



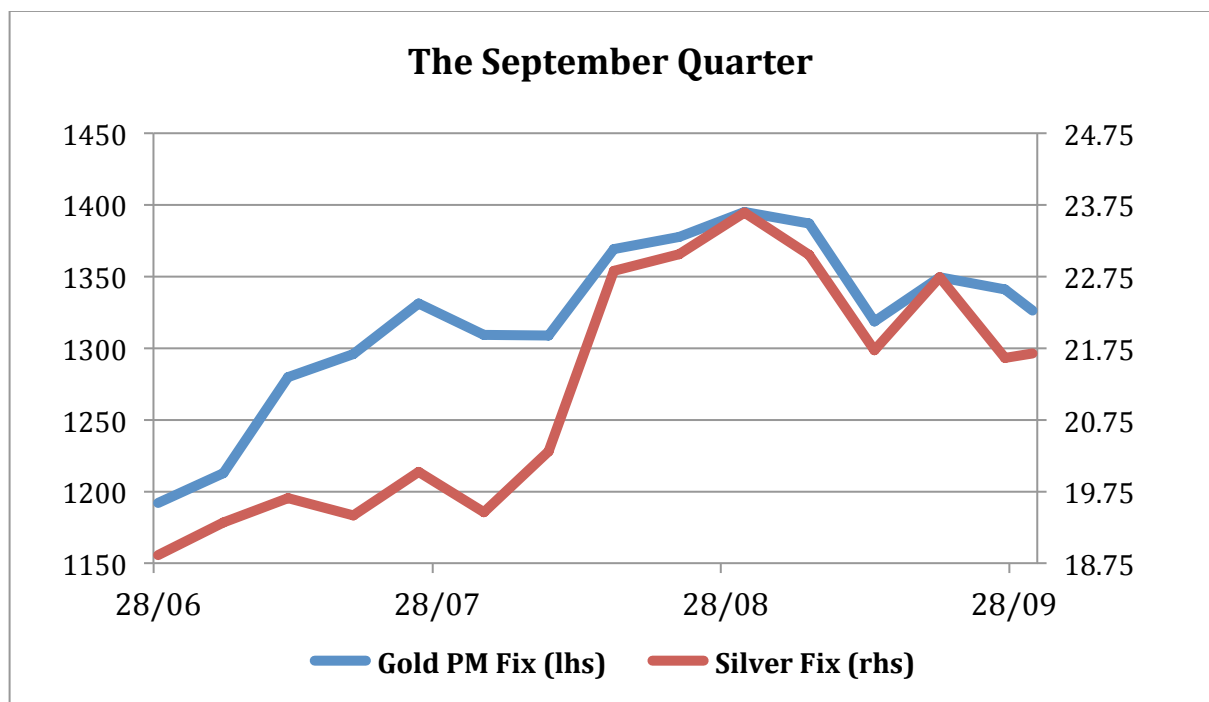
10th October 2013

Directions Report- Did the June low mark the bottom for precious metals?

It's been another interesting quarter for precious metals investors.

After the most violent quarterly correction in decades, which saw the USD gold price fall to a low of \$1192.00 on the London PM Fix on June 28th, and silver trade at USD \$18.86 on the same day, many thought that the decade-long precious metal bull market was well and truly over.

Despite the hysteria in the media at the time, with predictions of a sub-\$1000 gold price appearing on an almost daily basis from a variety of investment banking 'experts', the quarter just passed has provided some relief to precious metal bulls, with gold up 11.24% in USD terms and silver up 14.95% between June and September.



Whilst this has been good to see, longs were disappointed in September, as both gold and silver pulled back (5% and 8% respectively from the 30th August PM fixes), a movement clearly visible on the chart above, which plots the original post June rally, and subsequent September correction in metal prices.

At one point in late August/early September, gold had actually traded up around the USD \$1430 mark, putting the rally at approximately 20% from the June low,

but it was unable to hold onto these gains, with the entire precious metals complex falling in the last month of the quarter.

Gold's inability to hold onto its gains from July and August was particularly frustrating for bulls in light of the fact that September is traditionally a good month for physical precious metals, and the fact that the much vaunted Federal Reserve 'tapering' of quantitative easing didn't eventuate, and has led many to question whether or not June really was the 'low' for this cycle, or whether or not this correction has further to run, and the last three months merely represent a dead cat bounce.

For me personally, with sentiment still overwhelmingly bearish, I think there is still a decent chance we could re-test the June lows of around USD \$1200 in the short-term.

Indeed, if we get a real GFC-style liquidity event (which is possible in light of the US government shutdown and debt ceiling debacle we're currently witnessing), we could see all markets sell off violently.

This has the potential to take gold lower too, at least in the short term, as its highly liquid nature would allow investors to raise cash to cover other obligations quickly.

This would potentially be a repeat of the 2008 sell-off, which saw gold drop from USD \$1000 to around \$700 in a matter of months, but just like then, we know now that the playbook from central banks the world over would be to push the foot even harder on the quantitative easing pedal, in an all out effort to avoid asset price deflation. This is a position strengthened by the likely appointment of Janet Yellen, a known 'monetary dove', as Ben Bernanke's replacement at the head of the Federal Reserve.

