HINDE CAPITAL

Hinde Gold Fund was launched on 19th October 2007 and by the end of December stood at AUM 10mm December 2007

1970's Return of the Wombles

TAFs & Money Supply

Demand Balloons, Helium rises

S & L echo Aunt Fannie and Uncle Freddie

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1970's Return of the Wombles

The Wombles were fictional characters created by the author Elizabeth Beresford in a series of children's novels. They were cuddly furry animals that gained iconic status in the mid 70s when they were immortalised in animation form. Great viewing for children of the era.

–"Make Good Use of BAD RUBBISH" was their Mantra. Clearly they were ahead of their time. The 70s were a difficult time for most people in the UK , culminating in the "Winter of Discontent". This was the term used to describe the British Winter of 1978 to 1979 during which we saw widespread strikes by the trade unions demanding higher pay to compensate for the inflationary cost of living. The BBC (British Broadcasting Corporation or Auntie as it's affectionately called) used the Wombles cartoon as a wonderful piece of socialist propaganda. Work together and make use of all you have, as you don't have much, well in retrospect it was. I just liked Bungo, the over-enthusiastic Womble and Great Uncle Bulgaria the sage Womble leader.

Could it be that Central Banker's have taken a leaf out of the Womble's book when they introduced their next answer to the Credit crisis the TAF: Term Auction Facility. This was a Fed operation coordinated with similar mechanisms implemented by the BofE and ECB. Essentially this is just a rolling repo facility whereby they accepted a widen selection of collateral from the bank's in return for drawing on funding facilities. Central Bankers are Making Good Use of BAD RUBBISH.

Great Uncle Bulgaria & Mervyn King: "Pensive"

TAFs & Money Supply

Last month we spoke of the return of the TED spread. Since then traditional monetary policy, including 25 bps cuts from both the FED and BofE in December did little to thaw the current freeze in the global banking system. The Central Bank's appear to have coordinated a series of liquidity injections to unlock the funding gridlock.

The basic idea of the TAF was that the Fed would specify a certain maximum amount that it would like banks to borrow. Its intention was to lend up to $20 billion for a 28-day term on December 17th, and lend up to an additional $20 billion for a 35-day period on December 20th. Potential borrowers bid an interest rate to receive this loan, with each $20 billion going to the best bidders. Banks must also provide collateral for these loans.

The objective was clearly not just to get $40 billion more in reserves into the banking system, indeed a run of the mill open market operation could accomplish that just fine. The objective was to get the reserves into the hands of those particular banks that need them most. Of course, those same banks could have got them through the Fed discount window, but choose not to, perhaps because of the stigma (it was always seen as an emergency lending facility), or perhaps because of the financial penalty charged for discount borrowing relative to borrowing on the fed funds market from other banks. In effect, the term auction facility would reduce the spread between the discount rate and the fed funds rate to however low it needed to be in order to motivate $40 billion worth of borrowing.

The other aspect the TAF has achieved is to allow the Fed to accept lower-quality collateral from borrowers than its rules require for open market operations conducted through repurchase agreements. What may matter are not the reserves put in the system, nor who gets those reserves, but that the troublesome assets have been taken temporarily taken off some institutions' balance sheets.

In other words make GOOD (use) of BAD RUBBISH, just like our friends the Wombles did. In reality I suspect these assets (CDOs etc) will default anyway, but by the Fed et al. holding such assets, the very Public default that would ensue would protect the banking system from perhaps a more fallout. Perception is everything, if investors feel safe they resume investing and/or lending. The mere fact that the default occurs when the Fed owns the assets hides the reality. The Fed will be absorbing these losses along with everybody else, but the Fed would absorb these losses by creating more money.

http://www.econbrowser.com/archives/2007/09/money_creation.html

The link to this essay provides a useful albeit simplistic insight to money creation. Undoubtedly money creation, money supply and credit are complex constructs and how price velocity takes place-inflation or deflation as a consequence of increased or decreased money supply is thus also complex.

Hussman a scholar of economics and finance who runs several Strategic Growth Funds, provides an excellent insight into the FED and ECB liquidity injections.

(1) A Little Acid Test for Fed "Liquidity"
http://www.hussmanfunds.com/wmc/wmc071217.htm

(2)Vanishing Act: Are the Fed and the ECB misleading Investors about liquidity
http://www.hussmanfunds.com/wmc/wmc071224.htm

Rather like Professor Hamilton of Econbrowser.com he also suggests money is not liquefying the system, and as Hamilton suggests:

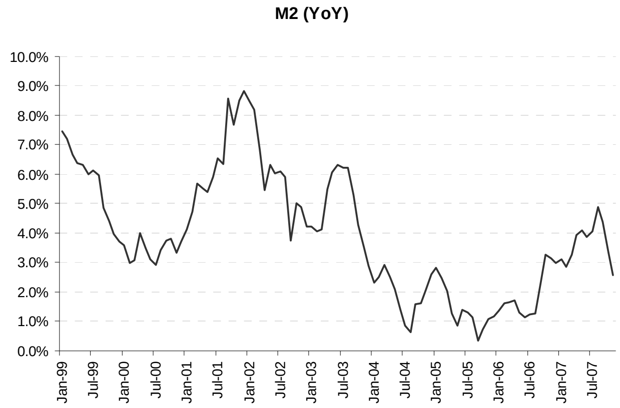
If one wanted to motivate such concerns from a monetarist perspective, one could not point to money that has been printed so far. Instead, the story would have to be that, in order to achieve the path for the fed funds rate that the Fed is now likely to set for the following year, the Fed will eventually need to add more reserves that do end up as more cash in circulation. In this scenario, markets have been reacting to an anticipation of future money creation and not to something that has already happened.

