# THE GLOBAL SPECULATOR

Volume 2, Issue 11, 5 December 2007

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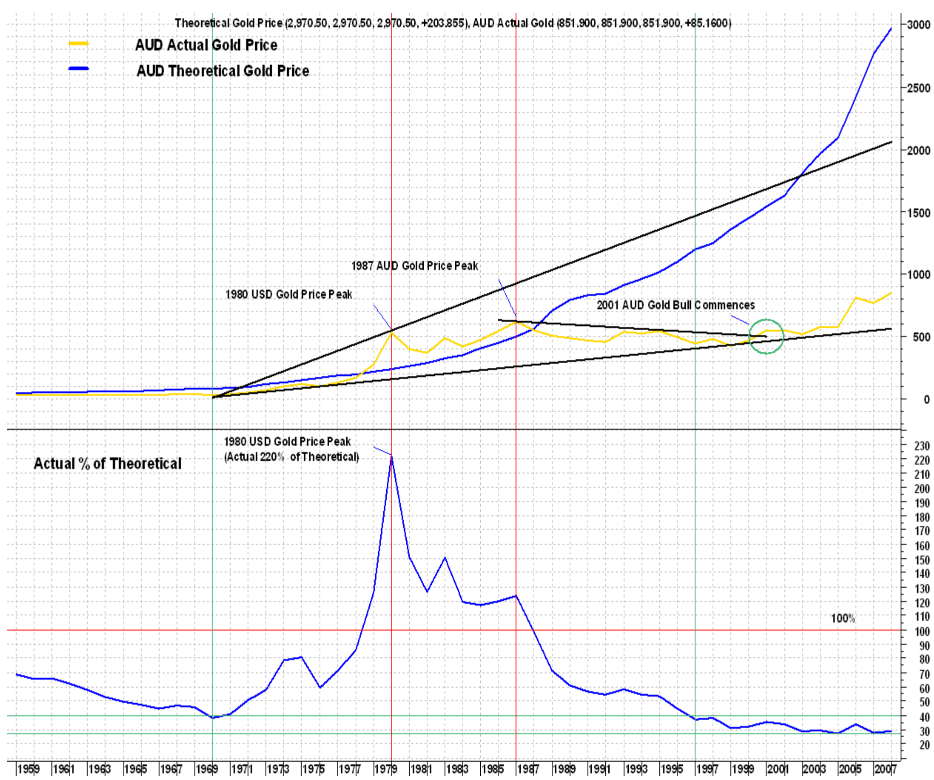
## INTRODUCTION

The M3 monetary aggregates for Australia grew at a lazy 3% in October (36% annualized!) as the RBA intervened to ease credit tensions. Today I want to revisit our Theoretical Price of Gold (Indicated in Blue in the chart below) based on growth rate differentials between monetary supply (M3) and above ground Gold stocks. Looking at the last 8 years we can see the actual Gold price (In Yellow) has remained consistently around 30% of this theoretical value (See bottom section of the chart). What becomes painstakingly obvious when looking at this chart is the actual price of Gold in Australian dollars has failed to bridge this gap that has existed since parity was last achieved back in 1988. When you look at this seemingly Grand Canyon like chasm that has formed, it is difficult to believe that the actual price of Gold could ever reach parity again (AUD$2,970 an ounce and growing). However, when we look back to the 1970's we can see that the price of Gold faced a very similar challenge at the commencement of that decade and by 1980 had actually managed to double this theoretical price (Who would have believed it then!). People are beginning to open their eyes to the inflation problem. Even central banks such as the RBA are openly voicing their concerns. Expect this rather innocuous gap to close over the coming years as the Gold price continues to respond to inflationary concerns and the Aussie dollar begins to lose its speculative appeal.



