EUREKA report

It's all good news for gold

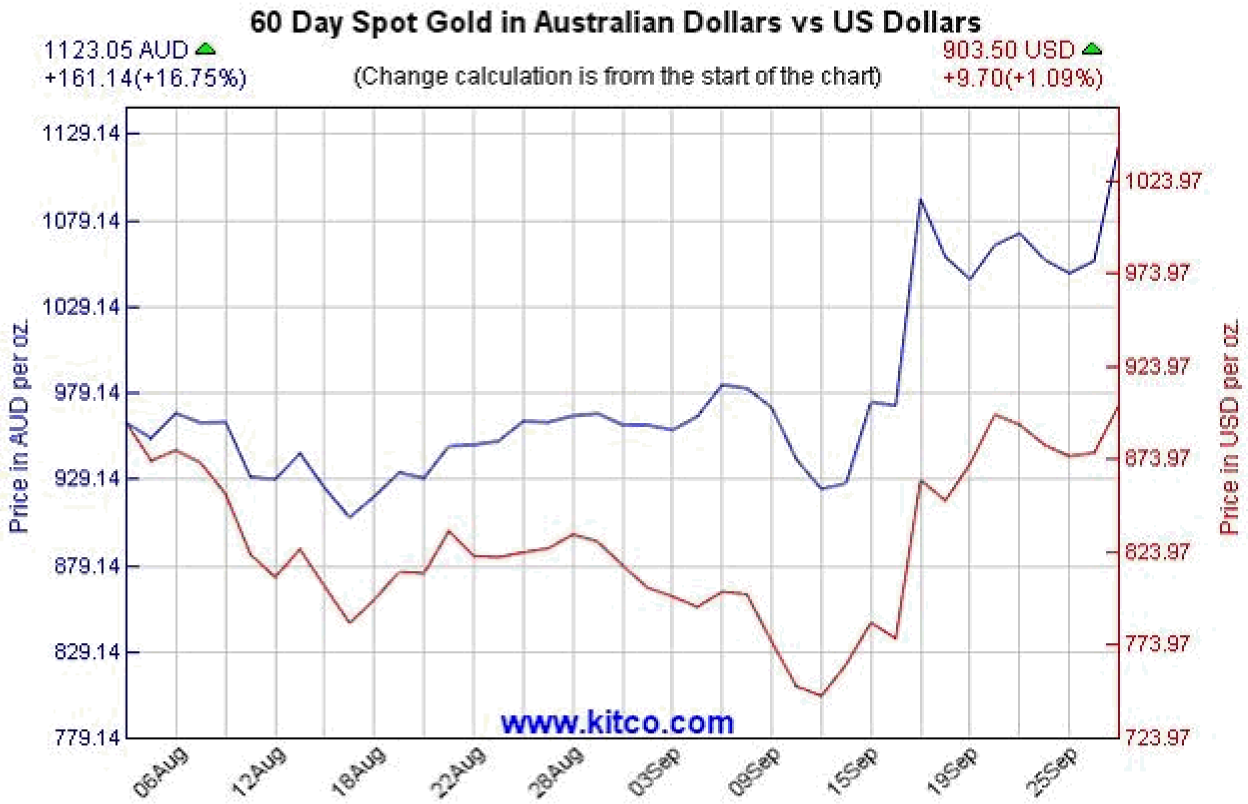
By Troy Schwensen
October 1, 2008

PORTFOLIO POINT: Sharemarket volatility and an easing Australian dollar are lifting the gold price, and producers' shares have surged.

With the price of commodities falling heavily and the uncertainty that exists in global financial markets, the Australian dollar has come under heavy selling pressure lately as sovereign wealth funds continue to leave our markets and head for the safety of cash.

Gold has been a strong beneficiary of safe-haven buying and this, coupled with the weaker Australian dollar, has meant stellar returns for Australian precious metals investors.

The chart below shows the performance of gold in Australian dollars versus that of US dollars over the past 60 days. The US dollar price has remained relatively unchanged, at about $US900, but in Australian dollars it has surged by more than 16% to more than $1100.



With the expectation of further rate cuts from the Reserve Bank, possibly as early as next week, the Australian dollar appears to have its work cut out for it in the intermediate term. An ongoing current account deficit (6.5% of GDP for 2007-08) combined with an ever growing dependence on foreign debt (net foreign liabilities 66% of GDP) has created a “perfect storm” scenario. Although the dollar will continue to show volatility, an extended slowdown in the world economy could see continued weakness.

This is welcome news for local gold producers, who have been fighting the negative effects of increasing cost pressures. We have seen shares in producing gold mining companies largely outperform the All Ordinaries index over the past four weeks as market uncertainty prompts a flight to quality. Shares in Australia's leading gold producers, Newcrest Mining and Lihir Gold, have increased more than 50% from their lows made just less than three weeks ago.

Regardless of whether there is a successful outcome concerning the US bailout package, pumping more liquidity into world financial markets in the hope of reinvigorating confidence is anything but a long-term solution.

Excess credit is at the heart of the problems we now face and providing more of the same in greater quantities is certainly not the answer. Gold is one of the few investments left that is nobody else's liability.

Troy Schwensen is editor of The Global Speculator and a research analyst for GoldNerds.