# HindeSight

HINDE CAPITAL

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August 09

## Aurophobia

**Gold engenders a diversified range of opinions and emotions unlike any other asset class. Misconceptions abound; it is an inflation not a deflation hedge. It is a portfolio diversifier. It is money, a currency, a store of value and a safe haven asset.**

**We define and challenge the validity of all these beliefs. Thematically using the theory of the Austrian Business Cycle we explain why gold and equities rally together Tactically we observe the gold seasonality, now, then and for the future**

**A Golden Constant?**

**A B C – A Taster**

**Zimbabwefication?**

**Golden Facts 1970s & 2000s**

**Seasonality – A Golden Constant?**

**Seasonal Sensitivity**

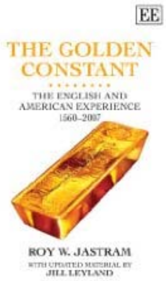
**Epilogue**

***Perfection is not attainable but if we chase perfection, we can catch excellence***

***Dictionary is the only place that success comes before work. Hard work is the price we must pay for success. I think you can accomplish anything if you're willing to pay the price***

# A Golden Constant?

The resurrection of a classic study of gold's relationship with prices - the Golden Constant - originally scribed by Roy Jastram comes at a pertinent juncture not only in monetary history but potentially at a significant time of the year where seasonally gold prices are due to rise in nominal terms. The book had been out of print for many years with copies so hard to come by that they were themselves as valuable as an ounce of gold.




With the gold price reaching new records in 2008, the new edition, on Roy Jastram's seminal work, considered by some to be the finest empirical analysis of the gold price, is certainly timely (and not coincidental). Published in 1977, the author's painstaking work on historical statistics enabled fluctuations since 1560 in the value of gold and its purchasing power to be studied. It established, for the first time, how gold's purchasing power had been maintained over the centuries. This edition by Jill Leyland, former economic advisor to the World Gold Council reprints Jastram's entire original text but adds two more chapters to bring the book up to date shedding new light on gold's relevance today.

Jastram wrote: "I do not presume to take on the role of an economic historian or a monetary economist as well" (he was until he passed away Professor of Economics at the University of California, Berkeley), He undertook the methodology of a statistician to make a quantitative analysis of this economic period of history. By determining the statistical relationship between a unified series of the price of gold and that of a unified series representing the level of wholesale commodity prices he could measure the purchasing power of gold. He defined this as "operational wealth".

Here at Hinde Capital we run a gold fund whose singular purpose is to offer investors the opportunity to seek preservation of capital against the erosion of the purchasing power of money. Investing in the precious metals sector not only satisfies this criteria but also offers the secondary objective of capital appreciation. We think not in absolute terms but in real terms, or as Jastram puts it - in 'operational wealth' terms.

The Golden Constant is a very important work on the price stabilizer role of gold throughout modern times (from 1560 to 1976 and now 2007) as a store of value and as a way to keep prices stable. The book helps to answer a question which many investors ask us at Hinde Capital: how does gold protect me and perform in periods of deflation? Most then go on to answer the question in the same breath. "Surely it goes down", they say. By inference the assumption here is that in inflationary periods gold will rise in price. Certainly it's fair to say that this is the rule of thumb assumed by most. It is by observing Jastram's work we can perhaps disavow investors of this belief.

A very concise assimilation of his work examining the relationship of England's & USA's commodity prices and gold certainly reveals some startling facts:

**England – Inflationary periods: the purchasing power of gold  Deflationary periods: the purchasing power of gold**

| | | | | | |
|---|---|---|---|---|---|
| 1933-1976 | -25% | 1675-1695 | -21% | 1920-1933 | +251% |
| 1897-1920 | -67% | 1623-1658 | -34% | 1873-1896 | + 82% |
| 1793-1813 | -27% | | | 1813-1851 | + 70% |
| 1752-1776 | -21% | | | 1658-1669 | + 42% |
| 1702-1723 | -22% | | | | |