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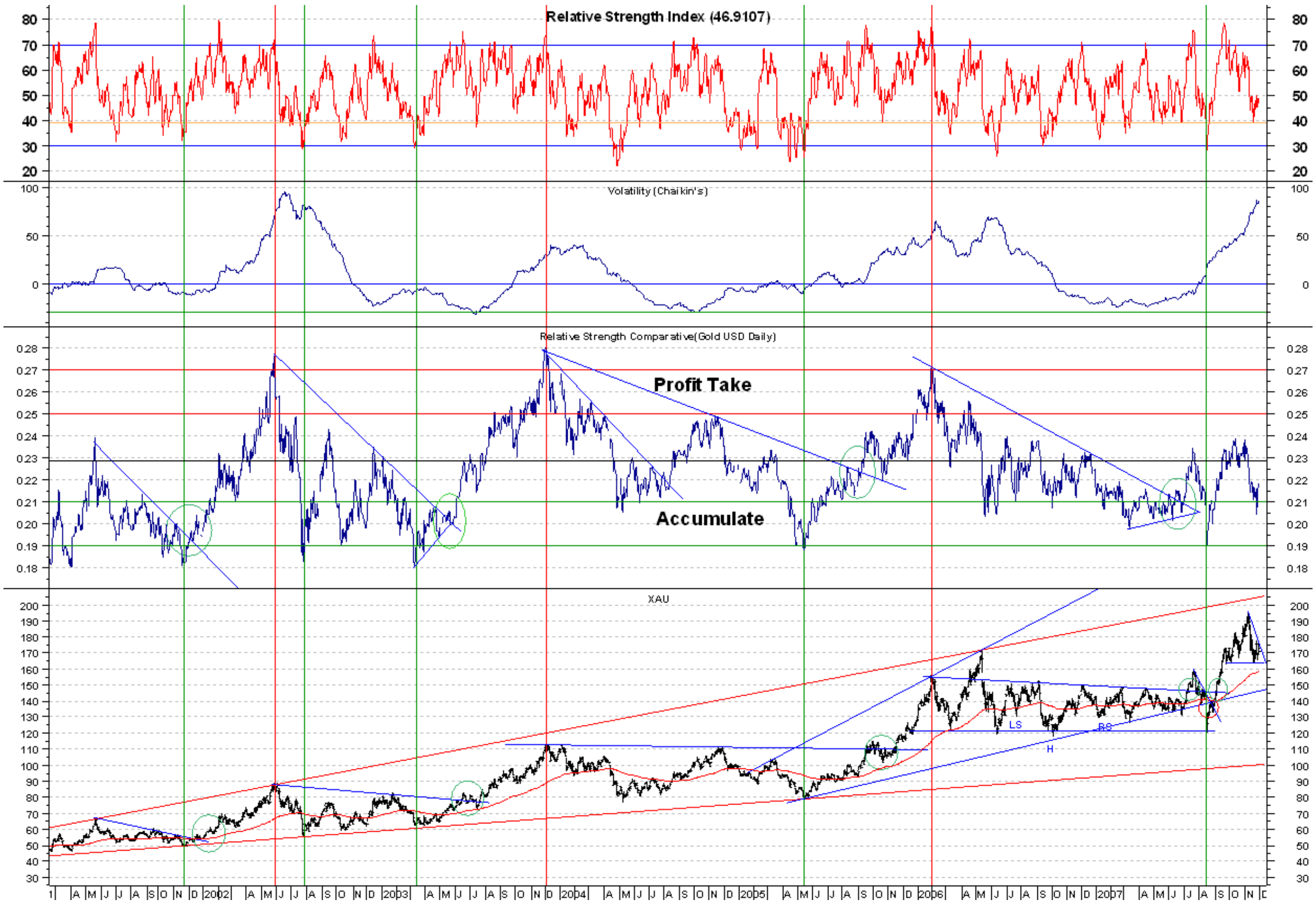
# XAU




# XAU GOLD RATIO

| Key Dates | XAU/Gold | XAU | XAU Performance | Gold Price | Gold Performance | Net Position |
|---|---|---|---|---|---|---|
| 19/11/2001 | 0.18 | 49.46 | | 272.90 | | |
| 28/05/2002 | 0.27 | 88.65 | 79.24% | 325.50 | 19.27% | 59.96% |
| 26/07/2002 | 0.18 | 55.73 | -37.13% | 303.30 | -6.82% | -30.31% |
| 08/12/2003 | 0.28 | 112.21 | 101.35% | 406.60 | 34.06% | 67.29% |
| 13/05/2005 | 0.19 | 78.99 | -29.61% | 420.70 | 3.47% | -33.07% |
| 31/01/2006 | 0.27 | 154.19 | 95.20% | 570.70 | 35.65% | 59.55% |
| 16/08/2007 | 0.19 | 125.99 | -18.29% | 662.25 | 16.04% | -34.33% |
| **Current (30/11/07)** | **0.22** | **171.07** | **35.78%** | **783.50** | **18.31%** | **17.47%** |

