

The Denver Gold Group European Gold Forum 2011

Zurich, Switzerland

Dr. Martin Murenbeeld
April 13, 2011



Overview - Last Year's Forecast

We were bullish – tempered by some concerns

Gold Price Scenarios

	<u>2010-avg</u>	<u>2010-end</u>	<u>2011-avg</u>
Scenario A: p.=.10%	\$1015 \$858	\$915	
Scenario B: p.=.40%	\$1140 \$1230	\$1170	
Scenario C: p.=.50%	\$1221 \$1425	\$1326	

Weighted:

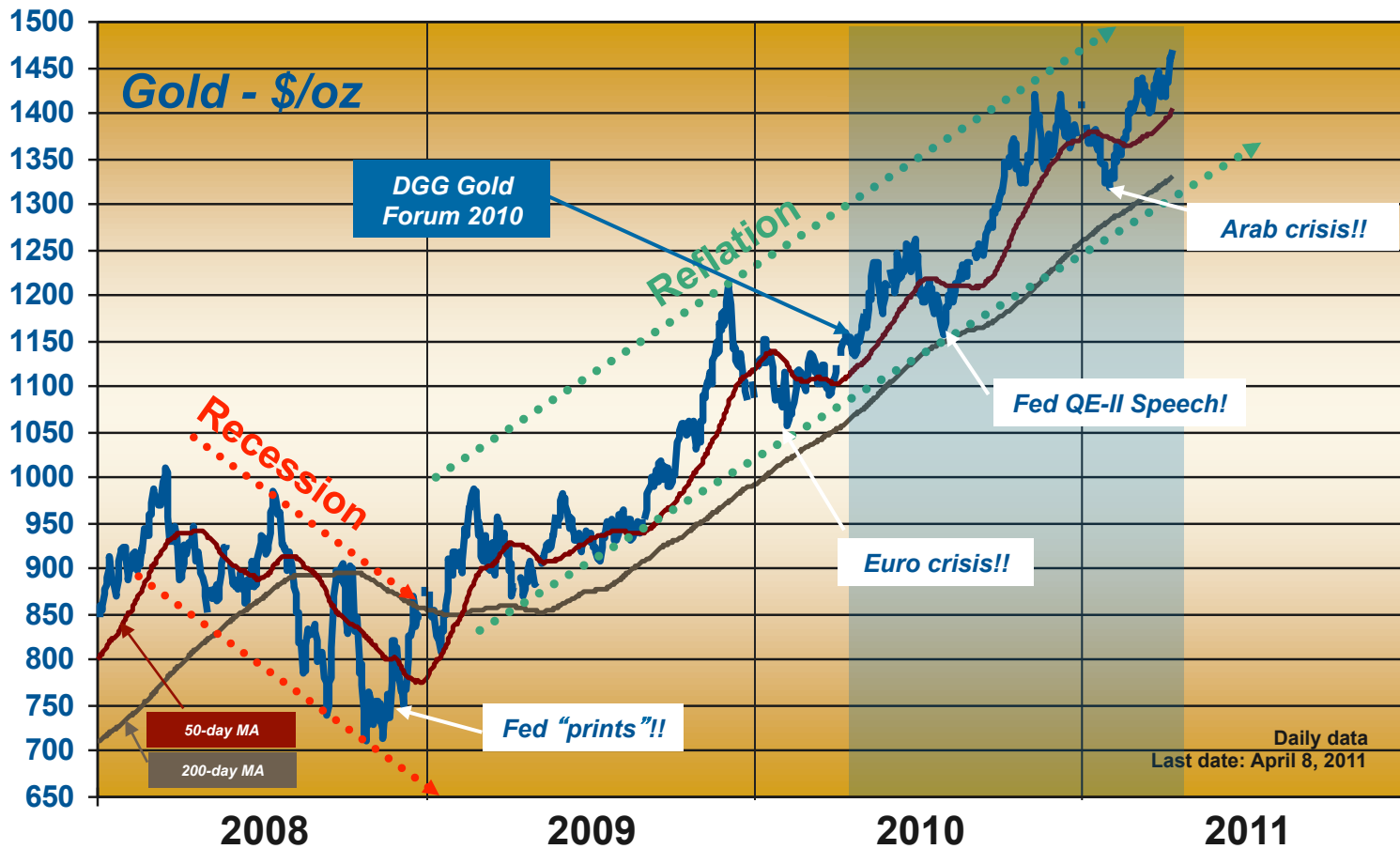
\$1170 \$1226

\$1293 **DUNDEE**WEALTH[®]



Overview - Gold Rose More Than Forecast

Boosted by policy, debt crisis, and geopolitics ...



Outlook: Ten Bullish Arguments

New!

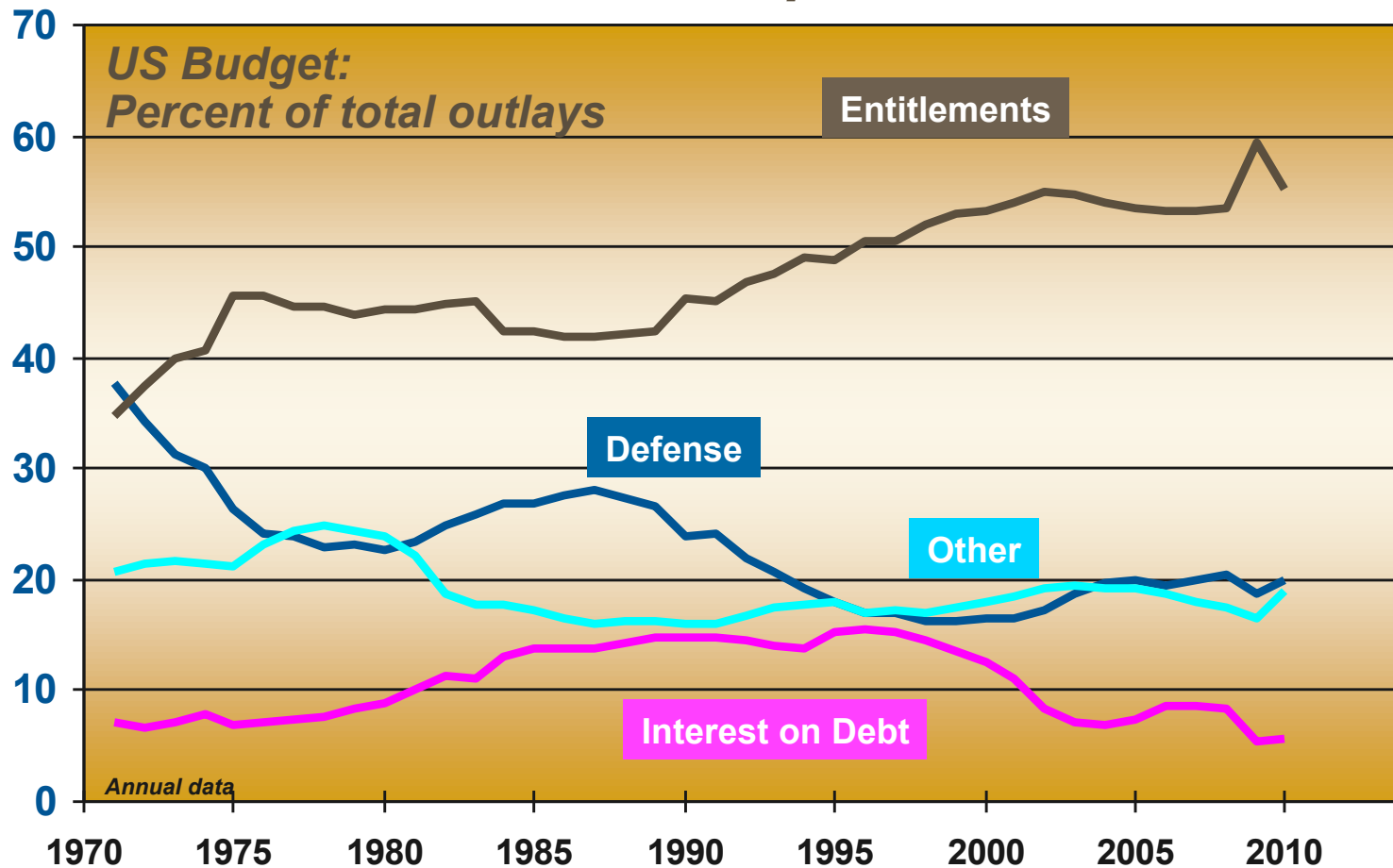
1. **Global fiscal and monetary reflation: PIIGS, US, etc.**
2. **Inflation in the EM's: boosts "Chindia" demand**
3. **Global imbalances: dollar fundamentally weak**
4. **Global FX reserves "excessive": diversification**
5. **Central banks buying gold: huge attitude change**
6. **Gold not in a bubble: room to rise**
7. **Mine supply up only modestly: "peak" gold?**
8. **Investment demand: ETF, India, China positive**
9. **Commodity price cycle: many years to run (BRIC)**
10. **Geopolitical environment: positive**

Bullish: (1) Global Reflation

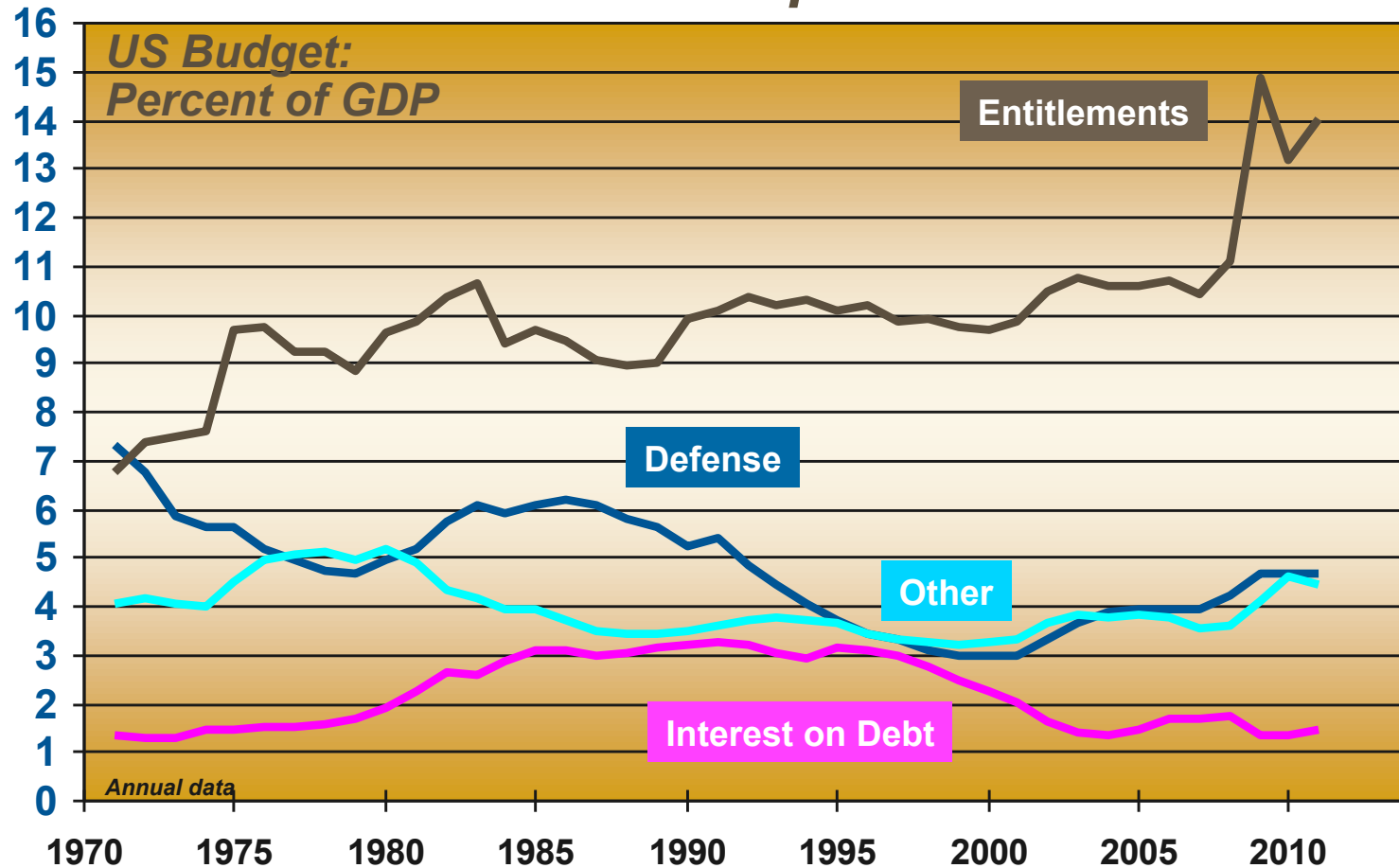
Antecedents of the Sovereign Debt Crisis:

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. ***Convergence in the Euro-zone:*** *Interest rates “converged” to German rates - and “undisciplined” governments continued to borrow excessively*

Bullish: (1) Global Reflation - Retirement Entitlements have blown up in Western economies



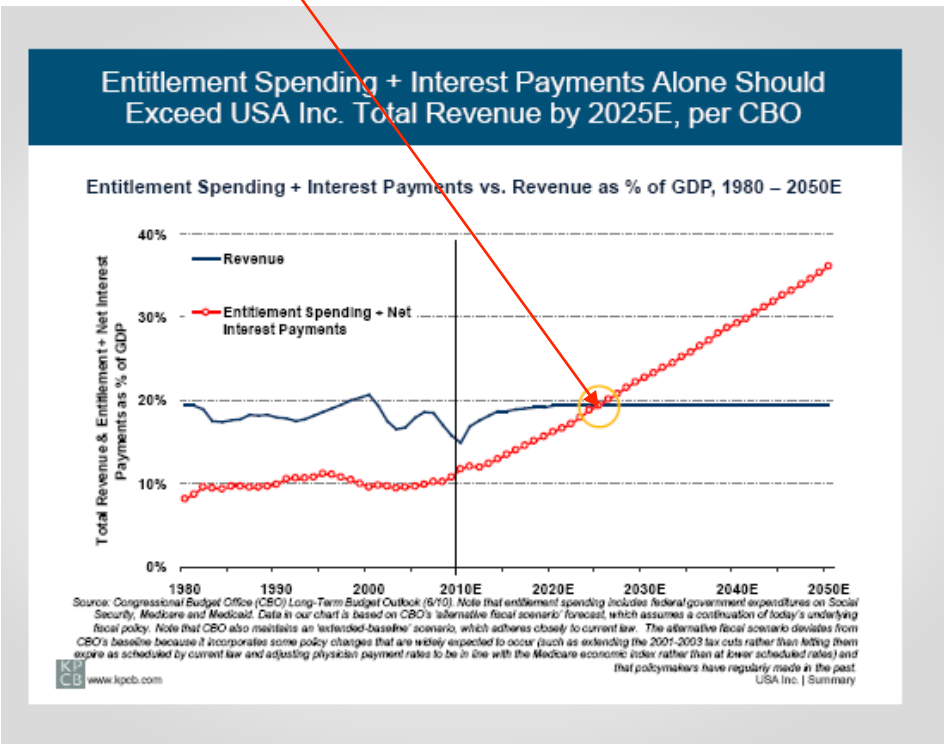
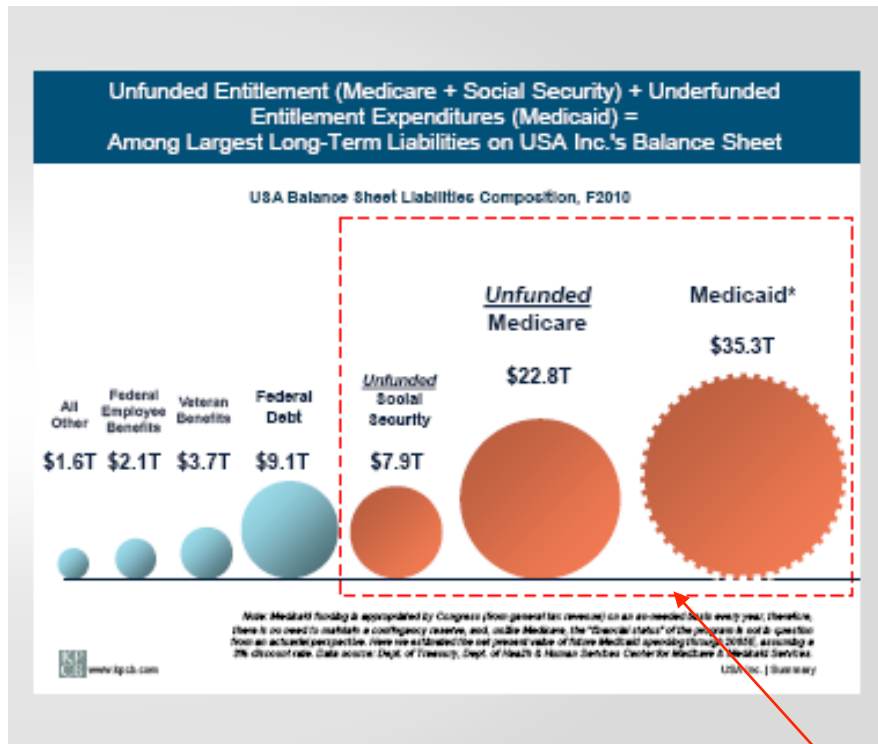
Bullish: (1) Global Reflation - Retirement Entitlements have blown up in Western economies



Bullish: (1) Global Reflation - Retirement

The US sovereign debt crisis

Entitlement + interest > tax revenue!

