



## Physical Gold – The Ongoing Bull Market

**Gold has had a disappointing run this year. After finishing 2012 at \$1664, prices plunged in both April and June, closing out the financial year at USD \$1192, down 28% in USD terms in only six months.**

Despite this recent weakness, a look at gold over a longer period highlights how strong it has been, outperforming many of the traditional assets where trustees tend to concentrate their portfolios, in some cases by a considerable margin.

### **Returns to end June 2013**

<u>Asset Class</u>	<u>1yr</u>	<u>5yr</u>	<u>8yr</u>	<u>10yr</u>
<b>Australian Shares</b>	<b>22.8</b>	<b>2.9</b>	<b>6.0</b>	<b>9.4</b>
<b>Cash &amp; Term Deposits</b>	<b>3.2</b>	<b>4.3</b>	<b>5.2</b>	<b>5.0</b>
<b>Listed Property</b>	<b>24.0</b>	<b>0.3</b>	<b>-4.0</b>	<b>2.7</b>
<b>Physical Gold (in AUD)</b>	<b>-15.7</b>	<b>5.9</b>	<b>10.7</b>	<b>9.6</b>

And while the current correction has made many investors understandably nervous, a sober assessment of the economic landscape highlights that all the fundamentals underpinning the gold bull market are still in place.

Therefore, whilst further short-term weakness can't be ruled out (especially with investor sentiment so negative), much like the previous corrections we've seen this decade, this current bout of weakness is likely to prove a fantastic buying opportunity for those who have a longer time frame in mind.

### **Economic Reality and the Outlook for Precious Metals**

Despite the hope and optimism that a year of rising equity markets generates, the reality is that the global economy is not recovering from the GFC.

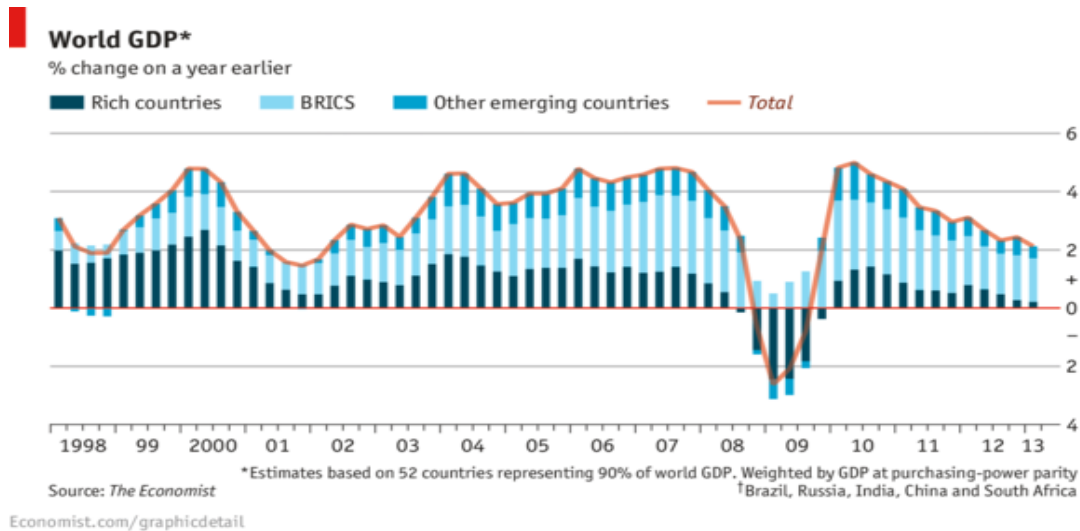
The GFC was the end result of a multi-decade explosion in debt across the developed world, made possible by 30 years of falling interest rates, which engulfed all sectors of society (individuals, businesses and government).

Despite the chaos this caused only a few years ago, to date, governments & central banks have attempted to cure the problem with even more debt.

