

GOLD BULL: BELIEVE IT OR NOT?

Having spent the last 5 year period learning as much as I can about financial markets and more specifically the precious metals sector, I recently delved briefly into the area of human psychology in an attempt to gain a more rounded perspective. As many of you are aware, human psychology plays a major role in financial markets. Gaining an understanding of why people believe what they believe can be of great benefit.

Many years ago I received a book written by the infamous **Anthony Robbins** called "**Awaken the Giant Within**". Whilst reading this book a second time I came across an interesting chapter called "**Belief Systems: The Power to Create and the Power to Destroy**". This in turn got me thinking about the precious metals bull market and why so few people in the world today **presently** identify this as a viable opportunity. I would like to share with you a few of my findings:

WHAT IS A BELIEF?

To begin with AR defines a **belief** as follows: "A feeling of certainty about something. That sense of certainty allows you to tap into resources that allow you to produce intelligent results. Once accepted, our beliefs become unquestioned commands to our nervous systems, and they have the power to expand and destroy the possibilities of our present and future".

HOW DO WE TURN AN IDEA INTO A BELIEF?

AR offers a simple metaphor:

"If you can think of an idea as being like a table top with no legs, you'll have a fair representation of why an idea doesn't feel as certain as a belief. Without any legs, that table top won't even stand up by itself."

The legs AR refers to are references that support the idea. That is experiences you have had in your life which support your beliefs. The more you experience, the more certainty that exists and the more conviction you have about your beliefs. If you look at the past 24 years, we have experienced an unprecedented period of stock and property market growth. Most people have experienced substantial increases in wealth during this time, naturally solidifying their beliefs. That is in order to grow your wealth, property and shares are the natural investments of choice, "**without question**".

Another concept discussed by AR is that of "**Social Proof**":

"So often people believe something because everybody else believes it. This is known in psychology as social proof. The thing is social proof is not always accurate. When people are not sure what to do, they look to others for guidance."

"Some of the strongest social proof that people use is information they get from "experts". But are these experts always right?"

When you think about these concepts it is not difficult to see why Gold remains largely ignored and consequently grossly undervalued in terms of **Monetary Inflation**. The so called experts are those from the main stream financial media that continue to feed market participants with what they want to hear. The property market has only recently started to show signs of distress, whilst the stock market seems to have reluctantly been handed the batten and

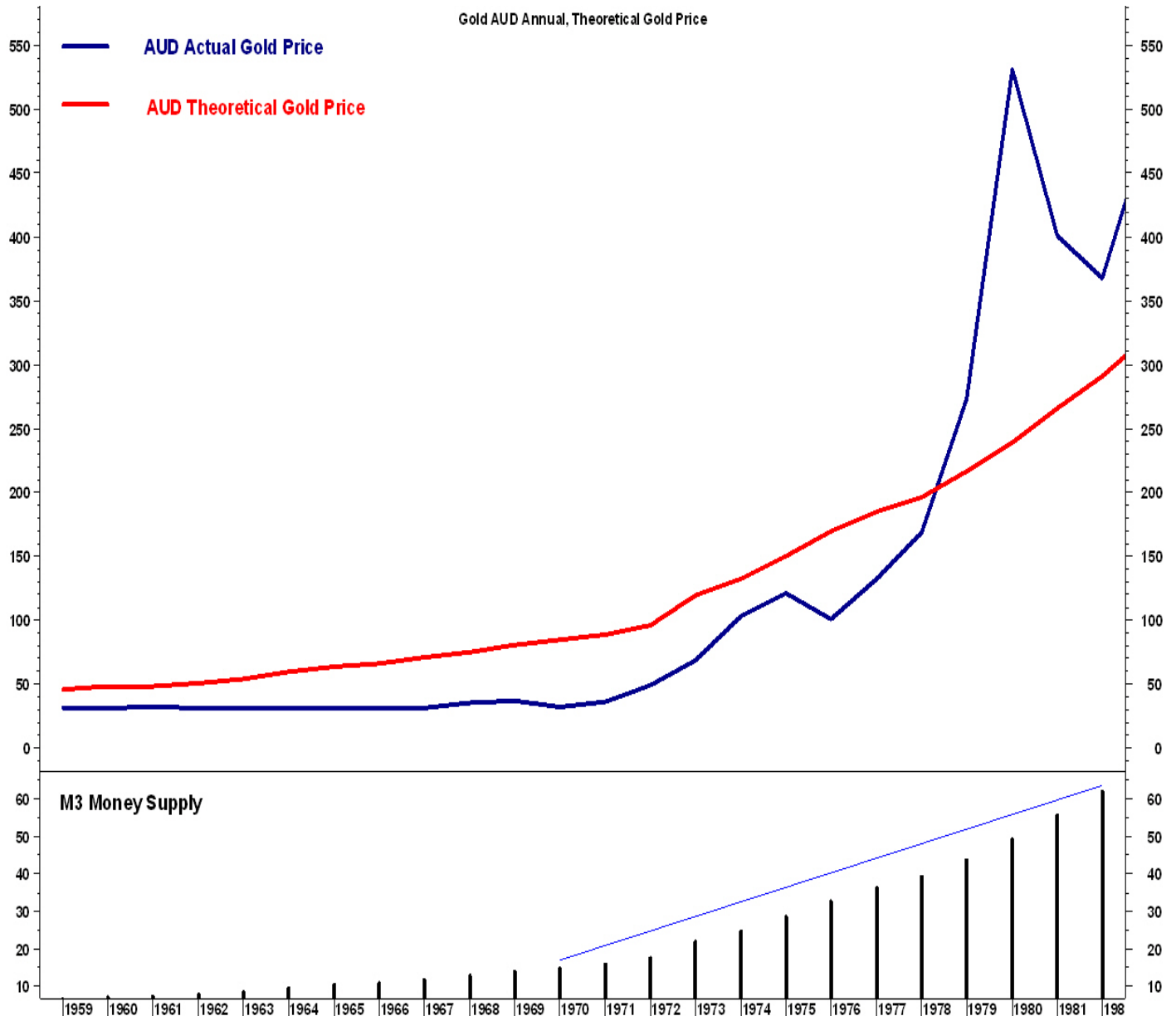
continues to run making new highs. Apart from the bursting of the Dot com bubble there hasn't been any obvious events up until now that have caused mainstream market participants to **seriously** question their existing beliefs.