*Gold held its value better in deflationary periods than inflationary periods, would be the inference.*

In isolation these numbers do not have much worth for investors. For instance from 1933 to 1976 gold in nominal terms (exclusive of inflation) rose over 1400% but in real terms as we can see fell 25%. Its operational wealth fell 25%, in Jastram parlance. One can see that in this case gold was still a good hedge against inflation, but there were other goods that kept abreast more closely with inflation. Now to what these are is not important; suffice to say they were not assets that investors could purchase in any quantity, even if accessible at all. Gold (and silver) were the only viable assets primarily because of the high value to weight ratio. Gold may not keep entirely abreast of “inflation” at any one moment in time but it is the least volatile and stable ‘tracker’ for investors –

Jastram concluded that

- Gold is a poor hedge against major inflations
- Gold appreciates in “operational wealth” in major deflations
- •Gold is an ineffective hedge against annual commodity price increases
- •Gold does however maintain its purchasing power over long periods of time

**Retrieval Phenomenon Debunked**

Intriguingly gold does not tend to move towards commodity prices but rather commodity prices return to the price of gold. He referred to this as the Retrieval Phenomenon.  Remember gold was given a value based on a fixed weight throughout these ages and his work concluded at a time when prices, certainly in the Western world, had had their most egregious price fluctuations in history. The formal abandonment of the last vestiges of a gold standard (a gold-exchange standard in reality) in 1971 under the Smithsonian agreement has since seen a chaotic period of monetary history. The revised edition of Jastram’s book addresses some of this reality in its conclusion on the relationship of gold and inflation and deflation.

Most individuals associate gold as a protector against inflation based on what we call the “recency bias”. Often we are hopelessly myopic in our understanding of past and present events. This assumption is primarily based on the reality that from 1950-1976 gold chased US goods prices higher. Gold had been price fixed previously at $35 ounce so the collapse of the London Gold Pool in 1968 led to the “catching up” of gold to other commodities. So the last forty years of fiat based monetary system stand out against the relative constant of the last four centuries. Now that the financial system is untethered to gold, we would concur that the propensity for gold to experience market fluctuations relative to commodities and other assets will see gold chase the price of commodities, rather than as acting as an anchor. This was the conclusion Leyland came to.

We would also contend that gold just like in the 1970s will continue to forge ahead of developed nation equity indices and a geometrically weighted basket of commodities such as the Continuous Commodity Index (the old Commodity Research Bureau Index) on a nominal as well as real basis. As an aside it should be noted that the inflation or deflations that Jastram covered were markedly benign relative to anything experienced in the 20th century. Before we can really assess the operational wealth of gold during ‘flations we must have an appreciation of their meaning.

**A Question of Definition**- *inflation and deflation*

Jastram tackles his empirical analysis by suggesting he is merely adopting a quantitative approach and makes no attempt to make a comment on the monetary role of gold. Likewise he adopts a non-monetary analysis of the meaning of deflation and inflation. He arbitrarily refers to “inflation (as) a period of rapidly rising prices; deflation connotes an interval of swiftly falling prices”.

If you were to ask mainstream economists what inflation is, they typically respond that inflation is an ongoing rise in the consumer price index of approximately 2 to 3 percent per annum; if the increase remains between zero and 2 to 3 percent, then these economists would speak of price stability.

Currently, annual changes in consumer price are running at around zero. So it comes as no surprise that mainstream economists do not see inflation whatsoever; in fact, they would warn against *deflation*, which they characterize as an ongoing decline in consumer prices.

The prices of assets such as stocks, bonds, and real estate are typically considered different from consumer prices. Asset prices are seen as prices *sui generis*, especially as they are not included in the official definitions of price indices. So-called *asset price inflation* - a term which mainstream economists use for characterizing the phenomena of extraordinarily strong and ongoing increases in the prices of, for instance, stocks and housing, is not seen for what it really is: a visible symptom of the erosion of the purchasing power of money.