A look at the chart of the XAU for the month of November 07 shows a strong initial rally to a high of 194 (Falling short of the predicted 200+ target), before retreating back sharply to 171, a decline of 11.85% from the peak. The XAU/Gold ratio has fallen down to 0.218 and briefly entered the accumulate zone during late November as the XAU found support around the 165 - 170 level. There has been some solid consolidation at this level as the precious metals shares have endured a rather sharp 7% fall in the Gold price. Where Gold and the Gold shares go in the short term will be largely dependent on the market response to the up and coming interest rate decision. December and January are typically strong months for the equity markets and an early Christmas present from the Fed via a rate cut might be just what the market is looking for to induce another "short" lived spike. The market as it presents reminds me a lot of a drunk that can barely stand up on his own but continues to be force fed more drinks from his "so called" friends in the hope that he can rekindle that party spirit he has seemingly lost via his intoxication. The inevitable result is going to be messy and painful for all concerned!

## OUTLOOK

The two short term scenarios as I see it over the coming weeks and months:

**Scenario 1:** A rate cut from the Fed will see the XAU and the gold price break out from present consolidation patterns and rally to at least test their previous highs. Whether these highs are taken out will be largely dependent on just how much mileage the general equity markets can generate from this next round of rate cuts (I am assuming a rate cut is a given). There is a perception at the present time that Gold shares represent a risky investment class and have generally lost their traditional safe haven appeal. With the market presently developing a healthy aversion to anything risky, it appears that the Gold sector at least for the short term will continue to be held to ransom by the general mood in the equity markets. I am leaning towards this bullish scenario but am maintaining a healthy degree of caution for the medium term.

**Scenario 2:** The next round of rate cuts continues its present trend towards a diminishing rate of benefits to the general equity markets and the precious metals sector gets caught up in a panic sell off in the overall market. This could result in the XAU breaching support at 165 – 170 and falling down to at least the next support level at 145-150. The markets continue to look increasingly shaky and the risk of this scenario occurring continues to increase in my opinion. For now I do not support this scenario.

**Intermediate Term Outlook:**

My next target for the XAU is 195 – 200 (Previous high). Whether we can go on and attempt a move to my intermediate term target of 230 – 240 will largely be dependent on just how successful these rate cuts are at injecting some life into the equity markets. Regardless of what transpires in the near term, these targets represent a bare minimum over the longer term.

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# NORTH AMERICAN SILVER INDEX (NASI)


The NASI for the month of November 07 successfully made a new high of 9,124 before succumbing to selling pressure which saw the index retrace just under 5% before steadying. The NASI has held up remarkably well and continues to hold support at an intermediate trend line that has been in place since the lows made in August 07. The Relative Strength Index comparative with the Silver price (Middle Section) indicates the Silver shares continue to outperform the metal (A trend in place since May 06) which continues to be bullish in its implications for the immediate future.

## OUTLOOK

The two potential short term scenarios as I see it over the coming weeks and months:

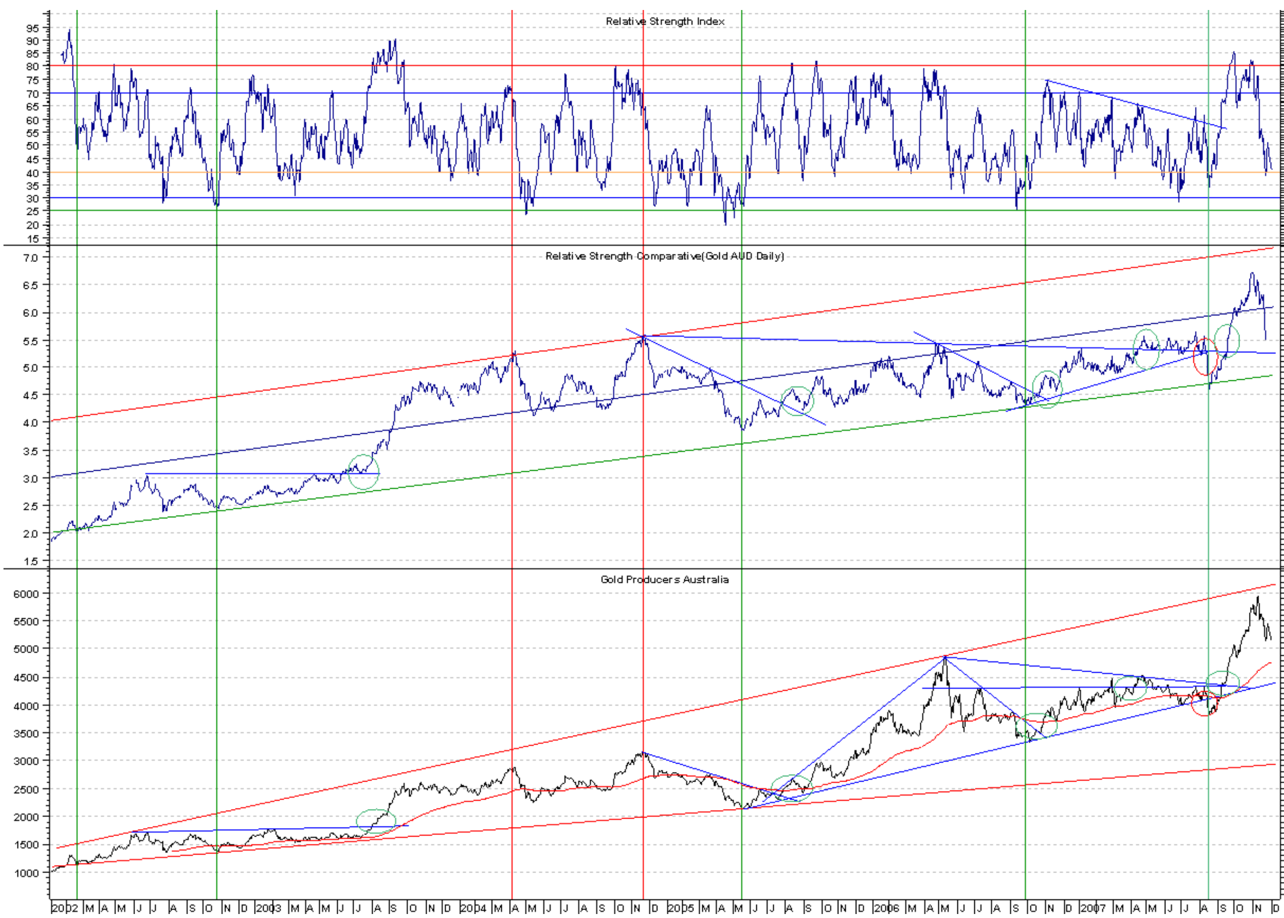
**Scenario 1:** The Silver index will continue to rally higher with the impending rate cut. I am presently leaning towards this scenario but, as mentioned previously, remain concerned with how much more mileage the equity markets will get from these continuous rate cuts. The precious metals markets at this stage of the game will need relatively stable market conditions to continue attracting new investment. Any fear or panic will at least initially be met with caution.

**Scenario 2:** If the gold and silver price were to get caught up in a sharp fall in the equity markets, we could see a worse case scenario of yet another retrace back to the previous resistance which should now act as support at 7,800 – 8,000. A worse case scenario at this stage would then be subsequent falls towards the next support level at around 6,800 – 7,000. Whilst this remains a very real risk in the current climate of uncertainty, I don't support this scenario at the present time.

**Intermediate Term Outlook:**

Over the intermediate term my next target for the NASI is around the 11,000 mark towards March and April 2008 assuming at the very least a relatively stable and panic free period in the equity markets leading up until then.

# AUSTRALIAN PRODUCERS INDEX (API)




During the month of November 07, the Australian Gold Producers index peaked at 5,950 (Target was 6,500) before pulling back towards the 5,200 level, a fall of just over 12.5%. We mentioned last month the risk of buying new positions when the index strays significantly from its 150 day Moving Average (5,800 versus 4,500 – Oct 07) and this theory was vindicated with the pull back we experienced in the later part of November. On the other hand, to buy the dips on a correction towards the 150 day Moving average (Presently at 4,770) has been a prudent strategy in the past.

