

# Thoughts on Gold and Resources

## The Forbes Manhattan Conference

Dr. Martin Murenbeeld  
November 4, 2010



### Overview

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- 1. Gold bullion is in a long-term bull market***
- 2. Resources will continue to benefit from Asian demand for years to come***



## **Gold in a Bull Market**

### **Nine bullish arguments:**

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1. **Global fiscal and monetary reflation: PIIGS, US, etc.**
2. **Global imbalances: the dollar must decline**
3. **Global FX reserves are “excessive”: diversification**
4. **Central bank attitudes to gold: now positive**
5. **Gold is not in a bubble: room to rise**
6. **Mine supply is flat: “peak” gold?**
7. **Investment demand: long-run uptrend**
8. **Commodity price cycle: many years to run**
9. **Geopolitical environment: positive**

2

## **Bullish: (1) Global Reflation**

### **Antecedents of the (PIIGS) Sovereign Debt Crisis:**

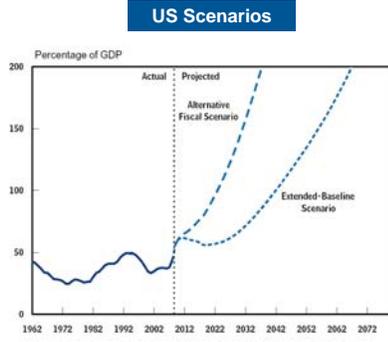
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1. **Baby-Boomer Retirements: The fiscal stresses this would cause was visible years ago**
2. **The Great Recession: Pushed budgets into record deficit – just when the early boomers are about to retire**
3. **The Euro Common Currency: Membership in the Euro System allowed interest rates to “converge” - and “undisciplined” governments to borrow excessively**

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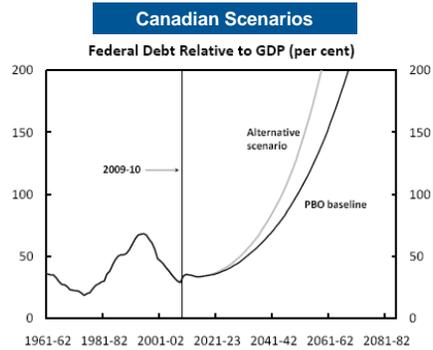
## Bullish: (1) Global Reflation

The baby-boomers are about to retire ...



Source: Congressional Budget Office, November 6<sup>th</sup> presentation by Director Elmendorf

Slides: Federal Debt Under CBO's Long-Term Budget Scenario



Source: Office of Parliamentary Budget Officer

"Fiscal Sustainability Report", Feb 18, 2010

### Policy Options:

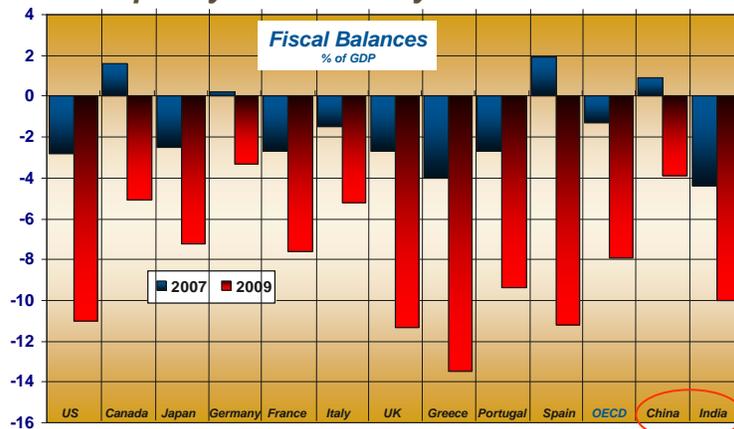
- Increase retirement age
- Decrease payment per service
- Increase tax rates for services
- Decrease benefits
- Decrease number of services
- Institute new taxes (VAT?)

4

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## Bullish: (1) Global Reflation

Fiscal policy blown out by "Great Recession"



Source: OECD, IMF

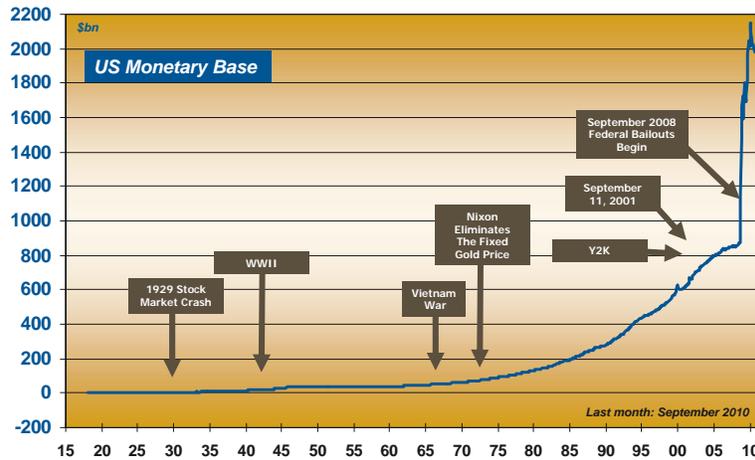
**THEY ARE ALL PIGS!**

5

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## **Bullish: (1) Global Reflation**

*Monetary policy blown up by "Great Recession"*



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## **Bullish: (1) Global Reflation**

*So how will governments handle their debts?*

### **Government Choices:**

*Renege on promises*

*Cut other services*

*Raise taxes*

*Print more money?*

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## Bullish: (1) Global Reflation

Money drives gold ...