Perception is everything, but as Hussman points out such perception of "liquidity" injections provides false hope.

In short, Wall Street analysts aren't paying attention to the data if they believe that the Fed is "pumping" hundreds of billions into the economy to provide some kind of "safety net" for the banking system or the mortgage market. Is it really too much to ask that they make some attempt to understand the subject about which they opine incessantly?

As for the Fed itself, it's a great gift to offer people hope, but a great disservice to offer people false hope, and I think that's what the Fed is doing. What's going on in the mortgage market is not a crisis of *confidence* that we can talk ourselves out of – it's a problem of structural insolvency, where many borrowers literally don't have the means to service their debt over the long-term, because many of them were counting on rising home prices over the short-term. By acting as if a few billion in repos will substantially change this equation, the Fed is raising hopes, and setting the markets and the economy up for disappointment that will be far worse as a result. Bernanke would be better off admitting that the Fed has no chance of providing meaningful "liquidity" when the Federal government is issuing Treasuries at ten times the rate the Fed can absorb them. At that point, Americans would see better that the resources we need to invest, compete and become a financially sound nation are being hoarded by the Federal government and sent up in flames.

I suspect in reality the CBs undertook these lending facilities to get the GARBAGE off bank balance sheets and to a place of monetisation. Incidentally Northern Rock has been monetised by the BofE and ultimately the UK taxpayer will foot the bill. Also as yields rally across global bond curves, evidence in the Fed Treasury accounts suggest they have been purchasing significant amounts of 10 year assets; monetisation.



Data Source: Bloomberg, Chart: Hinde Capital

US M2 Money Supply Not Expanding At Present

Demand Balloons Helium Rises

Recently I read a WSJ article on the scarcity in supply of Helium and how prices are "rising". Irony of ironies that helium best known for inflating party balloons should be experiencing robust inflation. The article had me chuckling as it was littered with puns. However on reflection the reality of resource scarcities it depicts is rather alarming. I include a brief exert from the article;

Helium is found in varying concentrations in the world's natural-gas deposits, and is separated out in a special refining process. As with oil and natural gas, the easiest-to-get helium supplies have been tapped and are declining. Meanwhile, scientific research has rapidly multiplied the uses of helium in the past 50 years. It is needed to make computer microchips, flat-panel displays, fiber optics and to operate magnetic resonance imaging, or MRI, scans and welding machines.

The technology explosion is sucking up helium supplies at dizzying rates. U.S. helium demand is up more than 80% in the past two decades, and is growing at more than 20% annually in developing regions such as Asia.

"We've not seen the supply and demand at this imbalance in the past. We're running on the edge of the supply-demand curve," says Jane Hoffman, global helium director for Praxair Inc.

Supplies in the world's largest helium reserve near Amarillo, Texas, are expected to run out in eight years. Finding and developing new helium sources will take years and millions of dollars in investment.

http://online.wsj.com/article/SB119682793344314212.html

The consequences of scarce resources are that of heightened global turmoil. Oil and energy products are clearly the driver of Global economic health. The search for alternative energies has had a large impact on price of foodstuffs as demand for Bio fuels has a put a strain on agricultural supplies. Couple this with refining of Emerging country eating habits to emulate that of Western diets and the supply demand curve has really got out of kilter. Not to mention the strain placed on our water resources. FACT- food prices are rising dramatically.

This is potentially lasting addition of inflation as the carrying capacity of the world cannot meet the demands of the population. The mathematician Malthus described that when the carrying the capacity of the world could not be met, pestilence, war, famine and or natural disasters would strike the earth to reduce the population. Such events became known as a "Malthusian check", that allowed equilibrium to be restored.

The US Department of Agriculture estimated food inflation for food served in the home to run at 4.2% for 2007. (Such a number applies to the UK.) On that basis I think we should all eat at someone else's house. In the table below courtesy of Brad Zigler, from Sept to Dec of this year alone one can see the level of food inflation has been dramatic. Wheat prices have risen 92% this past year, and corn 44% over the last 15 months. The price of meat has risen as grains are also used in livestock feed. This will make its way through the supply chain to consumer food products.

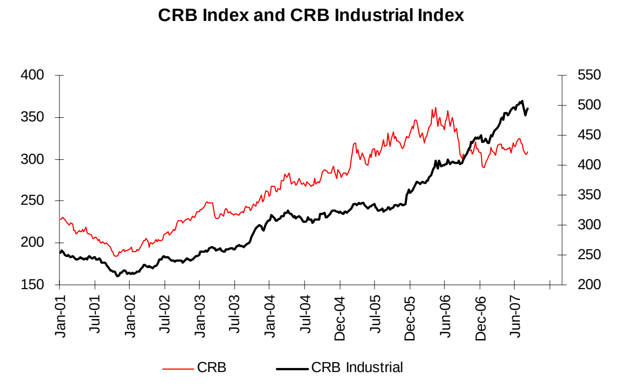
Commodity	Contract Month	Sep Price	Dec Price	% Change
Milk	Feb-08	15.72 c/cwt	17.97 c/cwt	14.30
Orange Juice	Mar-08	130.00 c/ib	146.05 c/ib	12.40
Sugar	Mar-08	10.02 c/ib	10.90 c/ib	8.80
Cocoa	Mar-08	$1,986/tonne	$2,034/tonne	2.40
Wheat	Mar-08	922.00 c/bu	941.25 c/bu	2.10
Coffee	Mar-08	132.30 c/ib	142.00 c/ib	1.00

In 1973 the simultaneous failure of the Russian wheat and Peruvian Anchovy harvest (anchovies were used in fertiliser) led to a quadrupling in wheat prices and heightened tension between the US and Russia.