They've run unprecedented budget deficits, leading to trillions of dollars in additional government debt. They've pushed real interest rates near if not below zero percent, thereby punishing savers.

Finally, they've resorted to money printing on an epic scale, despite this being an economic policy with a 100% historical track record of failure.

Despite these steps, as the following chart produced by The Economist in late June highlights, there remains a clear downtrend in economic activity across the globe, especially in the developed world.



Nowhere is this more obvious than in the global employment picture. European unemployment has just hit a new record high of 12.1%, whilst youth unemployment is over 25% on the continent.

In America, the jobs report released earlier this month showed a flat unemployment rate, but a significant **increase** in the underemployment rate, to 14.3%.

These numbers are significantly worse than those recorded at the time the GFC supposedly ended.

Even Australian jobs numbers released Thursday showed clear deterioration, not surprising as we struggle to decouple from our dependence on the mining boom.

When you add in the impending impact of the ageing population, which going forward will have a negative impact on both developed world growth and sovereign balance sheets (already stretched to extremes), it is fair to say that we face a set of economic conditions more challenging than the Great Depression.

A continued deterioration in the economy, and this environment of elevated risk will ultimately support gold prices going forward, as investors grow nervous

about the outlook for, and historically low yields on offer in traditional investments like equities, cash, property and bonds.

And the potential is considerable when one considers the current breakdown of the world's financial asset pool.

### **Breakdown of Global Asset Pool**

<b>Asset Class</b>	<b>Percentage of Global Financial Assets</b>
<b>Fixed Income (Bonds)</b>	53.00%
<b>Equities</b>	37.00%
<b>Money Markets</b>	5.50%
<b>Alternatives</b>	4.00%
<b>Gold</b>	0.50%

As you can imagine, if even a trickle of funds rotate away from fixed income, equities or money markets toward gold, we believe prices will skyrocket.

Providing further impetus to gold price appreciation is the likelihood that the challenges in the economy discussed earlier will be met with even more debt, even lower interest rates (especially in Australia), and a continued commitment by central banks around the world to maintain, if not expand, quantitative easing.

Ultimately, that means we'll be in an environment of negative real interest rates and high inflation risk for years to come, bullish for physical gold (a non-yielding asset) as it eliminates the opportunity cost of owning the yellow metal.

On top of continued economic weakness, negative real interest rates, significant risk and low yields in traditional assets, the other major factor which will prove bullish for precious metals going forward is the incredible physical demand from emerging markets.

The central banks of Brazil, Russia, India and China, amongst others (who, to date, own proportionally very little gold) are busy diversifying their reserves away from US & European government bonds into physical gold.

This is a process likely to continue for many years, requiring the purchase of thousands of tonnes, and it is being complimented by unprecedented retail demand, particularly in China, where imports of gold regularly run at over 100 tonnes a month.

Given gold's scarcity, and more importantly, the stability of its overall supply (the key differentiator between it and other commodities), this demand can only lead to much higher prices.

## Would a gold boom really be so unexpected from here?

A significant rally from here in the gold price would not be without precedent. In the last great gold bull market of the 1970s, where gold rose from \$35 to \$850, there was a roughly 18 month period where prices corrected by 45%, as the chart below shows.



Rather than spelling the end of the bull-market, that mid-1970s correction, which looks very similar to the one we're currently experiencing, proved an incredible buying opportunity, with prices skyrocketing over 700% from that point on.

Considering that gold is still severely undervalued by historical standards (relative to inflation, its relationship with equities, or vs. a perpetually expanding global money supply), and the fact that the fundamentals underpinning the current bull market are stronger than those that saw such a stunning move back in the late 1970s, similar returns should not be ruled out in the years ahead.

It could be even better news for trustees as a potential fall in the AUD would add to their upside potential, as well as providing some much needed currency diversification.

With no easy way out from the uncertain times we're in, the investment potential, and portfolio insurance that physical gold offers is likely to prove increasingly attractive to prudent investors in the years ahead.



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