8

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## Bullish: (1) Global Reflation

Gold rises and falls with liquidity

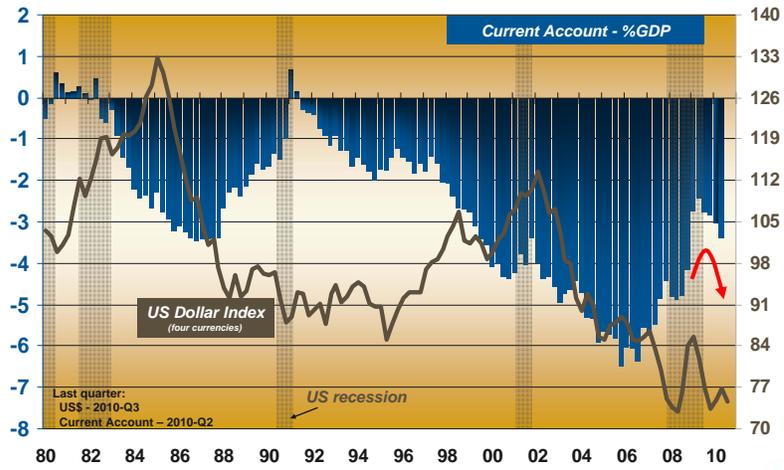


9

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## Bullish: (2) Global Imbalances

The US current account deficit is rising again

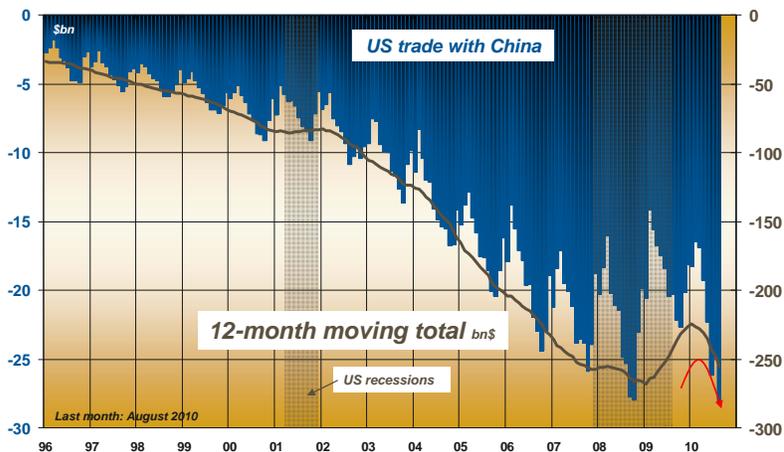


10

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## Bullish: (2) Global Imbalances

The US trade deficit with China is unsustainable

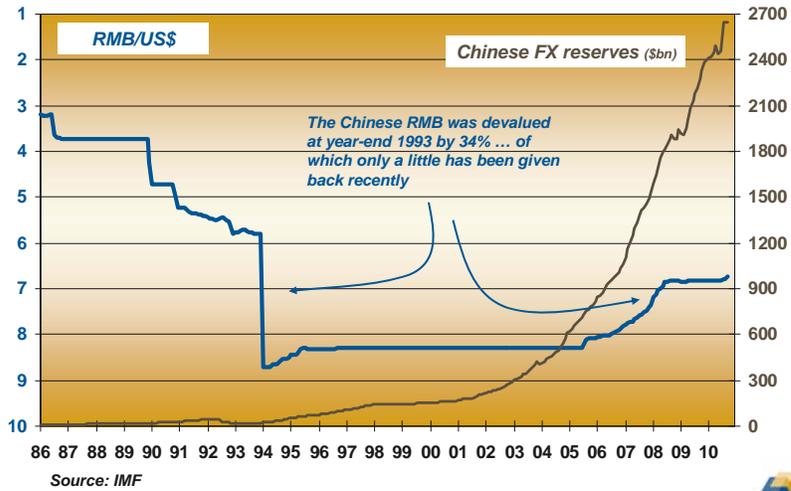


11

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## Bullish: (2) Global Imbalances

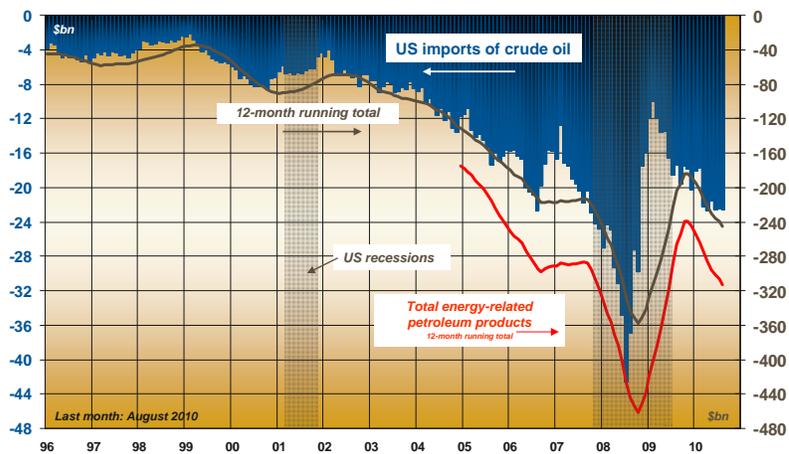
### China must revalue; reserves are excessive!