*Austrian Economists’ Definition of Inflation*

In sharp contrast, Austrians hold that *inflation is an increase in the money stock*, and that the upward drift of money prices is a consequence of a rise in the money stock. From the Austrians' viewpoint, rising prices are a *symptom* of an increase in the money stock. But what determines the price of money?

‘Supply and demand’ - the same forces that determine all prices on the market. If the supply of a good increases, the price will fall and vice versa. Likewise if the supply of money rises, it will tend to lower its ‘price’; an increase in the demand for money will raise it.

Let us put this another way. If people value cash (or their cash balances) more highly, the demand for money increases, and prices fall. The same total sum of cash now confers a higher ‘real’ balance, i.e. it is higher in proportion to the prices of goods – to the work that money has to perform. In short, the effective cash balances of the public have increased. Conversely, a fall in the demand for cash will cause increased spending and higher prices.

The public’s desire for lower effective cash balances will be satisfied by the necessity for given total cash to perform more work. If asked, most people will say I want more money, as much as they can get. However what they really want, are more effective units of money (higher purchasing power). They want a greater *command* of goods and services for the same amount of money.

We referenced earlier Jastram’s concept of “operational wealth” - the ability of a person to operate with his dollars based on the number of the dollars he has and the price of things he might want to command with them. It’s fair to say although Jastram does not define gold as money he demonstrates it acts like it with this equivalent terminology. [To explore the relationship further between the purchasing power of money and gold we refer you to Why Gold?]

Mainstream economists may say that if a rise in the money stock is accompanied by a (sufficient) rise in the supply of goods and services, the increase in the money stock would not cause inflation, as it would not make prices go up.

From the Austrian viewpoint, such an argument does not hold true. Had the money remained unchanged, money prices would have actually declined (other things being equal), thereby increasing the purchasing power of money.

In other words, a rise in the money stock *prevents* the money stock from gaining in purchasing power (other things being equal). That said, there are two consequences that come with a rise in the money stock that need to be highlighted. First, the visible effect is a rise in money prices; it is the result of a rise in the money stock while the supply of goods and services remains unchanged. ***Second, the invisible effect is brought about by a rise in the money stock, even if it is accompanied by a rising supply of goods and services: the rise in the money stock prevents money prices from declining. Needless to say, to most people the first effect goes unnoticed, as a result of a misguided definition of inflation**.* That said, the only economically meaningful definition of *inflation* is a rise in the money stock.

Therefore it's all just a question of definition really, inflation signals a reduction in purchasing power brought about by the increase in the supply of money. An increase in the supply of money means that more units of money are doing the social work of exchange and that increase offers no social value. Conversely a genuine deflation is a sustained contraction in the total supply of money (and credit), not a fall in the general price level.

**Known Knowns, Known Unknowns & the Unknown Unknowns**

*It's not the certainties that make life interesting...it's the uncertainties. There are known knowns. These are things we know that we know. There are known unknowns. That is to say, there are things we know we don't know. But there are also unknown unknowns – the things we don't know we don't know*

*(Donald Rumsfeld - (the arch Machiavelli))*

*Known Knowns* – we have experienced a massive credit contraction in sectors of the economy that Hyman Minsky would define as suffering from a collapse of speculative finance.

*Known Knowns* – authorities have responded to this contraction with a cocktail of Keynesian fiscal fixes, expanding monetary bases, and monetised debt. This we now know reduces the effectiveness of money and raises prices. Inflation.

*Known Knowns* - what is known is that money will float the prices of assets with finite supply while stabilising the contraction of sectors with oversupply such as real estate and its debt.

