Gold – A store of value

"The desire for gold is the most universal and deeply rooted commercial instinct of the human race." – Gerald M. Loeb

For those who don't know, Loeb began his investment career in 1921 and first became known for his book, *The Battle for Investment Survival,* which was popular during the Great Depression and is still considered a classic today. *Barron's*, The *Wall Street Journal*, and *Forbes* called Loeb "the most quoted man on Wall Street".

If Loeb were still around today, he would say put all your eggs in one basket and watch the basket. This is similar to what the true gold bugs do and if you had invested along side with them since last fall you would have enjoyed seeing gold surge from a low of US $692.50/oz. on October 24, 2008 to approximately US $995/oz. on February 23, 2009. Not bad considering the S&P 500 is down over 30% in a similar period. However, the real sweet spot has been in gold equities with some stocks realizing returns of 25% to 300%. We could give you a list of these, but it's far too long.

The move to the upside does not surprise us – in fact we expected it, but what perhaps may be different to some are the reasons. What is different this time?

For one, the media is behind it like never before. Whether it is The *Wall Street Journal*, Bloomberg or CNBC, they are all talking up the yellow metal big time. Now, some may have an uneasy contrarian's point of view, but what is evident to us is that this is a different gold market. The perception of gold is changing.

What we mean by this is that gold is not only moving up as an inverse price movement to the Greenback. Lately, gold has moved with the dollar as often as not. This partially reflects the fact that buying is coming from non-U.S. sources, and that it is being treated as a currency (i.e. store of value) in its own right. We still think the dollar has downside and that gold's negative correlation to the dollar will come back, but in the meantime, this new interest in the yellow metal from newcomers is welcomed by gold bugs and investors alike.

These newcomers include some big money investors like pension funds, mutual funds, and institutional investors that wouldn't have given gold the time of day normally. These new players could send gold to all time highs, but that's not certain, in our opinion. There are so many variables that affect the gold price it's difficult to say whether it will stay above US $1,000/oz. or retreat. Gold is notorious for giving back big gains. What is certain, though, is that there will be continued volatility in the yellow metal which will create trading opportunities.

One way to trade the gold market is with ETFs (Exchange Traded Funds) such as HGU-TSX. This is a double-leveraged gold equity ETF. With current daily dollar volumes, the biggest ETFs are now running at several billion a day and are also a way for the big boys to play. That's another reason those new pools of capital are now on the scene.

These new capital pools have been putting some big money into gold companies, too. Together **Yamana Gold Inc.** [YRI-TSX], **Agnico-Eagle Mines Ltd.** [AEM-TSX], **Kinross Gold Corp.** [K-TSX], and **Osisko Exploration Ltée** [OSK-TSX] have attracted more than $1 billion in new money. Shares of Osisko dropped well below $2 per share in November on concerns the company wouldn't be able secure the capital they needed to move ahead with their mine plan. The stock is currently trading back up to approximately $5.00/share. **NovaGold Resources Inc.** [NG-TSX] shares dropped all the way down to $0.47 cents, only to battle back to $4.80 as we write this. **Aurizon Mines Ltd.** [ARZ-TSX] has made a huge recovery and was also trading as low as $1.21 last October. On February 17, Aurizon broke the $5 barrier. Clearly, the quality gold companies have recovered well. Many smaller gold companies that were ripe to fail during the credit crunch are getting cash injections, too. These are just some of the bigger deals. The point is that there is big money flowing into this sector.

There are many reasons we can think of to say this gold market has legs. With many assets deflating, gold is suddenly a preferred central bank asset again. Central banks only sold 75% of the gold they could have under the central bank selling agreement in 2008 and they may do even less this year. On the other hand, gold lease rates have been rising, with the one-year lease rate at about 1%.This makes the margins too small for carry trades to be profitable enough to justify the currency risk, so more of the central bank bullion is staying in the vaults.

In our opinion, gold wins no matter what. Gold wins in an inflationary environment because it's a store of value. Gold also wins in a deflationary market as central banks debase their currency. One thing for sure – there will be volatility based on all these newcomers. Volatility creates opportunity. ■

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