

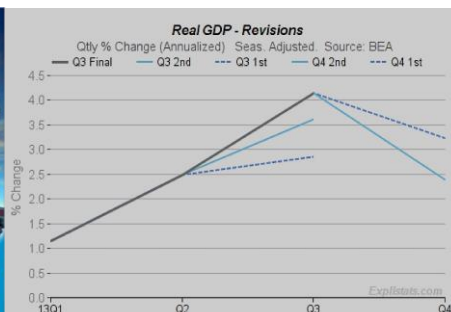
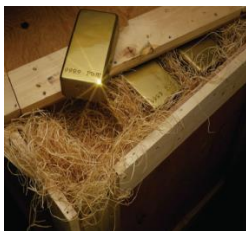
# Physical gold update (\$1,381.50 per Troy ounce, March 14<sup>th</sup>, 2014)

Gold only monetary reserve precious metal, thus driven by "store of value" considerations

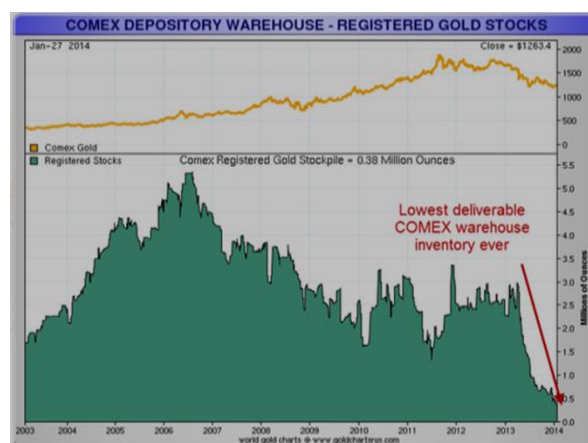
March 2014

The same value of gold can be stored in roughly 3% the space which silver would require

Fed Chairwoman Yellen: "Fed May Pause Tapering if Weakness Persists" 2/27/14



Source: CS



Sources: www.goldchartsrus.com, www.caseyresearch.com

## Tactical reasons supporting physical gold purchases (at current gold price level):

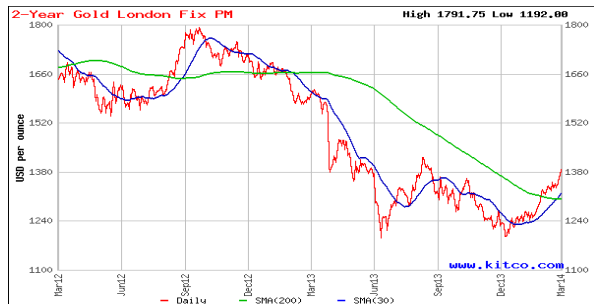
- The fabricated notion of an accelerating economic recovery is being displaced by numerous downside restatements of recent economic activity (see chart above) and by recent reports of broad-based macroeconomic weakness such as anemic real retail sales, an inventory reduction-based decline in industrial production, frequent below expectations monthly payroll growth, over 1m fewer Americans working today than six years ago, and a labor participation rate and real household income at or near 40-year lows. Moreover, the economic fallout associated with both last year's stout tax increases and the Obamacare rollout continues. This opens the door to increased monthly QE: "The Fed may pause tapering if economic weakness persists," said Janet Yellen. Currency debasement boosts the gold price; gold is a monetary reserve. (Sources: BEA, BLS, Fed, CBO, Census, Forbes, WSJ, Hoisington Management, SGS)
- Short sellers have been selling gold without the requisite deliverable physical inventory for much of the past year. Should the gold price continue to firm, this could result in a short squeeze at some point.
- COMEX deliverable gold inventory was recently at a historical low, pointing to additional supply constraints, should physical gold demand increase:

- Global physical gold demand remains robust; Chinese and Indian gold coin sales broke records in 2013 and jewelry demand, roughly 50% of total gold demand in metric ton terms, grew by 12.6% with strong indications carrying into 2014, especially in the population-dominating Asian re-emerging markets. (<http://finance.townhall.com/columnists/peterschiff/2014/03/07/gold-scams-revisited-n1805396>, [www.investing.com/analysis/china%E2%80%99s-physical-gold-demand-surges-204820](http://www.investing.com/analysis/china%E2%80%99s-physical-gold-demand-surges-204820); [www.cnbc.com/id/101394113#](http://www.cnbc.com/id/101394113#); [www.reuters.com/article/2014/02/14/newcrest-earnings-gold-idUSL3N0LJ16Y20140214](http://www.reuters.com/article/2014/02/14/newcrest-earnings-gold-idUSL3N0LJ16Y20140214); [www.zerohedge.com/news/2014-01-25/ft-goes-there-demand-physical-gold-one-day-paper-price-manipulation-will-end-catastrophe](http://www.zerohedge.com/news/2014-01-25/ft-goes-there-demand-physical-gold-one-day-paper-price-manipulation-will-end-catastrophe); [www.gold.org/investment/statistics/demand\\_and\\_supply\\_statistics/](http://www.gold.org/investment/statistics/demand_and_supply_statistics/))
- Physical gold remains a very tight market in which demand has exceeded mined supply by 42% over the past two years and by 23% last year. (GFMS)
- Gold is an allocation minnow. In 2013 gold demand was 3,756 metric tons, valued at \$170bn; contrast this \$170bn with the average growth in the value of global financial assets (various forms of debt and equity) of over \$9trn p.a. between 2000 and Q2:2012. Furthermore, consider that less than 0.8% of global financial assets of over \$225trn are allocated in physical gold – a sudden shift towards greater gold exposure could push gold prices materially higher given supply limitations; going from 0.8% to 1.6% would imply sourcing 31,000 tons of additional gold or 11 years of production at current rates!

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([http://www.gold.org/investment/statistics/demand\\_and\\_supply\\_statistics/](http://www.gold.org/investment/statistics/demand_and_supply_statistics/);  
[www.mckinsey.com/insights/global\\_capital\\_markets/financial\\_globalization](http://www.mckinsey.com/insights/global_capital_markets/financial_globalization))

- Chart technicians, who consider more expensive assets more desirable, especially once they have crossed key moving average lines, may also continue to become more gold price bullish:



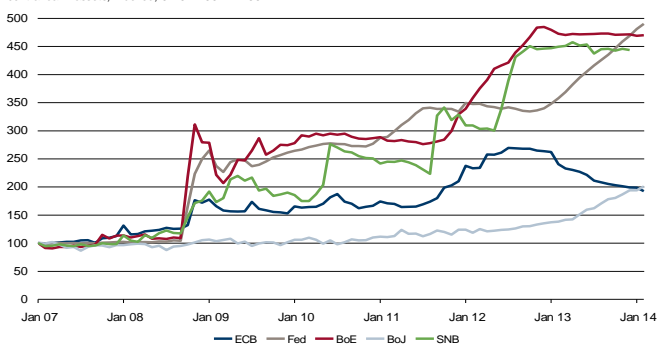
[http://www.kitco.com/charts/techcharts\\_gold.html](http://www.kitco.com/charts/techcharts_gold.html)

- If **even** arguably “massaged with a positive bias” macroeconomic releases -- from monthly job formation to real GDP growth -- are frequently revised downward, indicating material economic weakness, then monetary asset gold could be a beneficiary of an allocation shift away from stocks.
- Historically speaking, we are overdue for a recession some 4.5 years into an extraordinarily artificially stimulated -- both from fiscal and monetary policy perspectives -- recovery. Upshot: another belated (like in 2008) rotation out of the stock market, which thanks to QE is arguably no longer a good leading indicator, could lead to reallocations not only into Treasuries, but also into relatively thinly traded physical gold.

### Strategic reasons supporting physical gold purchases:

- “Next to language, money is the most important medium through which modern societies communicate” Bernd Widdig, author of “Culture and Inflation in Weimar Germany”

central bank assets, indexed, 01.01.2007 = 100



Sources: Datastream, CS

- The federal government has suspended the federal debt ceiling. This clearly suggests even less federal spending discipline -- with clear “QE implications” -- and potentially even bigger future deficits than the \$1.2trn plus federal deficit average of the past five years. (FY2013’s “un-gimmicked” cash deficit was approximately \$1.06trn, as corroborated by a Treasury release on October 17, 2013 that gross federal debt rose by \$300bn in one day, by the implied yoy increase in the gross federal debt of \$1.01trn, and by a \$40bn yoy

drawdown in federal government cash balances.)

