Philequity Corner (November 30, 2009)
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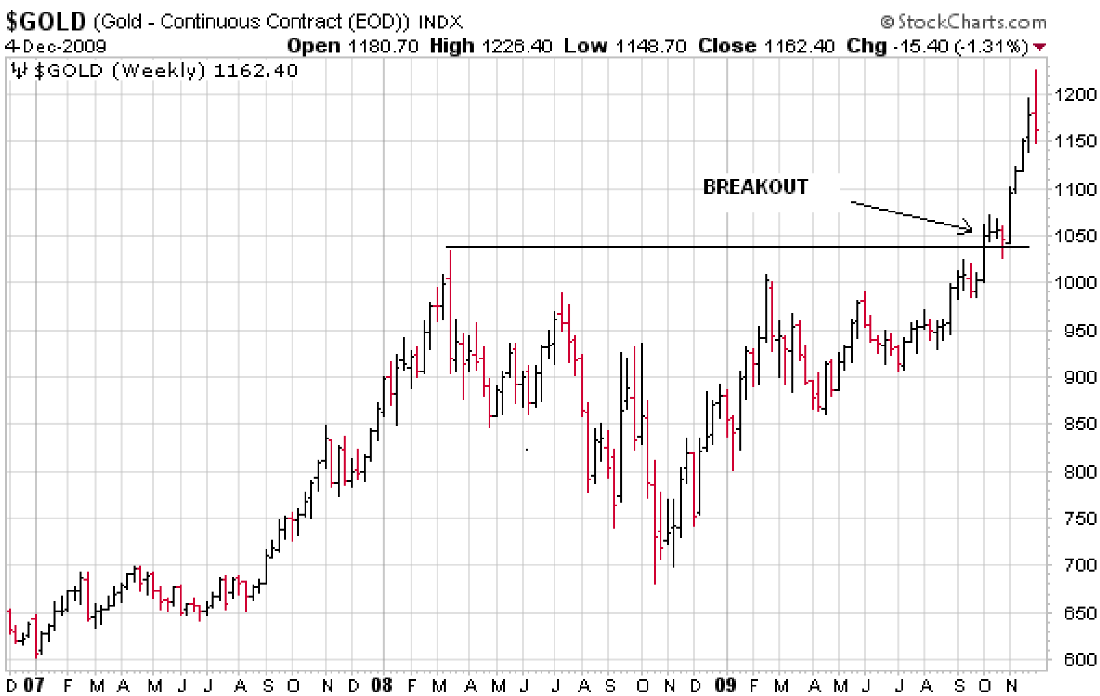
Gold Rush

We prepared this article on gold a few months ago but we had to put it off because of the huge impact of some local events. These are the fight for control of Meralco, the impact of typhoon Ondoy on the economy and the stock market, the emergence of Noynoy as a game changer in Philippine politics and as possible catalyst in the stock market.

As seen from chart below, when gold broke above $1,050 per oz. in early October, it was a clear breakout. While the price retested the breakout point during the last week of October, it has surged unhampered since November. By last week, the price of gold has zoomed as high as $1,226.4 before settling at $1,162.4 on Friday.



Reasons for gold's strong performance

Gold performed strongly this year (up 31.4 percent year-to-date) amid a confluence of factors cited below:

1) **Central banks turn from net sellers to net buyers.** In the 1990s and earlier this decade, central banks (especially the Eurozone central banks) were major sellers of gold. It is only this year that central banks have been net buyers. The buying of India, China, Russia and even Sri Lanka have turned central banks from net sellers to net buyers.

2) **Ultra-accommodative policies by central banks.** Recent statements by the Fed and global central banks to maintain their ultra-accommodative policies are positive for gold. Fed Chairman Bernanke is a renowned expert of the Great Depression. The real concern of central banks today is that they may increase interest rates prematurely just like in the

1930s and risk a "double-dip" recession. However, we are fortunate to have Bernanke who is making sure to combat depression by calibrating interest rates carefully.

3) **US dollar weakness.** The Fed's near-zero interest rate policy is driving the US dollar weaker, prompting investors to seek alternatives like gold in order to hedge against the falling greenback.

4) **Distrust over "FIAT" currencies or paper money.** Fiat currencies are paper money issued by governments. There is now growing doubts over the issuance of fiat currencies. The skepticism stems from the massive printing of money in the US and other countries worldwide. Mainstream financial players are turning to hard assets like gold and other commodities.