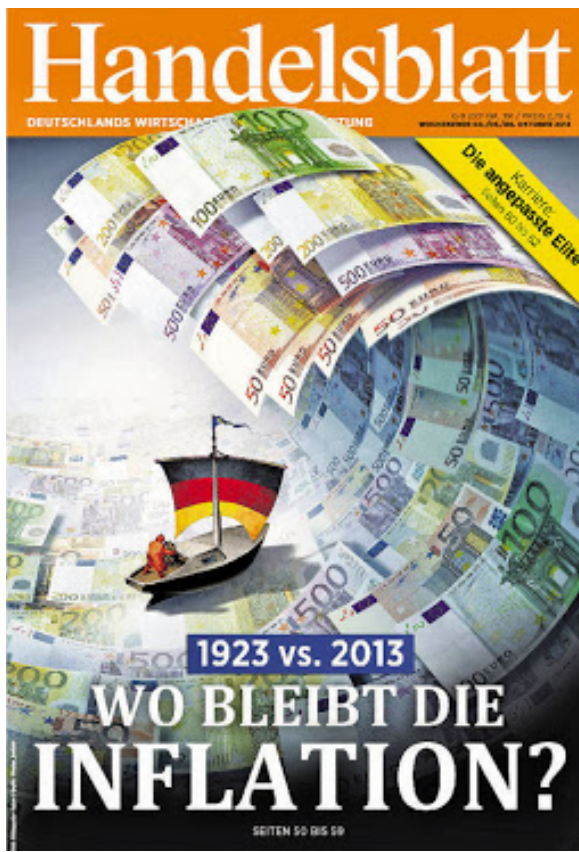
Therefore, whilst I see a further sell-off in precious metals as a short-term possibility, long-term investors would still be wise to ignore the day-to-day price volatility and treat any such corrections as potential buying opportunities.

In this quarter's Directions report, we're going to focus on the recent London Bullion Market Association conference in Rome, as well as take a look at the US Government shutdown and debt ceiling debate.

We'll also touch on news from Holland that a pension fund there won the right to keep its gold investments, much to the displeasure of the Dutch central bank, and we'll also be looking at gold investment in the context of the hundreds of trillions of dollars in financial assets floating around the market-place.

But first, let's start with a magazine cover in Germany:

The Germans ask – “Wo Bleibt Die Inflation”? or “Where is the inflation”?



German newspaper *Handelsblatt* posed the question on the front cover of a recent edition, comparing the crisis of monetary crisis of 1923 to the current state of the world in 2013.

The headline is noteworthy because it indicates clearly that fear of high, or hyperinflation is something that Germany does still worry about, even though it occurred nearly 100 years ago in the country.

It's also noteworthy because these kinds of headlines, or questions as to the 'absence' of inflation, have also been posed all around the West in the last few years since the Fed, the ECB, BoE, BoJ etc. all started monetising debts in the post-GFC world.

In many cases, articles in the West asking 'where is the inflation?' have had an air of arrogance about them, as if to suggest that anyone warning of the dire consequences of printing money didn't appreciate how intelligent central bankers were, and how in control of the global financial market places and economies they are.

[The following article from Paul Krugman](#) certainly fits into that camp.

Generally speaking, when you see that kind of 'analysis' you know the ugly consequences of such drastic intervention in the economy can't be too far away from making themselves known.

What was interesting from the *Handelsblatt* paper though was not that they were asking 'where is the inflation?' in a Krugman-esque manner (as in it's too low) but the fact that they were seemingly quite concerned about much higher inflation in the future, as well as negative fallout from global QE, with the article stating amongst other things that it was:

- Too early to judge the full effects of the ECB's policies
- That there will be negative impacts and higher inflation down the line

- That all the money printing is not feeding through to the real economy nor helping generate a sustainable recovery
- That one of the reasons inflation was 'low' is because central banks only measure asset prices and therefore significant increases in stock and real estate markets are classified as a 'bull market' rather than the asset price inflation they really are.

One of the comments by a reader following the article is worth sharing as well:

"The reasons that inflation remains part of the German psyche is that it wasn't just a phenomenon of the 20s. Serious inflation began far earlier. In 1914 the German mark was 20 to the pound sterling, and by 1918 it was already at 200.

The reason is that the Imperial German Government funded the Great War by money printing. They increased the money supply by a factor of ten, from 2.7bn mark in 1914 to 27bn mark in 1918, and not surprisingly, a tenfold increase in the money supply got them a tenfold, or 1000%, inflation in just four years.

Visitors to Berlin in late 1918, after the Armistice, noted that Germans had already lost faith in the mark, and were exchanging their cash for anything real - stocks, shares, gold, silver, real estate and foreign currencies.

This process was pro-cyclical. The more that Germans dumped the mark, the lower it fell. By 1921 it had fallen to 700 to the pound, and the process accelerated into 1923, which was the blow-off phase.

Date	German marks per 1 ounce of gold
Jan-19	170.00
Sep-19	499.00
Jan-20	1,340.00
Sep-20	1,204.00
Jan-21	1,349.00
Sep-21	2,175.00
Jan-22	3,976.00
Sep-22	30,381.00
Jan-23	372,477.00
Sep-23	269,439,000.00
2/10/23	6,631,749,000.00
9/10/23	24,868,950,000.00
16/10/23	84,969,072,000.00
23/10/23	1,160,552,882,000.00
30/10/23	1,347,070,000,000.00
5/11/23	8,700,000,000,000.00
30/11/23	87,000,000,000,000.00

Since then, hyperinflation has had a many myths attached to it. That it was a phenomenon of 1923 - in fact it was a ten-year process. That it was "caused" by reparations - in fact it started five years before reparations were agreed.

That it "just happened" when in fact it was a direct consequence of money printing. Banknotes don't print themselves."