(<http://research.stlouisfed.org/fred2/series/FYFSD>; [www.shadowstats.com](http://www.shadowstats.com), 11/27/13)

- The rollout of Obamacare and all its affordability, coverage, and administrative issues -- multiple executive branch-based, politically-driven, arguably unconstitutional waivers notwithstanding -- will likely continue to suppress both full-time job creation and capital spending in the vital small business segment, the wellspring of national payroll growth. This points to sustained weakness in private sector employment and thus national income accounts -- and, by extension, in federal tax receipts. QE-dependency, revisited.

([www.cbo.gov/publication/45050#](http://www.cbo.gov/publication/45050#); [www.cnsnews.com/commentary/hansbader/trillion-dollars-and-two-million-jobs-lost-obamacare-increases-deficit-after](http://www.cnsnews.com/commentary/hansbader/trillion-dollars-and-two-million-jobs-lost-obamacare-increases-deficit-after))

- The recent increase in tax receipts was driven by materially higher marginal taxes on both income and capital. Same will inevitably result in less private sector economic activity and, by extension, lower federal income tax receipts. QE-dependency, revisited.

([www.hoisingtonmgt.com/pdf/HIM2012Q4NP.pdf](http://www.hoisingtonmgt.com/pdf/HIM2012Q4NP.pdf);  
[http://online.wsj.com/article/SB10001424127887324581504578231721868759336.html?mod=opinion\\_newsreel](http://online.wsj.com/article/SB10001424127887324581504578231721868759336.html?mod=opinion_newsreel); [www.wnd.com/2012/12/the-depardieu-revolution](http://www.wnd.com/2012/12/the-depardieu-revolution))

- Private sector job creation and economic vibrancy are not only being negatively impacted by Obamacare fallout and significantly higher marginal tax rates, but by sustained growth in regulatory complexity (over 6,400 new posted federal regulations filed in the last 90 days); by an ongoing reduction in the legitimacy of the Constitution, the rule of law, and the associated property rights; and by a free market-destructive surge in crony capitalism.

([www.regulations.gov/#?home;tab=search](http://www.regulations.gov/#?home;tab=search);  
[www.forbes.com/sites/peterferrara/2014/01/24/after-five-years-of-obamanomics-a-record-100-million-americans-not-working/](http://www.forbes.com/sites/peterferrara/2014/01/24/after-five-years-of-obamanomics-a-record-100-million-americans-not-working/);  
[www.forbes.com/sites/realspin/2013/11/19/obamas-disdain-for-the-constitution-means-we-risk-losing-our-republic/](http://www.forbes.com/sites/realspin/2013/11/19/obamas-disdain-for-the-constitution-means-we-risk-losing-our-republic/);  
<http://online.wsj.com/article/SB10001424127887323981504578177913940268102.html?KEYWORDS=America+as+rule+of+law+nation>;  
[www.forbes.com/sites/markhendrickson/2013/03/21/the-epa-the-worst-of-many-rogue-federal-agencies-part-ii/](http://www.forbes.com/sites/markhendrickson/2013/03/21/the-epa-the-worst-of-many-rogue-federal-agencies-part-ii/);  
<http://benswann.com/obama-administration-overrides-congress-by-giving-wyoming-town-over-to-indian-tribe/>;  
<http://finance.townhall.com/columnists/hunterlewis/2014/02/16/crony-capitalism-in-america-20082012-legal-predators-n1795686/page/full>;  
[www.zerohedge.com/news/2014-02-12/spot-average-federal-employee-salary](http://www.zerohedge.com/news/2014-02-12/spot-average-federal-employee-salary))

The “wealth of nations” corrosive effects of the above developments suggest not only continued lethargic nationwide payroll and investment growth, but increasing government welfare and healthcare outlays. The sustained shortfall in federal government receipts relative to outlays that should ensue will be exacerbated by an aging population wherein the bulging Baby Boom generation will continue to reach the age of 65 at the rate of 10,000 per day for the next 16 years. ([www.pewresearch.org/daily-number/baby-boomers-retire/#](http://www.pewresearch.org/daily-number/baby-boomers-retire/#))