Minsky in his life's work described the reinforcing dynamic of speculative finance, decreasing debt quality and economic volatility that has come to characterise our times. He explained how the bullish rise in employment, investment and profits tends to confirm in the minds of business leaders and bankers the soundness of an approach that ultimately fosters volatility and unacceptable risk. Or put another way, in an investment boom profits would be increasing along with investment. This added credence to his proposition that the fundamental instability in the capitalist economy (as it stands) increases until it reaches a speculative frenzy.

*Known Unknowns* – we now know that governments and monetary authorities have increased the supply of money, what most don't know is whether this is "inflationary". The invisble effect described says otherwise!

*Known Unknowns* – Inflation is given, but how will it manifest itself. As we have described it is not so simple to say we will have widespread price increases in all goods and assets. What is unknown is where it will manifest first.

*Unknown Unknowns* - most don't realise that gold can protect you both in deflation and inflation as Jastram's work has suggested. They are not mutually exclusive. You can also have both inflation and deflation simultaneously; however what is now known is gold is *constant* and it is a historical fact that gold has maintained or conserved its operational wealth during all currency debasements and ultimate destructions. No fiat currency has ever survived in history.

Finally we add our own philosophical sound byte: unknown knowns – we know these will happen, but not when:

*Unknown Knowns* – "the Attila effect". Gold has served as a financial refuge in political, economic and personal catastrophes (unknown and unforeseen). As one Jastram critic put it when Attila turns up in your pantry it would be fair to say gold is "priceless" – and that Jastram acknowledged: "*anyone who fears the collapse of his country's currency is acting rationally when he shelters his assets in gold*".

# Austrian Business Cycle (ABC)- A Taster?

**The Cantillon Effect**

*He realized well that the abundance of money makes everything dear, but he did not analyse how that takes place. The great difficulty of this analysis consists in discovering by what path and in what proportion the increase of money raises the price of things.*

*Richard Cantillon (died 1734) Essai sur la nature du commerce en genera*l

The Essay on the Nature of Commerce was arguably the first general treatise on economics. Cantillon understood the market as an entrepreneurial process, and held to the Austrian theory of money creation: that it enters the economy in a step-by-step fashion disrupting prices along the way. That monetary influences play a dominant role in determining both the volume and direction of production is a truth which is probably as pertinent now as any time in the last century.

Cantillon had argued that the result of an increase in the stock of money will not be uniform across the economy, but rather will cause prices to rise at uneven rates in different sectors, thereby changing relative prices in the process. He understood the mercantilist ambitions of merchants and bankers and how they created excessive credit to purloin cheap goods at the expense of the masses. He understood it and most notably profited form it – John Law's fiat paper driven South Sea bubble.

In modern societies, when governments or central banks increase the supply of money, they do not do so in a way that affects everyone equally. Instead, new money is created by the government or by banks to be spent on specific goods and services. The demand for these specific goods rises, thereby raising their prices first. In a Misesian economy as money holdings increase, the marginal utility of money declines so that certain goods are revalued ahead of money on subjective preference scales, pushing the prices of these goods upward. Gradually the new money ripples through the economy, raising demand and prices as it goes. Income and wealth are thereby redistributed to those who receive the new money early in the process, at the expense of those who receive the new money later, or those who live on fixed incomes and receive none of the new money.

*Monetary theory is like a Japanese garden…an apparent simplicity conceals a sophisticated reality*

As far as the impact on prices goes today, the rise in the monetary base sponsored by the global central banks - and particularly the Fed as 'defender' of the reserve currency - has so far been restricted to the invisible effect, alluded to earlier. First and foremost, the base money increase prevents banks' troubled asset prices from adjusting to lower levels. Buyers of these assets have to pay a higher price when compared to the scenario in which the Fed hadn't increased the money supply.

In addition, prohibiting the prices of banks' assets from adjusting downwards keeps markets from performing an essential function, namely rewarding those players who serve the needs of their clients and pushing those players out of the market who do not.

Furthermore, as prices of banks' troubled assets are kept from declining, the need for revaluing other assets (such as book loans extended to firms, house builders, bonds, stocks, etc.) tends to decline or is prevented altogether.