For a brief review of exactly what happened to the German mark and how many of them you needed to buy an ounce of gold, the table below, sourced from data available via market oracle, is instructive

What's interesting is that, whilst the mark was losing value at a rapid pace over 4 years between January of 1919 and January of 1922, it was from that point on that the devaluation went 'exponential',

Source:

<http://www.marketoracle.co.uk/Article8530.html>

especially from September of 1923.

Needless to say, with this history still firmly in the minds of the German state and its peoples, the inflation debate, and the role of Germany in supporting the entire European project is not going away anytime soon.

Rightfully aware of their own history, there will be a significant section of the German public, and political movement who are resistant to constant bailouts of Europe and her southern states, as well as the ECB keeping the markets well lubricated with constant liquidity.

On the other side of this argument though, there is no easy way out for Germany. If they don't continue to bail out other member nations, and allow the ECB to do 'whatever it takes' in a monetary sense, then the disintegration of the euro will lead to massive social, political and financial disruption and dislocation all across the continent, as well as throw the world back into a prolonged recession.

Germany itself would suffer as a much higher euro (or deutsche mark) relative to southern state currencies (lira, peseta, drachma etc.) would impact German exporters, not to mention the fact these nations would in all likelihood default on the debts they owe, causing huge disruption to the balance sheets of German banks, pension funds and asset managers.

In all likelihood, Germany refusing to stand behind the debts of Euro members would lead to the German state needing to bail out the entire German financial system.

Understandably, no politician, no matter whether they lean left or right, and whether they are German, French, Italian or British wants to be seen as the architect of such an outcome.

The London Bullion Market Association conference in Rome

The LBMA have recently concluded their annual conference, held in Rome this year. Featuring over 800 attendees and 300 organisations including precious metal refineries, government mints, banks, central banks, pension funds, regulators, exchanges, bullion dealers, financial media and other industry participants, the conference is one of the leading precious metal events on the planet.

By all reports, the overwhelming theme of the conference was one of reasoned optimism, in that everyone acknowledged the difficult year gold has had, but were encouraged that the fundamentals underpinning the bull market are still in place.

There were presentations from a variety of central banks, including the Italian and German, both of whom reiterated the important role gold plays in the international monetary system today.

According to the Bundesbank, central banks continue to own physical gold and value it because gold is:

- Universally acceptable
- Provides diversification
- Provides robustness against shocks
- Provides a level of confidence

It's also worth reminding readers of the words of Salvatore Rossi, director general of the Italian central bank, who stated that:

"Not only does it (gold) have the vital characteristic of allowing diversification, in particular when financial markets are highly integrated, in addition it is unique among assets in that it is not issued by any government or central bank, so its value can't be influenced by political decisions or by the solvency of any institution. These features, coupled with historic ... and psychological reasons, stand in favour of gold's importance as a component of central bank reserves. "Gold underpins the independence of central banks in their ability to (act) as the ultimate bearer of domestic financial stability."

Source: <http://www.reuters.com/article/2013/09/30/lbma-central-banks-idUSL6N0HQ16A20130930>

The strategic role that gold plays, and the importance of owning gold as a reserve asset is something that is obviously well understood in the USA as well. [As this article from MarketWatch points out](#), even with the US government in shutdown mode, and with concerns over the debt ceiling and the risk that the US government might default on its debt (a topic I cover below), selling their gold to help pay the bills is absolutely off the agenda.

Considering that the value of the gold the USA purportedly owns is worth the better part of \$350 billion, it would give them some wiggle room and negotiating time if they did sell it whilst working out their finances.

As the fund manager quoted in the article states, *"with gold on the ropes this year, investors are increasingly questioning the intrinsic value of gold. Given the craziness in D.C, it seems to me investors should really be questioning the intrinsic value of paper dollars backed by feckless promises."*

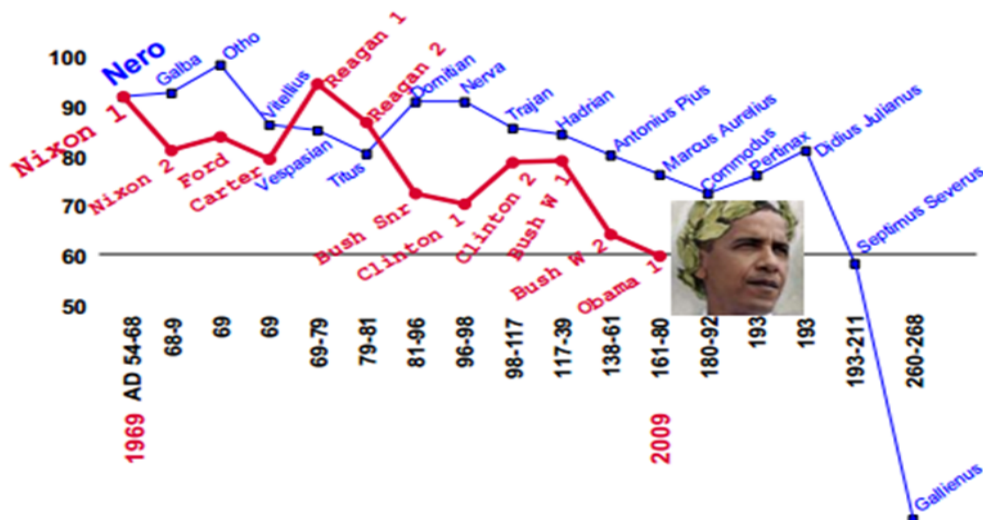
Indeed.