5) **Anticipation of hyper-inflation**. Gold is a traditional hedge and a solid refuge amid inflationary pressures. The massive stimulus programs by governments and the low interest rates environment have fostered a situation where a super-spike in inflation is highly probable.

6) **Investment in gold ETFs (e.g. GLD).** Investments in exchange-traded funds (ETFs) have grown exponentially during the past few years. In fact, StreetTracks' Gold Shares ETF (GLD) - the world's largest gold fund – is now the 6th biggest holder of gold. It now holds more gold than the People's Bank of China. GLD's holdings stood at 1,130 tons as of November 30.

Rank	Country	Gold reserves (tons)	Gold as % of total reserves
1	US	8,133.5	77.4%
2	Germany	3,408.3	69.2%
3	IMF	3,005.3	-
4	Italy	2,451.8	66.6%
5	France	2,445.1	70.6%
6	StreetTracks' GLD	1,130.0	-
7	China	1,054.0	1.9%
8	Switzerland	1,041.1	21.1%
9	Japan	765.2	2.3%
10	Netherlands	612.5	59.6%

Source: World Gold Council, Wikipedia

7) **A new asset class.** Gold is now an asset class in its own right, given the strong interest from exchange traded funds (ETFs), hedge funds and other institutional investors. Most portfolio managers have included gold in their holdings, in addition to equities, fixed income and alternative investments.

8) **John Paulson is buying gold.** John Paulson who earned about $20 billion for his funds between 2007 and early 2009 wagering against the housing market and financial stocks, is betting big on gold this time. His success as an investor has caused a huge following among hedge fund managers and retail investors. His latest hedge fund 13k filing shows GLD ETF as his biggest holding at 15.22 percent. He also holds 8.54 percent of his portfolio is Anglo Ashanti, 3.26 percent in Kinross Gold and 1.55% in Gold Fields. Paulson is also set to launch a gold fund in 2010, betting on the devaluation of the US dollar and future inflation.

9) **China and Russia are keen on buying gold.** China, which holds $2.27 trillion in reserves, only has 1.9 percent of their reserves in gold. Although China has recently raised its gold holdings, it has done so by buying domestically mined gold (not yet from international gold markets). Russia, which has $444 billion in reserves, only holds 4.3 percent of it in gold. Even a small adjustment by these two countries to diversify away from US dollar reserves should make a huge impact on the demand for gold.

10) **Supply of gold is dwindling.** So far, gold mining output peaked in 2001. The only major producers with increasing output have been China and Russia. China is the world's top producer of gold, but the People's Bank of China buys all the gold produced domestically. Russia is buying gold, not only domestically, but in international markets.

11) **Demand has gone up.** Demand is coming from all sectors. Aside from investment demand coming from asset managers and ETFs, and consumer demand coming from jewelry, central banks are now net buyers.

12) **Removal of hedges of mining companies.** Gold mining companies led by Barrick, Newmont Mining and Anglo Gold Ashanti have removed the last of their gold hedges. This suggests that these gold producers are not expecting prices to decline sharply anytime soon.

13) **Technicals point to more upside.** Momentum is the one moving the price higher. As shown in the earlier chart, gold had a clear breakout at the $1,000 per oz. level. Based on technical analysis, the huge reverse head-and-shoulders formation (see chart above) that gold so laboriously formed in 2008 and 2009 measures out for gold an upside target of $1,300 at least.

14) **Economic recovery.** Finally, all asset classes (equities, gold, precious metals and other commodities, high yield and high-grade bonds) tend to move up as the world emerges from recession.

15) **Ready and eager buyers for IMF gold sales.** IMF sales of gold used to be an overhang on gold prices. But the eagerness of central banks to diversify their reserves have caused a huge demand for gold. India, for example, have recently bought 200 tons of gold from the IMF. Even Sri Lanka recently announced its purchase of 10 tons of gold from the IMF.

Is it too late to join the gold rush?

With gold breaching 1,050 and the long-term chart looking very bullish, people are now forecasting $1,300 and even $2,000. However, caution is warranted. Given gold's parabolic rise, a correction is needed.

The long-term trend is still pointing up. However, a correction may happen just like what we saw last Friday. A good entry point is somewhere nearer to the breakout point of gold between $1,050 and $1,100.

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