

# The SA Bullion Gold Report

Fourth Quarter 2009

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## Prices Fourth Quarter 2009

	01 Jan 2000	31 Dec 2008	30 Sept 2009	31 Dec 2009
Gold in USD/oz	281.50	843.50	989.50	1,085.25
ZAR/USD rate	6.11	9.62	7.42	7.66
Gold in ZAR/oz	1,721.09	8,114.98	7,341.10	8,307.59

## Performance to 31 Dec 2009 (in %)

	Quarter	1 Year	10 Years (cumulative)	10 Years (annualized)
Gold in USD/oz	9.7	28.7	285.5	14.4
ZAR/USD rate	-3.2	22.9	-25.4	-2.3
Gold in ZAR/oz	13.2	2.4	382.7	17.0

## Long Term Performance of Major Equity Indices to 31 Dec 2009

	01 Jan 2000	31 Dec 2009	Change (%) cumulative	Change (%) annualised
Dow Jones Ind Ave	11,453.48	10,428.05	-8.6	-0.9
S&P 500	1,498.58	1,144.98	-23.6	-2.7

*Note 1: at time of writing gold prices were \$1,153.50 and R8,489.76*

## Review

The last year was an excellent one for equities and a mixed one for gold – great for Dollar investors but mediocre for Rand investors as the Rand strengthened enormously against the Dollar. The last decade was a dreadful one for mainstream equity investors the world over, this notwithstanding the incredible bull market from 2003 to 2007. Broad equity investors in the US lost more than 23% of their money as their reward for being invested in US stocks for 10 years. Gold investors, on the other hand, reaped a reward of 285% on their money over the same period. And throughout the decade it was difficult to persuade investors to place a small portion of their cash in gold, and this largely remains the case today.

In our report last quarter we said that we thought the gold price would present attractive performance in the last few months of 2009. It returned nearly 10% in US dollars and just over 13% in South African Rands.

## Reflation

For some years we have predicted reflation in the US and the First World. We have believed that the process would succeed and in so doing inflict damage in some areas. We have consistently said that the US must “inflate or die”. Well, inflate it has. We expected the economy of the US to be reflat and we knew that America would have to reflate asset prices to save the day in what was essentially a solvency crisis in the last two years. This has come to pass and with it has come increasing monetary disorder brought about by further structural weakness in the US and in its currency.

The means of reflation in First World nations has centred around:

- Policy rates low for long;
- Quantitative easing;
- Fiscal stimulation; and
- Government intervention in enterprise.

These policies have worked – sort of. The US economy, as with most economies, is out of recession. But, whilst the US authorities have taken interest rates to zero and engineered the greatest fiscal blitz of all time, the economy has barely lifted its head, growing an annualized 2.2% in the third quarter compared to an average of 7.3% for average first quarters following a recession since the last world war. See further analysis of the US economy under 'The Internals of the US Economy'.

The reflation of asset prices has been fairly successful, at least in stockmarkets, although not in property markets and bond markets. The banking system has been saved, much recent wealth-destruction has been reversed and the average man in the street has his head above water.

When there are essentially no savings, however, reflation is toxic medicine and it leaves casualties. More government credit thrown at a credit-induced problem might mean that the taxpayers save the banks and insurance companies, but at a price. The long term costs include:

- Government budgets running large deficits, increasing the national debt;
- Government bonds receiving downgraded ratings making national debt more expensive;
- Weakening currencies as the sovereign risks mount;
- Excess economic capacity causing pricing dislocations; and
- Increased foreign (Chinese and Japanese) ownership of domestic resources.

### **The Internals of the US Economy**

The US, as an example of all the leading countries, is desperately trying to increase final demand, or consumption. As we have previously reported, healthy final demand requires a fully employed and well paid workforce; and we would add "with savings".

#### **Employment:**

In our last report we provided gloomy statistics of the US unemployment situation – and of course this is of crucial importance to final demand. The picture has deteriorated since our last report. In December US unemployment climbed to 10.0% from 9.8% the previous quarter. This reporting uses the official U-3 unemployment rate. The more truthful U-6 measure of unemployment now stands at 17.3% as the labour force contracted by 661,000 jobs. We would not be surprised to see U-6 breach 20% or even 25%, before stability returns to the labour market. This would mean that 1 in 5 American workers, or worse, would be without jobs.

#### **Homes:**

Defaults and repossessions of family homes are running at 300,000 per month. This awful statistic will deteriorate later this year when \$134bn of option Adjustable Rate Mortgages reset at higher rates of interest. Should sovereign bond defaults materialize then higher mortgage rates will be unavoidable. Home prices are going to go lower (and bad bank mortgage debts will rise).

#### **Consumer Credit:**

Banks are scared. They have huge capacity to lend and yet they're pulling in their horns, hoarding their cash rather than lending. They see trouble. On 8 January 2010 the Federal Reserve Board released their figures for Consumer Credit to the end of November 2009. The startling statistics reveal that Consumer Credit is contracting at dramatically increasing rates – now 8.5% per annum! This fact presents an enormous problem for the authorities. If they cannot force-feed the banks and the public to increase Consumer Credit then this will either impact economic growth or the government sector will have to do the heavy lifting and play an ever-increasing role in the economy. Either way the outcome is not good.