12

## Bullish: (2) Global Imbalances

### US energy deficit bleeds dollars on world markets



13

## Bullish: (2) Global Imbalances

The Obama Administration wants the dollar down

**“We can’t go back to the era where the Chinese or the Germans or other countries just are selling everything to us, we’re taking out a bunch of credit card debt or home equity loans, but we’re not selling anything to them”**

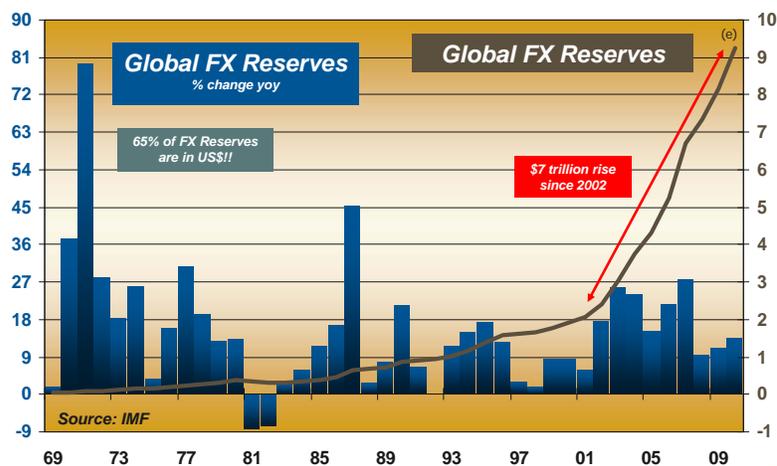
President Obama on CNN in run-up to the G-20 Meeting in Pittsburgh, Sep 2009

**So now we have “currency wars”!**

14

## Bullish: (3) Global Reserves

Foreign exchange reserves have exploded\*



\* Most are held by emerging country central banks

15

**Bullish: (3) Global Reserves**  
*Global reserves are “excessive”*

Foreign Exchange Reserves (countries over \$100 bn)			
	bn\$		bn\$
China	2648.3	India	256.2
Japan	1015.1	Brazil	254.1
Russia	436.6	Switzerland	202.4
Saudi Arabia	422.4	Thailand	149.3
Taiwan	372.1	Algeria	146.2
Korea	281.4	Mexico	106.1
Hong Kong	260.6		
		<b>TOTAL</b>	<b>6550.9</b>

*Addendum: Fuel Exporters \$1350.5bn*  
*Source: IMF - data through August 2010*

16

**Bullish: (3) Global Reserves**  
*Diversification out of \$'s in FX reserves likely*

*The choices for a central bank are limited:*

1. **Other currencies**
  - *These currencies must have deep international capital markets - some do not: renminbi, ruble: some do: yen, pound, euro (but is euro now suspect?)*
2. **SDR's issued by the IMF**
  - *The SDR is a basket currency that includes only the dollar, yen, pound, and euro - it has limited use outside of central bank markets*
3. **Gold, other “hard” assets, mining investments**
  - *But gold market is “narrow” and China likes commodity-producing assets*

17

## ***Bullish: (4) Central Bank Attitudes***

*Central bank attitudes towards gold have changed*

- 1. CBGA signatories are selling less gold (not selling at all)***
- 2. China raised its gold reserves from 600 to 1054 tonnes***
- 3. India bought 200 tonnes of IMF gold***
- 4. Russia and India have suggested a new SDR basket should include gold***

18

## ***Bullish: (5) Gold Not in a Bubble***

*Gold looks like it is in bubble ...*



19

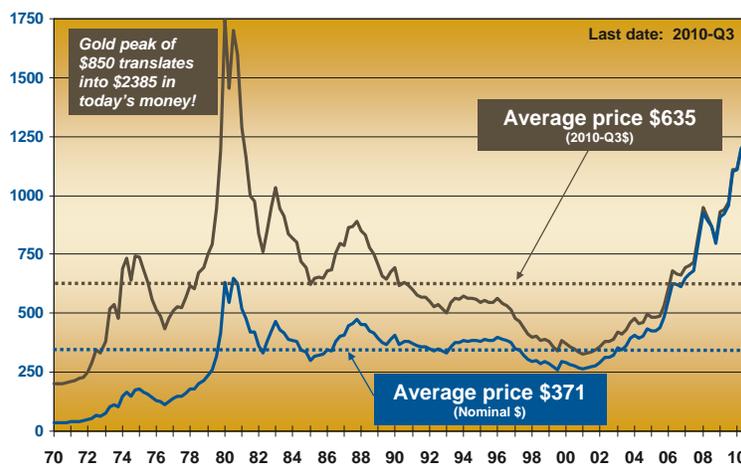
## Bullish: (5) Gold Not in a Bubble ... but that may be a function of perspective



20

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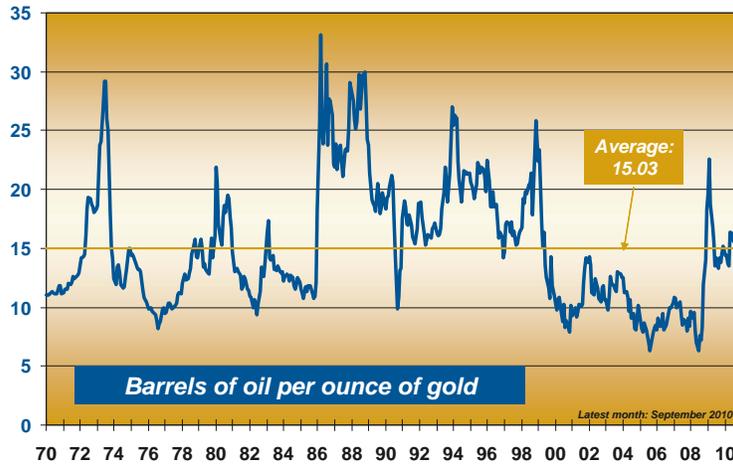
## Bullish: (5) Gold Not in a Bubble It is not in a bubble in constant Dollars