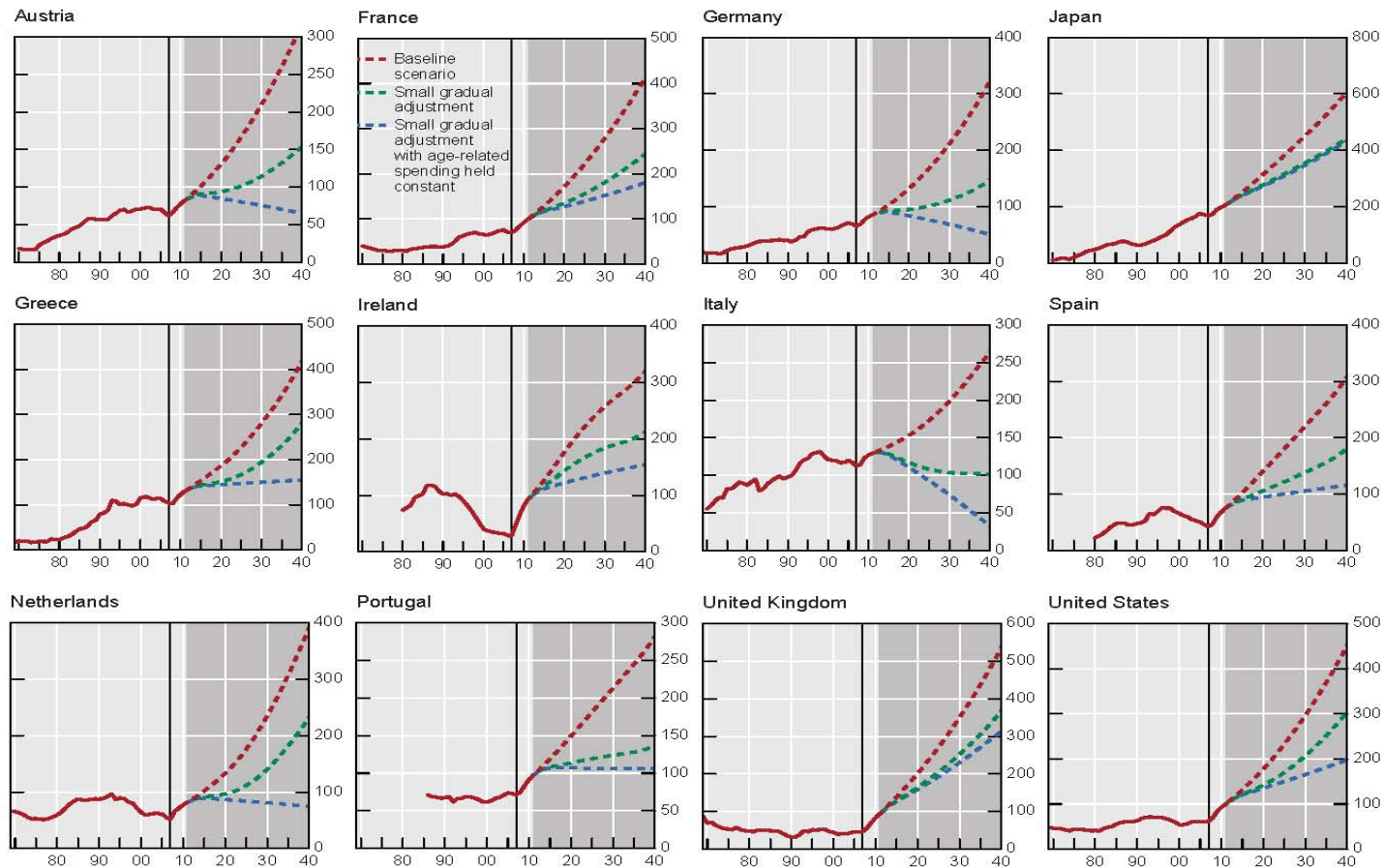


Source: USA Inc., www.kpbc.com

Unfunded entitlements: \$66 trillion
(450% of GDP)

Bullish: (1) Global Reflation - Retirement

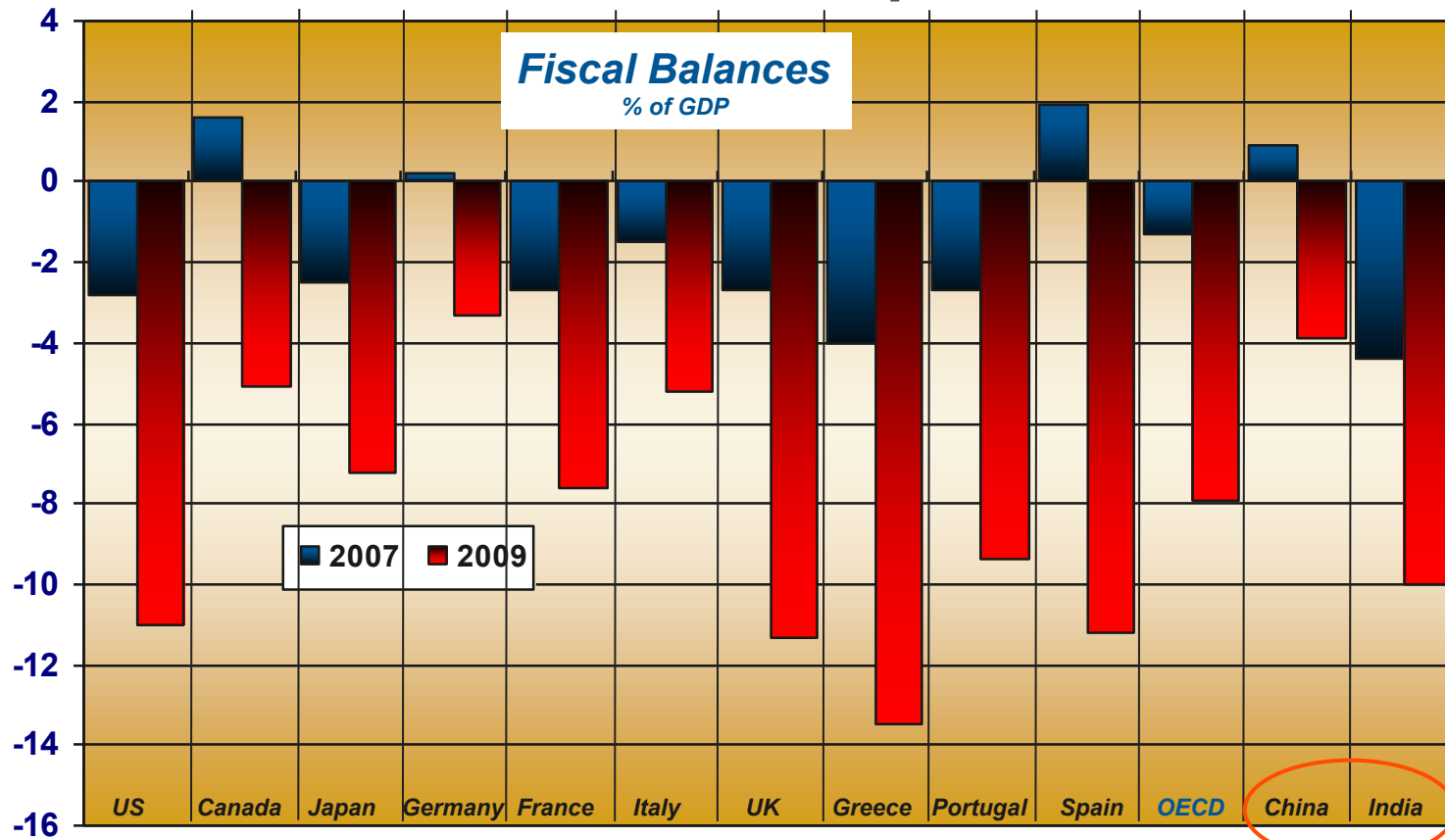
But retirement debt crisis not confined to the US



source: Bank for International Settlements, Working Paper #300, March 2010

Bullish: (1) Global Reflation - Recession

The "Great Recession" blew up deficits



Source: OECD, IMF

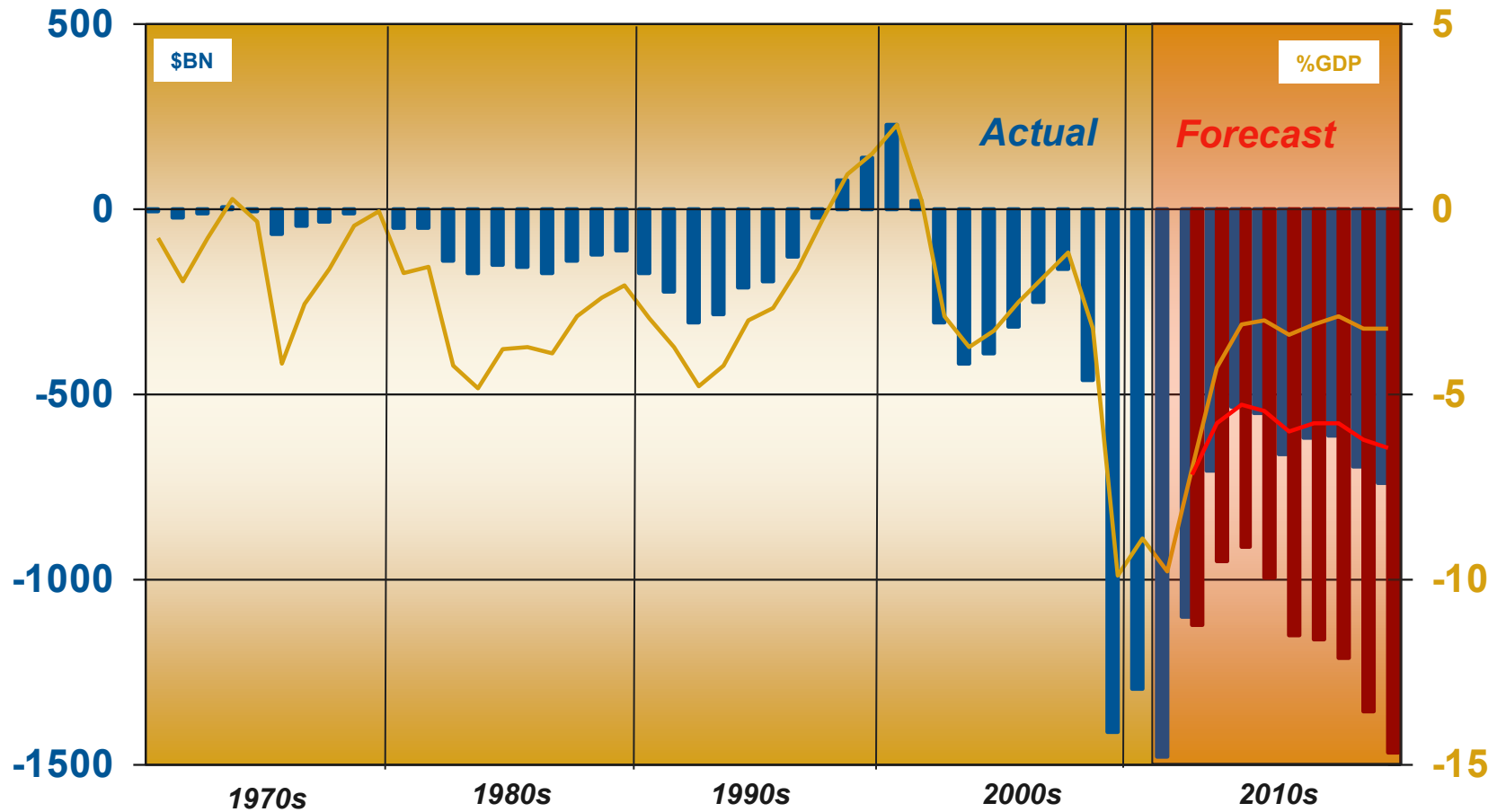
THEY ARE ALL PIGS!