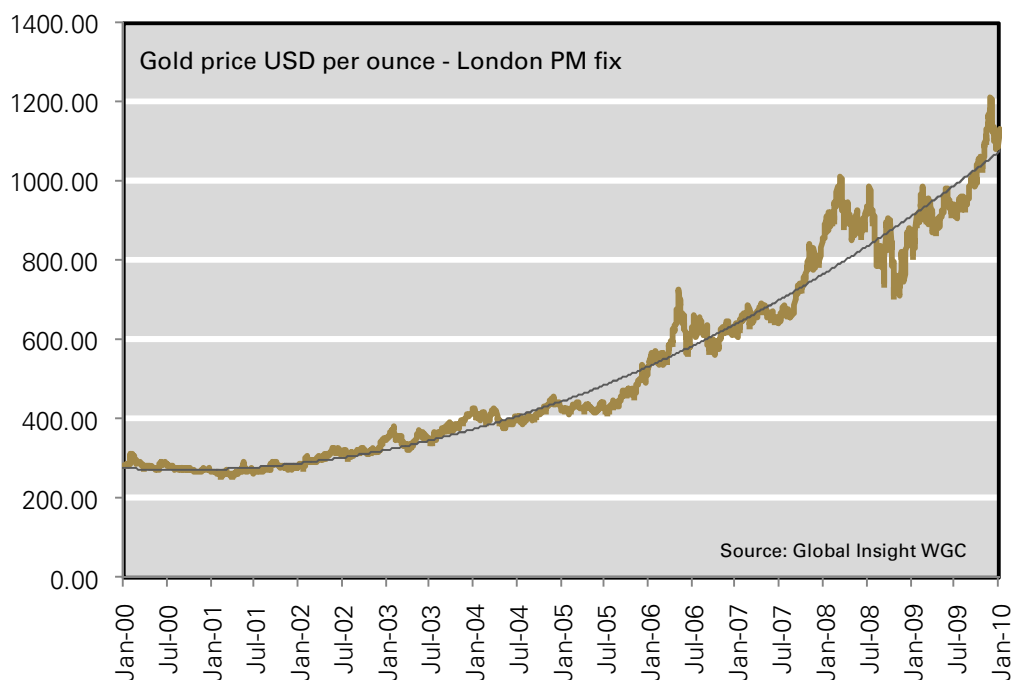
#### **Economic Growth:**

As reported under 'Reflation' above, the US economy grew at an annualized rate of 2.2% in the third quarter of 2009. Discouragingly however, scrutiny of the official U.S. Bureau of Economic Analysis data reveals that the large positive contributors to the GDP growth figure are auto purchases (on the back of the government stimulus package), gasoline (on the back of higher oil prices), government business (defense and non-defense) and then more innocently, imports and exports. Regular readers will recall that last quarter we predicted that oil would become a key driver of reflation. This economic data does not bode well and is not representative of a healthily growing economy.

#### **Gold Price Action**

Following its long consolidation gold broke upwards at a dizzy rate in the last months of 2009 and in the process became overcooked. Thankfully gold has pulled back a bit so as to present us with better entry prices once again.

We expect gold to consolidate for some weeks prior to the next leg up in this huge gold bull market. Our analysis leads us to believe that the 20-week moving average of \$1,067 will form support in the period leading up to the next leg up when we expect to see \$1,600. See graph:



Since our last report the cash flush central bank of India made a big positive statement when they acquired over 200 tons of gold from the International Monetary Fund. Naturally one might ask if this does not represent a negative statement on gold by the IMF! We believe not. The IMF has strong left-leaning tendencies and is desperate to assist poor nations with the cash proceeds at this difficult time.

### The Rand

Following its massive run up against the Dollar until the third quarter, the Rand has stabilized in a broad range of approximately R7.30 to R7.70 to the Dollar. In our previous report, when the exchange rate was R7.42 to the Dollar we stated that it was our expectation that the Rand was not likely to appreciate much more. We gave our reasons, and until the facts change, we continue to hold that view.

### Gold as an Insurance Policy and Risk Diversifier

The lift in the stockmarkets has not changed the case for gold one iota. Gold never was a competitor to shares. It is the Dollar that is in trouble as well as the Yen, Euro and Pound. In fact all currencies, including the Rand. And it is to these currencies that gold is a mighty competitor in these tough times. As an aside, we feel we must mention that we believe the huge rally in shares will reverse and retreat, probably led by a bond crisis.

Fading into the recent past is the default by Iceland. In December we experienced what was essentially a default by Dubai. Of this we are sure – there are more to come, and big ones at that. Leading contenders are the states of California and Illinois and the countries of Portugal, Ireland, Greece, Spain, Japan and Britain. The US follows that pack closely. The risks for bonds, property, interest rates, risk assets and currencies are mounting.

Exactly where the axe will fall we do not know. But of this we are certain – in these bad times it makes sense to have some “gold bullion as a currency component in every investment portfolio”.

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