WHY BELIEVE IN A STRONG FUTURE FOR GOLD?

If I had to highlight just one singular reference that supports my belief in a strong Gold market going forward it would have to be the concept of **Monetary Inflation**. Both the property and share markets have been the major beneficiaries of this inflation over the past 25 years. Whilst core inflation has remained low, there has been no pressure to raise interest rates, thus allowing the party to continue. In recent years however, this has predictably changed and core inflation has started to show its ugly face, effectively gate crashing the party. Central banks around the world have no choice but to combat this form of inflation. If they don't they risk people losing confidence in money (The very foundation of the financial system). Back in November 2005 I wrote an article where I calculated the monetary inflation adjusted price of Gold in Australian dollar terms. I looked at the growth rate of Australian money supply (M3) and compared this with the world average growth rates in above ground Gold inventory, to determine a Monetary Inflation adjusted price (For a more thorough explanation see:- **Every Asset has a Fair Value** in the Articles section)

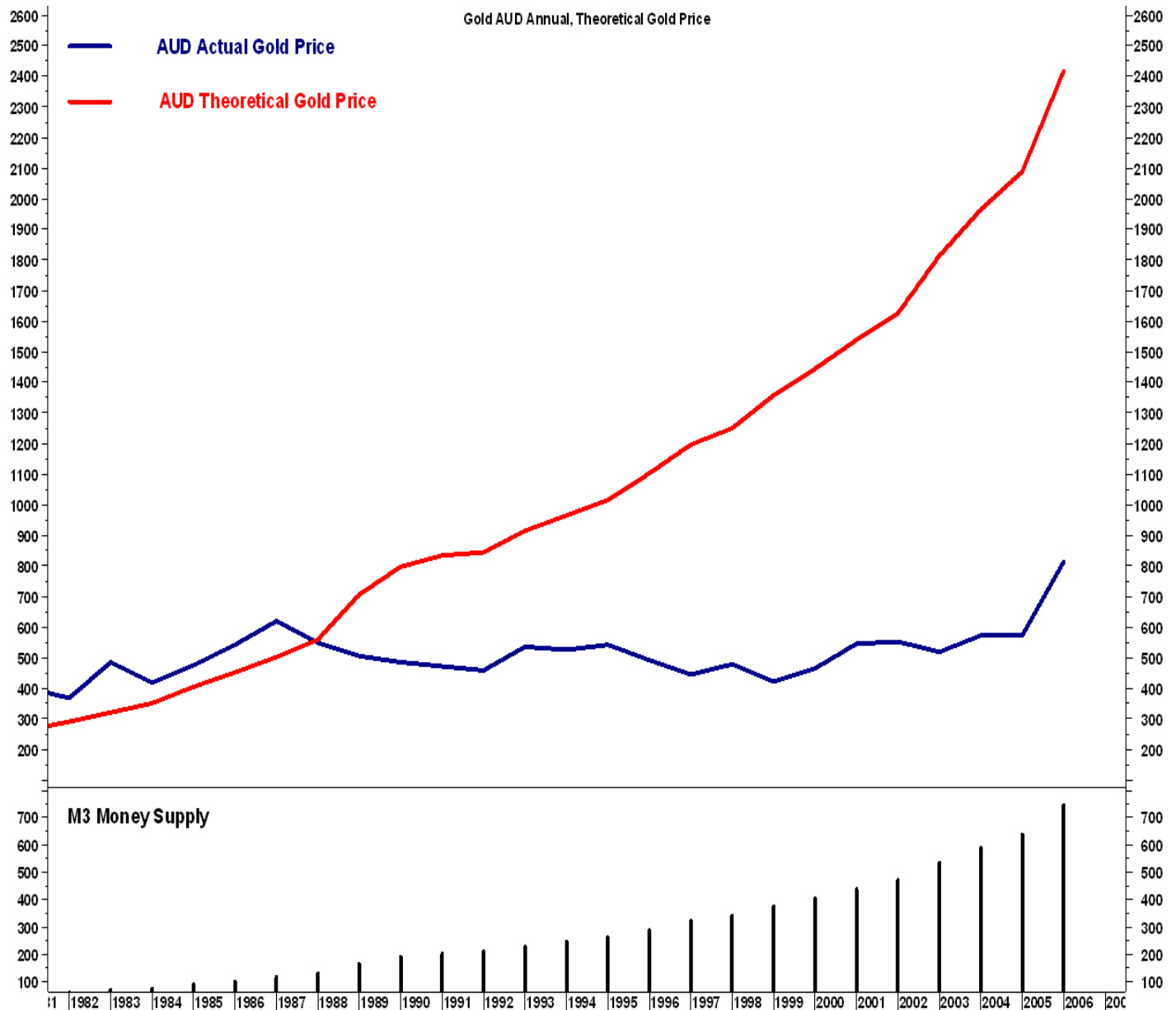
The diagrams that follow show a comparison between the Actual Gold price (In Blue) and the Monetary Inflation adjusted price of Gold (Theoretical Price – In Red) in terms of Australian dollars. It also tracks the M3 money supply in the bottom section.

ACTUAL VS THEORETICAL 1960 – 1982



The first diagram is a look at the period of 1960 to 1982. We can see that in the low core inflation, low interest rate environment leading up to the 1970's, the theoretical price of gold remained considerably above the actual price (**Actual price 38% of Theoretical in 1970**). People's confidence in financial assets remained high. The 1970's saw the abolition of the Gold standard and a period of intense M3 growth which helped fuel increasing core inflation. This forced an increase in interest rates which in turn triggered a number of recessions impacting negatively on financial markets. People during this period seriously questioned their belief and confidence in the financial system. We can see the actual gold price increased dramatically in this time of uncertainty eventually exceeding the theoretical price by more than two times in 1980.

ACTUAL VS THEORETICAL 1982 – 2006



