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Gold bull has many years, thousands of dollars to go

The gold market powered its way to a succession of new all-time highs in the wake of India's stunning purchase of 200 tonnes of IMF gold and mounting concern about the fate of the U.S. dollar. There is little doubt that India's actions drew widespread attention to a historic shift in the attitude of central banks towards gold.

For at least the past 15 years, Western central banks have been flooding the market with massive quantities of gold, primarily by leasing it surreptitiously to their bullion-bank cronies. Ostensibly that portion of their activities, which was transparent (i.e., direct sales), was for reserve diversification. However, the real motive for their behavior was to depress the price of the yellow metal, thereby reducing critical scrutiny of their increasingly reckless monetary policy, ensuring that interest rates remained at low levels and allowing the U.S. dollar to retain its supremacy.

In the 1990s, it turned out to be a wildly successful strategy and resulted in the gold price plumbing depths that were truly uneconomic (US\$250-US\$300 per ounce) while financial assets flourished. Unfortunately for



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them, it sowed the seeds for what subsequently transpired: a robust bull market in gold in the first decade of the new century, accompanied by increasing chaos in the stock, debt and real-estate markets. However, undaunted, the central banks and their accomplices have persisted, becoming more and more intrusive in all markets, while subjecting gold and silver to truly counterintuitive trading behavior and unwarranted stomach-churning corrections.

Today, the western central banks are discovering, to their increasing discomfort, what history has always conclusively demonstrated; the manipulation of the free market process ultimately fails. No amount of government interference and price manipulation can change the reality of the free market over the long term.

In this whole sordid process what has always been particularly intriguing to me is that an earlier generation of central bankers unsuccessfully tried the same ploy with gold in the 1960s.

Utilizing the considerably more transparent London Gold Pool, they succeeded in holding gold at the official price of about US\$35 per ounce for a number of years before being totally overwhelmed by the reality of the situation. In the following

decade of the '70s, gold rose a mere 2,300 per cent.

Armed with this history, one would have surmised that our current collection of central bank geniuses might have considered that their present attempt at price control, albeit considerably more clandestine, could meet a similar fate. Alas, the hubris of central bankers is a well known trait, and this represents just another graphic example of their arrogance.

However, what remains to play out is the denouement of their folly in this instance. Markets that have been artificially capped tend to catapult upwards when the suppression ultimately fails. In my opinion, the last experience in the '60s and '70s was a mere bagatelle in comparison to what is unfolding today. It has always been an accepted canard that "the greater and longer the manipulation, the greater the eventual price rise is going to be." In the latest episode, there has been dramatically more central bank gold expended.

Credible estimates suggest that as much as 15,000 tonnes, or virtually half of all the central bank gold reserves, have hit the market compared to roughly 3,000 tonnes in the days of the London Gold Pool. This exercise has also occurred over a longer time frame against the backdrop of a much more fragile financial structure, particularly in the west-

ern world. Thus, you are free to use your imagination to estimate how high the gold price is ultimately going to go this time.

Accordingly, I find it almost nauseating that various pundits are currently referring to gold as overpriced and in a bubble phase. In reality, gold remains in a stealth bull market that will have seen nine consecutively higher year-end closes at the end of 2009.

Despite this, it has attracted very little attention from the investing public in general. The dedicated goldphile has participated throughout and a number of sophisticated financial players have come on board recently, the latest being the legendary trader Paul Tudor Jones, but the average investor remains blithely unaware at this juncture.

It is instructive to remember that at the end of the last bull market in 1980, people were lined up around the block outside the Bank of Nova Scotia in downtown Toronto to purchase physical gold. Today, the only lines that have formed are outside emporiums set up so the unsuspecting public can unload their gold jewelry for cash. To have a bubble of any significance, there has to be wide public belief and it certainly isn't on display in the gold market at present.