Back to the LBMA and according to those who attended, the best presenter of the conference was Andy Smith, an independent precious metal analyst.

Andy produced the following graph, which was by all reports a real crowd pleaser, showing currency devaluation under the Romans as well as the USD since 1971 when Nixon took the US off the Gold Standard.

Emperors... with no clothes

Denarius silver percent; \$index normalised to Nero



Source: Andy Smith, [LBMA conference](#)

Andy went on to point out that Detroit, which has been in the news of late after defaulting on \$600 million worth of debt (that used to be a lot of money), has only half the debt per head of the US national average.

It hardly bodes well for the future United States as a whole.

Some of Andy's other insights included:

- Gold is a psychological market
- Retail gold investors are far more intelligent than is assumed
- Inflation is neither necessary nor sufficient to push gold prices much higher
- What is necessary is for people to change psychology regarding the value of the paper money
- India is a role model for the West when it comes to household saving and they are wise not to trust government or banks to safeguard wealth
- Asset confiscation by desperate governments is coming

I would definitely agree with Andy's thoughts and expand on the psychological one to state that all asset markets ultimately are psychological (to paraphrase Carl Menger I believe that "*value doesn't exist outside of the conscience of men*") and it is in understanding the change in investor psychology that is likely to occur in the years ahead where the big money lies.

Whilst the mood was bullish at the LBMA it must be stated that many participants did see potential short-term weakness ahead, and not all were 100% convinced that June really did mark the lows in this cyclical correction.

Indeed panellists at the LBMA [saw the potential for a fall to USD \\$1050](#) in the near-term, clearing out 'weak longs' before the bull market can resume its natural trajectory.

This is an important point for physical metal investors to be aware of as they recalibrate their strategies for the final three months of 2013 and into next year

Dutch disease

In an interesting piece of news over the last couple of weeks, it would appear that [Dutch pension fund SPVG \(Stichting Pensioenfonds Vereenigde Glasfabrieken\)](#) has 'won' the 'right' to maintain its investment in gold, which, according to best estimates, was 13% of their total investment pool.

The pension fund, estimated to hold about 300 million euros in assets, first made headlines back in 2011 due to its gold exposure, is run for the benefit of a group of Dutch glass-makers.

The gold, which was originally purchased several years ago, caught the attention of the Dutch Central Bank, which actually went to court to force the pension fund to sell the bullion, claiming the pension fund was reckless for investing in bullion, that gold was a risky asset, and that the pension fund was failing to comply with the 'prudent person' rule.

The pension fund director, a Mr Kees Pruissen, stated several years ago that; *"We invest in members' interest, and have benefited from the appreciation in the gold price. Especially in uncertain economic times, it proved a refuge... **we trust gold as an investment**".*

It's safe to say that Australian's investing their superannuation funds would have benefitted had investment managers in this country had the foresight to follow Mr Pruissen's strategy.

Had they allocated a portion of capital from our \$1.6 trillion superannuation industry into physical gold, returns would have been much higher.

Unfortunately, so far that hasn't happened, and it's one of the main reasons returns over 10 years to June 2013 were only around 3.2% per annum, some several percentage points lower than what physical gold and silver have returned, barely in line with inflation and worse than cash in a bank account.

Back to the Netherlands and this specific case, fortunately, on appeal, the pension fund won its appeal, and is now allowed to maintain its holding in bullion, or repurchase it should it wish to.

The story is interesting for a number of reasons, not least of which is whether or not central banks should even have the right to oversee/interfere with the asset allocation decisions of pension fund and asset managers, who presumably, in

their role as trustee must meet certain criteria which would make you think they are capable of making these decisions themselves.

Secondly, the reasons behind the central bank arguing the pension fund managers were behaving recklessly were that gold is “too risky” and “fluctuates too much to be classified as an investment”.

Gold can be volatile as a stand-alone asset, but so are equities, and a 13% allocation would have demonstrable diversification advantages against equity market risk and an over-concentration in sovereign debt, which is where the lion’s share of this particular pension fund’s assets were invested.

Never has that diversification been more useful and important than in the post-GFC period.

Essentially, the central bank was arguing that this pension fund should hold even more of its money in sovereign debt, at a time when returns from these securities have never been lower, and governments issuing that debt and responsible for servicing it have never been deeper in debt (or more of a credit risk).

It’s a disturbing thought to consider that the Dutch Central Bank really believes that this is would be a prudent asset management decision by pension funds on behalf of retirees and their vital investment funds.

Finally, one can’t but wonder at the hypocrisy of a central bank arguing that it is reckless for a pension fund to hold 13% of its assets in bullion, when, according to the World Gold Council, the Dutch hold 612.5 tonnes, or over 50% of their foreign exchange reserves in bullion.

This makes them the 9th largest national holder of bullion in the world, as you can see in the table below.

Country	Tonnes	Percentage of Foreign Exchange Reserves
United States	8,133.50	70%
Germany	3,390.60	66%
Italy	2,451.80	65%
France	2,435.40	65%
China	1,054.10	1%
Switzerland	1,040.10	8%
Russia	1,002.8	
Japan	765.2	2%
Netherlands	612.5	52%

Source: World Gold Council as at June 2013

If holding 13% of your reserves in bullion is irresponsible and you’re responsible for €300 million in assets, what does it say when you hold 50% of your reserves in bullion and you’re responsible for the financial stability of an entire nation?

One thing is for sure, and that is the Dutch Central Bank certainly doesn't practice what they preach.