Don Coxe of BMONesbitt points out that by examining prices of this era it is clear that rising prices of foodstuffs had a far greater impact on global inflation than real estate price runups in New York and London. So far commodity prices to date have failed to keep up with inflation, for example the grains are still near historic lows and are far below the '73 levels even adjusting for intervening inflation. He concludes that a rapid escalation in commodity prices has a quick and dramatic impact on a consumer's discretionary spending as producer and then consumer prices rise. This was evidenced in the '70s.

The perversion of the Gold standard that was the Bretton Woods currency arrangement of 1944, allowed the CBs to print money in the hope of stimulating more discretionary spending that had been crimped by higher oil prices. As I suggested last month Friedman argued that by CBs printing money (to ironically) offset the impact of soaring food and energy inflation, they actually prevented the consumer from reigning in discretionary spending at exactly the time they needed to and succeeded only in driving all goods prices up.

The Echo of 70s stagflation is omnipresent. Last week ZWE Npower passed on the full cost of wholesale energy price increases, when it delivered a rise of 12.7% for British electricity prices and 17.2% for gas prices.



Data Source: Bloomberg, Chart: Hinde Capital

Commodity Prices Remain Elevated

S & L Echo Aunt Fannie and Uncle Freddie

The Federal National Mortgage Association (known familiarly as Fannie Mae) and the Federal Home Loan Mortgage Corporation (or Freddie Mac) were created by acts of the Congress and are thus known as government-sponsored enterprises, or GSEs.

The GSE's – with their quasi-government status (hence market perceptions of superior debt quality) – were for years instrumental in nurturing market distortions and powerful inflationary biases throughout American housing markets (homes and mortgages). By the time GSE accounting irregularities brought an abrupt halt to their ballooning Credit expansion back in 2004, inflationary biases had become more than sufficiently powerful to accommodate the shift to massive issuance of Wall Street-backed "private-label" MBS. This Credit onslaught was, at least for awhile, sufficient to sustain the Credit Bubble.

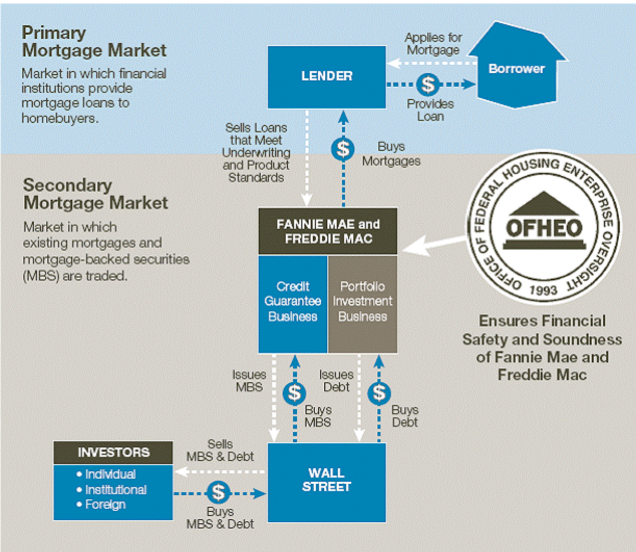
Originally the Congress chartered these two companies with the goal of expanding the amount of capital available to the residential mortgage market, thereby promoting homeownership, particularly among low- and middle-income households. Although they retain their government charters, Fannie and Freddie were converted (in 1968 and 1989, respectively) to private, publicly traded, for-profit companies. Congress continues to provide the charter under which these company operate but provides no financial backing. This government connection allows the company to operate under the guise of being federally backed, giving borrowers and lenders alike added security in the process. It is an "implicit guarantee".

Fannie Mae and Freddie Mac each run two lines of business. Their first line of business involves purchasing mortgages from primary mortgage originators, such as community bankers; packaging them into securities known as mortgage-backed securities (MBS); enhancing these MBS with credit guarantees; and then selling the guaranteed securities.

The GSEs' second line of business involves the purchase of mortgage-backed securities and other types of assets for their own investment portfolios. Beginning in the mid-1990s, the GSEs began to rapidly increase the quantity of mortgages and other assets that they purchased and retained in their portfolios. From the end of 1990 until the end of 2003, the combined portfolios of Fannie Mae and Freddie Mac grew more than tenfold, from $135 billion to $1.56 trillion, and the share they hold of outstanding residential mortgages increased from less than 5 percent to more than 20 percent. Moreover, to finance their own holdings of MBS and other assets, in 2005 the two GSEs together issued almost $3 trillion in debt. Today, the two companies have $5.2 trillion of debt and MBS obligations outstanding, exceeding the $4.9 trillion of publicly held debt of the U.S. government. (Bernanke)

This line of business has raised public concern because its fundamental source of profitability is the widespread perception by investors that the U.S. government would not allow a GSE to fail, notwithstanding the fact that-- as numerous government officials have asserted-- the government has given no such guarantees. The perception of government backing allows Fannie and Freddie to borrow in open capital markets at an interest rate only slightly above that paid by the U.S. Treasury and below that paid by other private participants in mortgage markets. By borrowing at this preferential rate and purchasing assets (including MBS) that pay returns considerably greater than the Treasury rate, the GSEs can enjoy profits of an effectively unlimited scale. Consequently, the GSEs' ability to borrow at a preferential rate provides them with strong incentives both to expand the range of assets that they acquire and to increase the size of their portfolios to the greatest extent possible.