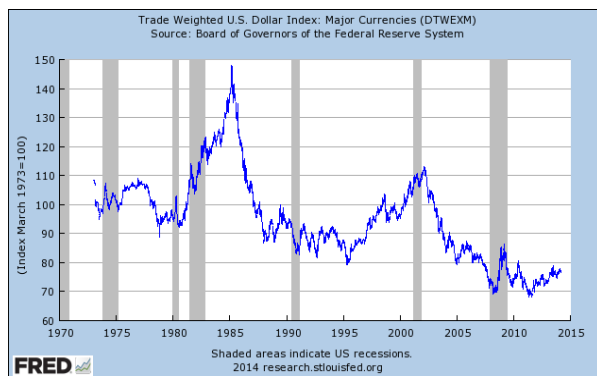
- The associated structural/secular increase in federal budget deficits, which could explode near term if a historically-speaking “overdue” recession hits, would not only continue to add to America’s already fiscally unsound \$17.5trn federal debt burden, but it would de facto force -- or enable -- the Fed to engage in even more QE, both to support the longer-duration balance sheets of its member banks and to continue to support the misguided Keynesian deficitary policy that has failed to generate even pedestrian economic growth ever since “hyper QE” was initiated in late 2008.

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## Global reasons supporting physical gold purchases:

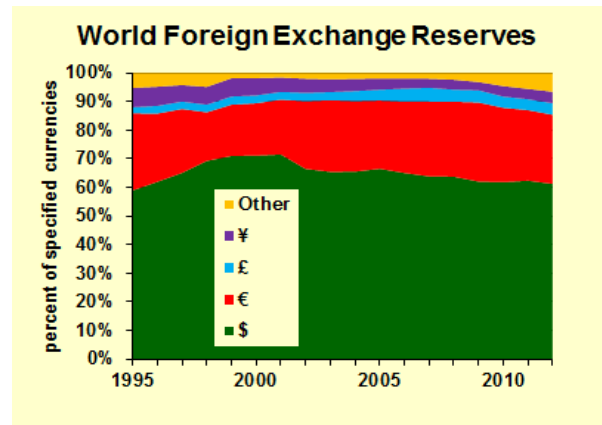
- Robust Asian demand. Asia is home to nearly 60% of the world's population; China and India together account for 38% of the world's population. Residents of those two "re-emerging" countries, which comprised over 45% of the world's GDP 191 years ago, still consider gold and silver to be money. The massive increase in per capita income experienced in Asia over the past 20 years has begun to translate into markedly stronger gold and silver purchases; this could continue to underpin gold demand. (University of Groningen, NL)
- Dollar valuation vulnerability. If the dollar's globally traded value were to suffer a sudden and sharp, demand erosion-based decline -- perhaps triggered by the Saudis shifting from exclusively accepting dollars for their oil exports to seeking payment in a basket of currencies (dollar, euro, yuan, yen) or possibly by increasing Chinese traction in establishing yuan-based bilateral trade deals or trade pacts with other nations -- then gold priced in USD could be a beneficiary of rising US inflation expectations. Such an unfortunate development amidst the ongoing erosion of the dollar's traditional "safe haven" status, America's intractably large trade deficits, and America's declining share of worldwide exports (from 12.4% in 1993 to 8.3% in 2011) could lead to sustained downward pressure on the dollar and upward pressure on the dollar value of gold.

(Datastream; /www.bloomberg.com/news/2013-03-26/china-brazil-sign-currency-swap-agreement-for-30-billion.html; www.financialsense.com/contributors/dan-collins/rise-petro-yuan; http://english.peopledaily.com.cn/g0778/8309983.html)



- "Dollar overexposure" risk. It is possible that foreigners collectively hold over \$16trn in cash/near cash, roughly the size of America's GDP. Foreigners held in excess of \$5.6trn of federal debt last summer alone, up from \$1trn in 2001. Much of this reflects America's accumulated current account deficit since 1985, which exceeds \$8trn. Moreover, last year the Fed's QE of \$1.04trn eclipsed the net funding requirements of the US Treasury; there are indications that a material portion of the Fed's balance sheet expansion is continuing to land on foreign money center banks' balance sheets, of course virtually for free given an effective Fed Funds Rate of zero. Should foreigners' incentives or propensity to hold such a large amount of dollars erode, this could trigger sizable dollar sales/flights into home currencies/other currencies. Same could drive down the trade-weighted

value of the dollar sharply and, by extension, push up American import prices/inflation and USD-based gold prices. This risk is elevated by the sheer size of dollar-based foreign reserve currency holdings -- approximately 60% of the major currencies, based on a late 2013 Forbes chart:



<http://research.stlouisfed.org/fred2/graph/?s%5b1%5d%5bid%5d=FDHBFIN;>  
[http://research.stlouisfed.org/fred2/graph/?s\[1\]\[id\]=FEDFUNDS;](http://research.stlouisfed.org/fred2/graph/?s[1][id]=FEDFUNDS;)  
[http://research.stlouisfed.org/fred2/series/BASE/downloaddata;](http://research.stlouisfed.org/fred2/series/BASE/downloaddata) www.bea.gov/  
 www.shadowstats.com; [http://strategicinvestment.com/;](http://strategicinvestment.com/)  
[www.forbes.com/sites/charleskadlec/2012/02/06/the-federal-reserves-explicit-goal-devalue-the-dollar-33/](http://www.forbes.com/sites/charleskadlec/2012/02/06/the-federal-reserves-explicit-goal-devalue-the-dollar-33/)

## Gold price bullish wild cards (speculative issues):

- Does America really have gold reserves totaling 8,133 metric tons? In late 2012 Germany, the world's second biggest official gold owner, wanted to audit its gold reserves at the Fed. The Germans were denied access! Thus in January 2013 Germany's Bundesbank announced that it would repatriate 300 metric tons out of the 1,536 metric tons Germany has with the NY Fed. The Fed said: "in seven years." Why seven years to repatriate less than 20% of Germany's gold domiciled on American soil? As per year end 2013, a Bundesbank spokesman reported that only five tons had been transported from NYC to Germany. Upshot: gold may prove less accessible, more hidden, and thus scarcer than commonly perceived, which bodes well for gold prices.

(www.finanzen.net/nachricht/rohstoffe/2014-mehr-Goldtransporte-Bundesbank-will-mehr-Gold-aus-New-York-zurueckholen-3310440;  
[http://www.globalresearch.ca/u-s-dollar-collapse-where-is-germanys-gold/5321894;](http://www.globalresearch.ca/u-s-dollar-collapse-where-is-germanys-gold/5321894) <http://www.zerohedge.com/news/2014-01-19/germany-has-recovered-paltry-5-tons-gold-ny-fed-after-one-year>)

- Very robust Chinese gold demand. China last reported its gold reserves -- 1,054 metric tons -- in 2009; in 2013 a PBOC staffer reported that Chinese reserves had not changed materially since 2009. Yet China is the largest gold miner in the world (an estimated 437 metric tons were extracted in 2013; the government purportedly purchases all domestic mine production). Plus, China continues to import far more gold than any other country -- 1,158 metric tons last year, or 39% of all mined gold in 2013, which totaled 2,969 metric tons. Implication: stouter than reported strategic Chinese "official sector" gold purchases appear to be

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moving gold from weak to strong hands, boding well for long-term gold prices. (GFMS)

- Meanwhile, Chinese public gold demand, based on statistics issued by the Shanghai Gold Exchange and the Hong Kong government, rose to 2,668 metric tons last year. This demand can be added to the 437 metric tons of mined gold, as said was absorbed by the Chinese government, *resulting in aggregate 2013 Chinese gold demand of some 3,105 metric tons or nearly 83% of the global gold demand of 3,756 metric tons as reported by the World Gold Council*. Finally, little of China's gold appears to be leaving the country; Chinese jewelry exports are a small fraction of the thousands of tons of bullion that is being imported or mined domestically. In a nutshell, China appears to be accumulating gold to a degree which is either widely under-reported or under-appreciated. The (unreported) source of this gold must, collectively, be Western nations. To repeat: gold appears to be moving from weak to strong hands. Historically, the nation with largest gold reserves has also had the reserve currency.
- Cessation of long-standing gold market manipulation by certain leading financial institutions, including allegedly sustained selling of naked shorts in the gold futures market by intermediaries of select leading central banks -- as apparently condoned by regulatory agencies with oversight -- could result in a higher "normalized" gold price.