In any event, it's good to see the pension fund has won the day and the workers contributing to it have a healthy allocation to gold in their retirement portfolios.

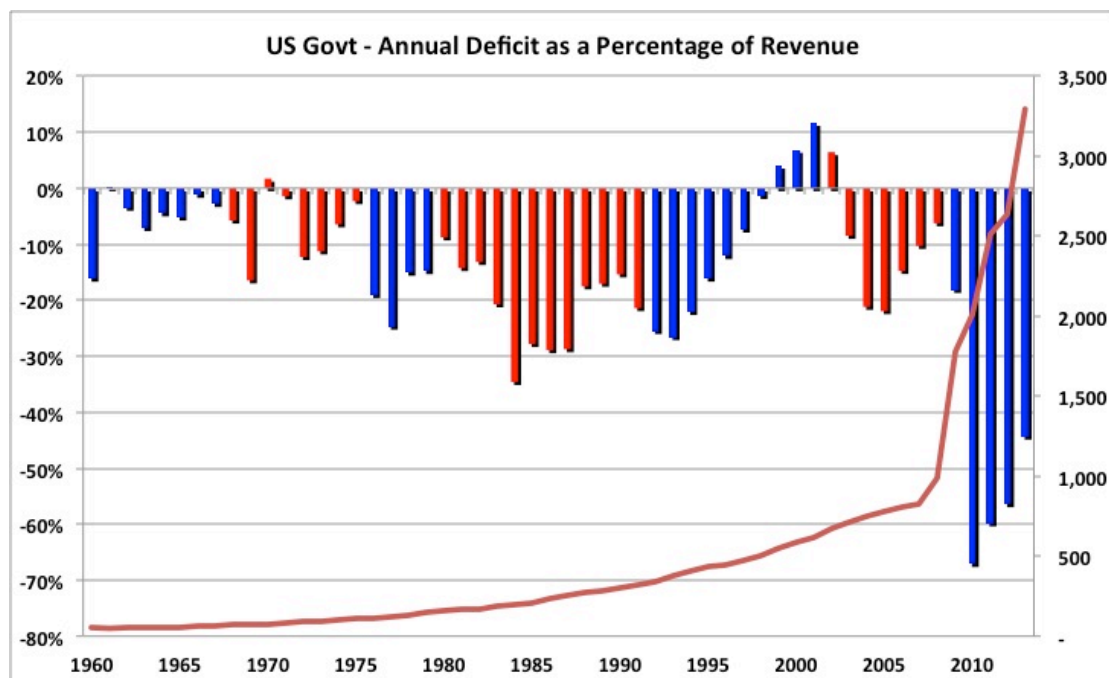
The US Government shutdown and the debt ceiling

If the farce that is the US Government shutdown isn't bad enough – over the next couple of weeks we're going to be treated to the 'debt-ceiling' debate, a Washington merry-go-round where 'leaders' (and I use the term loosely) from both sides of politics talk of the need to support the economy and the American people, but also to behave in the long-term interests of the nation by acting in a financially responsible manner, generally by enacting 'reforms', which they promise will save hundreds of billions of dollars at some indeterminate point in the future.

Saving money and living within your means is, of course, the right thing to do, but 'the economy always just needs that little bit of extra support' and 'it would be irresponsible to cut spending now' are the mantras!

We've seen this show before, with the debt ceiling being raised some 90 times in the last 40 years.

The truth is that the US Government, no matter whether they've been under Republican- or Democrat-controlled administrations, have been running deficits, and needing to raise their debt ceiling, pretty much every year since at least 1960, as you can see from the chart below:



Source: Congressional Budget Office and Federal Reserve

The chart, which shows the annual expenditure of the US Government in excess of its tax revenue, highlights very clearly that for nearly every year since the Kennedy administration in the early 1960s, the US Government has run deficit, after deficit, after deficit.

Officially, the Clinton administration did run a few surpluses, but this was predominantly achieved by 'raiding' the Social Security Trust Fund, and it also has to be stated that Clinton was in office during the greatest boom in American history, meaning corporate and income tax revenues were flying through the door under his administration.

Despite that, US total debt outstanding has risen every year, and as you can see in the last five years, has veritably exploded under the Obama administration.

The red line on the graph, which as you can see spikes up enormously from the around the time the GFC hit, is the US base money supply, highlighting how important Federal Reserve money printing has been in financing the US Government deficit these past few years.

The bottom line is that there is next to no chance they won't raise the debt ceiling, and they'll keep on running hundreds of billion dollar deficits each and every year, exacerbating the imbalances in the economy and heightening economic and investment risks.

