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# In 2008, Gold Should Glitter

By James Turk

Bull markets begin when few people are paying attention. So it is not surprising that sentiment for gold hit rock bottom back in July 1999. That month marked the end of the selling climax precipitated by the announcement in May 1999 by then British Exchequer Gordon Brown that Britain would be selling one-half of its gold reserve. The "Brown bottom" in gold was in place at $252. Gold has been climbing ever since.

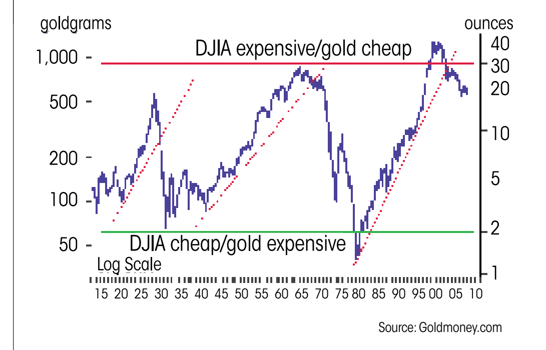
Of course, gold's advance since then has not been a straight line. It never is. Bull markets always climb countless "walls of worry," and gold has seen plenty of those during the past eight years, with more to come, no doubt, as investors look toward the prospects for gold in 2008. But with "walls of worry" come opportunities. Gold has risen in price each year of this decade, and good reasons suggest that this unbroken string of annual price appreciation will continue. So even though gold is now approaching its record high price of $850, it is still a good time to buy it. Here are some of the more important reasons to expect a much higher gold price in the year ahead. In fact, it is reasonable to expect that in 2008 gold will reach that level long thought impossible—a four-digit gold price.

## Gold Is Still A Good Value

Although gold's previous record high of $850 reached in January 1980 gets attention, rarely do people consider that a 1980-dollar had substantially more purchasing power than a 2007-dollar. Adjusting for 27 years of inflation, it takes $2,208 today to equal the purchasing power of $850 in January 1980. So by this measure, gold is still far from a true record high.

Another useful measure to determine gold's relative value can be made by comparing gold to the Dow Jones Industrial Average. Gold is overvalued when it takes only one ounce to buy the DJIA. For example in the 1930s, one ounce of gold at $35 bought the DJIA, and it did so again in 1980 when an ounce of gold was $850 and the DJIA was 800. Though this ratio has fallen from more than 40 ounces in 2000, it still takes 16 ounces of gold to buy the DJIA, meaning that gold continues to be a relatively good value while the DJIA is relatively expensive. See Figure 1.

**FIGURE 1:** Dow Jones Industrials in Gold (December 1913-October 2007)




Source: Goldmoney.com

There are times to be invested in equities and other times it is useful to keep a portfolio in cash. We are in one of those moments of time where cash is the place to be–but not dollar-cash. Rather, an investor's liquidity should be in gold, waiting for the next opportunity to buy the DJIA. That will be when one ounce of gold again buys the DJIA, like it did in the 1930s and in 1980. But what will that price be? No one knows of course. The price of gold and the DJIA will depend on whether the Federal Reserve deflates the monetary system as it did in the 1930s or inflates it like it did in the 1970s. Right now, Americans remain on the road to inflation, but regardless, the 1-to-1 relationship between the DJIA and gold is the target to await before moving a portfolio out of gold-cash to equities.

## HOW TO BUY GOLD

People should ask themselves three important questions when buying gold. Is the gold safe? Is the gold safe? Is the gold safe? Safety is paramount to everything else. Because gold is the bedrock asset in a portfolio, an individual should not take risks with it. For this reason, I always recommend buying physical metal, and people have two choices: buy gold coins or bars and store the gold themselves, or have someone store it for them.

Regardless of which option individuals choose, they must do their homework about the company with which they are doing business. Is it trustworthy and reliable? John Rubino and I explain ways to do this in our book, *The Coming Collapse of the Dollar*. Like everything else regarding one's portfolio, buying gold requires thoughtful analysis. Investors should start by conducting an online search for "buy gold." Then they can start investigating the choices to determine which ones work best for them.