There are strong incentives to gamble whenever you're playing with somebody else's money. If you have none of your personal money at risk, then the upside when you gamble with somebody else's capital is all yours and the downside is none of your concern. AND that’s exactly what they did GAMBLE with taxpayers money. Consequently the “avuncular” nature that Aunty Fannie and Uncle Freddie are so ready to stress; of helping the poor low income earner get cheaper mortgages sticks a bit in the throat. Management has profited very handsomely. The way to solve this problem is to raise capital requirements, but as we will see this has had consequences.

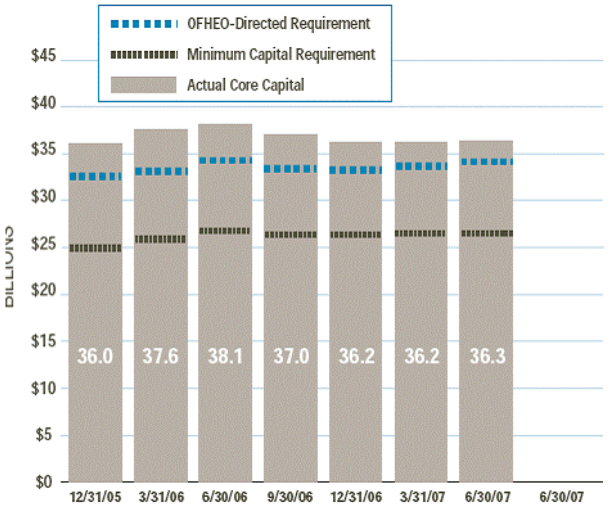


Towards the end of November Freddie Mac said that not only did it lose $1.2 billion in the third quarter, but it bounced up against capital requirements imposed by federal regulators, forcing it to sell $45 billion in loans in September and October. Freddie Mac estimated its core capital at the end of the quarter was $34.6 billion-- a mere $600 million above the 30 percent capital surplus requirement set by the Office of Federal Housing Enterprise Oversight (OFHEO).

The OFHEO has been setting minimum capital requirements for the GSEs, currently at around $34 billion for Freddie. Here's a graph showing how Freddie was managing to stay above the minimum requirements set by the OFHEO up through the second quarter:

If it can't raise more capital-- one move being considered is to cut shareholder dividends by 50 percent-- then Freddie executives say they may have to limit growth or reduce the size of the company's retained loan portfolio, and slow down the pace at which it guarantees loans.

Fannie Mae, which on Nov. 9 reported $1.4 billion in third-quarter losses, has a little more leeway-- its core capital at the end of the third quarter was $41.7 billion, or $2.3 billion above OFHEO's requirements.



Freddie Mac Core Capital by Quarter

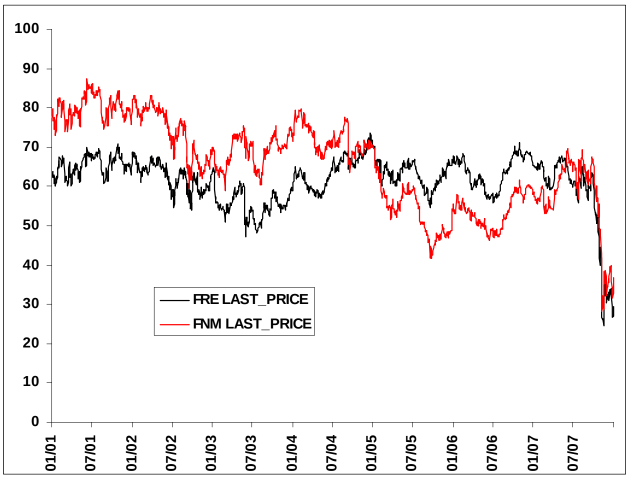
It seems ironic to me that the GSE’s are having to dump mortgage paper into the secondary market at the exact time they should be shoring up the markets and purchasing all this distressed paper. They are after all the BUYER of LAST RESORT.

It wasn’t my intention to write so much on the GSEs but they are as good example as any of how the “shadow” banking sector has hijacked the banking system. They fostered cheaper money by re-packaging MBS after MBS and with their quasi-government backing investors and reserve managers like Asian CBs hoovered them up to earn incremental yield. Weldon points out this fact

At its recent secular peak, the ‘accumulation’ of US Agency Bonds by foreign official accounts was taking place at a rampant rate of year-year, based on this year’s total of $794.3 billion, against last year’s total, which was $252.4 billion less at $541.9 billion . In other words, foreign official holdings of US Agency debt have risen by nearly FIFTYPERCENT in just the last TWELVE MONTHS (up +46.6% yr-yr).Over the last four weeks this trend has reversed as well, with the rolling 12-month pace of accumulation falling to $240.1 billion within the most recent weekly report on the offer from the Fed. Today, foreign official accounts hold almost $800 billion.

Moreover, foreign private investors have been rabid buyers as well, with net purchases of more than a HALF TRILLION worth since the beginning of 2005 alone, totalling $518.2 billion as revealed with the TIC data for the end-September. In just 33 months, private foreign accounts have bought a HALF TRILLION … while foreign official accounts have purchased another HALF TRILLION.

Despite pundits talking about privatisation- try privatising all the above- it seems much more likely that after so many years of "implicit" guarantee from the Government, that they will carry out an S & L styled bail out and nationalise them. However this is in part the reason why we have this sub-prime mess in the first place, as knowledge that the Government will be their for the marginal investor, i.e. creating a Moral Hazard.



