

# Investor's Digest

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*With all the carnage that has hit the world this past year, shouldn't gold have made a fresh high by now?*

## Gold may have already reached its best price

Let me admit that I am no gold bug. Over the years at our management firm, we have bought gold and we have sold gold. We have made some money on gold a couple of times, but we have no particular attraction or affinity for it. It pays no income to hold it; it serves little practical purpose for humans or the planet. I find no reason to love it.



Danielle Park

When asked about gold by the media, I have repeatedly said that we would buy gold again if we got a buy on our rules. Until then, we wouldn't. Evidently such impartial commentary enrages some. Time and again, I have tried to assure that it is nothing personal — we just need a breakout on our metrics before we can see a buy on gold. But as time goes on and gold prices fail to break through last spring's peak, one can't help but ponder this: is gold more likely to be a buy or a sell here? Let's look at the chart:

Since 2001 and for seven long years as the U.S. dollar fell, the price of gold had an exceptionally good run of more than 300 per cent. But as the U.S. dollar broke out a year-ago January, gold broke down. Since then as the great reckoning broke loose in the global economy, we have seen gold make lower highs, and

lower lows.

I don't profess to know the future. But with all the carnage that has hit the world this past year, shouldn't gold have made a fresh high by now? If the economic world does come to an end any time soon, then gold may well break higher still. But the alternate scenario should also be considered. Maybe — just maybe — the worst of this market crisis is now passing by.

Yes the U.S. has a lot of problems. But the rest of the world is in tatters too, and relatively speaking, most are worse off. Incredible to suggest I know, but what if the U.S. stock market manages the now largely unexpected and begins to buck up?

Let's look at this chart of the S&P 500 and compare it to the chart of gold: Fourteen months into this bear market, the S&P has lost more than 40 per cent and is now at monthly price support last touched in 2003. In relative strength, the U.S. market is

now more oversold than it has been at any time in over 20 years. Meanwhile, gold has so far lingered within 10 per cent of its all time high.

Investing is about weighing probable outcomes. This is really all we have. When we look at the two charts, we must focus on practical questions. With gold at an eight-year high, and the S&P at a six-year low, we must ask ourselves which asset has the greater probability of outperforming now?

The January issue of *National Geographic* did a front-cover feature on "Gold. The true cost of a global obsession." Leaving aside the contrarian-sentiment arguments one could see in this mainstream coverage, the article brings up some interesting facts on gold:

- Adjusted for inflation in 2008 dollars, US\$1,000 has been the high water price for gold since Sir Isaac Newton first standardized it in 1717. (The NG article has a great chart of this.)

- Every time it has spiked through this level in the past three centuries, gold prices have fallen for the next 100 years or so.

- Investors are marginal buyers of gold. Jewelry and trinket demand have accounted for about 75 per cent of global gold demand this decade.

- Worldwide jewelry demand collapsed with other wealth in 2008 and is expected to fall fur-



ther in 2009.

• In all of history, only 161,000 tons of gold have ever been mined, barely enough to fill two Olympic-size swimming pools. More than half of that supply has been extracted from the earth in the past 50 years alone.

The most bullish argument I hear for gold is that retail investors, now sacred out of their wits by the global downturn, mistrusting governments and paper money, will continue to feverishly snatch up gold bars, coins, wafers and gold ETFs. Maybe they will; but for how much longer? They can't eat or drink it. They can't use it for shelter; it won't pay them an income.

Even gold-obsessed East Indians generally stop buying gold to collect when its price passes US\$750 an ounce. East Indian demand collapsed last year, with India's gold imports plunging 81 per cent in December.

Maybe with the on-going implosion of hedge funds that were recklessly speculating in this and other commodities over the past seven years, dumb money is gone for awhile, and gold prices will continue to fall. Maybe the

world won't end, and the U.S. dollar won't lose its benchmark status — at least just yet. Maybe the beleaguered stock market will start to recover this year, and gold will continue to contract from its multiyear high. Based on history, at least, it would seem that gold's inevitable reversion to the mean is now overdue.



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