The second diagram shows the 24 years from 1982 to 2006. We can see that in this period where high interest rates eventually tamed core inflation, the actual price of Gold fell below the theoretical value, as people regained confidence in the financial system and interest rates eventually declined. This consequently fueled unprecedented gains in financial assets. We can see now in 2006 that a massive disconnect again exists between the Actual and Theoretical prices (**Actual is just 33% of Theoretical**). A look at the M3 growth over the past 24 years should give you some idea as to what has fueled higher share and property prices in recent times. In the past 12 months we have seen "official" core inflation numbers start to rise and the central banks around the world have predictably responded by increasing interest rates. Most of the growth in M3 has been via increasing debt levels. Rising interest rates and high levels of debt are obviously not a good combination. It is for this reason that I believe confidence levels will be increasingly tested in the years to come and the price of Gold will be the ultimate beneficiary (Just like in the 1970's).

PAIN IS THE ULTIMATE TOOL FOR SHIFTING BELIEF

Unfortunately many people have to experience pain and loss before they start questioning existing beliefs. It is this very concept that leaves a majority of investors skeptical of the future of precious metals. Having spent the bulk of the past 24 years in a secular bear market, many people still have a negative perception, despite the healthy increases in recent times. Like I mentioned previously, property and shares have continued to provide investors with a return on investment. When one has performed poorly, the other has picked up the slack maintaining people's confidence in the system. Gold will only start to realize its monetary inflation adjusted price in times of uncertainty, during which time investment demand for precious metals will increase as people start to question the validity of existing beliefs.

CONCLUSION

Some of the most successful investors and speculators of our times have been people that have had the ability to successfully pre-empt changes in people's belief patterns, having the foresight to position themselves accordingly. These people do not require the support system of **social proof** and have the courage of their convictions to act accordingly in advance. They have done their homework and genuinely **believe** in what they are doing and their conviction is not easily shaken.

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