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Bullish: (1) Global Reflation - Recession

US deficits large as far as eye can see

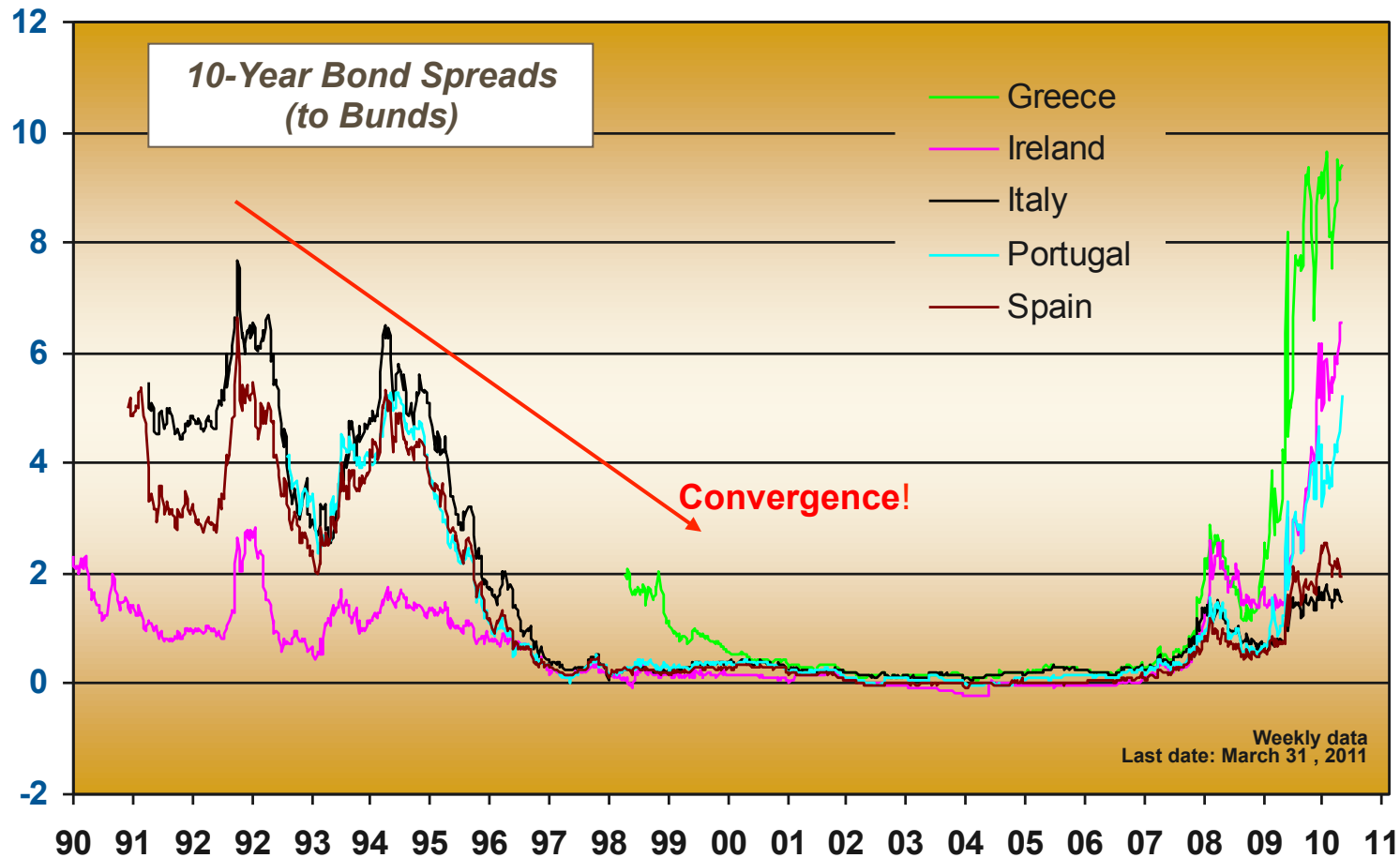


Blue: CBO current law projections, Jan 2011

Red: CBO projections if the income tax, estate tax and gift tax provisions of the 2010 Tax Relief Act are extended combined with the AMT (alternative minimum tax) indexed for inflation and if Medicare's payment rates for physicians held constant

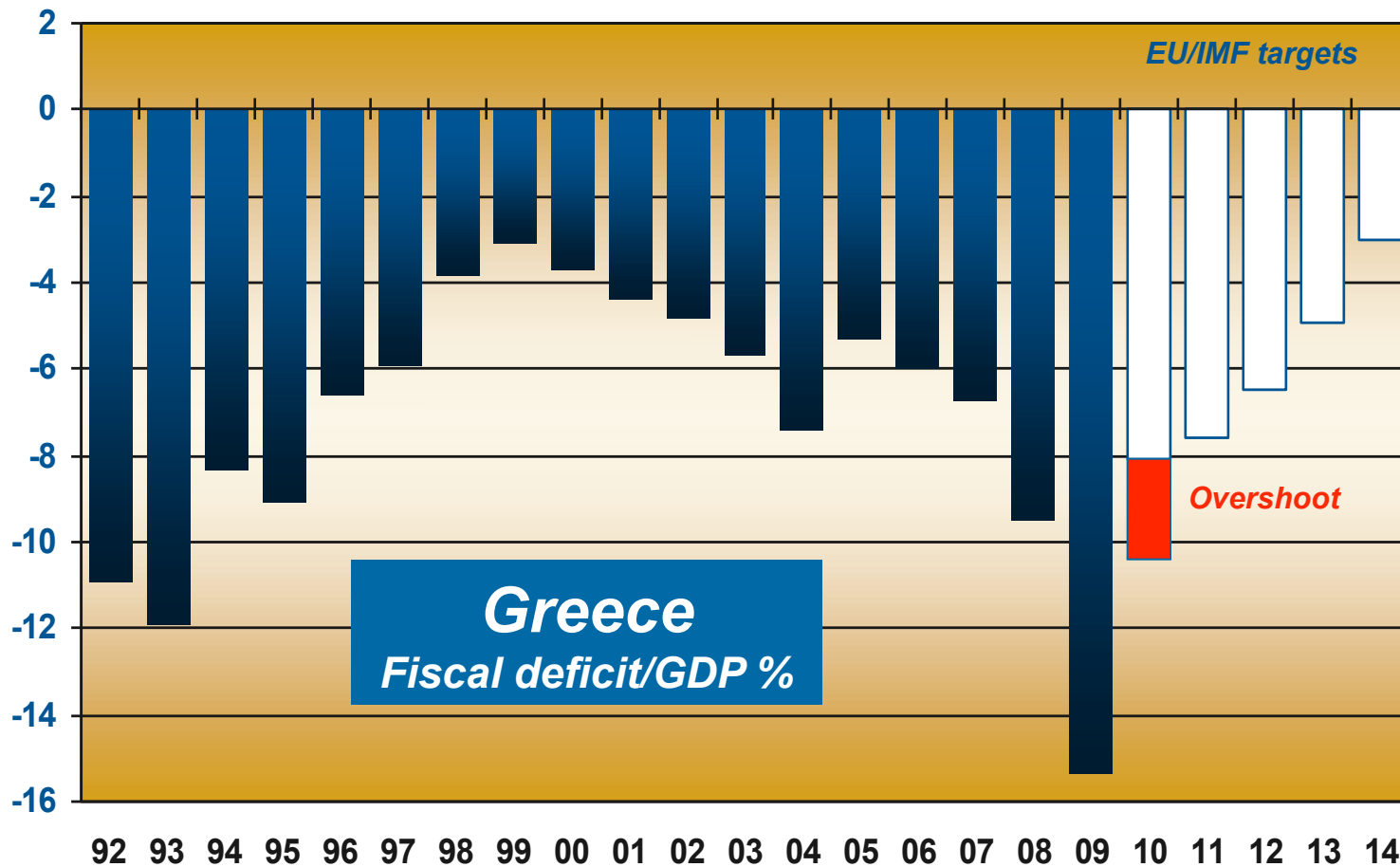
Bullish: (1) Global Reflation - Convergence

Euro convergence encouraged borrowing by PIIGS

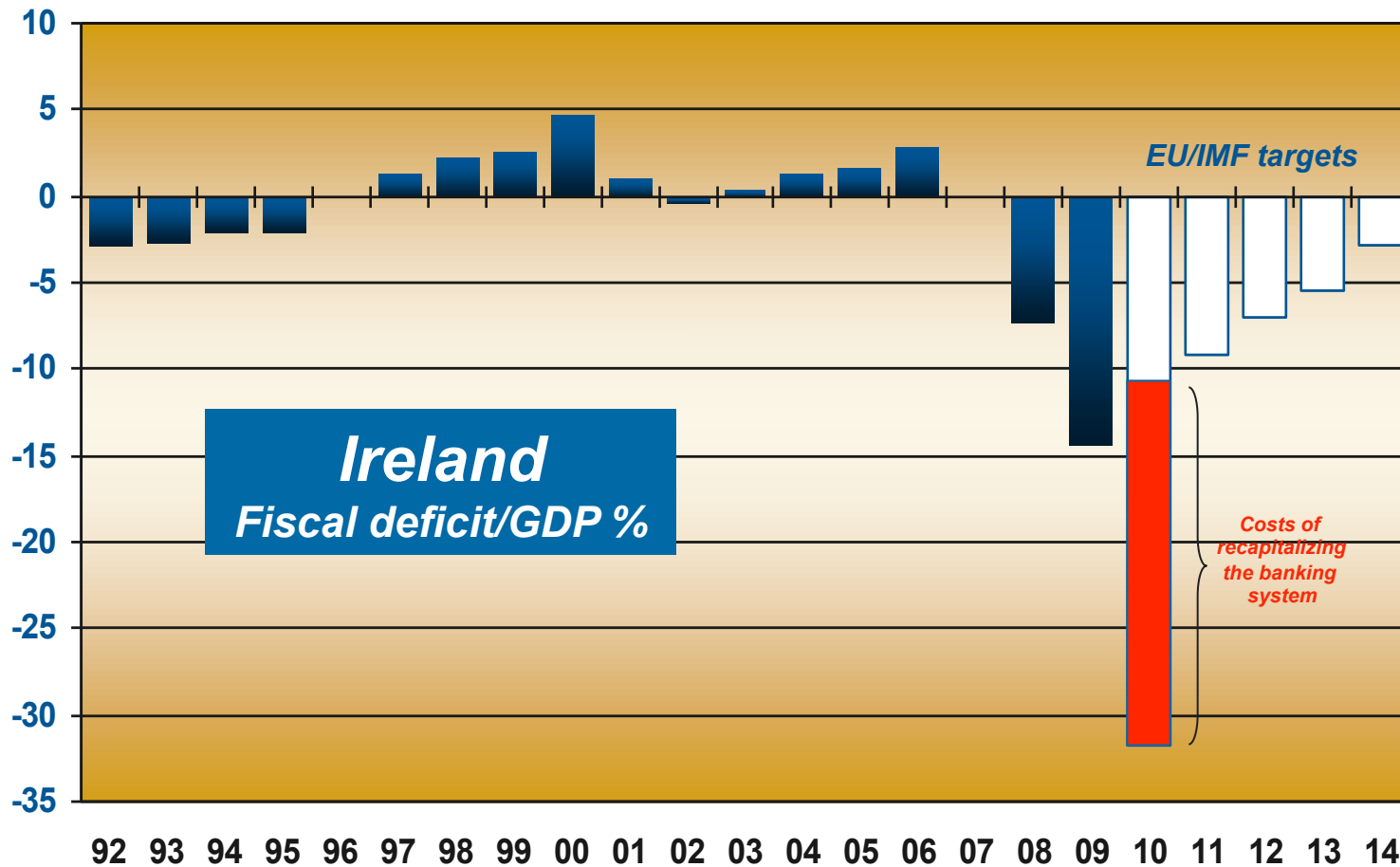


Source: Datastream

Bullish: (1) Global Reflation - Convergence ***EU targets imposed - but unlikely to be met***

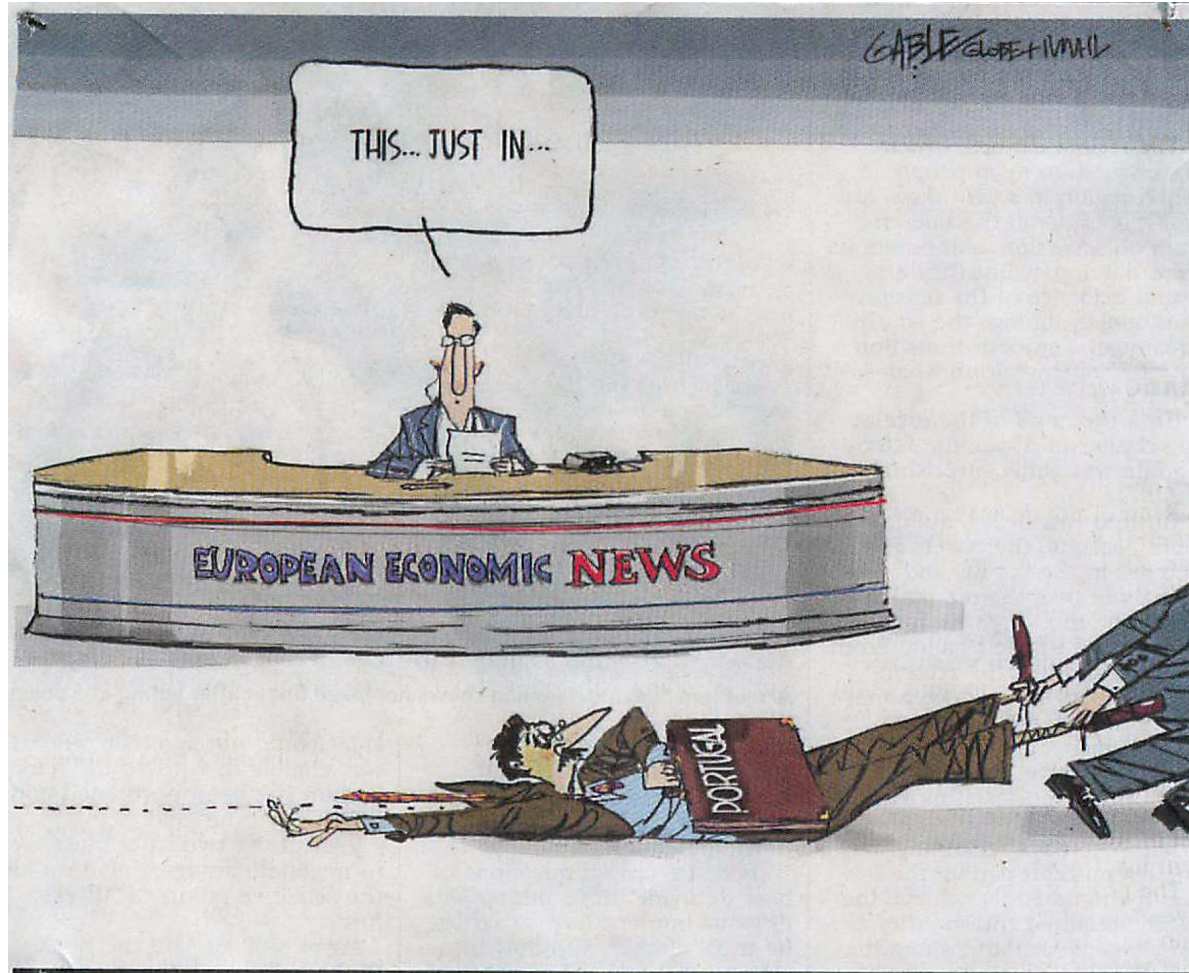


Bullish: (1) Global Reflation - Convergence ***EU targets imposed - but unlikely to be met***

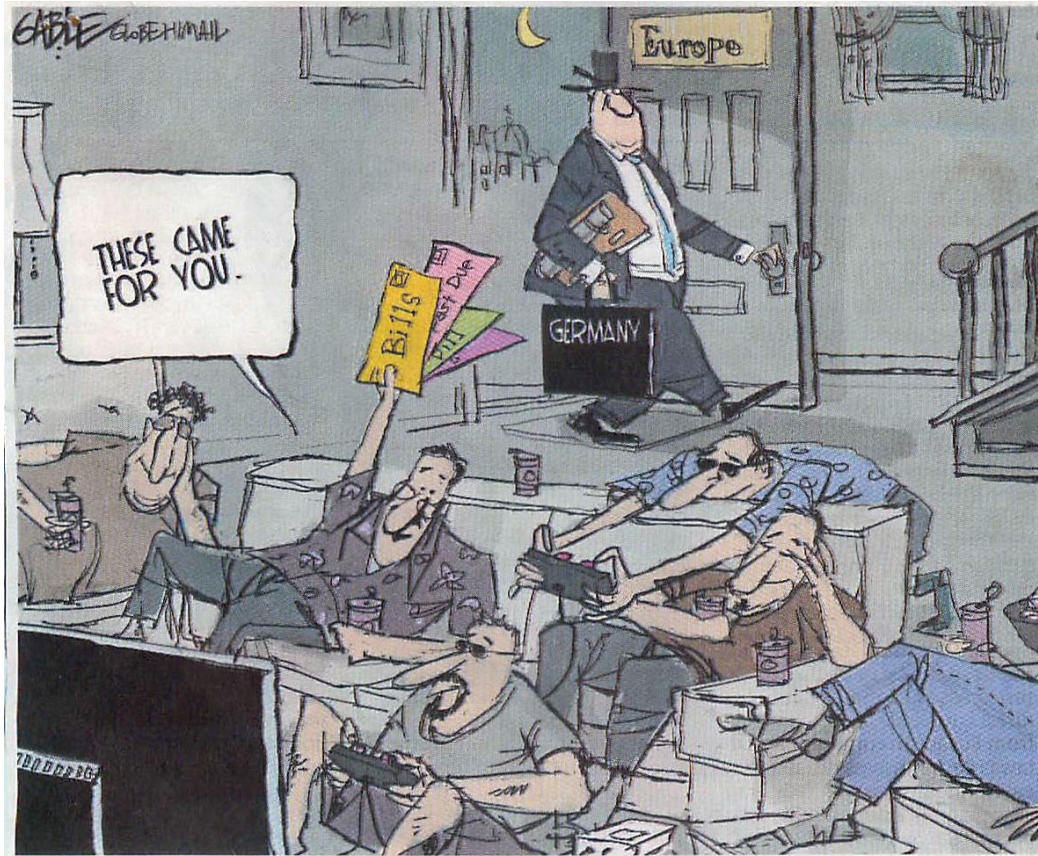


Bullish: (1) Global Reflation - Convergence

And now Portugal needs €80 billion!