21

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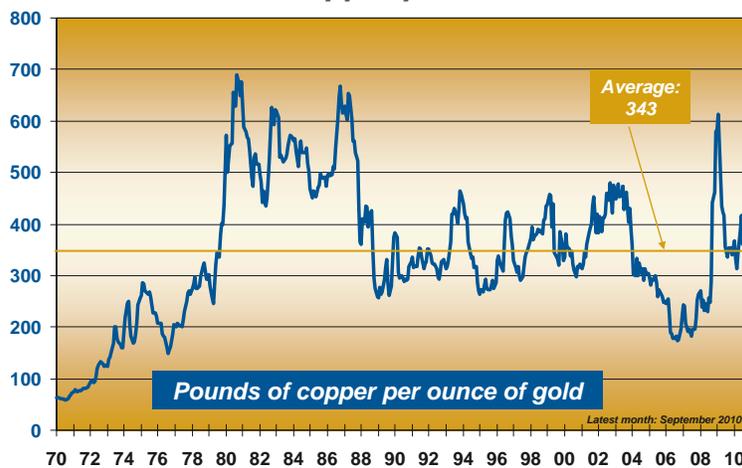
### **Bullish: (5) Gold Not in a Bubble** **Not in terms of oil prices**



22

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### **Bullish: (5) Gold Not in a Bubble** **Not in terms of copper prices**

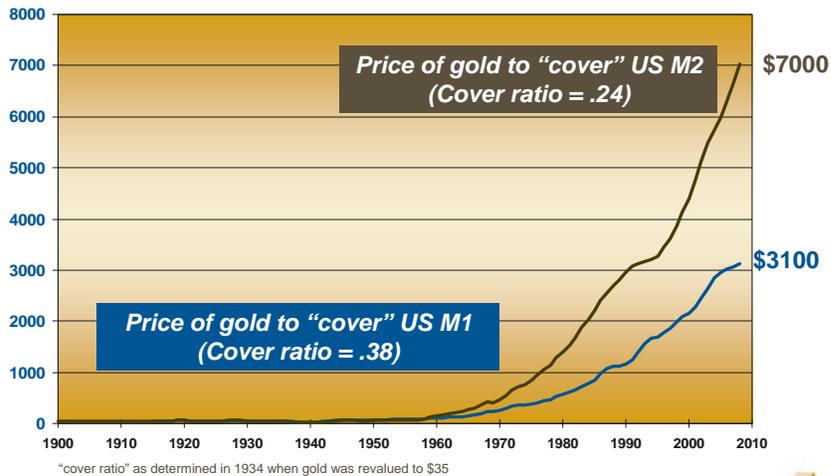


23

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## Bullish: (5) Gold Not in a Bubble

Not if US gold had to "cover" US money supply

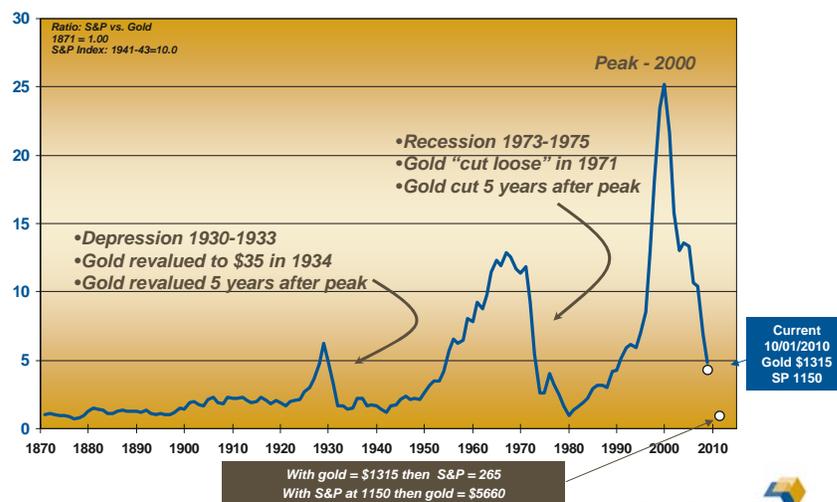


24

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## Bullish: (5) Gold Not in a Bubble

Gold still "cheap" In terms of financial assets



25

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## Bullish: (5) Gold Not in a Bubble

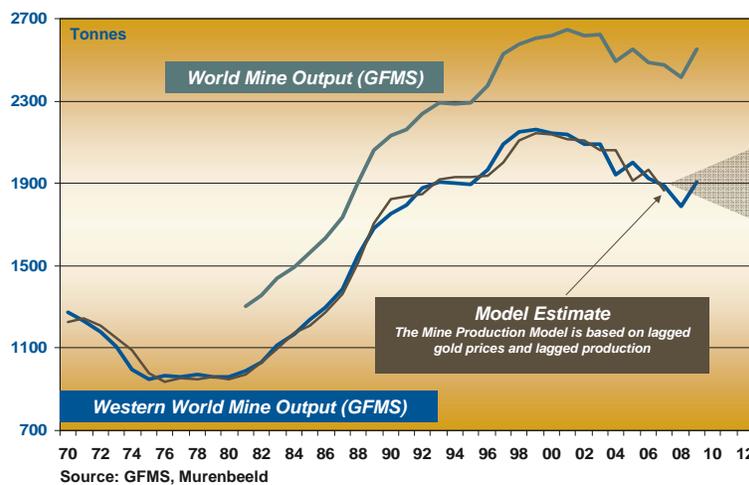
*It may one day be – but that day is not now*



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## Bullish: (6) Gold Supply

*Model suggests WW mine flat*



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## **Bullish: (6) Gold Supply**

*The general commodity supply outlook is impaired*

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1. **Difficult governments: i.e., Venezuela**
2. **Governments are in debt: i.e., Australia has introduced a “resource super-profits tax” ...**
3. **Environmental hurdles: i.e., the Gulf of Mexico disaster changes the future for off-shore drilling**
4. **“Peak” gold, “peak” oil, peak ... : The low-hanging fruit has been picked ...**

