



Why Are Investors Seeking Gold Rather Than the US Dollar?

Gold has historically been used as a store of value and a hedge against inflation. Within recent times gold prices have surged but this time around investors are betting on it as a hedge against the US dollar, in order to preserve their wealth.

Gold is bought and sold in US dollars and has an inverse relationship with the dollar i.e. as the value of the dollar falls, gold prices tend to rise and vice-versa.

Since bottoming at a price of \$256.60 per ounce on 2nd April 2001, gold prices have increased by more than 300%. In 2008, gold hit the \$1,000 mark and traded around this threshold for some time. However, in Sept. 2009 it crossed the \$1,000 mark and at the time of writing was trading at \$1,065 per ounce.

The primary reason for the increase in gold prices has been the fear of inflation returning, leading to a precipitous fall in the value of the dollar. This is because the US government has been increasing the money supply in order to fund its stimulus packages. We would have seen that the US money supply (if we look as coins, paper money and central bank reserves less dollars held abroad) would have grown from 1,451.6billion as at Sept. 2008 to 1,659.9billion as at Sept. 2009. This represents an increase of about 14.3% in just a year. Such actions would most likely lead to an erosion of the value of the dollar.

In addition to this, there is the concern of rising US debt. The current national debt level is about \$11.6 trillion while GDP is forecasted to be about \$14.4 trillion. This takes the current debt level to about 73.6% of GDP as opposed to 51% in 1988.. According to the Office of Management and Budget, their budget forecast, as at July 2009, showed that debt is projected to rise by 1.7trillion in FY 2009 and 1.17trillion in FY 2010. This could cause the debt level to rise to about \$13 trillion by 2013. With debt to GDP already at 73.6%, investors are getting a bit jittery since this burden may affect the ability of the US to fulfill its interest payment obligations.

There are a number of options the US government has whereby they can meet its debt obligations. These include:

- 1) increase in taxes,
- 2) cut in government spending or
- 3) print more money thereby allowing inflation to occur and thus reducing the cost of the debt burden.

Experts suggest that the last reason may be the most viable. This is because unemployment has already soared to about 10%, wage levels are stagnant because of a decline in consumer spending and as a result of this an increase in taxes would not increase revenue but it would cause a reduction in the disposable income available for the US citizen, a reduction in their spending power and even increase their debt burden, as the average citizen seeks to maintain current living standards by

increasing their credit card debt. Furthermore, the economy is still very weak, and the US government may be unwilling to cut spending as it may result in a reduction in consumer demand for goods and services, a fall in production and profit levels for companies, and ultimately an increase in unemployment levels. It is this fear of a double-dip recession that prevents the government from reducing spending. This is why the government may resort to printing money. It is their hope that they will be able to stop before inflation becomes a problem.

The global community, however, clearly recognizes that this is an imminent problem and has already begun searching out new options. For example, earlier this month the Gulf Arabs along with Russia, China, France and Japan began planning to 'end their dollar dealings for oil'. According to Robert Fisk, the Independent's Middle East correspondent, these countries are planning to use a basket of currencies which would include Japanese yen, Chinese yuan, euro, gold and a new unified currency which is planned for nations in the Gulf Co-Operation Council (GCC), including Saudi Arabia, Abu Dhabi, Kuwait and Qatar.

China has also been driving demand by encouraging its citizens to invest in gold. They recognize that their citizens need to rely on their personal savings for retirement since they do not have any safety nets such as Social Security or Pension Plans to provide income in retirement. The Chinese government is also aware that politically, it just cannot convert its reserves to gold thereby driving the US dollar down. However, if their citizens engage in the buying of gold sending gold prices higher, the government can then disassociate themselves from being the cause of the "problem"

While fear of a depreciation of the US dollar has been driving demand, there are also supply side factors that are also supporting the increase in gold prices. Supply has been reduced because of factors including:

1) Reduction in mining. Gold resources are being depleted and the quality is also diminishing. It is estimated that gold production has decreased by 9.3% from 2001 to present.

2) The Central Bank Gold Agreement that was signed in 2001 and recently renewed, limits European Central Banks including the IMF, sale of gold to 400 tons per year. This means that even if governments wanted to sell reserves, they can't strain the supply of gold on the market.

Thus the increase in demand combined with a reduction in supply will cause the price of gold to continue to climb in the short to medium-term. For the investor that is willing to take some risk and further diversify their portfolio, gold may be a worthwhile investment. An investor can consider investing in an ETF such as SPDR Gold Trust (GLD), which is a fund that actually holds gold bullion, or maybe into Barrick Gold Corporation (ABX), the world's largest gold miner. The only drawback of the latter is that the risks are company-specific and not diversified as the former.

Table 1: Regional Market Performance (as at 23 October 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
TTSE Composite	783.19	-0.20	-0.62	-7.09	-16.48
All Trinidad	1,109.13	-0.36	0.58	-3.95	-12.73
JSE Index	80,481.97	-0.20	0.09	0.41	-15.15
JSE Select	1,787.08	-0.41	-1.11	-9.96	-29.90
All Jamaica	65,101.81	-0.40	-1.05	-12.02	-30.41
BSE Composite	821.71	-1.41	-1.32	-10.67	-18.65

Table 2: International Market Performance (as at 23 October 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
S&P 500	1,079.60	-0.74	1.77	19.52	18.88
Nasdaq Composite	2,154.47	-0.11	1.08	36.62	34.33
Dow Jones Industrial	9,972.18	-0.24	2.29	13.63	14.74
German Dax	5,740.25	-0.05	0.67	19.33	27.01
FTSE 100	5,242.57	1.01	2.01	18.23	28.25
Nikkei 225	10,282.99	0.25	-0.84	17.56	21.53
Hang Seng	22,589.73	3.01	4.60	57.01	64.16
DJ Eurostoxx	2,886.08	-0.26	-0.04	17.73	17.70

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