## No Counterparty Risk

National currencies depend on the safety of the bank where someone deposits his or her currency. The U.S. subprime crisis has highlighted the severity of that risk, and the run on U.K.-based Northern Rock Bank highlights the fragility of the banking system.

National currencies have counterparty risk, but gold does not. As the subprime crisis continues to deepen, the ability to avoid this risk by holding gold during this period of financial turmoil and uncertainty about the safety and solvency of banks more than offsets any interest income one earns on bank interest.

## National Currencies Are Managed

Central banks manage all national currencies. Some do a better job than others, but

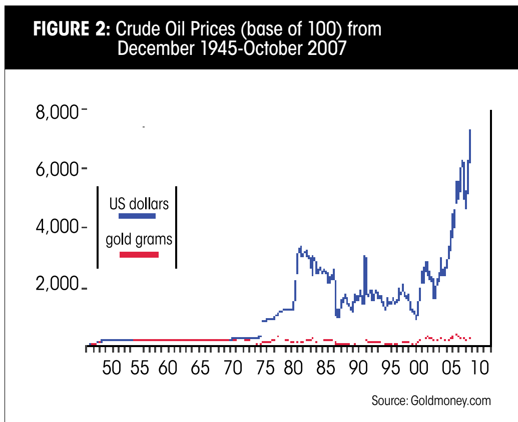



**FIGURE 2:** Crude Oil Prices (base of 100) from December 1945-October 2007

all national currencies, without exception, are being debased by inflation. In contrast to national currencies, gold cannot be inflated because it cannot be created out of "thin air" such as dollars, euros and other currencies. Consequently, an ounce of gold preserves its purchasing power. The price of crude oil shows (see Figure 2 ) that an ounce of gold has essentially the same purchasing power today as any other time since 1945.

Figure 2 also illustrates the reasons gold is money; it is useful in economic calculation. In other words, during long periods, gold conveys the utility of goods and services by the value people place on them and straightforwardly conveys that usefulness in terms of prices, which at least for commodities, remain remarkably stable—and much more stable than the dollar price of any commodity.

## Central Banks Are Losing Control

Central banks intervene in markets. That is what they do. They intervene in bonds and other debt instruments to influence interest rates. They intervene in currency markets to influence foreign exchange rates. And similarly, they intervene in the gold market to influence the price of the metal. Gold is a monetary barometer that measures how well national currencies are managed. A rising gold price indicates that a currency is being poorly managed, meaning that its purchasing power is being inflated away. This reality explains the objective of central bank intervention in the gold market, which is to cap the price of gold. By doing so, central bankers hope to make the dollar look worthy of being the world's reserve currency, but years of mismanagement are now causing people around the world to question whether the dollar should remain in that esteemed role.

What's more, people are now beginning to understand the impact of central bank intervention on the gold price and the shallow reasons for it, thanks largely to the efforts of the Gold Anti-Trust Action Committee, which for several years has well documented the central banks' intervention in the gold market. GATA has published the research of many analysts, including several articles by myself, and all of this work is available free at www.GATA.org. Because of central bank intervention, the gold price is much lower than it would be had there been no intervention.

That in itself is a solid reason to buy gold, but history also provides some strong evidence that gold should be acquired when its price is kept artificially low by central bank intervention. Now that central banks are losing control, the gold price will move toward its free-market price, just like it did after central banks stopped intervening in the late 1960s.

## The Global Monetary System Is Broken

Global imbalances from trade and capital flows have become so huge that colossal pools of "hot money" are constantly looking for a safe home. The movements of this money now dwarf the flow of capital required for global trade and commerce and has, therefore, become a destabilizing force in the international monetary system. These imbalances did not occur under the classical gold standard, proving its efficacy. Thus, I anticipate that in the not-too-distant future, gold will once again be at the center of global commerce because only gold can impose the necessary discipline on money creation. And only discipline on the money creation process will end these destabilizing imbalances.

Basically, without some external discipline, which gold provided at one time, central banks will create money to excess. Figure 3 is a good example of that reality.