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## OUTLOOK

The two short term scenarios as I see it over the coming weeks:

**Scenario 1:** The API will find support at around the 5,000 – 5,200 levels before rallying back up towards previous highs. The Gold price in Australian dollars continues to gather some momentum with a weaker Aussie dollar and should continue to rally from here, leading to improved trading conditions for the Aussie miners. I presently support this scenario.

**Scenario 2:** If the gold and silver prices get caught up in a sharp fall with the general equity markets, we could see a repeat of the August breakdown and a move of the index back towards strong support at the 4,400 level. Whilst a very valid risk, I do not support this scenario at the present stage.

**Intermediate Term Outlook:**

My intermediate term target continues to be 6,500 towards the early part of 2008, contingent on general market stability.

## AUSTRALIAN THEORETICAL PRICE OF GOLD UPDATE

| Date | 10 Year BB Interest Rates | Official CPI | M3 Aggregate Money Supply | Rate of Australian M3 Change | Gold Production Av Annual Increase (1.73%) | Australian Theoretical Gold Price | Actual Australian Gold Price | Actual as a % of Theoretical |
|---|---|---|---|---|---|---|---|---|
| Jun-07 | 6.26 | 2.10 | 867.9 | 3.3460% | 0.14% | 2,760.86 | 766.64 | 27.77% |
| Jul-07 | 6.03 | | 874.6 | 0.7720% | 0.14% | 2,778.20 | 774.60 | 27.88% |
| Aug-07 | 5.92 | | 895.8 | 2.4240% | 0.14% | 2,841.53 | 826.01 | 29.07% |
| Sep-07 | 6.16 | 1.90 | 911.9 | 1.7973% | 0.14% | 2,888.51 | 839.60 | 29.07% |
| Oct-07 | 6.18 | | 939.1 | 2.9828% | 0.14% | 2,970.50 | 851.90 | 28.68% |

As we discussed earlier, the month of October 07 has seen M3 increase close to 3%. If we take the first 4 months of this financial year, we get an annualized rate of 24.60% which equates to some pretty serious liquidity. We haven't seen this level of monetary inflation since the late 1980's. The **Theoretical Price of Gold** has risen to AUD$2,970, with the actual price continuing to trade at a bargain 28.68% of the theoretical. As I type this, the price of gold in Australian dollars has risen to over AUD$920 an ounce, or just under 31% of the Theoretical value. The Australian dollar peaked at US$0.9376 on the 07/11/07. It has since pulled back to a level of around US$0.8702 or just over 7%. The trade deficit for last month came in at a record level of close to AUD$3 billion. This continues to point towards a mass of Aussie dollars leaving the country. These dollars need to largely be reinvested back into Aussie investments to avoid further dollar weakness as they are exchanged for other domestic currencies. A strong Aussie dollar has largely been responsible for masking price inflation via cheap imports. Price inflation pressures continue to build here in Australia which will be met by further rate rises in the future which **may** continue to help prop up the Aussie dollar. This will last for as long as the economy can continue to sustain the rising cost of credit. At some point in time the debt burdened consumer will break (As is happening in the US) at which point these rate rises will come to an end, as will the Aussie dollar's run with the looming threat of a recession.