28

## **Bullish: (7) Investment Demand**

*Can we make a case for investment demand?*

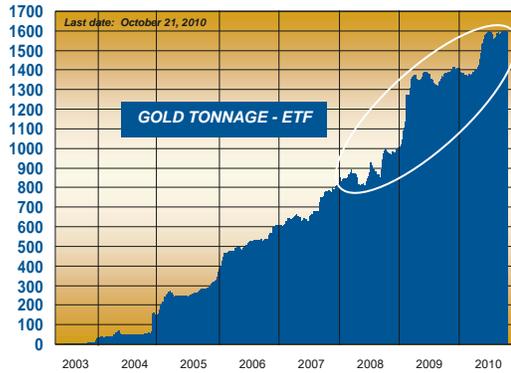
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1. **Central banks are rediscovering that gold is not another central bank’s liability (i.e., China holds US Federal Reserve liabilities!)**
2. **The private sector is beginning to worry about the nature of fiat currencies and the likelihood of currency debasement**
3. **The private sector is also discovering that gold has attractive portfolio characteristics (gold improves the “efficient frontier”)**
4. **Commodities in general, and gold specifically, are morphing into an “investment asset class” (like real estate did once it became securitized)**
5. **Jewelry demand wasn’t always the dominant demand in the gold market; private and central bank demand was historically more dominant**
6. **Major deregulation of Asian gold markets encourages people with an affinity for gold to invest in gold (and jewelry in many parts of the world is seen to be investment as well as adornment demand)**

29

**Bullish: (7) Investment Demand**  
*The gold ETF rising strongly since introduction*

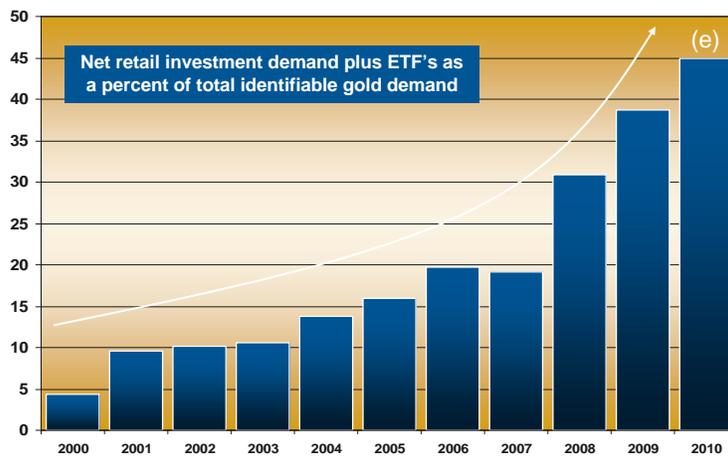
- **ETF demand has been very strong during this period of financial stress**



30

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**Bullish: (7) Investment Demand**  
*Retail investment plus ETF demand rising*



Source: World Gold Council "Gold Demand Trends"  
 Based on data tabulated by GFMS  
 2010 estimate by DundeeWealth Economics

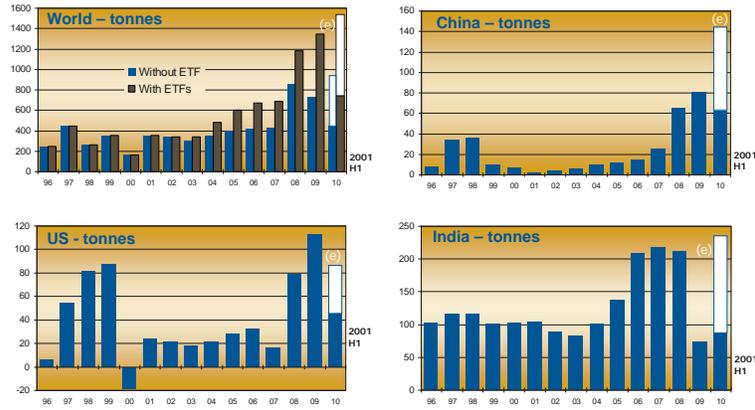
31

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## Bullish: (7) Investment Demand

### Retail investment demand will grow in Asia

Net Retail Investment Demand (excluding ETF's)



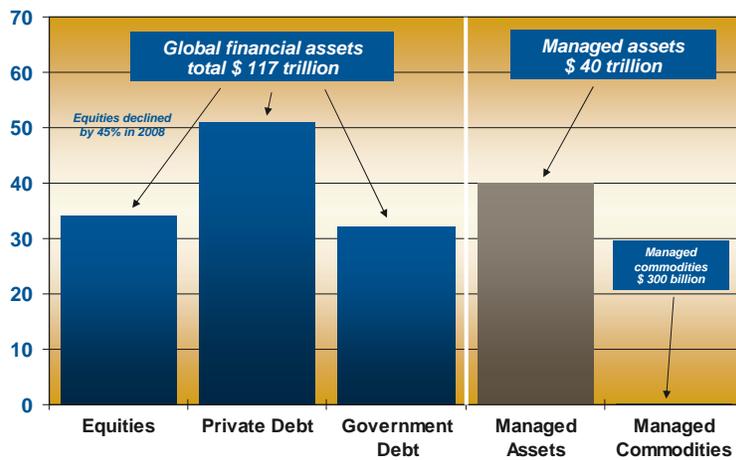
Source: World Gold Council, GFMS  
Estimates by DundeeWealth Economics