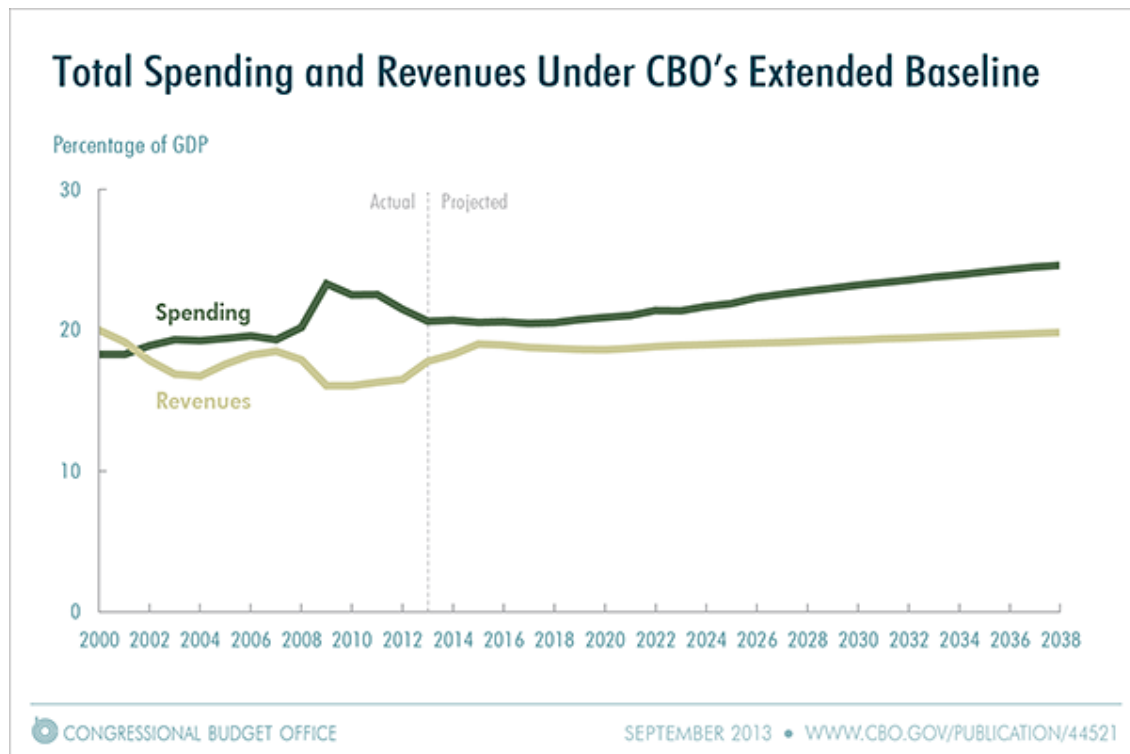
Make no mistake about it, the case for investing in precious metals has only been enhanced by the latest embarrassing display out of Washington.

As readers will know, it's the debt itself, not some artificial legislative ceiling that is the real problem America faces, along with the majority of the developed world; \$16.96 trillion, as I write, up from \$9.8 trillion in 2008, or just under \$150,000 for each and every tax paying American.

That's a scary enough figure, but doesn't even scratch the surface of the around \$125 trillion in unfunded liabilities which comes to a personal liability of over **\$1 million** for each and every taxpayer [according to US Debt Clock](#).

\$1 million per taxpayer. That is not a misprint.

For a graphical representation of how the situation will continue to deteriorate in the years (and decades) ahead, look no further than this graph from the Congressional Budget Office (CBO), which was included in their recently released long-term budget outlook, which shows spending and revenues, as a percentage of GDP, forecast all the way out to 2038.



Source: Congressional Budget Office

As you can see, they plan on spending more money than they take in in taxation revenue every year into perpetuity, borrowing literally trillions and trillions more dollars, all of which will need to either come from private investors, or more likely, the Federal Reserve.

The link to the full report actually contains charts out to 2088 and yes, you guessed it, there is literally no forecast of even a balanced budget anywhere for the next 75 years, let alone a surplus that would allow any of this debt to be repaid!

Make no mistake about it, charts like the one above would keep Ben Bernanke and his likely successor up at night, and make it crystal clear why the Fed can't ever really hope to end QE now they are the largest buyer of Treasury debt.

But regardless of the fact the US Treasury plans to keep borrowing, and the Fed plans to keep printing the money to fund said borrowing, this situation can't last, and it won't last.

These obligations simply can't be honoured, and the problem of dealing with them is not going to be resolved without severe market turmoil.

As more and more markets participants realise this, and the inherent risk in all asset markets at this particular point, the move towards precious metals is likely to be phenomenal.

Does this affect the Fed tapering QE?

As a final comment on the shutdown and the debt ceiling debate, one 'agency' of the government that will be particularly frustrated with it is the Federal Reserve. Government shutdown equals no data releases, or at least a significant reduction in them, which makes it harder for the Fed to assess the state of the economy and whether or not they should begin their much-vaunted QE taper programme, maintain the status quo, or even expand it!

As Denis Lockhart, President of the Federal Reserve Bank of Atlanta stated, *"if this lasts for several more days, by the end of October we will still be looking at a very ambiguous situation. Less data is not helpful in gauging where the economy is and where it's going"*.

If you read between the lines, ignoring the long-term issues discussed above which highlight why in the long run the Fed can't end QE, it's really difficult to see the Fed wanting to add to market uncertainty even in the short-term by tapering its asset purchase program.

The US Government shutdown, debt ceiling debate and a potential tapering of QE really could be an axis of evil (or triumvirate of terror) with regards to the financial markets, and could lead to precipitous falls in equities and bonds (and potentially even gold, if we see a short-term liquidity event), whilst adding considerable risk to currency markets too.

The Fed will be keen not to add to the uncertainty and for this reason they should hold the line on the \$85 billion a month QE programme for now.

The likely confirmation of Janet Yellen only makes it much more likely we'll be in QE world for a long time to come.

'Sundown in America' – David Stockman at his best

David Stockman is one of my favourite analysts. Former Director of the Office of Management and Budget (between 1981 and 1985), he's also the author of the *"The Great Deformation – The Corruption of Capitalism in America"*, a great look from an insider into what has really happened in Washington, as well as on Wall St. over the past few decades, highlighting the developments which led to the crisis history knows as the GFC, and why things are going to get considerably worse in the near future.