If, however, asset prices are kept from falling by monetary policy expanding the money supply, the mechanism of relative prices cannot do its job properly. It actually paves the way for making other prices — such as wages, and producer and consumer prices — go up. We don't have to time to expand on how swapping the decaying bank assets for "short term liquidity" – cash not only denigrates the central bank balance sheet but is de facto another means of creating more money as they are paying an artificially high price for an asset that in some cases doesn't exist.

At Hinde we have determined the authorities believe they have only two options available to them to deal with this ongoing crisis, by now invisible; renege on debts or inflate them away. Political expediency suggests they will reflate the system, as we now know to be true. What we also know is that based on our concept of inflation, money will drive prices higher in sectors with limited supply. We understand this, we get it, we believe now that gold will chase nominal equity prices higher and surpass them. Equity indices with a limited float of stock – take Taiwan, Pakistan, Turkey or specific sectors such as junior mining equities are likely to perform exceedingly well. As Variant Perception has highlighted often money supply increases correlate well to asset price appreciation.

**Faith Based System, Flucht in die Sachwerte, Katastrophenhausse**

*The most important thing about money is to maintain its stability…You have to chose 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.*

*George Bernard Shaw, 1928*

Optically of late investors have noticed that nominal prices of all assets commodities, gold and equities rise and fall together. Surely "greenshoots" should signal less appeal for gold. Ordinarily yes, but as we have seen "greenshoots" are merely runaway weeds, fed by too much water (money supply increases). These uniform price increases (note not relative) are merely a manifestation of this reality.

Allow us an excerpt from history. What seems to have happened in Kublai Khan's China is that a large and confident population worked harder than usual to accumulate a currency whose respectability was backed by the apparent integrity of a secure empire. As long as people strove to accumulate this money the state benefited from the productivity gains of a motivated population, which cost the state nothing. The empire's infrastructure was constructed on credit, its economy expanded on credit. This growth came from the power of a belief held by its citizenry that their labour was being validly remunerated in the token form of its Chinese imperial paper.

The very best living standards were enjoyed - not surprisingly - when people worked for something which it cost the state almost nothing to put into circulation in ever greater amounts. To be possible this required near unanimous confidence in the system, and not surprisingly the period was recognised as one of enlightened economic management - a view which persisted for several decades during a period of steady currency inflation.

Yet the most prosperous and confident period preceded rapid financial and political decline. When the confidence in the currency gave way there was wholesale destruction of the value of savings in almost all forms at once, and the popular energy required to sustain the empire rapidly disappeared.

A previously successful credit based system will eventually collapse under the weight of its historical circumstances and the excesses of credit which it is sucked into at the time of its greatest success. As the process of collapse unfolds one monetary store after another demolishes savers. If they hold notional long term obligations like pensions the underwriters fail. If they hold institutional debt the issuers fail. If they hold bank notes the banks fail. It takes very few failures before the population starts to see risk in every credit based construct. Their faith in their institutions evaporates, and they become acutely aware of the dangers of anything intangible, and anything whose supply can be easily expanded. This is when they begin to think obsessively about things whose supply is subject to some fundamental limit.

So "*once public opinion is convinced that the increase in the quantity of money will continue and never come to an end, and that consequently the prices of all commodities and services will not cease to rise, everybody becomes eager to buy as much as possible and to restrict his cash holding to a minimum size. For under these circumstances the regular costs incurred by holding cash are increased by the losses caused by the progressive fall in purchasing power. The advantages of holding cash must be paid for by sacrifices which are deemed unreasonably burdensome. This phenomenon was, in the great European inflations of the 'twenties, called flight into real goods (Flucht in die Sachwerte) or crack-up boom (Katastrophenhausse). The mathematical economists are at a loss to comprehend the causal relation between the increase in the quantity of money and what they call 'velocity of circulation.'*"