Will Germany Pay ...?



Mark Steyn

(MacLean's Columnist):

“Greece has run out of Greeks to stick it to. So it's turned to Germany ...”

Bullish: (1) Global Reflation

How will governments deal with exploding debts?

Government Choices:

Renege on promises

Cut other services

Raise taxes

Print more money?

Bullish: (1) Global Reflation

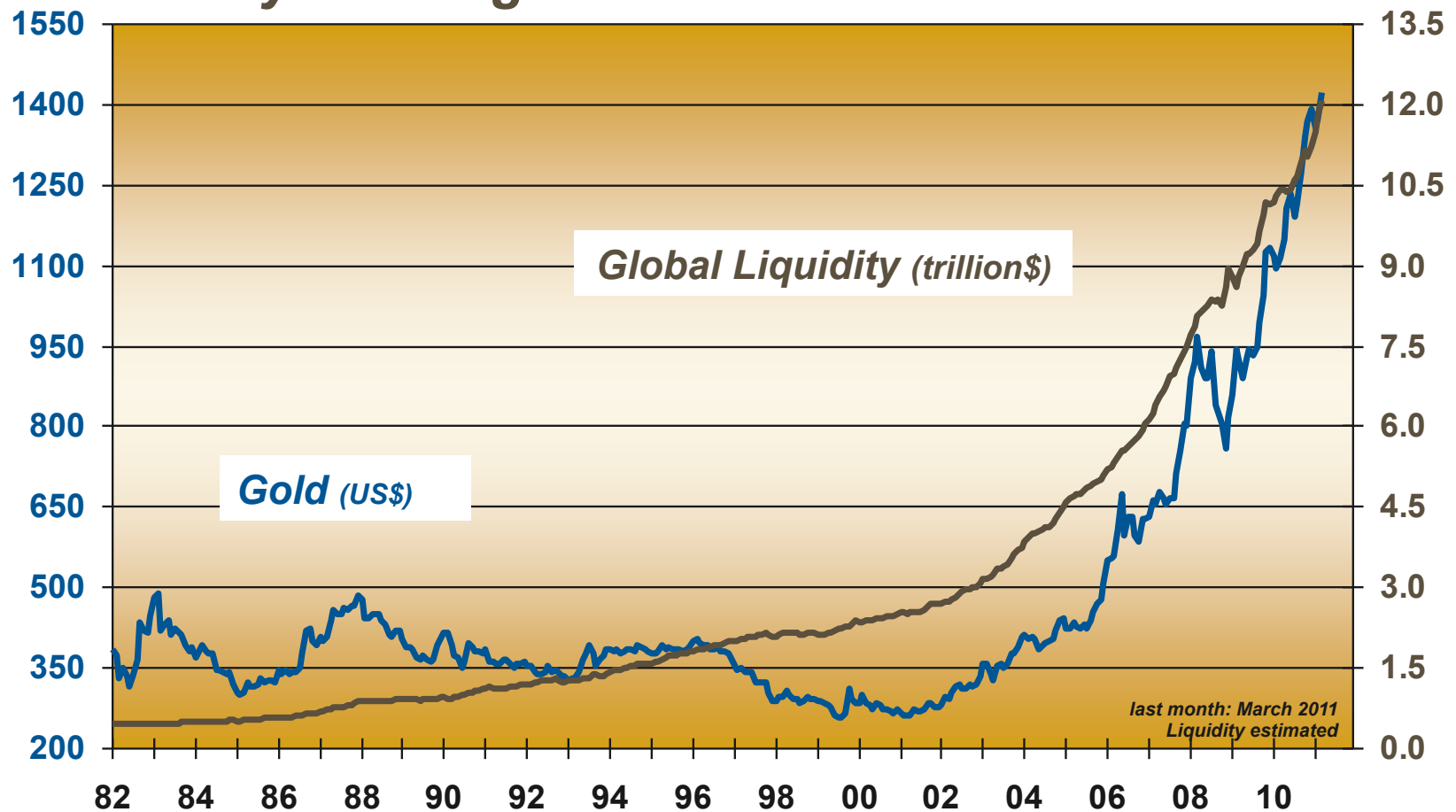
How will governments handle exploding debts?

“Throughout history, feckless governments have dodged their fiscal responsibility by turning to their monetary authority to devalue the currency, monetize debt and inflate their way out of structural deficits”

***Richard Fisher:
President and CEO of the FRB of Dallas
March 10, 2011***

Bullish: (1) Global Reflation

Money drives gold ...



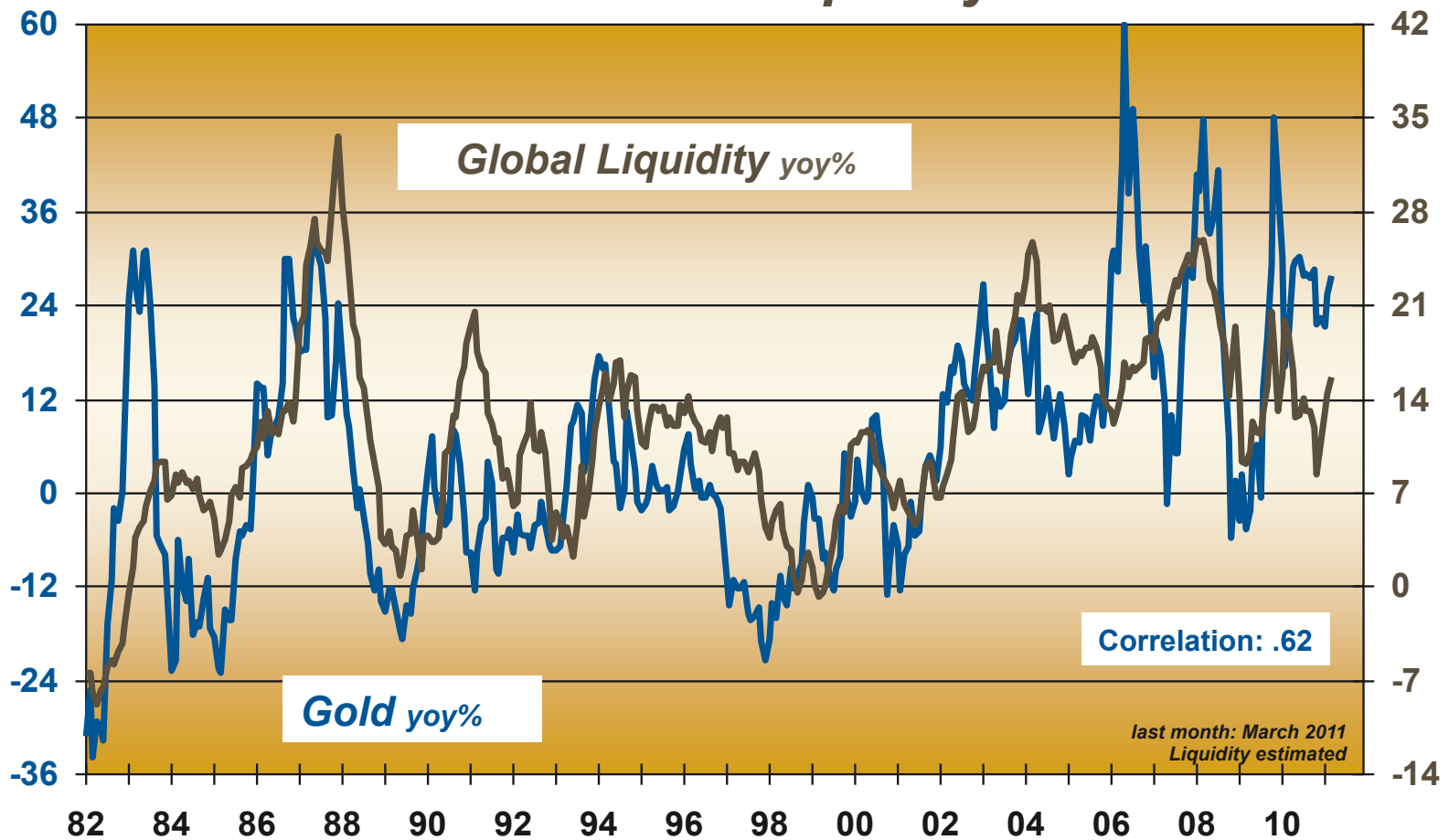
Global Liquidity: FX Reserves + US MBase
 Source: IMF, Federal Reserve



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Bullish: (1) Global Reflation

Gold rises and falls with liquidity

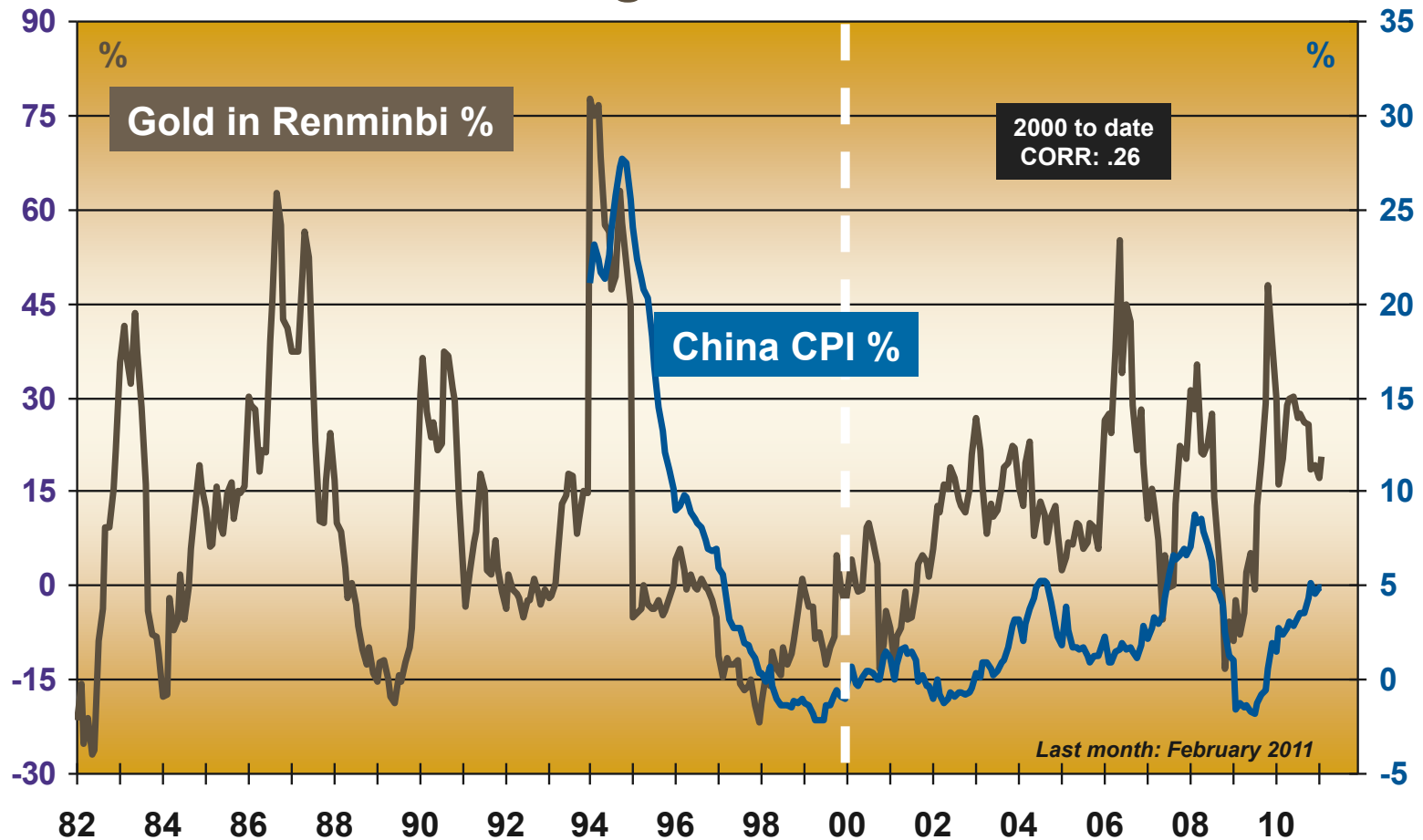


Global Liquidity: FX Reserves + US MBase
Source: IMF, Federal Reserve

last month: March 2011
Liquidity estimated

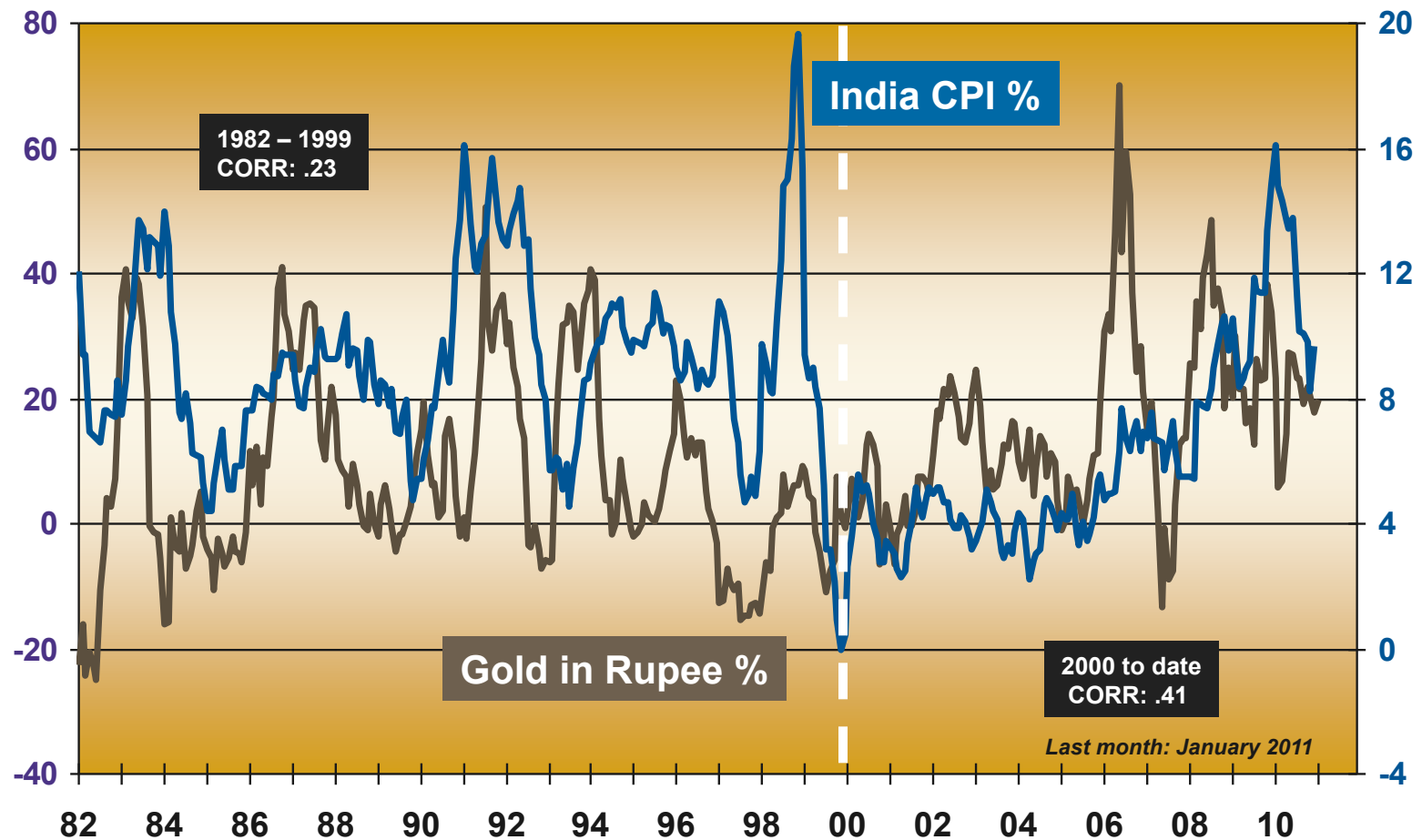
Bullish: (2) Inflation in China

China inflation rising ...