[The attached link contains a long and detailed speech he gave](#) a couple of weeks back regarding the true state of the economy, and life for everyday Americans compared to those living in the financial/political bubble on Wall St. and in Washington.

If you have 15 minutes, I highly recommend that you read the lot, but otherwise I think the following segment is the most pertinent:

“So we can summarize the last quarter century thus: What has been growing is the wealth of the rich, the remit of the state, the girth of Wall Street, the debt burden of the people, the prosperity of the beltway and the sway of the three great branches of government which are domiciled there---that is, the warfare state, the welfare state and the central bank.

What is flailing, by contrast, is the vast expanse of the Main Street economy where the great majority has experienced stagnant living standards, rising job insecurity, failure to accumulate any material savings, rapidly approaching old age and the certainty of a Hobbesian future where, inexorably, taxes will rise and social benefits will be cut.

And what is positively falling is the lower ranks of society whose prospects for jobs, income and a decent living standard have been steadily darkening.”

As much as I may wish it were not so, it is hard to find fault with his data, his rationale or his reasons.

His final comments are also very sobering for those who think we are going to pull out of this crisis in the next few years with limited financial, social or political disruption.

“Under these conditions, what remains of our free enterprise economy will buckle under the weight of taxes and crisis. Sundown in America is well nigh unavoidable.”

If ever there was a reason to want wealth protection, or to invest in physical gold and silver, those words sum it up pretty nicely.

The global pool of investable capital – another reason gold is no bubble

When analysing gold, the economy, other asset markets and ultimately whether or not gold is a bubble that has begun bursting, or is indeed a bargain with considerable upside ahead, there are a number of factors that are frequently talked about.

Money printing on an unprecedented global scale, ultra-low interest rates, low yields on bonds, sovereign debt risks all set the scene for why the macro-environment should be supportive of higher prices in the years ahead.

And comparing gold to equity markets, previous bull market tops or even a comparison to the previous bull market of the 1970s, all show that gold appears undervalued relative to history.

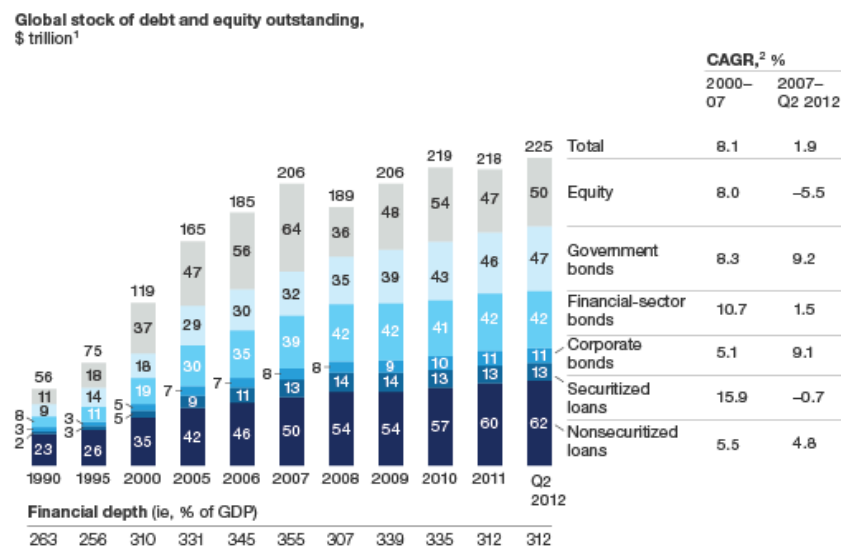
But one of the really interesting ways of looking at whether or not it's likely gold is a bubble or a bargain is by looking at the global pool of investable capital, and where gold fits into this.

Mckinsey Global Institute issued a report in August of 2011, which showed that there were \$212 trillion dollars worth of financial assets in the world as at the end of 2010.

By the end of June 2012, this number had swelled to \$225 trillion, with the main areas of growth in the post-GFC world being the amount of debt issued by governments, as you can see on the chart below:

Exhibit 1

Global financial assets have grown to \$225 trillion, but growth has slowed since 2007.



¹End-of-year figures for a sample of 183 countries, based on constant 2011 exchange rates. Figures may not sum to totals, because of rounding.

²Compound annual growth rate.

Source: McKinsey Global Institute analysis

[Source: Mckinsey Global Institute](#)

Over a year later, with equity markets up around 20% around the world in the past 12 months, and with trillions more in sovereign debt issued in the meantime, there's a good chance the number is closer to \$230 trillion today.

That's a lot of money!

How about the value of all the gold in the world?

According to our good friend Ronald Stoeferle over at Incrementum AG, there are currently 173,900 tonnes of known gold in existence.

I'll round this up to 175,000 tonnes for the purpose of working out the value of all the gold in the world.

With this in mind, the total value of all the gold in the world today is a mere \$7.46 trillion dollars, based on the London PM Fix price of USD \$1,326.50 as at the 30th September 2013.