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32

## Bullish: (7) Investment Demand

### Investment demand in gold/commodities will grow



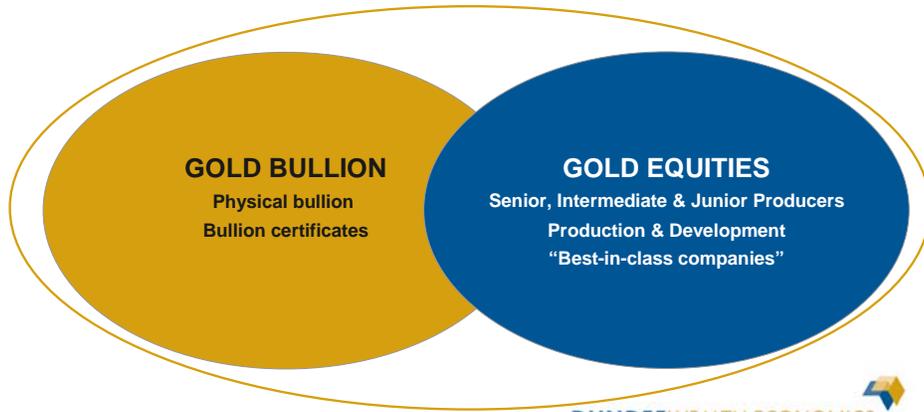
Source: McKinsey & Company, IMF, Barclay's  
Estimates are for 2008

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33

## **Bullish: (7) Investment Demand** *Gold investment products more sophisticated*

### *The Dynamic Strategic Gold Fund*



34

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## **Bullish: (9) Geopolitical** *The biggest geopolitical crisis to date ...*



35

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## Outlook: Six Bearish Arguments

1. **Policy “exit strategies”:** in US, Asia, Europe
2. **Strong dollar:** against the euro ...
3. **Deflation:** government debt more attractive
4. **Liquidity of last resort:** for Greece, Italy, ...
5. **Dehedging finished:** hedging to recommence
6. **Chinese recession:** commodity demand will decline

36

## Bearish: (1) Exit Strategies

Real rates will rise with “exit strategies”



37

## **Bearish: (1) Exit Strategies**

*fiscal policies must be tightened*

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### Assuming central banks do not “print money”:

1. *Tighter fiscal policies will be a drag on economic growth*
2. *Inflation pressures will remain subdued, and the threat of deflation will linger*
3. *Confidence in monetary policy (and fiscal policy) will improve*
4. *Which all will weigh heavily on the gold price*

38

## **Bearish: (4) Liquidity of Last Resort**

*The PIIGS need cash!*

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- *The PIIGS hold over 3000 tonnes of gold*
- *We have been concerned about Italy for years*
- *But Greece, Portugal, and Spain might be the first to sell – were it to come to that*

Gold Reserves	
	tonnes
Greece	112
Ireland	6
Iceland	2
Italy	2452
Portugal	383
Spain	281
Total	3236

39

## **Bearish: (6) A Chinese Recession**

### **Commodity demand could tumble**

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1. *China's growth rate will decline (a recession is <6%)*
2. *Investment cools - money could leave China*
3. *World equity markets sell off – some very sharply*
4. *A flight to safety will almost certainly favor US Treasuries*
5. *Chinese gold demand will suffer*

#### **But policy will respond ...**

1. *The PBoC will likely “print money”, and the government will expand fiscal policy*
2. *Other Asian central banks will want to insulate their economies, and print/devalue*
3. *Which could eventually see gold demand rise to new highs*

40

## **The October 2010 Forecast\***

*We are bullish – Scenario A is given low probability*

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### **Gold Price Scenarios**

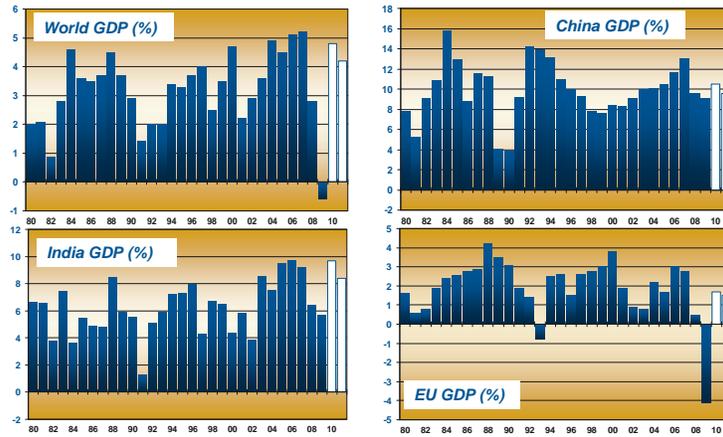
	<u>2010-avg</u>	<u>2010-end</u>	<u>2011-avg</u>
<b>Scenario A:</b> p.=.10%	<b>\$1187</b>	<b>\$1215</b>	<b>\$1074</b>
<b>Scenario B:</b> p.=.45%	<b>\$1217</b>	<b>\$1340</b>	<b>\$1398</b>
<b>Scenario C:</b> p.=.45%	<b>\$1237</b>	<b>\$1420</b>	<b>\$1559</b>
<b>Weighted:</b>	<b>\$1223</b>	<b>\$1365</b>	<b>\$1438</b>

\* Forecasts are updated quarterly

41

## Commodity/Resources

The IMF forecasts a moderate global recovery ...