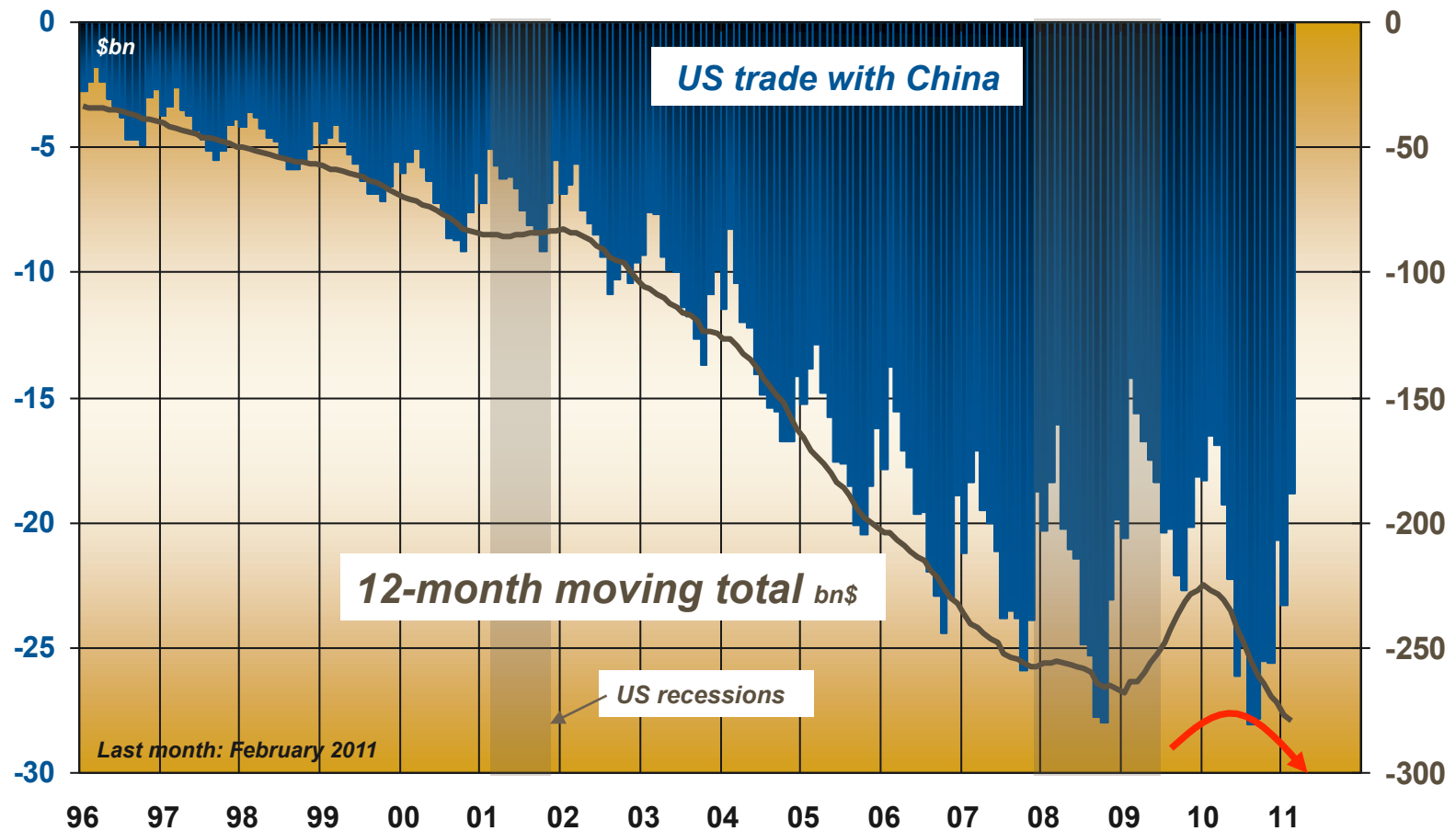
Bullish: (2) Inflation in India

India inflation rising ...



Bullish: (3) Global Imbalances

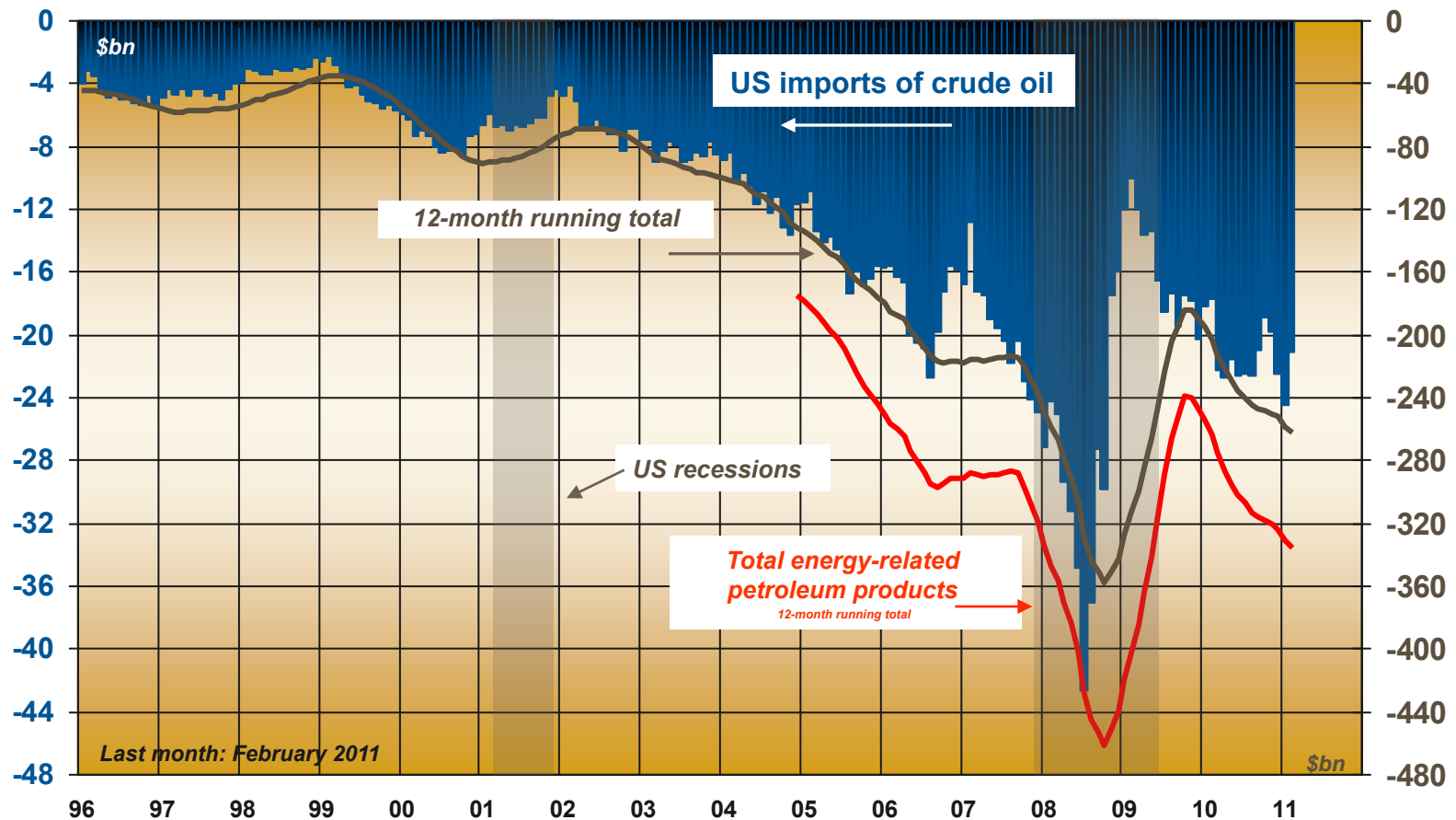
The US trade deficit with China is unsustainable



Source: US Dep't of Commerce

Bullish: (3) Global Imbalances

US energy deficit bleeds dollars on world markets



Bullish: (3) Global Imbalances

The fundamental problem

With a fixed exchange rate:

- ***China and other “surplus” countries should “inflate” – let inflation rise on the back of significant increases in the domestic money supply***
- ***The US and other “deficit” countries should “deflate” – let deflation and high unemployment run its course***

With a flexible exchange rate:

- ***China and other “surplus” countries should “inflate” modestly – and allow their currencies to rise***
- ***The US and other “deficit” countries should “deflate” modestly – and allow their currencies to decline***



Bullish: (4) Global Reserves ***Global reserves are “excessive”***

Foreign Exchange Reserves (countries over \$100 bn)			
	bn\$		bn\$
China	2847.3	Hong Kong	273.1
Japan	1031.0	India	272.0
Russia	447.2	Switzerland	221.0
Saudi Arabia	446.2	Thailand	172.9
Taiwan	390.7	Algeria	160.6
Brazil	299.2	Mexico	120.0
Korea	291.0	Malaysia	105.5
		TOTAL	7077.7

Addendum: Fuel Exporters \$1415.3 bn

Source: IMF, IFS February 2011

Bullish: (4) Global Reserves

Hence diversification out of dollars will continue

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. SDRs 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”, hence China likes commodity-producing assets instead*

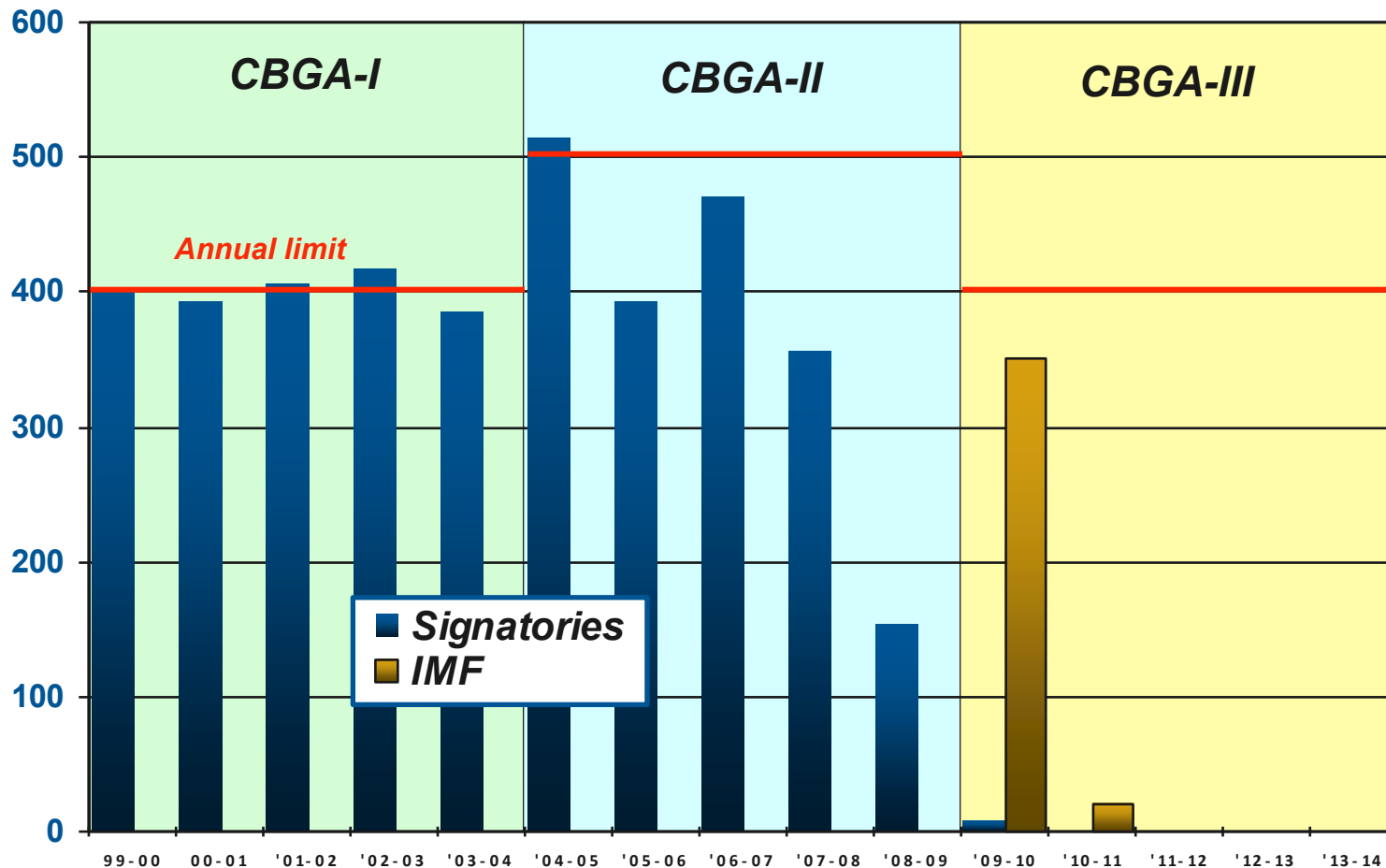
Bullish: (5) Central Bank Attitudes

Central bank attitudes towards gold have changed

- 1. CBGA signatories are no longer selling gold***
- 2. China has raised its gold reserves from 600 to 1054 tonnes***
- 3. India purchased 200 tonnes of IMF gold***
- 4. Russia buys monthly***
- 5. Russia and India have suggested a new SDR basket should include gold***