Data Source: Bloomberg, Chart: Hinde Capital

Fannie (FNM) and Freddie (FRE) Equity Plummeting

One thing is for sure the Sovereign World Funds (SWFs) won't be purchasing these stocks. After all they already own much of this Agency debt as it is. The SWFs have been picking up "cheap" banking assets instead. The speed of purchase and the rate at which assets are written off leaves me in know mind that the SWFs have not done their due diligence. Scary as this is in part how we reached such a Minsky moment.

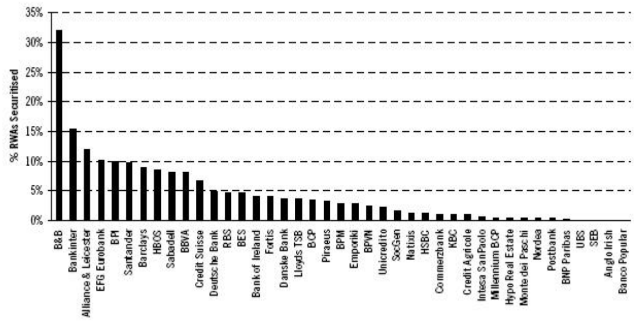
Involuntary Asset Growth & SWFs

Involuntary Asset Growth: Citigroup analysts have coined the term in a research note published December on banks; titled simply and ominously, "Creaking".

For European financial institutions, say Citi's banking research team, an unwanted €450bn is heading onto (or already on) balance sheets, whilst the response to the credit crunch might be to force deleveraging across the sector, banks, ironically, are currently facing substantial releveraging pressures. Citi estimate that the combined effect of ABCP conduits coming onto balance sheets, SIVs being restructured, "hung" leveraged loans and a hiatus in the securitisation market could result in almost €450bn of involuntary RWA (Risk Weighted Asset expansion) growth for the European bank sector. This is, of course, the broad end of the wedge. On the other end is all that news of CDO super-senior conduits, SIVs going into defeasance and securitisation markets closing.

Involuntary asset growth say Citi, will mark the onset of the "true credit crunch". And the scale of the crisis is only just becoming known to the banks themselves. Interestingly the UK bank's look set to suffer the most. This graph below estimates the current best guesstimate of banks' reliance on securitisation.

Figure 27. Amount of Balance Sheet Securitisation, by Bank



Data Source: Citigroup

Amount of Balance Sheet Securitisation by Bank

Funnily enough rumours were a bound this week that Bradford and Bingley (B&B) were in trouble and had gone to the emergency lending window at the BofE. Unsurprisingly, B&B's CDS blew wider as default risks heightened

The RWA growth and constant write-downs of billions of dollars means only one thing, bank's need to re-capitalise. The banks have turned to the Sovereign Wealth Funds. SWFs have been purchasing banking equity. Below is a list to date. So far it is loose change for these guys. Middle East and Asian SWFs who have vast growing surpluses are now shunning US debt and purchasing equity. On could argue this is a positive as this helps de-lever the financial system from debt, but buying equity is more expensive by nature of its dilution.

This is the TRANSFER of WEALTH we have spoken off in previous letters. Worryingly this is a potential transference of ownership from the Western banks to non-democratic countries. Well in part, interestingly of the US investment banks that have shored up their capital base, the SWFs have bought 4.9%of each equity. Above 5% and FED sanction is needed for the transaction.

Every time the financial markets seem in dire trouble some prop rears its head. First we had the Greenspan put, then we had the Bush double dividend tax cuts on equities, then central bank liquidity injections, which spurred private equity mammoths like Blackstone and last but not least consumers MEW cash. Now we have a new giant- the SWFs. The IMF believes that in the next few years the SWFs will exceed $10trillion. Incidentally this number would exceed holdings of all US mutual funds. More Moral Hazards to feed off. "Its okay the SWFs will buy it up!"

Date	Bank	Fund	Country	Size
Mar-06	Std Chart.	Temasek	Singapore	$4bn
Nov-07	Citigrp	ADIA	Abu Dhabi	$7.5bn
Dec-07	UBS	GIC	Singapore	$9.7bn
Dec-07	UBS		Oman	$1.8bn
Dec-07	Morg.Stan	CIC	China	$5bn
Jan-08	Mlynch	Temasek	Singapore	$5bn

Counterparty Risk and CDS

I think the next crisis could come from the Credit Default Swaps market. Remember, this is a market which essentially has no reserves to deal with default risk other than the capital accounts of the banks and hedge funds.

Credit default swaps originated as a form of credit protection that the holder of a credit risk could purchase as a hedge against a borrower's default. A holder of General Motors (GM) bonds, for example, can effectively insure against a default by GM, by purchasing protection in the form of a CDS from a willing counterparty. Many holders of collateralized debt obligations that have recently plummeted in value had hedged their positions through CDSs. Indeed ACA Financial has been a major seller of such protection. In December the rating agents downgraded ACA, which I suggest portends grave trouble ahead for the CDS and wider financial markets. Incidentally that means the overall Global economy as well, lest we forget.

A worst case scenario would be for the economy to fall into a serious recession next year which would hammer high yield bonds and cause defaults in certain riskier debt, for which CDSs have been bought and sold. With banks having to write down a lot of the mortgage related debt, they would be in poor position to have to handle even greater losses.

