumer Price Index, it would be at about 287.30 today. As of 3 July, the S&P 500 closed at 1262.90.

In addition to this, investors could invest in treasury inflation-protected securities (TISP), introduced in the US in 1997. Basically TISP are US treasury bonds whose principal increases at the same rate as the Consumer Price Index. Interest from these bonds are calculated from the inflated principal and paid at maturity. With securities such as these, there is no need to use gold as an inflation hedge.

While the bullion is not a very good hedge against inflation, it is not a terrible investment. The astute investor should not be swayed by market sentiments and invest a large portion of their portfolios in gold. Diversification into stocks and treasury inflation protected securities are a safer way to combat inflation. Be wary of the way you invest your hard earned dollars.

FINANCIAL & ECONOMIC INDICATORS

As at 3 July, 2008

<u>Exchange Rate/US\$</u>	<u>Closing Value</u>	<u>Previous Week</u>
Yen	106.74	106.18
Euro	1.57	1.58
Jamaica	72.02	71.90
Guyana	204.40	204.40

<u>Commodity Prices</u>	<u>Closing Value</u>	<u>Previous Week</u>
Crude oil (US\$/bbl)	145.29	139.64
Natural Gas (US\$/mmbtu)	13.01	12.69
Gold (US\$/Troy Ounce)	934.54	917.30

Eurobond Indices (Return % YTD, as of 3-July-08)

Lehman Brothers Global Aggregate Index	3.29
JP Morgan EMBI+ (percentage change)	20.80
CMMB Eurobond Index	n/d

<u>Policy Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
United States	1.50	1.75
Euro Zone	4.00	4.00
Japan	0.50	0.51
Brazil	12.25	12.25
Trinidad	8.25	8.25
Jamaica	13.50	13.50
Barbados	4.50	4.50

<u>Market Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
US 90-day T-Bill	1.82	1.69
US 10-Yr Treasury	3.98	4.04
3-month UK Libor	5.91	5.95
Japan 90-day T-Bill	0.53	0.53
Brazil 90-day T-Bill	12.88	12.88
TT 90-day T-Bill	7.17	7.17
Jamaica 90-day T-Bill	14.19	14.19
Barbados 90-day T-Bill	4.16	4.25

Sources: Bloomberg, CMMB, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados, www.lehman.com

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