



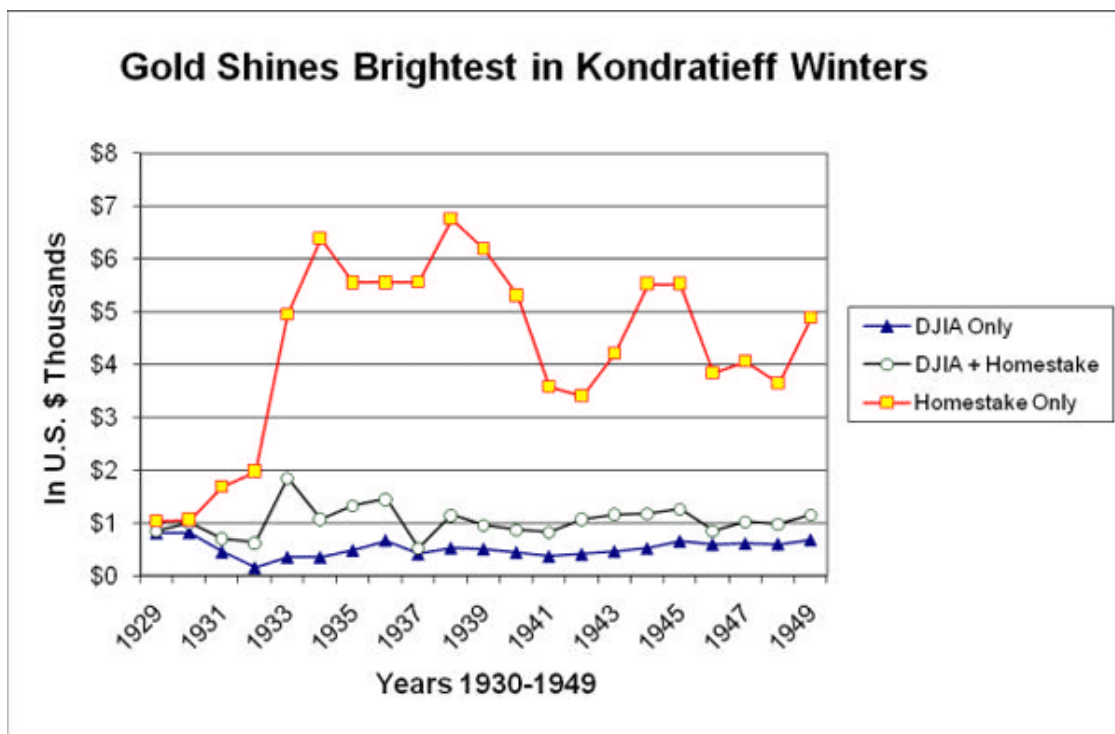
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Gold Stocks Were Financial Saviors During the 1930s Jay Taylor

Homestake Mining and Dome Mines were two gold producers that made their shareholders wealthy during the Great Depression. Before Barrick Gold acquired it, your editor received daily price data from Homestake Mining dating back to 1888. I used that information in some “what if” examples to see just how effective Homestake was in hedging against losses during the devastating 90% decline of the Dow Jones Industrials during the 1930s. Here is what I found.



In the chart above, the red line with yellow boxes represents the value of \$1,000 invested in Homestake starting in December 1928. Note at its peak in 1938, a \$1,000 investment in Homestake grew to \$6,760! Not only did it grow in nominal terms, but it was also even more impressive than it appeared, because with deflation, those \$6,760 bought more in 1938 than they did in 1929!

Now take a look at the gray line with white circles, representing year-end data points. This line represents what \$1,000 invested in 1928 would have been worth if 15% were put in Homestake and 85% in the Dow Jones Industrials. Certainly it wasn't as impressive as if you had invested everything in Homestake. Nonetheless, the losses would have been drastically reduced if you had reserved just 15% of your portfolio for this outstanding gold stock.

Following is a chart that shows the value of each of the hypothetical portfolios shown in the chart above:

would have nearly doubled in value, to \$1,970.

· For all year-end periods from 1928 through 1949, the Homestake-only portfolio was in positive territory. It gained to \$4,880 by 1949, representing a 6.2-times increase over the Dow-only portfolio.