*Ludwig Von Mises, Human Action- A treatise on economics.*

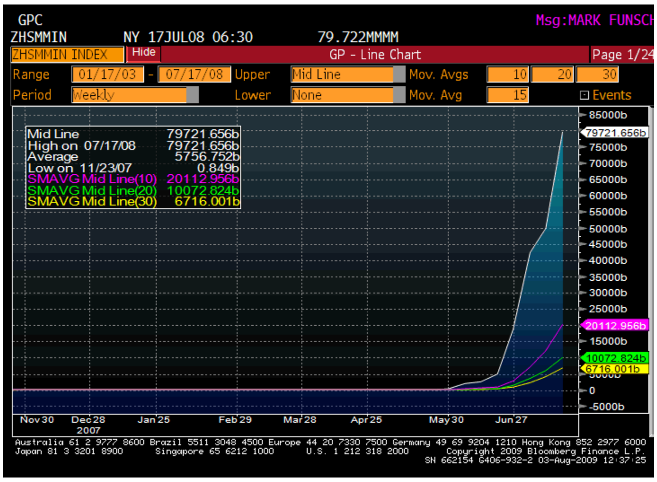
Does this all sound all too familiar? By now many investors are awakening to the rude fact that faith in the integrity of money and politics should be questioned. Inertia or ignorance is no longer an excuse not to examine the role of money and government. Earlier we touched on Minsky's concept of self-reinforcement. There has been collective illusion by the masses, a blind faith that the people assign money and government's role in society. Human action or behaviour can perversely work in reverse.

When individuals lose trust in the system and realise that the wealth illusion is predicated on forms of debt – household, corporate, government, and worse still ponzi debt - the intractable truth that these liabilities are just forms of paper money ironically sow the seeds of a *mistrust* in currency and credit (and at the exact time that there is a shortage of those dollars as individuals and organisations seek to repay their liabilities). Whilst seemingly offered no alternative to cash it doesn't take the masses too long to realise that even as it appears all assets and goods are falling in price, gold retains its purchasing power. Something experienced last year as dollars grew short. Physical bullion was scarce and paper gold instruments bore no nominal clarity as to the true price of gold.  Although even in the paper deleveraging of Comex futures, these pieces of paper held a higher relative value to other assets. (Note we do not use purchasing power, as they are not an operational store of wealth.)

A loss of faith in the system has momentarily been assuaged by state intervention. It is easier to trust in government to do the right thing, surely? A healthy dose of governmental ketamin is far better than a dose of reality – frugality instead of profligacy. So complicit are we in our undoing that the zombification of once productive sectors of our economy could perversely awaken to the *flucht in die sachwarte*. A global system that prescribes more of the same that helped cause this mess in the first place sows the seeds for such an event.

## Zimbabwefication?

In Barry Eichengreen & Michael Bordo's *The rise and fall of a Barbaric relic: the role of gold in the International Monetary System (1998)* they surmised it is unclear why inflation is not similarly good for equity markets (equities being claims on real assets). These were the same two writers who just before the end of the "bear market" in gold declared the central bank's appetite would progressively diminish. Ask Russia, China, Brazil et al. what they make of this statement. To our mind Eichengreen and Bordo have comprehensively missed the point; in a fiat currency world, increases in global monetary bases will see both gold and equities rally.