([www.bloomberg.com/news/2014-02-28/gold-fix-study-shows-signs-of-decade-of-bank-manipulation.html](http://www.bloomberg.com/news/2014-02-28/gold-fix-study-shows-signs-of-decade-of-bank-manipulation.html))

### Why physical gold purchases rather than gold certificates, gold ETFs, or gold stocks?

- Gold certificates bring us back into the very paper world/counterparty risks that we are trying to diversify away from with (physical) gold. Consider Goldman Sachs' short-lived investment banking freeze in 2008. More saliently, consider the huge balance sheet risks of global money center banks: according to the BIS ([https://www.bis.org/publ/otc\\_hy1311.pdf](https://www.bis.org/publ/otc_hy1311.pdf)) there was \$561trn -- roughly 35 times the size of the US GDP -- worth of mainly LIBOR-based OTC interest rate derivatives outstanding as of 6/2013. (The nominal value of the interest rate derivatives recently surpassed the nominal value of the mortgage security derivatives that threatened to shut down the global financial system in 2008 by a factor of 450:1.) The nature of interest rate derivatives dictates that banks are betting on stable or falling interest rates. Commensurately, money center banks' -- and the financial industry as such -- exposure to a return to historically more normal interest rates ("Between 1285 and the mid-1600s, yields on government bonds fluctuated between 6% and 10% and in some cases were around 20% ... Since the mid-1600s, the average yield on government bonds has been around 4%" -- James Dale Davidson, Strategic Investment, January 2014) could be expressed in liabilities/losses in the hundreds of billions, if not trillions, of dollars. Our point: just as witnessed in Greece and threatened elsewhere, neither

client assets nor derivative-based positions will necessarily be safe in terms of either government-mandated "bail-in" scenarios or in terms of counterparties' abilities to make good on their interest rate derivative obligations.

- Physical gold ETF holdings could, in an extreme case scenario that would endanger the viability of the global fiat money-based financial system, be subject to government-mandated, financial industry stabilization "bail-ins."
- ETFs/equity funds in gold mining stocks are more of a mining risk/reward play -- and, to a lesser degree, exposure to successful gold price hedging -- than a purchase of physical gold as a timeless store of value/a hedge against systemic instability. Moreover, gold extraction (mining) risks are rising sharply as gold gets progressively harder/more expensive to unearth. This makes investments in gold mining stocks highly speculative in nature, and thus the polar opposite of the allocation intention sought with accessible, physical gold holdings. (<http://www.bloomberg.com/news/2013-01-16/gfms-says-gold-mining-cash-costs-increased-17-to-most-ever.html>)

### Risks to purchasing gold at current price levels:

- If gold market manipulation continues to pressure near-term gold prices even though same would likely increase strategic gold price appreciation potential as manipulation has served to dampen the gold price.
- If leading central banks began to shrink their bloated balance sheets.
- If US/OECD governments recommitted to the rule of law/respect for property rights in place of increasingly arbitrary, "fiat government"-based systems.
- If, in addition to "purchasing power maintenance central bank sanity," we got tax, regulatory, and litigation reforms that would collectively strengthen free market capitalism and rein in increasingly pervasive misallocations, then the gold price per Troy ounce would collapse, in our view. Such developments, either separately and especially in concert, would constitute a very material risk to physical gold buyers at the current price of \$1,381.50 per Troy ounce. Some links to sound money-eviscerating and free market capital-threatening history, trends, and policies follow: <http://robertstoweengland.com/index.php/books/1042-a-nation-adrift-from-the-rule-of-law.html>; <http://skrason.wordpress.com/2011/06/02/the-erosion-of-the-rule-of-law-in-contemporary-western-culture/>; <http://www.opendemocracy.net/openindia/vijay-nagaraj/indian-constitutional-democracy-freedom-in-crisis>; <http://www.ibanet.org/Article/Detail.aspx?ArticleUId=f81c9310-243a-40a9-8a95-6506cb7f96fe>; <http://dailycaller.com/2014/01/08/epa-overrides-congress-hands-over-town-to-indian-tribes/>; <http://townhall.com/columnists/carlhorowitz/2013/01/05/obama-race-and-affirmative-action-why-the-second-term-will-be-worse-part-i-n1479259/page/full>; <http://www.cobdencentre.org/2014/03/speech-to-the-brazilian-chamber-of-commerce-in-london/>

### Conclusion:

Gold is like the global economy's thermostat. If "wealth of nations" enabling monetary, fiscal, and regulatory policies are consistently on offer and are buttressed by sound finances and rule of law legitimacy, then the price of gold



remains dormant. If such a framework is unravelling, gold reflects this, much like fever reflects the onset of an illness or disease.