Bullish: (5) Central Bank Attitudes

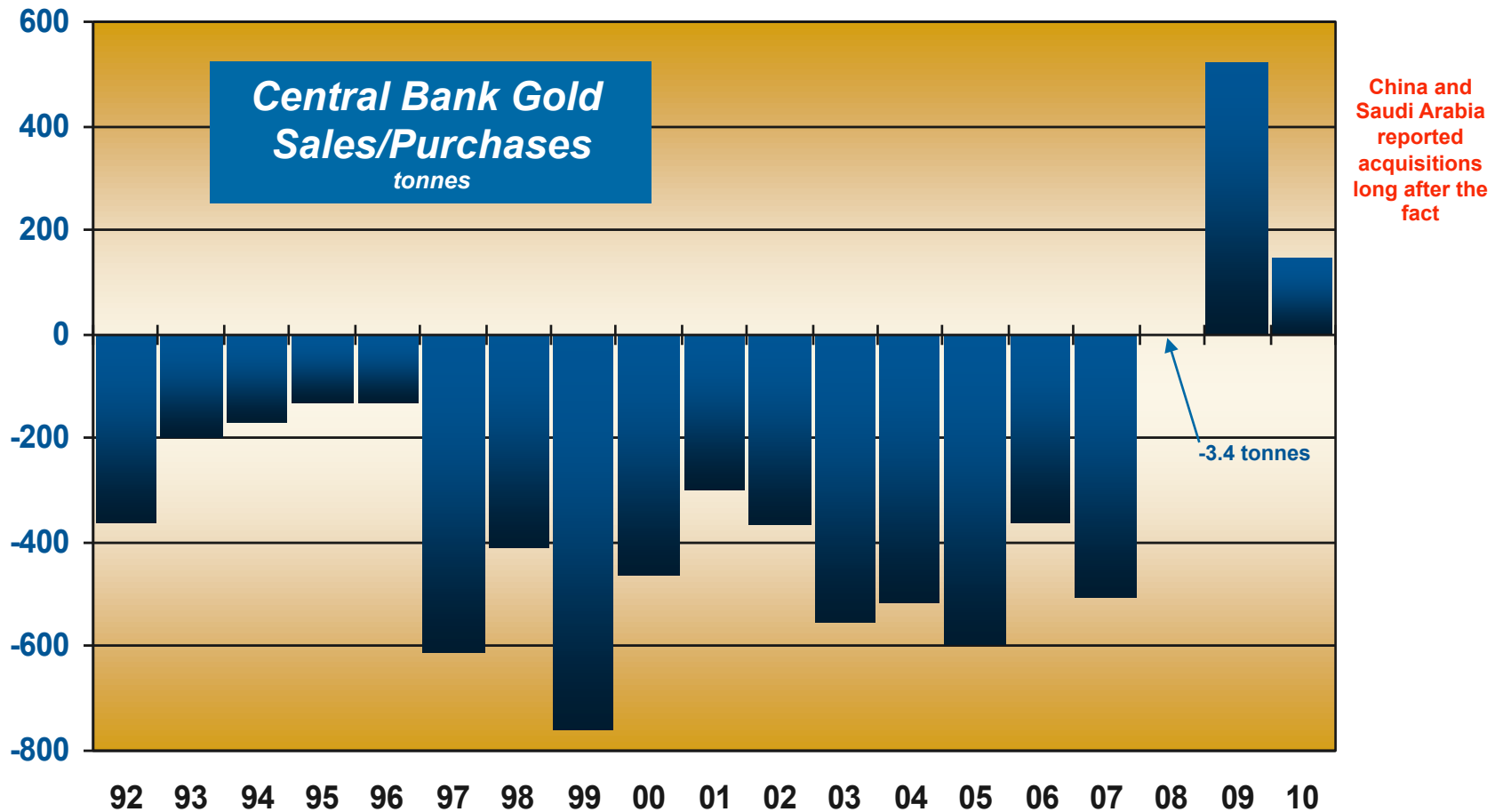
CBGA signatories have stopped selling gold



Source: IMF

Bullish: (5) Central Bank Attitudes

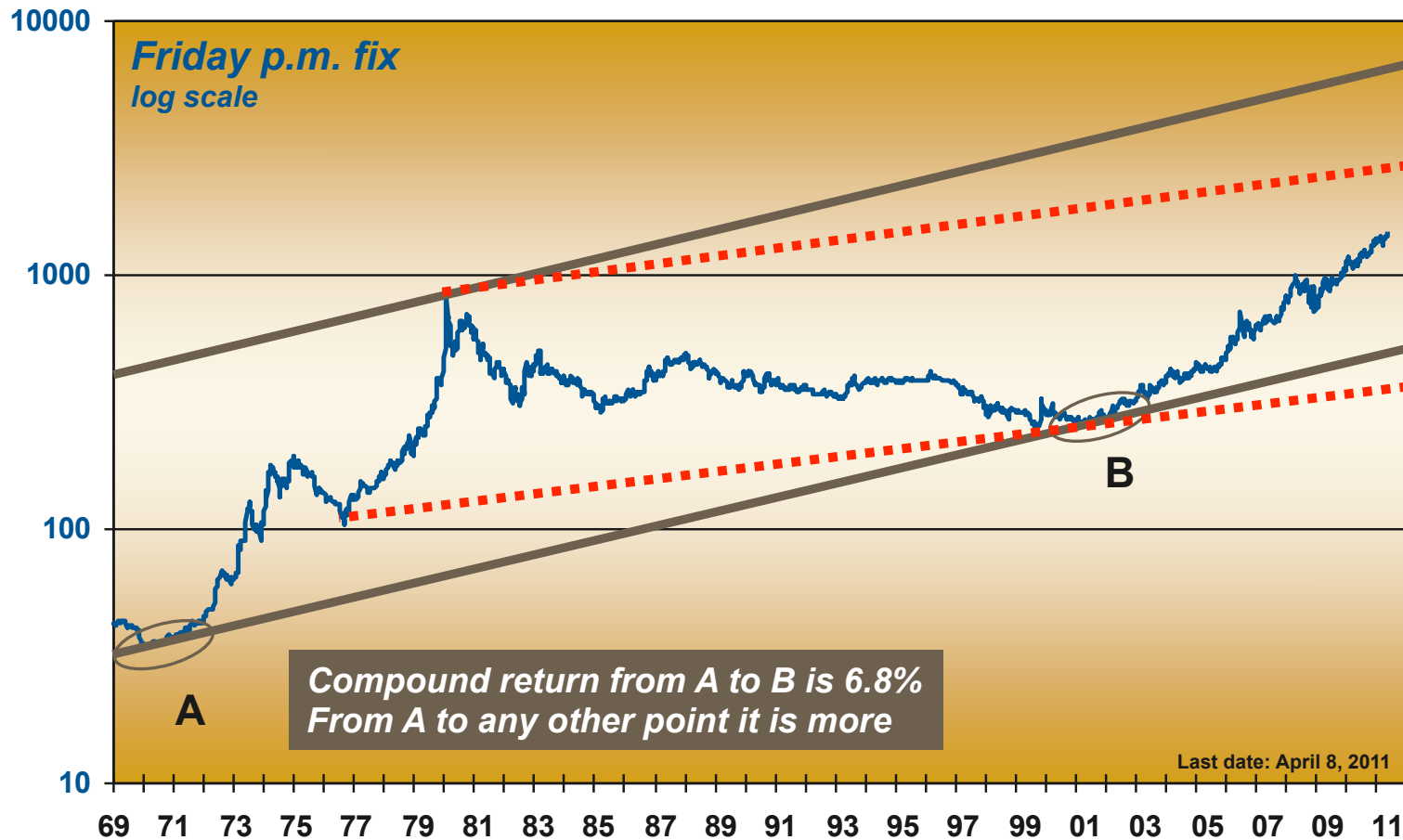
Central banks were selling – now buying



Source: IMF
Data as reported in IMF statistics, which do not necessarily agree with date of actual gold sales or acquisitions

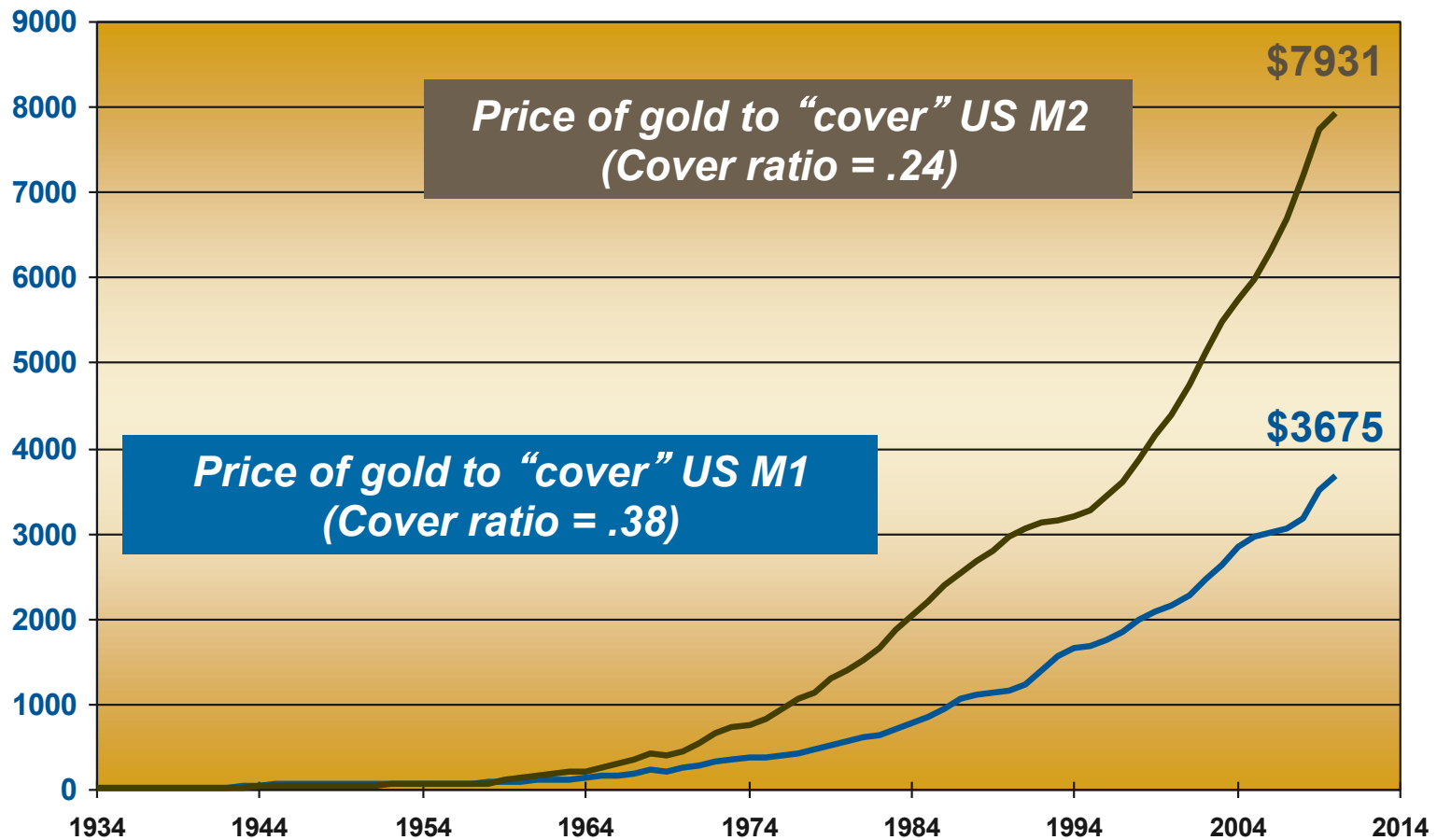
Bullish: (6) Gold Not in a Bubble

This chart puts the rise in a proper perspective



Bullish: (6) Gold Not in a Bubble

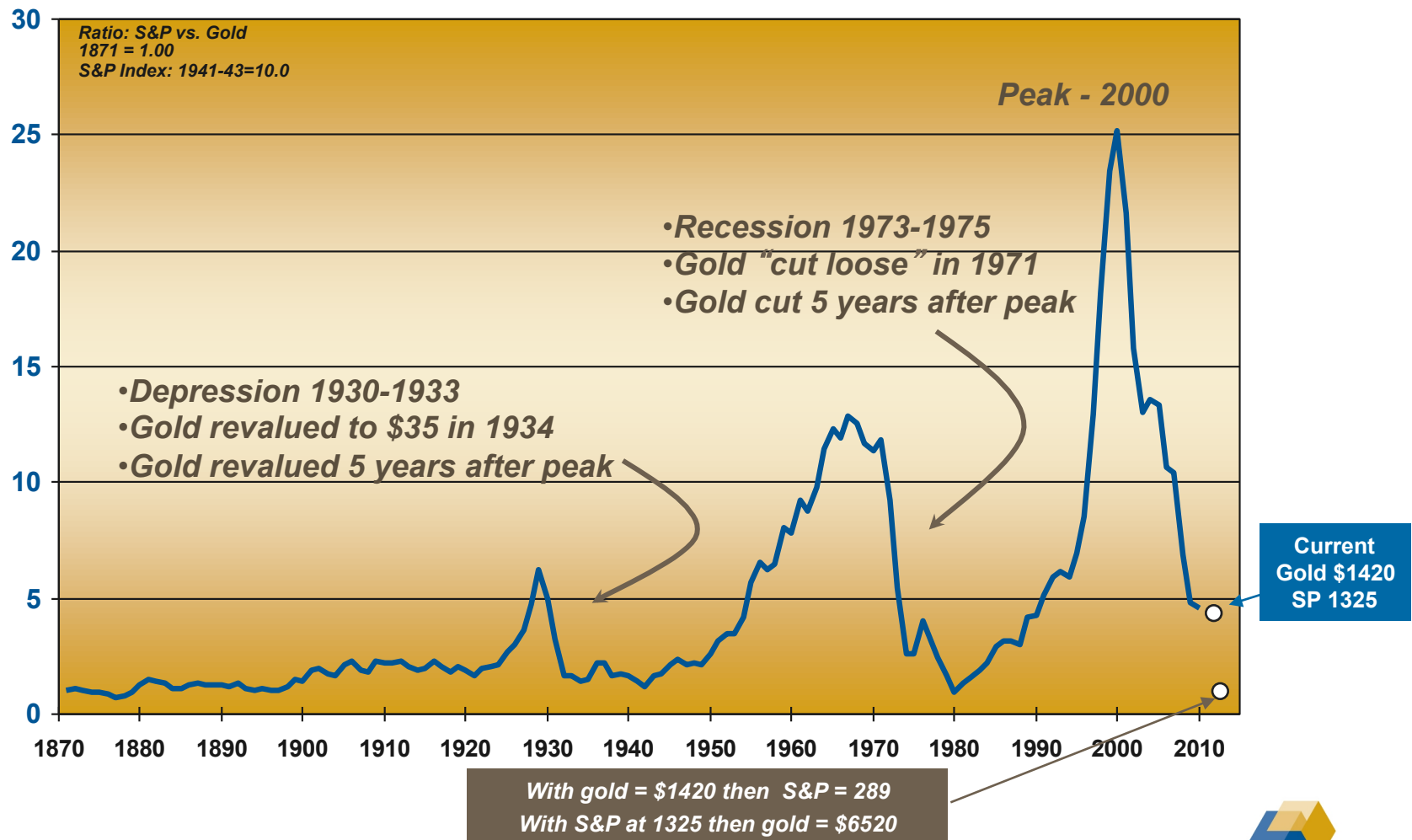
If US gold had to “cover” US money supply ... then ...