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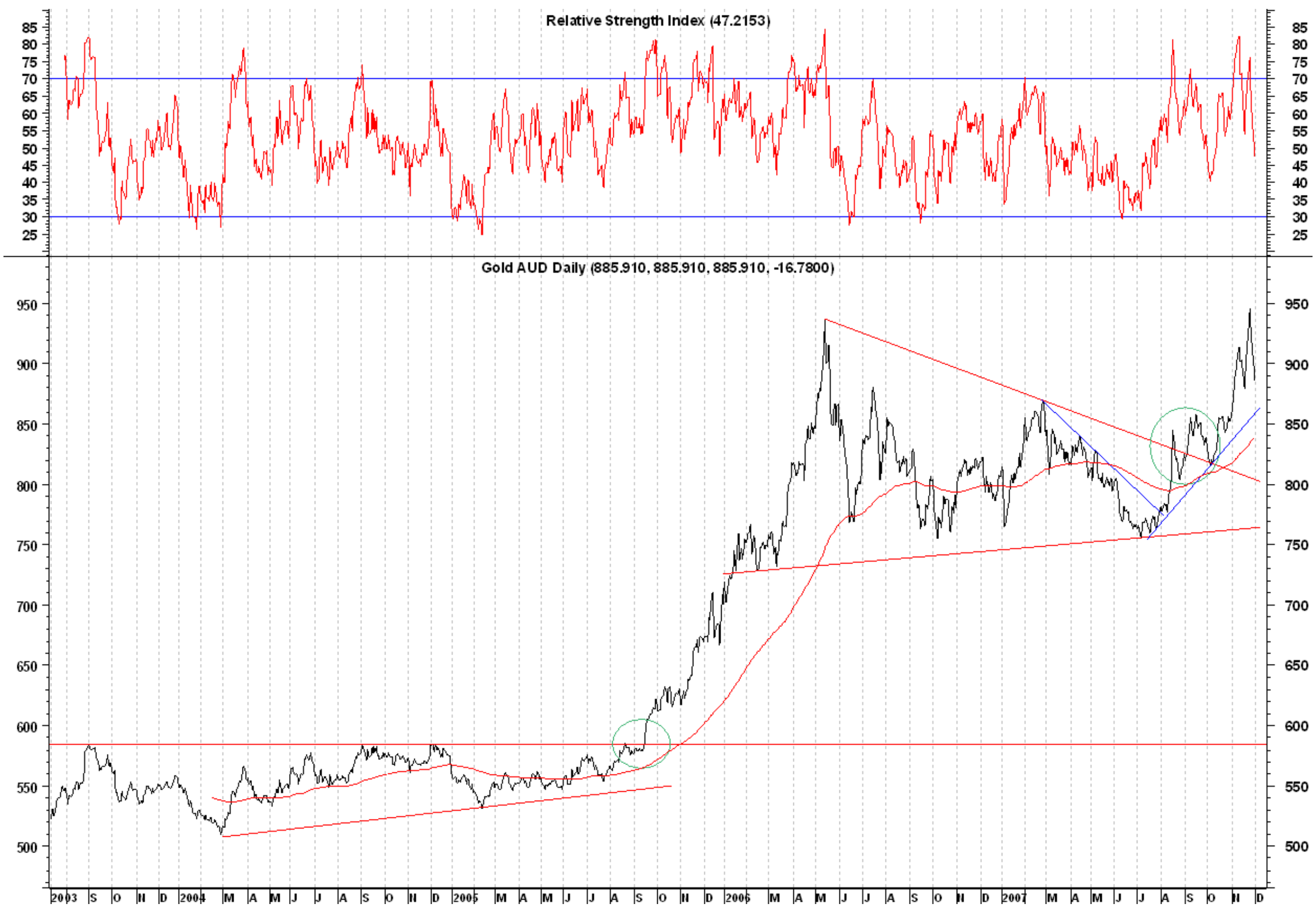
# AUSTRALIAN GOLD PRICE




# CLOSING COMMENTS

What started as a promising month quickly turned into a sharp pull back and a consolidation for the precious metals markets as the lure of profit taking became too difficult to resist, given the uncertainty surrounding the equity markets and the ongoing credit problems. One gets the feeling that these problems extend a little deeper than what a handful of interest rate cuts are going to be able to repair. You can't force people to borrow money. Unless the stock market can regain its upward momentum (At least in nominal terms) or the US housing market can bottom soon (Very unlikely), there is very little to entice speculators to borrow more money regardless of where interest rates go. At this stage of the game, I am reluctant to move money out of the safer producing precious metals companies into the more speculative juniors until I see a higher premium being offered for the majors (Higher XAU/Gold ratio closer to 0.25 - 0.27). If any companies are positioned to take advantage of the present Gold prices it is the producers. There is also much less risk associated with this group of companies and if investors aren't prepared to invest in this segment, there will generally be very little interest in the junior side of the market. There is no disputing that there is fantastic value being offered at the speculative end at the present time, but one should be very selective and ensure the companies they are looking at are well cashed up for the future. The juniors that are attempting to raise money at this time are doing so at a vast expense to their existing shareholders.

Troy Schwensen

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