More importantly, if gold were overpriced, the gold producers would be experiencing an earn-

ings bonanza. A close examination of the recent earnings statements of most major gold companies reveals that they are earning very little and are certainly not achieving the return on capital necessary to justify their involvement in a very risky and difficult business.

In reality, I find sentiment in the sector to be remarkably subdued in the face of compelling fundamentals. Many attractive junior gold stocks are not even keeping up with the rise in the gold price. If history were any guide, these stocks would be rising at three to four times the rate of the gain in the gold price, but investor skepticism is holding them back.

From a media perspective, if we were approaching the end of a bull market, the newspapers articles and television clips would be universally bullish touting the obvious merits of the yellow metal. There is indeed more coverage recently because of the relentless price rise but it tends to be skeptical with the bearish commentators still receiving top billing, despite having been continuously wrong.

Finally, it is widely acknowledged that if the peak gold price in the last great bull market (US\$850 in January, 1980) were to be adjusted to reflect the U.S. inflation rate in the intervening period, it would be equivalent to US\$2,300 today. The fact that the current gold price is approxi-

mately half of that should put to rest any suggestion that this is a bubble. That's not to say there aren't several bubbles forming in financial markets (most notably in government-debt instruments) as a result of a new bout of central bank madness, but gold is certainly not on the list. In fact, I believe that we are many years and several thousands of dollars in price away from the end of this powerful bull market.

Mine supply

One of the key factors that is going to contribute to the ongoing bull market is mine supply, or more accurately stated, lack thereof. Mine supply has been in a steady decline since early in the new century despite the constant rosy predictions of greater supply from the alleged industry expert GFMS Ltd. I have long been of the mind that the decline will continue for some time, irrespective of what the gold price does. I base my opinion on numerous factors including a dearth of quality projects ready for mining, continuing geopolitical and environmental issues, less high grading as the gold price rises, ongoing capital constraints and a chronic shortage of skilled miners and competent mine builders.

Thus, I was fascinated when Aaron Regent, the new head of the world's largest gold company **Barrick Gold**, was quoted at

RBC's annual gold conference in London lamenting the state of the gold mining business. He went so far as to suggest that global gold production was in terminal decline despite record prices and Herculean efforts by mining companies to discover new orebodies in remote areas. He alluded to "peak gold," implying production has reached levels which can't be exceeded. He also observed that ore grades have fallen from roughly 12 grams per tonne in 1950 to nearer three grams currently in U.S., Canada and Australia.

Following this pessimistic assessment, a more horrifying prediction was revealed in the *South African Journal of Science*. Chris Hartnady, the research and technical director of a Cape Town-based consultancy, stated South Africa's famous Witwatersrand goldfields are around 95 per cent exhausted and predicted that production rates should fall permanently below 100 tonnes per year within the next 10 years.

This is truly shocking in that gold production from the Witwatersrand, the largest goldfield ever discovered, peaked at around 1,000 tonnes per annum in 1970 and, although falling steadily since, still contributes around 230 tonnes per year or roughly 10 per cent of world production.

In view of these two evaluations by knowledgeable observers, I think it is fair to con-

clude that the emerging shortage of gold, driven by a huge expansion in investment demand and a rapidly diminishing central bank supply, is most assuredly not going to be alleviated by increased mine supply in any reasonable time frame.

I now firmly believe that the chances of gold ever trading below US\$1,000 per ounce are becoming increasingly remote. The only caveat I would offer is that, if the world suffered a catastrophic deflationary collapse, gold could briefly be swept under but would then emerge with even greater relative strength as the only true safe haven.

However, in a world of pure fiat currency, I think that a near-term deflationary outcome is highly unlikely. In fact, I suspect that gold is going to stage a parabolic rise from current levels shortly, a development that will come as a true shock to the many detractors of the world's only real money. This remains one of the best supply-demand imbalance stories I have ever encountered in my career and it will only be enhanced by the existence of massive short positions that will be nearly impossible to cover and myriad paper claims on gold that dwarf the available physical supply.

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