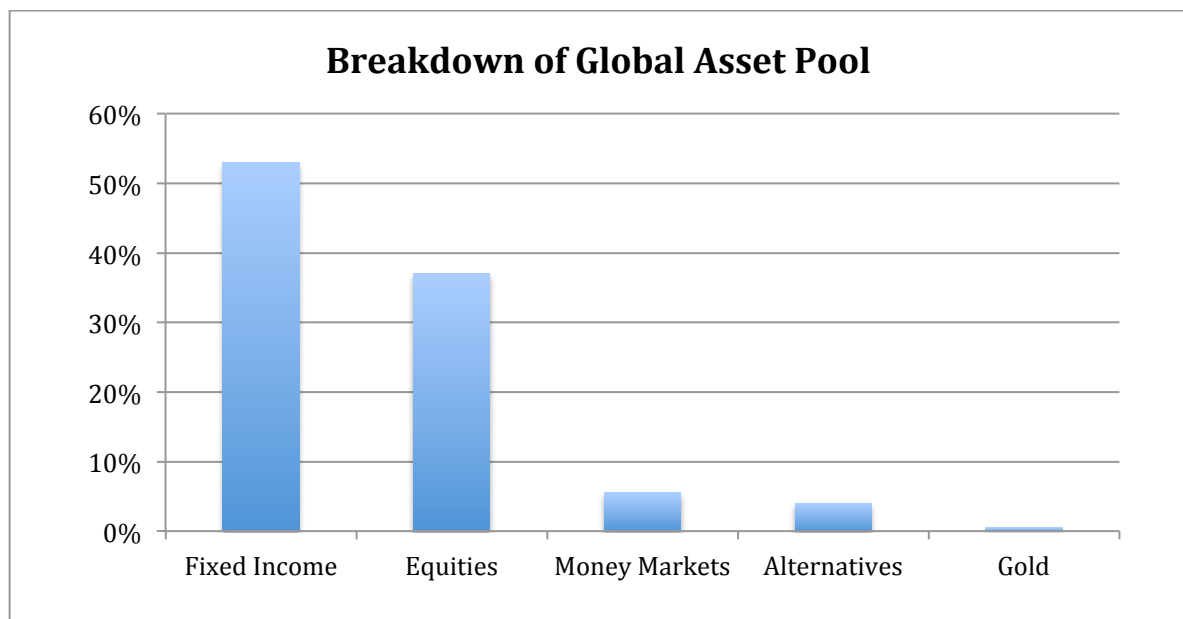
That number represents a mere 3.3% of the \$225 trillion in funds sloshing around the financial marketplace at this present time.

Metric	Value
Tonnes of gold in existence	175,000 tonnes
Ounces per tonne	32,150 ounces
Value per ounce	USD \$1326.50
Value per tonne	\$42,646,975
Total value of all gold	\$7.46 trillion
Pool of financial assets	\$225 trillion
Percentage of gold to financial assets	3.3%

But of course, whilst in theory all of this \$7.46 trillion of gold could be brought to the market to be sold, in reality much of it will never come back to market.

With this in mind, when we look at the pool of investable gold (privately held gold bullion and official sector holdings), we see that in reality, there is only a couple of trillion dollars worth of gold around, at today's prices anyhow.

When we compare that to the amount of money invested in the fixed income, equity and money markets, we come up with a global financial asset breakdown that looks like this.



How can there be a bubble in precious metals today if for every \$100 of investment capital there is

- \$53 in bonds
- \$37 in equities
- \$9.50 in money market funds and alternatives
- **Only \$0.50 cents in gold?**

Essentially that means there is over \$99 of investment capital that can be re-allocated toward gold (putting upward pressure on prices), for every \$0.50 that can be re-allocated away from gold (putting downward pressure on prices).

When you consider that, in the case of equities and bonds, (where the lion's share of capital is concentrated), both of these markets are more or less at all-time highs (or very close to them) on an almost global basis.

Furthermore, both of these asset markets offer what are historically paltry yields and are critically exposed to risks from, amongst other things, inflation, money printing, continued economic weakness and geopolitical uncertainty.

On the other hand, gold, and precious metals in general are on almost any historical metric extremely undervalued, and offer considerable upside potential.

With that in mind, whilst daily volatility in precious metals will continue, and some continued short-term weakness can't be ruled out, on a medium- to long-term basis it's highly unlikely that we're going to see money move out of gold and into these already bloated markets. In all likelihood, it will be the other way around, with money moving towards gold and precious metal-related investments.

And when you consider the fixity of supply, even if the rotation towards precious metals only represents 5 or 10% of the world's investable capital, it will lead to a surge in prices that will live in the history books.

A lot of smart money is positioned for this exact event.

Final comments

From an investment perspective, there's no money to be made merely knowing where the money is today, and what worked yesterday.

The money is made by working out where capital is going to flow to next.

Getting ahead of the curve in terms of positioning capital into precious metals has already been very profitable in the last 10 years, despite the volatility and corrections experienced along the way.

There is no good reason to expect the next few years to be any different, and it's one of the major reasons I'll continue to treat any corrections in precious metals as an opportunity to buy in cheap, both personally and with my self-managed super fund.

There will come a day when gold is expensive relative to traditional assets, and when the macro-economic environment no longer justifies such a high allocation to precious metals.

And when that day comes, there's no doubt some of the following things will be visible or in place:

- A cessation of quantitative easing measures enacted by central banks the world over
- A normalisation of interest rates, where savings in a bank account can earn at least 2-3% real returns after inflation
- A more stable geopolitical and economic environment
- Much lower valuations on traditional assets (equities/bonds/property) and commensurately higher yields in these investments
- Gold at significantly higher prices in real terms and relative to traditional assets
- An overwhelmingly bullish mainstream media consensus towards gold
- A plethora of new bullion dealers/mining companies and 'gold analysts' and 'experts' appearing in the media

Whilst I have no doubt we'll see that environment at some point in the future, clearly, that day is not today, and in all likelihood, we won't see it for a long time.

Until next quarter, wishing you every investing success,



Jordan Eliseo
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