John Mauldin in his excellent “Thoughts from the Frontline” details a paper from the August 2006 Journal of Mathematical Economics entitled "General Equilibrium with Endogenous Uncertainty and Default" written by Professor Graciela Chichilnisky of Columbia University and Ho-Mou Wu at the University of Taiwan. In it the authors demonstrate with some very serious mathematical proofs that the more of a certain type of assets (say insurance or derivatives) that are introduced into a market, while reducing the risks that individual's face, they increase overall systemic risks.

Furthermore the Chichilnisky paper concludes that the more we create new financial instruments, the more likely it is we will have systemic problems. And since we are creating them at an ever faster pace, and tying more and more market players together, we are sowing the seeds for another Black Swan event (see Mourinho’s Black Swan investor letter) that will crop up somewhere, leading to yet another crisis.

Cue the CDS market, what better example of a “Chichilnisky outcome”. As with so many other types of innovative financial products, CDSs have exploded in the past few years. They have become a simple way for investors to take long or short positions on particular companies or industries without having to buy or sell the actual underlying bank debt or securities. The notional amount of underlying obligations covered by CDSs now exceeds **$45 trillion,** up from less than $2 trillion in 2002.

In a low default environment, selling default protection through CDSs presented huge revenue opportunities. ACA more than doubled its CDS business over the past 12 months, and others have undoubtedly done likewise. However, if the events of the past several months have proven one thing, it is that investors have done a very poor job recently of accurately assessing and pricing risk. It is more likely than not that many CDS sellers have not properly gauged their exposure, or set aside sufficient reserves against it.

The potential ramifications are difficult to overstate. S&P contends that ACA is facing close to $3 billion of losses on its CDS exposures, for which it has only $650 million of reserved capital. There is no way to tell right now how many other banks, funds, and other insurers are similarly exposed. Of equal concern are the exposures of the CDS purchasers who believe themselves to be properly hedged against losses, but who may instead find their protection to be worthless because of their **COUNTERPARTY’S** inability to pay. What we are looking at here is the development of a credit crisis into a solvency crisis.

NOTA BENE: GOLD IS NO ONE’S LIABILITY

Gold is Money

GOLD	2005	2006	2007
Gold $	17.90%	23.10%	*32.50%*
Gold Euro	34.90%	10.50%	*20.00%*
Gold £	31.30%	8.30%	*31.60%*
Gold SFr	35.90%	14.10%	*24.00%*
Gold Yen	35.50%	24.40%	*23.20%*
Gold AUD$	24.90%	13.90%	*18.90%*
Gold CAN$	14.00%	23.50%	*12.50%*
Gold Rand	31.90%	37.10%	*29.60%*
Gold Yuan	15.00%	19.10%	*22.70%*
Gold Rupee	22.70%	20.80%	*16.60%*
Gold KWD	17.90%	23.20%	*23.70%*

Data Source: Bloomberg, Table Hinde Capital

This table is worth a thousand words. It illustrates quite clearly how Gold is appreciating not only versus the dollar but against all major currencies. This is quite incredible considering how strong some currencies have been against the USD. GOLD is slowly but surely becoming the:

UNIVERSAL WORLD CURRENCY

Global Gold Outlook

Gold continues to make headlines in the last few months. While in US dollar terms the rush towards the high 840’s was followed by a equally violent correction, it is making new highs against sterling as we close the books for 2007. Now as we enter a new year, this decoupling has continued as gold is not just viewed as the anti-dollar but as the ultimate currency of last resort. The global imbalances created by general currency debasement continue to threaten the status quo enjoyed for the last few decades and gold is a natural beneficiary. Like all commodities the size of the market place pales in comparison to the bond or equity markets resulting in exaggerated movements in both directions but its place in the global arena is growing. The extreme (open) interest at the highs by investors and speculators alike gets washed out very quickly on the down trades before the whole pattern starts again, but new spikes in price are higher and the dips are shallower than the last.

The beginning of the new for the CBGA2 year (which runs concurrently Sept to Sept) saw Central Bank sales of some 100+ tonnes in the first two months. As the CB Sales limit of 500 tonnes/year was not reached in either of last two years this would seem an aggressive front loading.

Who was buying? While the Indian jewellery demand and continued ETF investment is well documented, the demand side is gaining widespread interest. As emerging countries with growing dollar reserves seek diversification and inflationary pressures rise globally, the futile efforts of the western central banks to stem the gold market whilst keeping the monetary spigots wide open will continue to be tested. The CBGA2 CBs have been selling to Emerging country CBs, yet again we see evidence of more TRANSFERENCE OF WEALTH.

The Commodity rich and surplus rich CBs of China and Russia have been buying. Putin has ordered the CB to raise the gold share of its reserves to 10 per cent. On $470bn this equates to approx 1800 tonnes. This is 75% of one years mining supply. China has mandated, for now, 2% of new reserves to go into gold per year, but should they raise this to the CBGA reserve requirements, they would take 9000 tonnes off market (nearly 4 yrs of mine supply).

9th January 2008, mark that day in your diary. This saw the advent of the Shanghai Gold Future on the Shanghai Futures Exchange and heralds an event perhaps even greater in significance than the introduction of the GOLD ETFs.

Richard Russell, fabled investment writer, observes in his Gold Notes of his Dow Letters-

It seems obvious that China wants gold coming its way, both to the government, whose gold reserves are very low, and to its citizens. China is making it progressively easier for the people of China to accumulate gold. The following is from the December 29 Financial Times, "China To Trade Gold Futures Contracts. Beijing yesterday approved the launch of China's first gold futures contracts, with simulated trading on the Shanghai Futures Exchange set to begin on Wednesday. The exchange is expected to begin selling real renminbi-denominated contracts soon after and is preparing for huge demand from the rapidly expanding number of Chinese producers and consumers. ...Gold use in jewellery in China jumped 24% from a year earlier to 221 tonnes in the first nine months of 2007, overtaking the US to make China the second largest gold consumer after India, according to the World Gold Council. ... The Shanghai exchange, one of the country's three commodities futures exchanges, has already set the size of its gold futures contracts at 1,000 grams per lot and established a 5 percent limit on daily price movements as well as a minimum margin requirement of 7 percent of the gold contract value."