“cover ratio” as determined in 1934 when gold was revalued to \$35

Bullish: (6) Gold Not in a Bubble

Gold still inexpensive In terms of financial assets



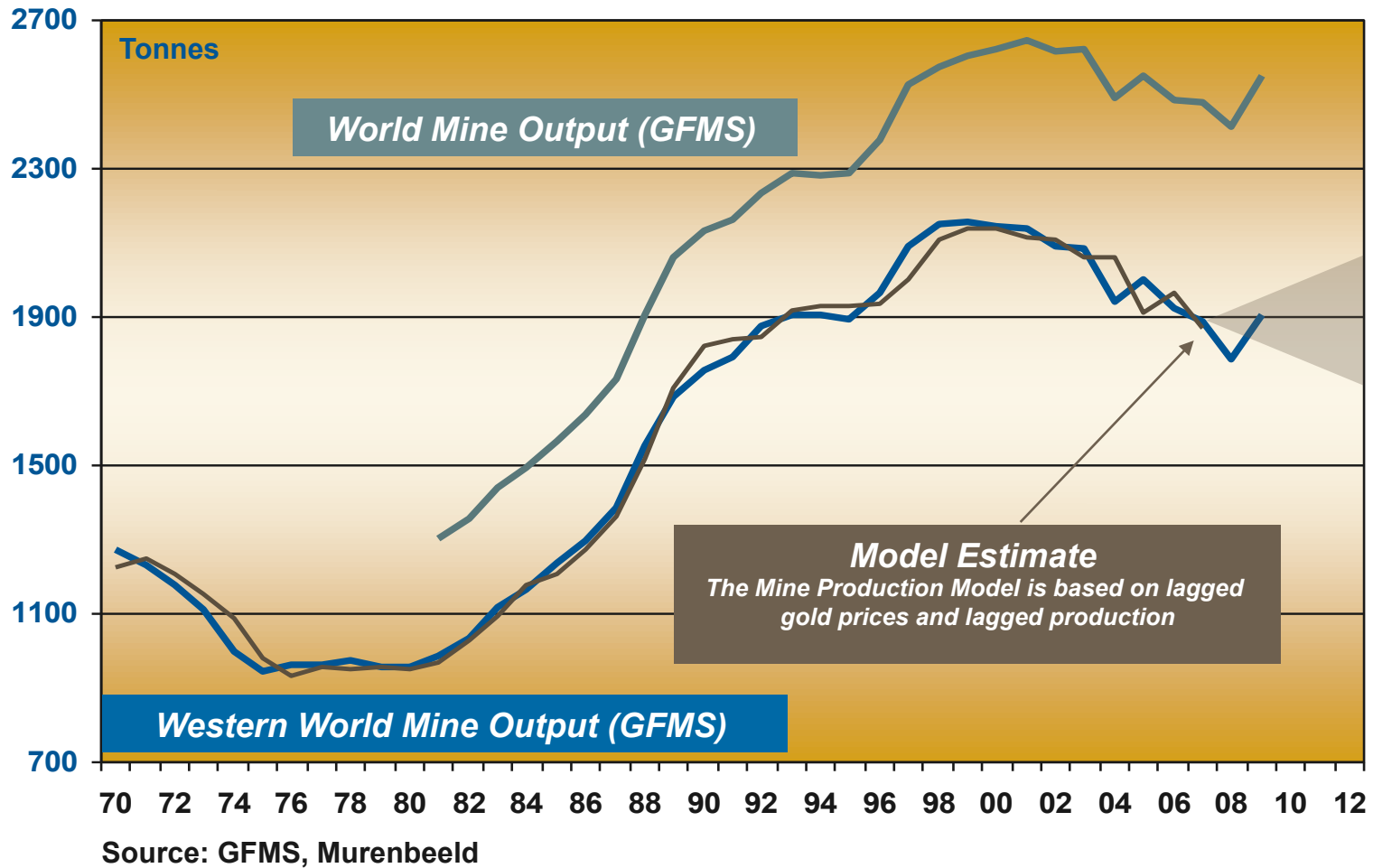
Bullish: (6) Gold Not in a Bubble

Gold may one day be – but that day is not now



Bullish: (7) Gold Supply

Model suggests WW mine output somewhat flat



Bullish: (7) Gold Supply

The general commodity supply outlook is impaired

- 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 ...***

Bullish: (8) Investment Demand

Can we make a case for investment demand?

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)***

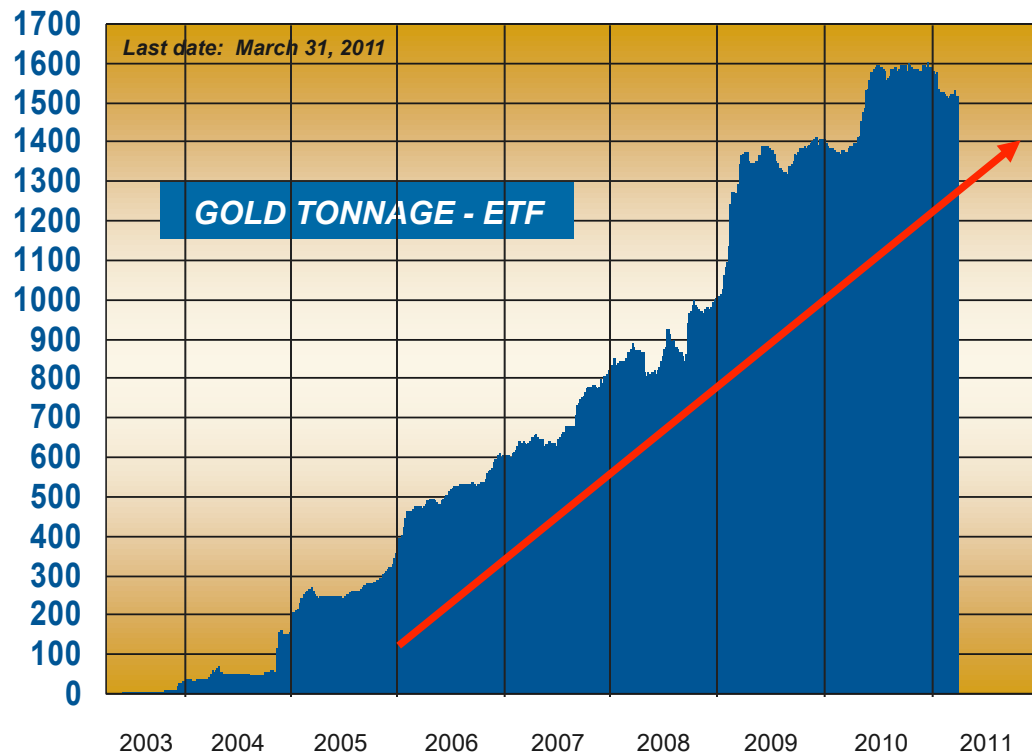


Bullish: (8) Investment Demand

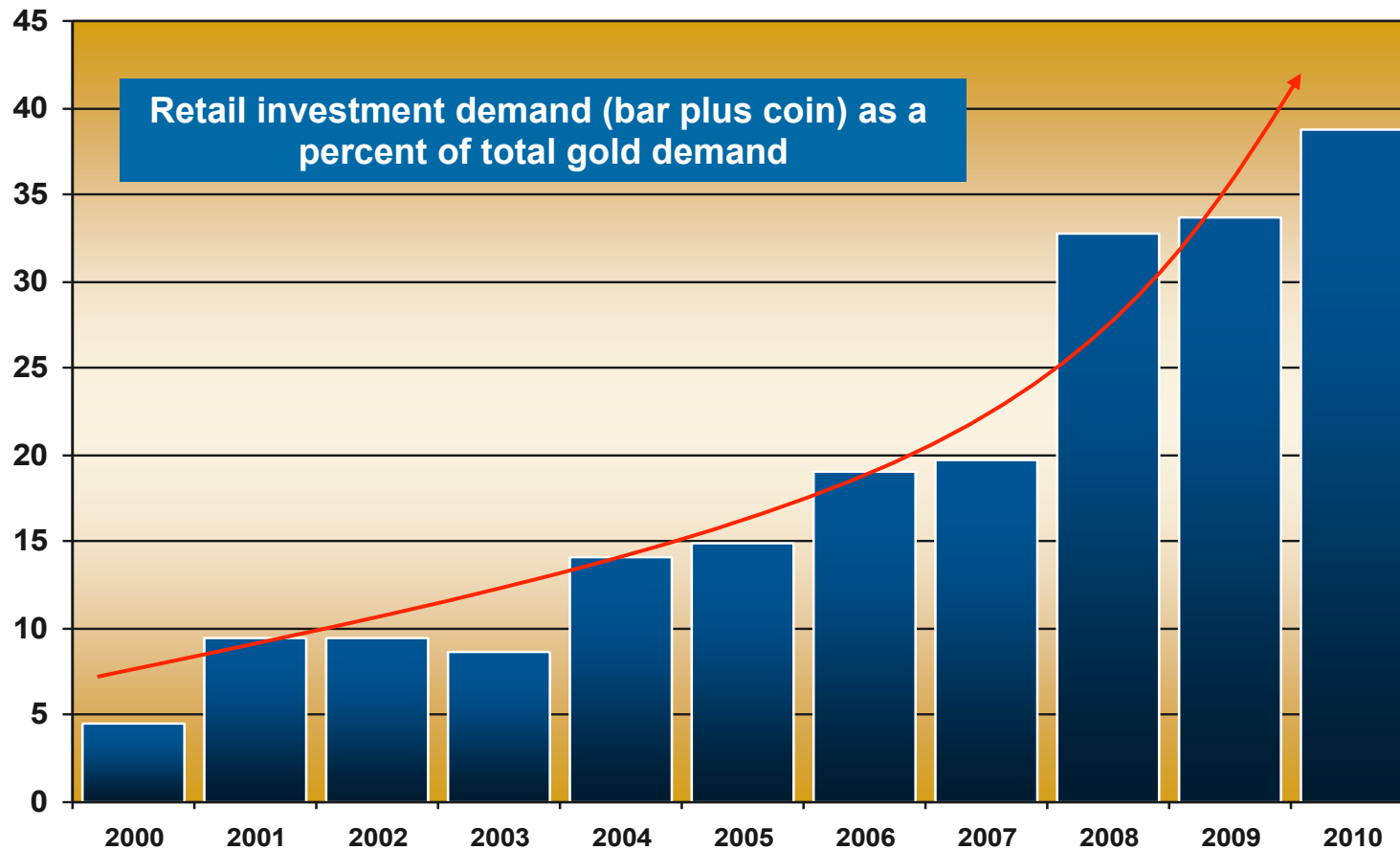
The gold ETF rising strongly since introduction

ETF demand is in a long-run uptrend even while from time to time there are reversals ...

Some investors simply prefer bullion ...



Bullish: (8) Investment Demand ***Retail investment demand – bullion!***

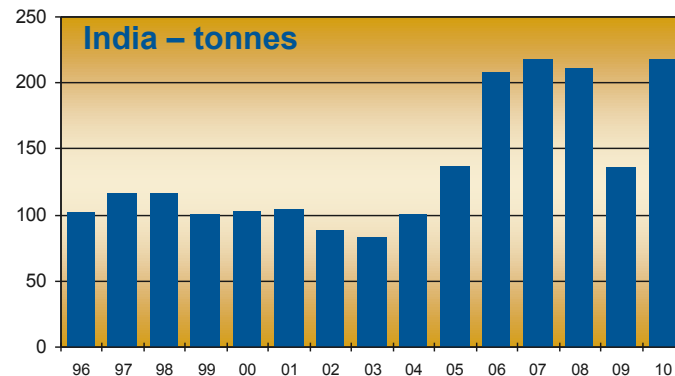
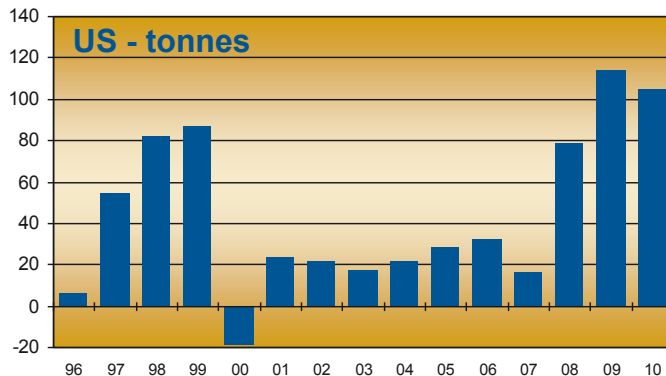
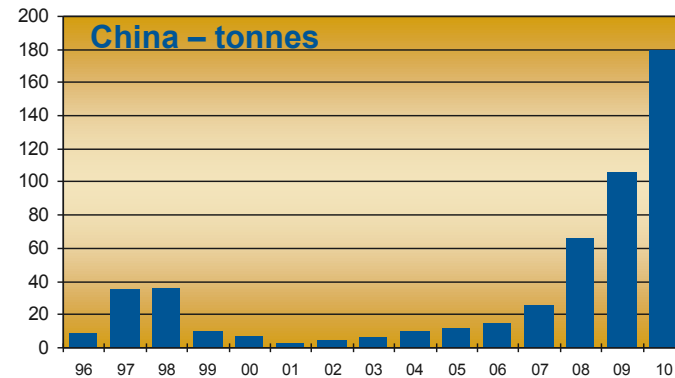
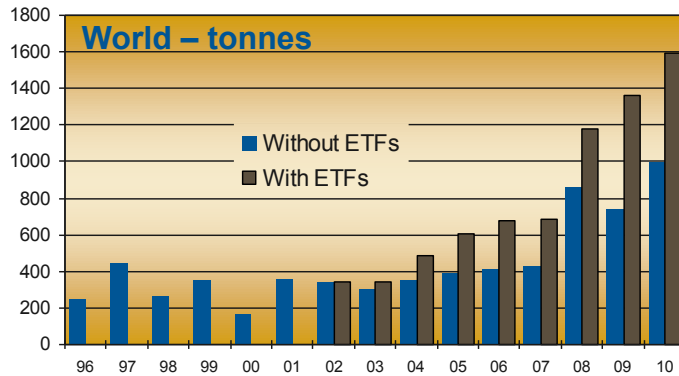


Source: World Gold Council “Gold Demand Trends – 2010”
Based on data tabulated by GFMS

Bullish: (8) Investment Demand

Retail investment demand will grow in Asia

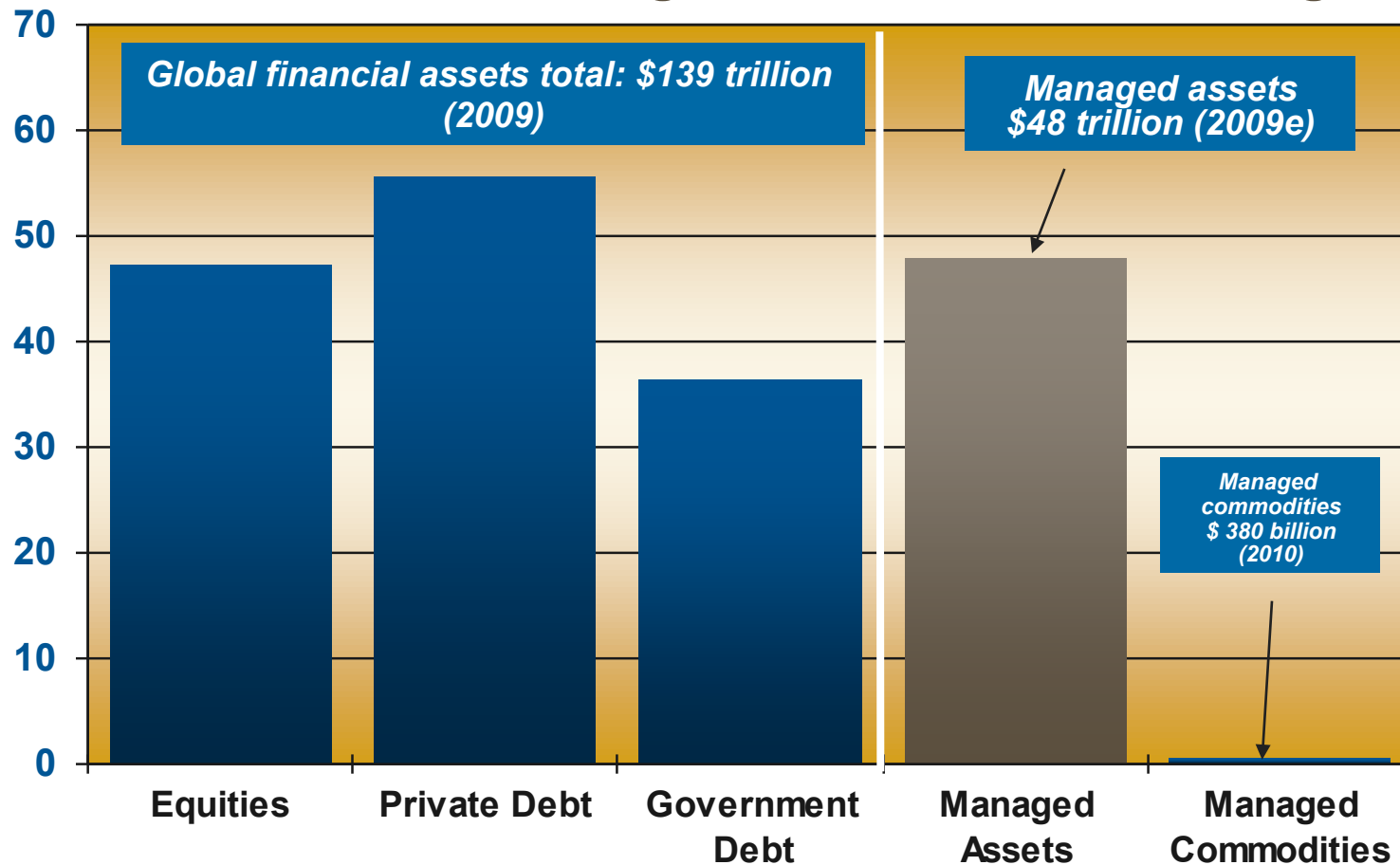
Net Retail Investment Demand (excluding ETF's)



