

# Why Gold Isn't Shining (Yet...)

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Today's comment is from guest writer Daniel Zurbrügg. He is the Managing Partner of Alpine Atlantic Global Management. In his 20-year-long career he managed assets for the Philip Morris Group and Compagnie Financière Richemont. Prior to joining Alpine Atlantic he was the head of asset management for Zurich based private bank "Bank Frey & Co. AG."

In the past few months, millions of investors have taken trillions in equity out of the markets, stashing it either on the sidelines or in negative-yielding US treasury notes.

And honestly can you blame them?

Real estate and equity prices have crashed and it's almost impossible to know when they're going to recover. Fixed-income investments are growing riskier by the day due to the global credit crisis and the projected spike in bankruptcy rates.

But here's the reality: The U.S. government is printing money so fast, that cash is not even a safe bet anymore. That makes gold the safe bet in these rather stormy economic times.

Investors who purchased gold lately have been disappointed because the price of gold has not responded to the crisis as expected. Just think about it: If we had told you a year ago that this financial crisis was going to be so severe, would you have bet on gold falling by 30%?

## Anatomy of a Disappointment



My guess is that very few of you would answer "no." We have spoken with many confused investors lately, who don't understand why gold is not responding positively to the current

crisis. As you can imagine, this only adds to their confusion of the global markets.

Once again, it's important to understand what moves the price of an asset short-term and what is driving that same price in the long-term. The long-term outlook for gold is still very attractive. We simply don't have a growing supply to match the rising demand for gold.

The massive infusion of liquidity is ultimately going to lead to a massive spike in capital flows, and an upward pressure on inflation. This should also support the price of gold longer-term. Also, the weakening U.S. dollar in recent years drove gold prices higher. And the current temporary dollar recovery is also having a negative impact on the gold price.

However, at the moment, the short-term impact of various factors is out-weighting the positive long-term fundamentals.

## Behind the Scenes in the Gold Markets

The reason gold has not performed well in the last couple of months is because institutional investors are dumping their gold holdings. These institutional investors need liquidity fast, so they're selling gold. This actually shows how bad the current crisis is for many. Gold is now one of very few assets that can be easily liquidated to generate cash.

And the creativity of the financial industry has resulted in the development of a lot of commodity-linked investment funds. Typically funds buy gold as one of the hard and soft assets in their commodity-backed baskets.

These funds have all been facing a massive amount of redemptions lately. That means fund managers are forced to sell all commodity baskets they own...including their positions in gold. They could not differentiate between oil, agricultural commodities, metals and precious metals due to the nature of these investment baskets. This just adds more selling pressure on gold.

The temporary recovery of the U.S. Dollar has also kept prices rather low, but the U.S. Dollar recovery is driven by short-term money flows. We at Alpine find it hard to believe that the U.S. Dollar will continue to gain ground.

While we have seen the price of gold falling, a physical shortage of gold has developed. Go to any bank here in Switzerland and tell them you would like to buy a large amount of physical gold, either as gold bars or coins. Most of them will tell you that you have to wait a couple of days or even weeks because they are running out of inventory.

This is because more investors are distinguishing between "paper gold" exposure like investment funds and physical gold that they can touch and store in a vault. The problem is that many investment products are directly linked to the credit risk of the product issuer. This was not a big concern a year ago, but it certainly matters today - as we've seen so many troubled banks collapse under the credit crisis.

So if you plan to invest in gold certificates or funds, be sure your investment is physically backed by gold. Also check to ensure your investment is easily tradable, and backed by a counterparty with low credit risk.

These are uncertain times and could remain so for quite some time to come. Eventually, we believe that the market is going to focus more on the longer-term outlook for gold again and the short-term selling pressure is going to subside. This should drive the price of gold upwards towards US\$1,000/ounce, possibly even higher.

We predict that ultimately, gold will shine again and that time could come sooner rather than later.

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*Alpine is an independent asset management company located in Zurich, Switzerland. The company offers "turnkey solutions" for offshore asset management, asset protection and banking, helping its clients to diversify assets globally.*

Editor's Note: I'm glad we got this article out in time, because it seems as though gold may be on the move once again. After posting a gain of roughly US\$60 just this past Friday, the metal is up US\$20 as I write you. Don't delay.