We tend to agree with Russell far from providing Chinese companies with an effective "in-country" hedging exchange for future production, which is true, it really opens up the country for wholesale accumulation of gold assets.

The People's China Daily reported that:

..the most actively traded contract for delivery in June settled at 224.74 yuan ($30.9) per gram, up 6.34 percent from the opening price. And the contract for delivery in December was 229.93 yuan ($31.6) per gram, up 8.86 percent. The total turnover of all contracts amounted to 27.3 billion yuan ($3.75 billion)…

This is nearly $4bn, not bad, even allowing for the crossing of trades to "dress up" volumes.

In light of such demand interest, in early December we felt the market would build a potential floor around $800 having seen a $773.10 low on 11th November. The GCG8 (Feb Gold) chart below depicts the a-b-c-d-e triangle pattern that we felt would occur, with a break of triangle propelling gold to close back at the highs met in November. Easy in hindsight, and not so easy at the time, although we attempted to hedge in and out on our bullion portion whilst building a growing position in precious metals equities.

While the metal has shown a continued resilience in this current uptrend, the same cannot be said for gold stocks. One of the metrics we observe is the ratio of the Gold price/ XAU. The XAU Index is the Philadelphia Stock Exchange Gold and Silver Index and is a capitalisation weighted index which includes the leading companies involved in the mining of gold and silver. The ratio reached a high in early November of 4.19 only to fall back to 5.00 by late December, a fall of some 20% with an unchanged gold price. This level almost matched the extreme low of 5.13 from August 16th.

While there is still on going concern that the costs of mining operations worldwide are increasing rapidly, this high to low on a well established ratio in 6 weeks is more likely reflective of other factors. Whether general market weakness, global margin calls or end of year tax loss selling we will start 2008 with most mining stocks trading ridiculously cheaply relative to the metal price in this current climate. We would expect to see a normalisation of this ratio in the first quarter.

Indeed in the rare instances when;
1) The rate of inflation has been higher than 6 months earlier,
2) Treasury bond yields have been lower than 6 months earlier,
3) the NAPM Purchasing Managers Index has been below 50, and
4) the Gold/XAU ratio has been above 4.0, the XAU has soared at an astounding rate of 123.63% annualized. In contrast, when none of these have been true, the XAU has plunged at -53.21% annualized. (Hussman 1999)

We believe these four criteria have been met. Too be fair we have substituted the non-ISM manufacturing for NAPM and observed the ECRI weekly rapid decline, signalling a deterioration in US economic growth.)

Gold prices for the Q4 rose by $110/oz. over that of Q3 ($790/oz. versus $680/oz.) setting the stage for some strong earnings momentum for many gold producers. While we are cognizant of the cost creep that has been occurring, we are quite confident that the cost curve has not moved at anywhere near the ascent of gold in the past three months. We believe that margin expansion will entice a new level of interest among investors not only for quarter-over-quarter growth but also on a relative valuation compared with S&P listed stocks. There are several gold companies that are currently trading below the average P/E ratio for the broader indices (based on our estimates using an $875-900/oz. gold price for 2008) IAMGOLD being our favourite on this basis.

Earnings momentum will set the stage for a new investor group that avoided the industry because of its lack of earnings power. These will be the Pension funds who ploughed into the big cap miners with exposure to base metal production. Return on Equity here far and away outstripped the Precious Metals sector. But now, with the average price of gold/silver set to rise and as we believe costs to rise only incrementally in the year ahead we expect good ROEs.

To date the market has assigned value to Growth stocks and less so to the leverage component. Growth stocks being those of increasing mine life and production. Companies with management perceived to be less experienced in development of mines (IAG) or less likely to deliver, geopolitical hotspots (Venezuela and Bolivia note CDE and GRZ) have behaved less favourably. But at some point a market discounts too much and value offers good risk reward, especially where there is deposit quality. We

expect greater performance from such stocks in the short term.
It is also our contention that precious metals equities will behave favourably over the next 6 months relative to the S&P500. Margin expansion versus margin contraction. Couple the potential for a developing top in generalised markets and a bear market to ensue and asset re-allocation will find its way primarily into a sector with the perception for asset protection and appreciation- the Precious Metals Sector.

Hussman Jan 08 on generalised equities:

I am emphatic that investors should evaluate their risk exposures and tolerances now, in order to *allow for* substantial further market weakness. Market conditions presently feature a Pandora's Box of rich valuations, vulnerable profit margins, rising default risk, rapidly deteriorating market internals, failing support levels, and accumulating evidence of oncoming recession. As I noted in my December 17 comment, *"there is one particular scenario that would be ominous in my view. That would be if we see a relatively uninterrupted series of declines that breaks cleanly through the August and November lows, followed by a one-day advance of 200-400 Dow points. That's a script that markets tend to follow pre-crash. Though it's not a strong expectation or forecast, it's something worth monitoring, because we've started to see the pattern of abrupt jumps and declines at 10-minute intervals that are often a hallmark of nervous markets."*

Marc Faber sets out three key observations in his famed Gloom Boom & Doom Report:

1) I have never experienced a bull market in equities without the participation of financial stocks. In addition, when financial stocks across the board collapse it is a very negative sign for the overall health of the stock market.
2) The fact that a stock has declined from the peak by 50 per cent or even 90 per cent does not make it necessarily inexpensive. In 1985, I recommended the purchase of a basket of Texas banks, which at the time had declined by 95 per cent from the peak, as a contrarian play. Subsequently, they all went bankrupt.
3) As I have explained before, the financial sector has become disproportionally large over the last 15 years or so. Therefore, I would also expect the reversion to the mean of the financial sector to take several years and not to be completed in just six months! In short, I would avoid purchasing financial stocks for now and would also defer new commitments to equities.