Source: World Gold Council, GFMS
Estimates by DundeeWealth Economics

Bullish: (8) Investment Demand

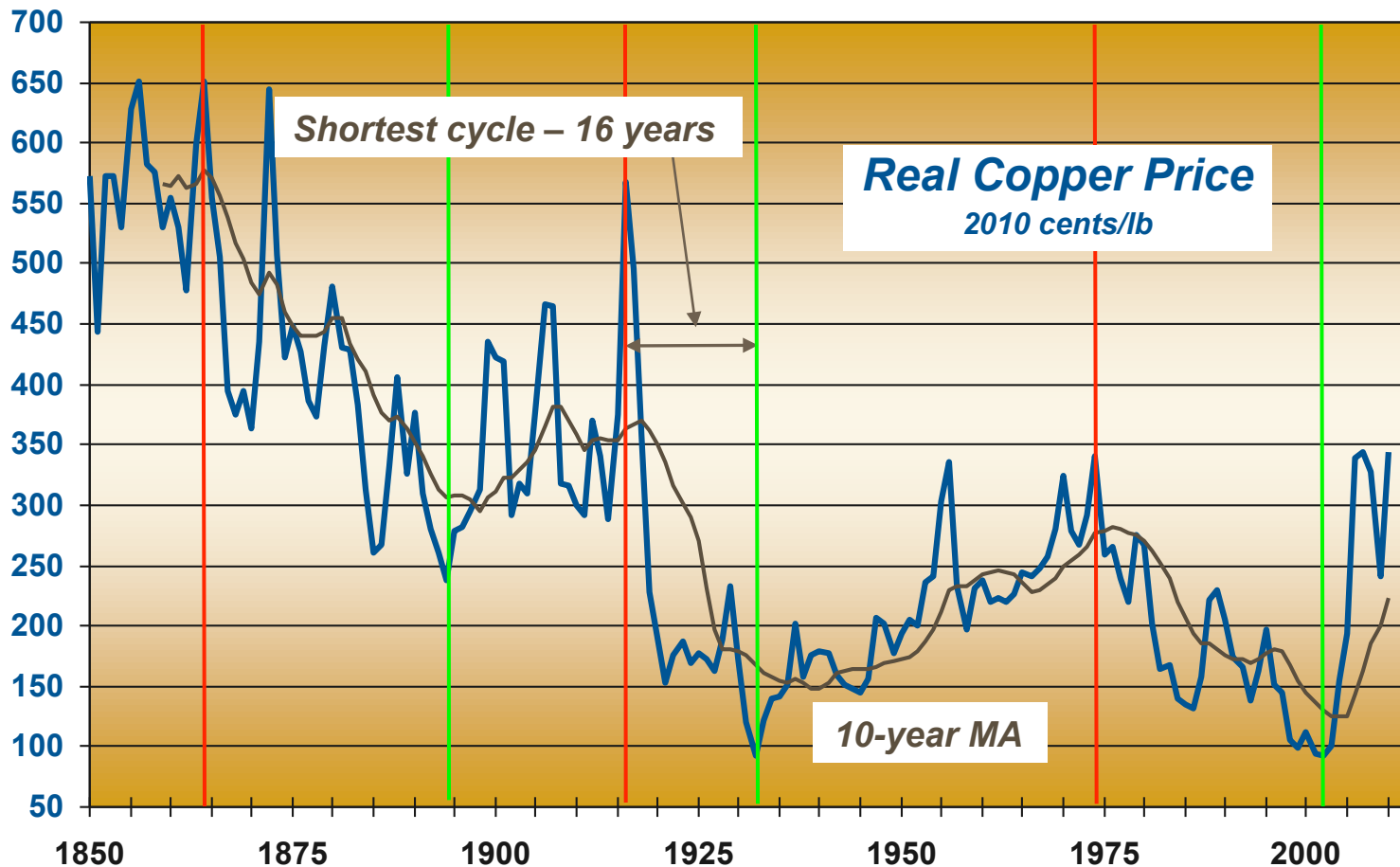
Investment demand in gold/commodities will grow



Original Sources: McKinsey & Company, IMF, Barclay's

Bullish: (9) Commodity Cycle

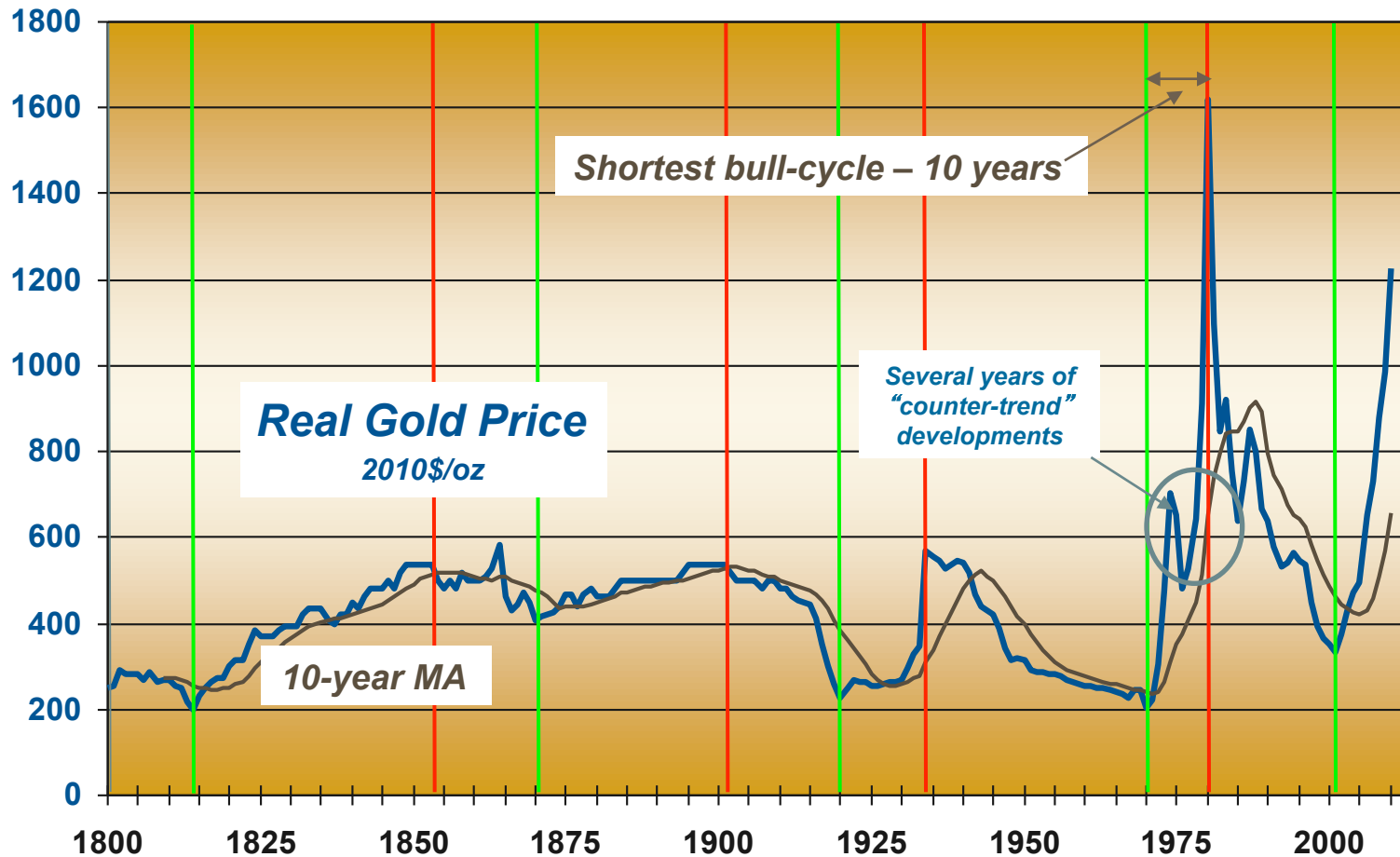
The shortest copper cycle lasted 16 years



****despite reversals – which are common in all cycles***

Bullish: (9) Commodity Cycle

The shortest gold cycle lasted 10 years



Bullish: (10) Geopolitical ***The biggest geopolitical crisis to date ...***

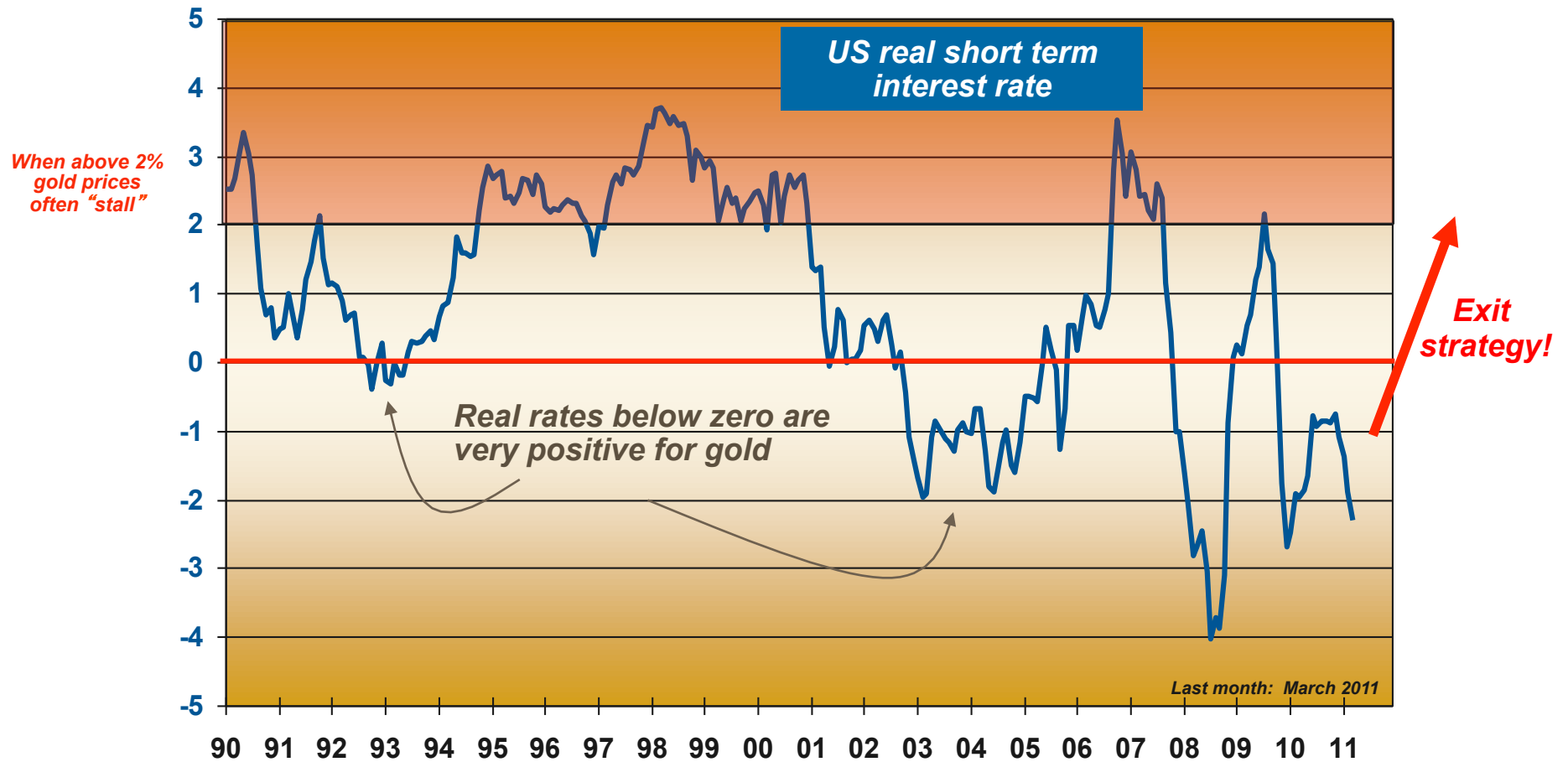


Outlook: Seven Bearish Arguments

- 1. Policy “exit strategies”:*** in China, India ... US?
- 2. Strong dollar:*** against the euro ... flight to safety?
- 3. Liquidity of last resort:*** for Greece, Italy, ..., Japan?
- 4. Resolution to EU debt crisis:*** The €500bn ESM and fiscal retrenchment boosts confidence
- 5. Equity markets continue to rally strongly:***
investment interest in gold wanes
- 6. Dehedging finished:*** hedging to recommence
- 7. Chinese recession:*** commodity demand will decline

Bearish: (1) Exit Strategies

US real rates will rise ... eventually



Bearish: (1) Exit Strategies

fiscal policies must also be tightened ...

Assuming fiscal AND monetary policies are tightened:

- 1. There will be a serious policy drag on growth***
- 2. Inflation pressures will dissipate and the threat of deflation will grow***
- 3. Confidence in monetary policy (and fiscal policy) will rise dramatically***
- 4. Which all will weigh heavily on the gold price***
- 5. UNLESS SUCH POLICIES ARE REVERSED!***

Bearish: (3) Liquidity of Last Resort

The PIIGS need cash!

- ***The PIIGS hold over 3000 tonnes of gold***
- ***We have been concerned about Italy for years***
- ***Then there is Japan with 765 tonnes of gold?***

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

Bearish: (7) A Chinese Recession

Commodity demand could tumble

In a Chinese recession:

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

But policy will respond:

- 1. The PBoC will “print money” and the government will expand fiscal policy... as it too learns about non-performing loans***
- 2. Other Asian central banks will want to insulate their economies, and print/devalue***
- 3. Which will eventually see gold demand rise to new highs***

*The Latest Forecast**

The scenarios make no allowance for geopolitics!!

Gold Price Scenarios

	<u>2011-avg</u>	<u>2011-end</u>	<u>2012-avg</u>
Scenario A: p = 10-20%		\$1255	\$1165
		\$1160	
Scenario B: p = 55-50%		\$1445	\$1500
		\$1546	
Scenario C: p = 35-30%		\$1595	\$1770
		\$1880	

* April 2011 Forecasts are updated quarterly
Weighted.

\$1476 \$1546

\$1573 **DUNDEEWEALTH**[®]



Thank you for your attention!

DUNDEEWEALTH ECONOMICS