Source: IMF, October 2010

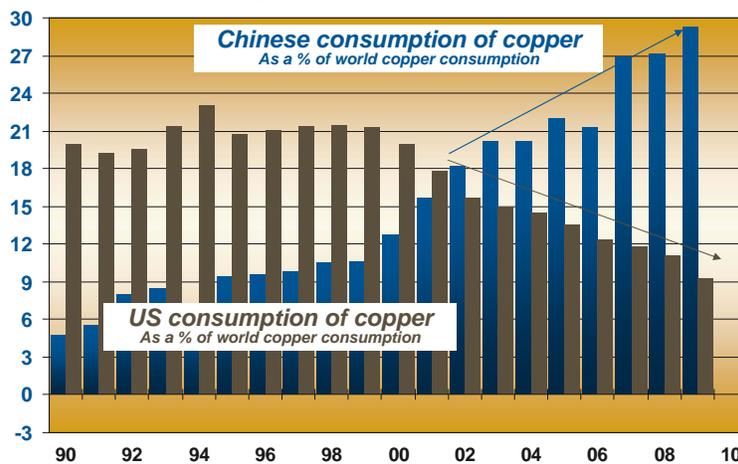
42

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## Commodity/Resources

China has a major impact on commodities



Source: World Metals Bureau

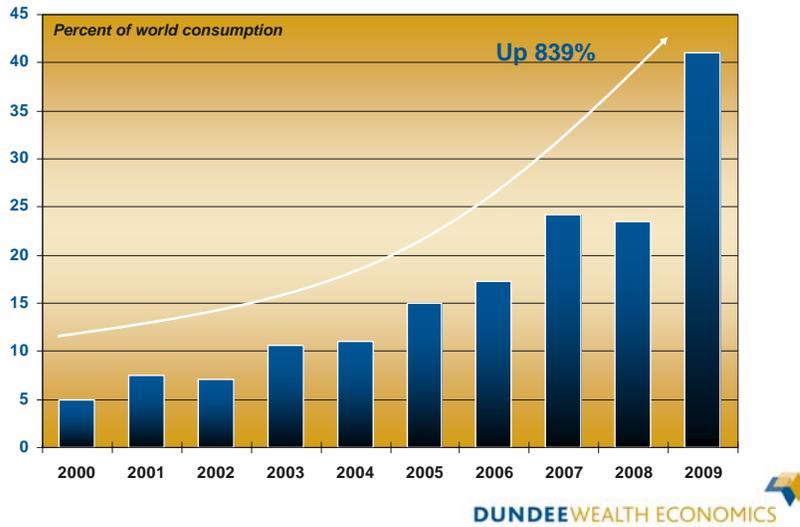
43

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## Commodity/Resources

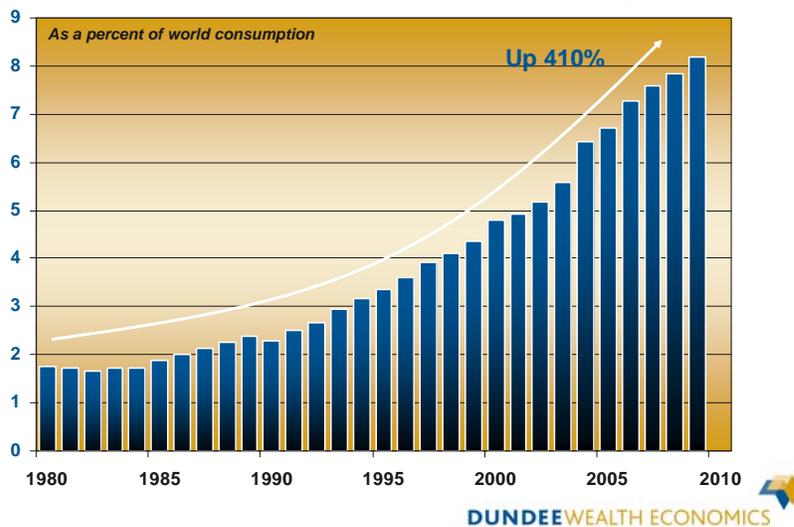
*China's oil consumption has risen dramatically*