As regards monetary policy, to this author more QE, not less, looks likely before all too long. This will keep the federal government from having to a) live within its means, b) revisit sound regulatory/taxation/litigation policy, c) reinvigorate the Constitution/the rule of law/property rights, and d) stem the rise in crony capitalism/Statism. At the same time, the Fed's growing, government bond-laced balance sheet brings with it heightened sovereign solvency risks and very substantial strategic inflation risks, both of a monetary and an asset misallocation-based nature. Clearly America's dollar reserve currency and the pronounced associated benefits, including cheap imports, are at risk if current fiscal and monetary policies are sustained. Unfortunately, the (lacking) political will to address the "elephants in the room" was displayed by the recent suspension of the federal debt ceiling.

*If history is any guide, and the laws of economics have not been repealed, then real money, physical gold, should (continue to) be a huge beneficiary of today's hapless trajectory. Said differently, gold should persist in protecting -- even enhancing, from a dollar point of view, given the implications of a potentially shifting global reserve currency order -- the long-term purchasing power of its owners. It has been observed that a Troy ounce of gold bought a tailored suit 100 years ago; the same is still the case today. The only thing that has changed, and colossally so with a dollar that is but a 4% stub ([www.usinflationcalculator.com/](http://www.usinflationcalculator.com/)) of what it was worth a century ago, is how many fiat dollars that same suit costs today. Can it be pure coincidence that the Federal Reserve Board was born a bit over 100 years ago, on December 23<sup>rd</sup>, 1913? And did you know what the price of gold per Troy ounce would be if America devoted its declared 8,133-ton gold reserves (or 261.5m Troy ounces) to backing the Fed's current \$3.833trn monetary base? \$14,657 per Troy ounce. (<http://research.stlouisfed.org/fred2/series/BOGMBASE>)*

For strategic accounts capable of perceiving risk beyond near-term fluctuations in the market value of an asset, physical gold at the current dollar price per Troy ounce represents an excellent satellite (5% - 10%) allocation, in our view. We consider this to true both in terms of purchasing power protection and in terms of gold's historically negative correlation to bonds and stocks.

Dan Kurz, blogger  
Dan\_34135@yahoo.com

March 2014

My strategic allocation convictions:

The golden rules of client-centric investing are: capital preservation, purchasing power preservation, and the strategic attainment of a real yield (the reward for forgoing consumption).

Contrast this client mandate with today's monetary policy, which is made for the benefit of debtors, not savers. This holds true for the short end and the long end of

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the yield curve. At the short end, numerous leading central banks have moved overnight intra-bank interest rates to zero. At the long end, the same institutions have increasingly resorted to "printing money" with which to purchase 10-year government bonds, artificially lowering yields available to investors while bloating central bank balance sheets, thereby creating substantial long-term monetary inflation and misallocation risks. Add to this the fact that G20 government debt/G20 GDP has surpassed 100% with rising structural, aging-based government deficits ahead of us, and investors are also staring rising solvency risks in the face. Last but not least, with current government bond yields into the nominal to zero percent range, those instruments' durations have lengthened markedly, in extreme cases, to de facto "zero coupon bond" equivalence, thereby dramatically raising capital loss perspectives when benchmark interest rates rise.

In summary, then, today's strategic fixed income investors must contend with historical yield deprivation and even negative real yields across the yield curve, on the one hand, while having to come to terms with expanding inflation, solvency, and capital loss risks on the other hand. Meanwhile, in the wake of an unprecedented (post WWII) deficit spending/QE-induced 4.5-year earnings recovery, equity investors must contend with what increasingly looks like a recession-induced earnings compression ahead as well as its implications for current valuations. Longer-term, shareholders face anemic real GDP growth -- and thus anemic profit growth -- associated with having to unwind the debt mountains referenced above.

So much for the problem. What about transparent and liquid investment-grade diversification, yield deprivation relief, inflation protection, capital preservation, and real yield solutions (themes) in today's investment landscape? I am convinced that I can help you identify some compelling, counterparty risk-free strategic asset allocation ideas via my investment depth and breadth and through my expertise in real or "scarcity assets," balance sheet compositions, and all-important asset valuations (during my Credit Suisse CIO Office tenure, these themes achieved an equally-weighted outperformance of 68% relative to the MSCI ACWI).