

Now What?

Since this is the inaugural entry in a new service for our friends at Kitco, we want to make a few “big picture” comments. There will be plenty of time to go into specific issues surrounding the precious metals markets at length in later columns.

As 2006 progresses, the market will force gold bugs (and silver bugs and platinum bugs and...) to rethink things. Not because unfolding history is going to prove them to be wrong. Just the opposite, in fact. As the next few years unfold we expect believers in metals to be proven SO right that they will have to rethink their own valuation models. We've thought that for some time now. We can recall talking to audiences three and four years ago about the reasons we were convinced we had entered a commodities super cycle. We said then that we fully expected prices to get to levels even we couldn't and wouldn't believe before it had run its course. Over three years and almost \$300 on the gold price later we still believe that. And no, we don't think it's over yet. Not by a long shot.

Back then, we were watching the US Dollar finally topping, knowing that would put metals and especially gold and silver at the starting gate. A falling Dollar carried commodity indices for close to three years but when the US\$ strengthened again in 2005 most “mainstream” commentators declared the bull market in gold, silver and other metals over. To us that proved nothing other than the fact those commentators didn't understand the underpinnings of the market. As happy as we and our readers were about the gains a faltering greenback provided we were still waiting for the main event.

The curtain rose on the latest phase of the bull market in the second half of 2005 when gold and many other metals started moving up with the Dollar and, indeed, with virtually all other currencies as well. This move was cheered by gold's followers as a sign that gold's day in the sun as the latest and greatest currency had arrived.

Well, not quite. You see, we're not gold bugs in the strict sense of the word. Yes, we understand and appreciate gold's value and agree that it's on an uptrend that is far from over. But we think that the latest moves in the gold price demonstrate a potentially much more important change. Not just precious metals becoming viewed by some as currencies in their own right, but more importantly as an indispensable asset class.

What's the difference? As a currency, gold can and will move against all other currencies and will be subject to some of the same variables, notably things like the spread between interest rates for gold on deposit and “risk free” interest rates mandated by various central banks. As an asset class, precious metals will also have added demand from retail and institutional investors who feel it's mandatory to hold at least a percentage of their assets in metals. Don't underestimate the potential size of this demand driver. It has been argued many times in the past how big a part the index and market funds played a part in underpinning the value of equity markets even when logic dictated they should fall. Funds that had to be fully invested by charter were there to pick up the slack when other investors backed off. Now apply that same idea, through both mainstream and commodity funds (a fund class we expect to explode in popularity in the next few years) and what do you get? A buyer for metals with the potential to dwarf almost anything else on the demand side. “Buy and hold” investors are a rare thing in most commodity markets, even gold. The arrival of a new class of buyers with almost limitless funds and a propensity to buy and forget may well take precious metals values to a new plateau. It's a wave you want to be riding, not swimming against.

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