15% Homestake / 85% DJIA chart

· A 15% allocation to Homestake would have reduced your overall portfolio loss by 38%, to \$620. That would be nothing to cheer about, but certainly a lot better than an 85% loss.

· By the end of 1949, by adding 15% of your portfolio to Homestake, you could have gained 16% in nominal terms and more in real terms, given the fact that the dollar gained purchasing power over the years. In 13 of 22 years, a 15% allocation would have kept your portfolio in positive territory, whereas 100% in the Dow would have been seriously negative during the entire 19-year period.

Clearly the inclusion of a quality gold producer reduced portfolio risk and enhanced wealth over a long period of time during the Great Depression. The question now is whether the same would hold true if the current timeframe turns out to be another deflationary depression.

We call your attention to several key points.

The Dow Alone:

- The Dow lost 55% of its value by the end of 1931 and 85% of its value by the end of 1932.
- During the entire duration of the Kwinter (as perceived by Ian Gordon), the Dow Jones-only portfolio would have been substantially underwater, with a 33% loss still being suffered in 1949.

The Homestake-Alone Portfolio

- By the end of 1932, a portfolio comprised of only Homestake Mining

Will Gold-Share History Repeat During This K-Winter?

There is an old saying that history always repeats, but never in the same way. In fact, things are different enough that most people take their eyes off the underlying dynamics that rule the universe we live in. I think this is one truism that has enabled people like Ian Gordon and another deflationist, Bob Hoye, to understand that no matter how powerful Ben Bernanke's fleet of helicopters may be, they cannot overcome the laws of markets any more than a fleet of U.S. Navy battle ships in the Gulf of Mexico could have stopped Katrina.

I'm not going to put words in Bob Hoye's mouth. I know from talking to him he isn't exactly on the same page as Ian Gordon with respect to the K-winter, though I don't think he really ever considered Ian's work. I tried to arrange a meeting between the two at one time in the past, mostly because I wanted to learn from both of them and also to see where the two might find a common ground of agreement. But based on my observation of Bob Hoye, I have to think of him as a "deflationist" who understands gold as well as anyone.

Regarding the gold sector in the current environment, here is what Bob said in his "Pivotal Events" letter to his institutional clients this past week:

"Our view in August was that the liquidity problem could become a disaster that would climax in the last part of October. The August 20 edition pointed out that in the 1929 and 1873 fall panics the price of gold declined along with everything else. Also noted was that Jay Gould, the famous operator, got short stocks and long gold in that fateful August of 1873. Then when long gold wasn't working he sold it and stayed short stocks.

"The Other point in that edition was to get short silver—mainly the stocks. At the time the gold/silver ratio, which had broken above 54 in late July, was at 62 on its way to around 100. The high close was 84 on Friday and it is very overbought. It is time to cover silver shorts.

"The Chart Works of earlier today had the alert on a tradable change in currencies. The up dollar index is going to stall out for a while, which will release a rally in the trashed items.

"The gold sector has virtually replicated the 1929 'model' and is poised for a cyclical bull market that could run for a couple of years as the conventional side suffers cyclical contraction. On the longer term, this could run through a number of business cycles making the sector an outstanding performer.

“It is time for traders and investor to get long. (the gold sector)

“We are not estimating a low for gold’s nominal price as the bottom could be violent. However the low should be set within the next few trading days.”

Why Gold Shares Do Best in a Deflationary Depression

The reason gold mining firms do better during a deflationary depression than during an inflationary depression is simple. Profit margins are at their best during these conditions. Why so? Because when there is panic in the

streets, people flee to the ultimate safe monetary haven, which is gold. Meanwhile, given a collapse in industrial demand, the cost of production falls.

One of the reasons gold mining stocks have underperformed other commodity stocks over the past few years was because the cost of production was rising so dramatically. We direct your attention to our discussion below of Hawthorne Gold, our Stock Pick of the Week. Note how gold has been rising relative to oil, copper, and commodities in general, as measured by the Rogers Raw Materials Fund. We are also hearing from

mining companies that in many instances it is now much easier to obtain drill rigs to explore and develop properties, and labor—both at the higher-skilled end of the spectrum to the common mine worker—is easier in some instances to find now than a year or two back.

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