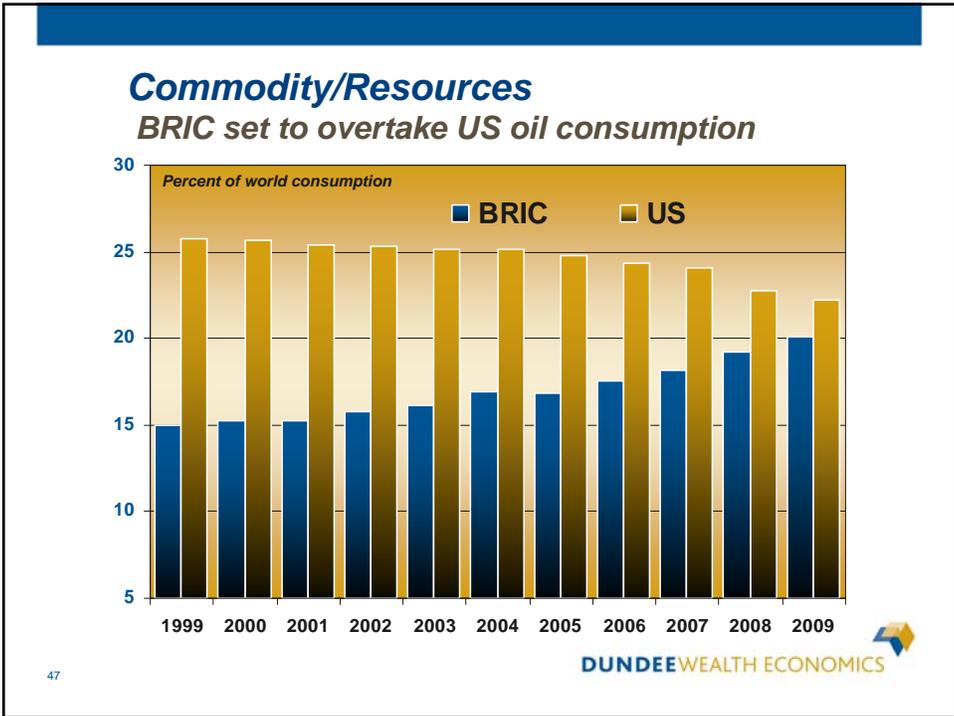
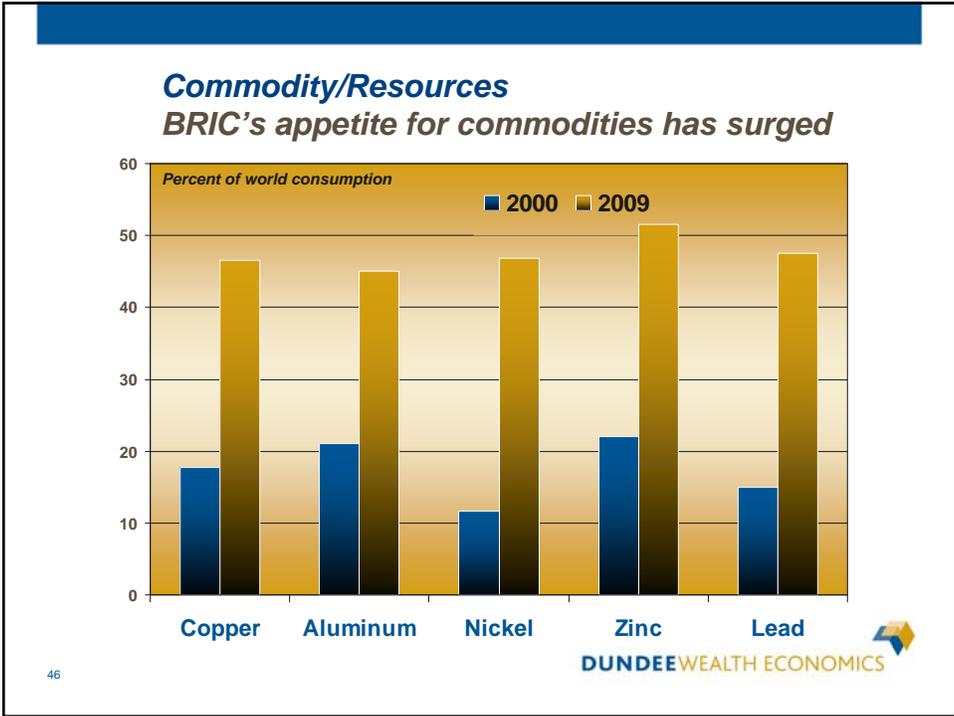
44

## Commodity/Resources

*China's nickel consumption has risen significantly*

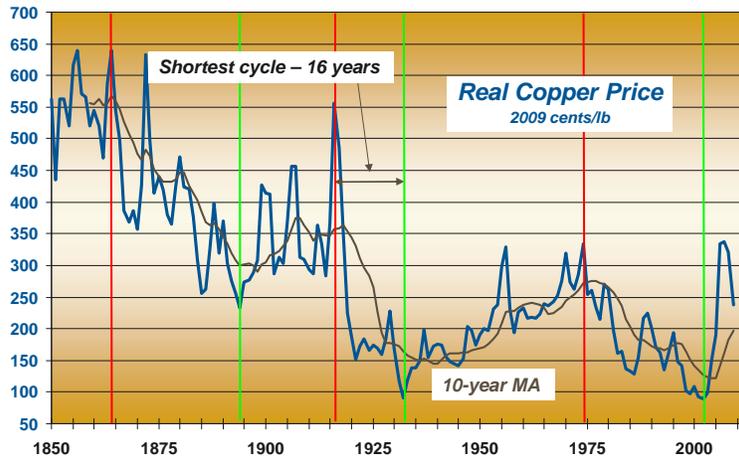


45



## Commodity/Resources

All commodities exhibit long cycles ...\*



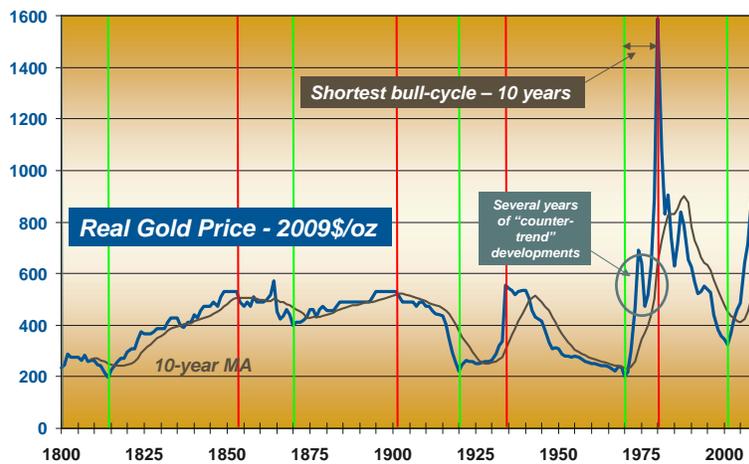
\*despite reversals, which are common in all cycles

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48

## Commodity/Resources

Including gold – which has had no reversal to date



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49

## **Commodity/Resources**

*In short, the demand side of market has exploded*

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1. **Commodity prices have been driven higher by fundamental structural changes in the global economy**
2. **Which suggests that the long-cycle is intact and will continue for many years**
3. **Some short-term price weakness is of course possible as China's economic growth decelerates to more normal and sustainable levels (8%-9%) and demand in OECD remains subdued.**

50

## **Last Thought**

**Boomers create asset bubbles ...**

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**Boomers have rotated through three assets:**

**Equities – Saving, Pension Assets**

*This asset bubble exploded in 2000-2001*

**Real Estate – Family Home, Recreational Property**

*This asset bubble exploded in 2007-2008*

**Debt Instruments – Retirement Income**

*This asset bubble exploded in 2011-2012 ??*

**After debt?**

**Resources and Gold – the emerging asset class?**

51

*Thank you for your attention*

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