M3, which is the total quantity of dollars in circulation, is presently growing at 15.2 percent per annum. The Federal Reserve

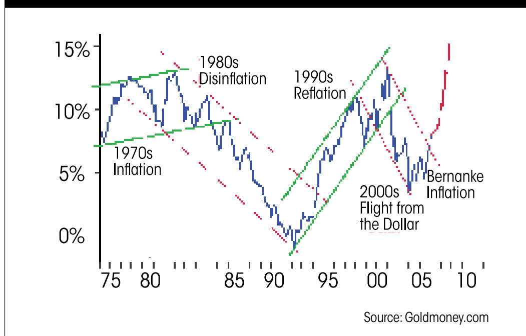



**FIGURE 3:** Quantity of Money (M3)–Annual Growth Rate January 1975-October 2007

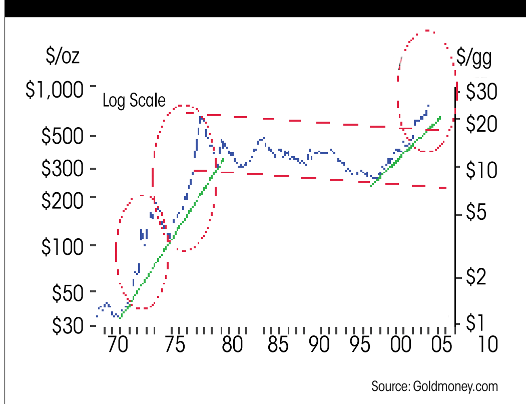



**FIGURE 4:** Monthly Gold Price December 1967-October 2007

stopped reporting M3 in February 2006, most likely to hide its intent to inflate the dollar. The red line since then is the current M3 estimate calculated by John Williams of ShadowStats.com. It is this excessive money creation that causes the destabilizing imbalances now wreaking havoc with the international monetary system and threatening to topple the dollar from its perch as the world's reserve currency.

## Technicals Remain Strong

Many people say that gold began a bear market in January 1980. I disagree. Figure 4 shows that gold formed a "flag" beginning in 1980, which is a bullish consolidation pattern. Through the 1980s and 1990s, gold consolidated the tremendous gains realized in the 1960s and 1970s. It was not a bear market but simply a "breather" in a multidecade bull market.

But this chart is also important for another reason. Note the green uptrend line marking gold's great bull market in the 1970s. Consider also the two red ovals in that decade. When gold pulled away from its uptrend line in the early 1970s and then again in the middle of the decade, it never looked back. The question then becomes, will history repeat? Gold is now pulling away from the green uptrend line formed this decade. If history is any guide—and I think it is—then gold will continue climbing from here. And the current red oval extends well into a four-digit gold price.

## It All Adds Up To Higher Gold

All of the above factors will increase the demand for gold. This increased demand will cause gold's rate of exchange to national currencies to rise, meaning gold's price will climb. And a four-digit gold price in the months immediately ahead looks to be a reasonable expectation. The important point is that gold is a relatively good value. Given the rate at which M3 is growing, there is considerable inflation in the pipeline, so owning gold is a good strategy as inflation becomes a larger problem in the months ahead. In this environment of growing monetary problems, I recommend that gold should still be accumulated, month in and month out under a long-term savings plan. Instead of saving fiat currency, everyone should be saving sound money—gold. But buy physical gold, not the ETF, certificates, futures and other forms of "paper" gold.

Gold and these types of paper gold are fundamentally different. With the paper gold, an investor owns exposure to the gold price; he or she does not own gold. With paper gold, a person has counterparty risk. In contrast, when the individual owns the physical metal, he or she gains exposure to the gold price without counterparty risk, which is what I recommend. Given the huge losses that banks worldwide are taking, everyone today should avoid counterparty risk. In other words, own "tangibles" instead of "promises."

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James Turk is the founder and chairman of GoldMoney.com. For more information see the website. He is the co-author of *The Coming Collapse of the Dollar*, see www.dollarcollapse.com.