Emerging stock markets are definitely to be avoided, he adds, *"following their significant out-performance over the last few years".*

In an environment of relative global tightening of liquidity I am afraid that emerging stock markets could be deserted by foreign investors as seems to have begun in the case of Asia.

Then yesterday Ben Bernanke spoke out- the outlook for 2008 has worsened and risks look more pronounced. His concerns for potential economic fallout from continued dislocation in the credit markets suggests he will need to act decisively and timely, as additional policy easing may well be necessary…. His dovish comments are suggestive of a 50bp cut come the end of January.

The words of Queen's Freddy Mercury "It's a Kinda of Magic" slip to mind. Equities which had near swallow dived their way into 2008 and looming on the edge of a precipitous fall through the August lows pulled back from the brink. Although not of the woods yet we are prepared for a spectacular clearing rally as markets do appear short term oversold. Too boot sentiment is overtly bearish.

We observed the American Association of Individual Investors Bull/Bear poll suggests investors are extremely negative. Bearish sentiment for US equities exceeded that of the bulls by the most since late 1990. Indeed 59% of investors expected stocks to fall over next 6 months. This is double the 32% 5 year average. Further note that in the first quarter of 1991 US equities rallied 14 per cent during q1 of that year. Assets in U.S. money-market funds increased by $61.3 billion during the week ended Jan. 8, the sixth-largest increase on record, to an all-time high of $3.15 trillion, according to iMoneyNet, a Westborough, Massachusetts-based firm that has tracked the funds since 1998. The above is suggestive of vast amounts of capital waiting on the sidelines to be invested back solely back into stocks.

Undoubtedly the rally in US 3mo T-bills in the last few months confirms that a lot of money went into cash. Yet our take is that much of this money will find its way into the commodity space and particular the precious metals sector. So if there was a risk to our call for a short cover in equities this would be it.

Furthermore we do not believe that money has necessarily been employed in our sector yet, for as we have mentioned we detect overseas gold purchases on the global market on the TOCOM and China exchanges. Our read is that the late December stealth move in Gold left investors trailing. Ever since we broke $850 respected analysts have been calling for a retracement:

Investment Bank Analyst: We believe current gold prices of about $865/oz. are likely buoyed by anticipated interest rate cuts, the recent assassination of Benazir Bhutto and other political events and therefore may not be sustainable…

Marc Faber of famed Gloom Boom Doom writes-

Interestingly, we know a lot of gold bulls who have already sold their positions and pray for a significant correction in order to establish again long positions….Central banks around the world have no other option but to print money and this will lead to a further depreciation in the value of paper money against precious metals….Still, nothing goes up in a straight line, notes Faber, and, therefore, investors need to be aware that gold could still correct to around $750 or so….But when we consider the upside potential of gold compared to its downside risk, the biggest mistake an investor could make is not to own any gold at all….

In Faber's opinion, "the gold bull market will come to an end when SWFs - sick and tired of their investments in financial stocks - will final purchase gold — probably at above $3,000 per ounce".

With all this in mind we are more concerned that the market will not give you a meaningful pull back and as we approach $900 (met on Feb contract) if anything people have been trying to aggress the short-side of the market.

Data Source: Sharelynx.com

CPI- US Dollar Debasement

Final Notes

Dennis Gartman: I have learnt much from his Letters over the years but when it comes to Gold stocks he is myopic. "Buy gold and buy puts on mining stocks he said on CNBC FastMoney. He has maintained this line of education all through this bull market in gold, citing the unmanageable unexpected events of mine disasters strikes, costs etc. Gold stocks since 2001 have rallied 1260% gold 251% QED with a "kin " between the E and D.

US Government bonds: Stagflation is bad for long end bonds. Forget FASB ruling of matched duration pension liabilities. We have negative real rates people and the Asians don't want US bonds at this yield. They will sell to the corporate pension funds as they lock in "cr*p" yields for your future. Another TRANSFERENCE OF WEALTH.

Roman Abromavich: Buys Russian Gold Miner Highland Gold. If it's good enough for our Chelsea man its good enough for us. We miss Mourinho, come back.

We give George Bernard Shaw the last say: The most important thing about money is to maintain its stability… You have to choose between trusting the natural stability of gold and the honesty and intelligence of members of the government. With due respect for these gentlemen, I advise you, as long as the capitalist system lasts, to vote for gold.

New Investment/SIPP

Hinde Capital Ltd is actively seeking investment for Hinde Gold Fund. The Fund is working with a select group of marketing professionals, both in the high net worth arena and on the institutional level. It is currently expecting additional funds for the January 1st share issuance and is working to gain exposure on many investment platforms including most of the SIPP providers to enable all investors an ability to take advantage of this opportunity.

Our website is www.hindecapital.com. All documentation on Fund and how to subscribe can be accessed there. In the interim please send all subscription requests to info@hindecapital.com