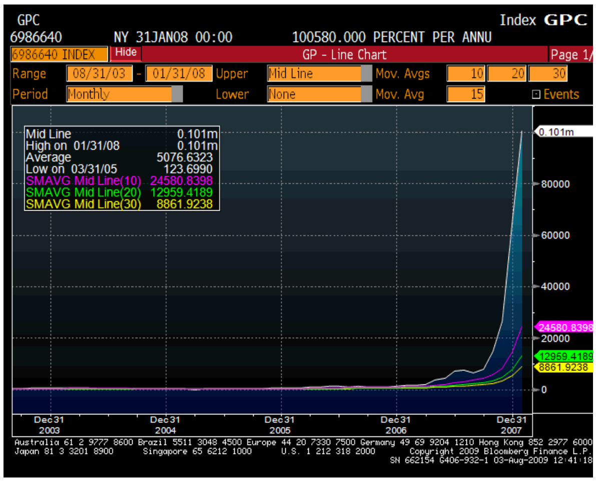




Chart: ZIM Industrial Index 2001- 2008

Chart: ZIM CPI YOY rates

| *Date* | 2006 | | | | | | |
|---|---|---|---|---|---|---|---|
| Money Supply (ZWD) | **45 Trillion** | | | | | | |
| *Date* | 2006 Aug | 2006 Sept | **2007 Nov** | 2007 Dec | 2008 Jan 21 | **2008 Jan 28** | 2008 March |
| Money Supply* ***(Revalued ZWD)** | 45 Billion | 35 billion | **58/67 Trillon** | 100 tln | 800 tln | **25 Quadrillion** | Over 900 quadln |

Table : Money Supply. Observe research at www.cato.org/zimbabwe for facts & figures on money supply & inflation rates

*On 24 July 2008, the Reserve Bank of Zimbabwe announced that "appropriate measures are being put in place to address the current setbacks being faced on the currency front, as well as on financial and accounting systems." It promised that in "the next few days" it would institute changes to the minimum cash withdrawal limits and IT systems' constraints. Currently, the government limits cash withdrawals to ZW$100 billion per day, which is less than the cost of a loaf of bread. IT systems cannot handle such large numbers; the automated teller machines for one major bank give a "data overflow error" and freeze customers attempt to withdraw money with so many zeros.*

The Zimbabwe (ZSE) was the best performing stock market in 2008. It rose over 30,000% in the next 12 months, a rise far in excess of the CPI rates, and despite an economic collapse. How come? Zimbabwe (Zim) followed the classic tenets of Austrian business cycle theory. Excess growth in money supply and credit sees money transfer initially (unfairly) to a few (connected with government) and their purchases cause certain items or goods to rise relative to others. It is not distributed equally to everyone but later it leaks out everywhere via the Cantillon effect. It should be noted after the Zimbabwe Dollar had been re-based (revalued), i.e. a few zeros were chopped off the bank notes, eventually inflation rates of over 231mm% were recorded, numbers we cannot comprehend. For no soon as you have written a cheque the price has at that rate doubled (or the value of currency has fallen).

As entrepreneurs react to these structural price changes, unjustified even though they are, by investing their capital, misallocation occurs. The more money supply grows the more distorted prices become, the more unsound businesses and ventures are “undertaken” that would not normally have occurred had there been no money supply growth. How does this money translate into equity purchases?

Often a nation’s stock market will become the main beneficiary of ‘fresh’ money. It enters first by the banks who loan it to other institutions and who “loan it cheaply” to entrepreneurs, who then respond to initial goods price increases by producing more goods. Others observe such production, and the owners purchase stock. Many instead of increasing their own production speculate with this money or other entrepreneurs. Whilst the value of money is plummeting in real terms as goods prices rise, stock prices are outstripping these gains. This leads to yet more misalignment of prices and bad decision-making. ‘Wealth’ is momentarily with a few who own the assets that are rising in value, but for the majority relative income is collapsing. So what does the government do. It meets the shortfall by issuing yet more currency to pay for the budget short fall. The amount of money issued so overwhelmed the existing share issuances of the Zim. Industrial Index that prices exploded. It’s all illusionary. In Zimbabwe there were very few safe havens to hide one’s money and people chose equities with real claims on assets that were rising. Incidentally some bought ‘gold’ mobile phone chips as a source of money to barter for other goods with.

Mugabe tried to blame such goods inflation on “greedy businesses” demanding price rises, so he set up price controls. It didn’t work for Nixon under his WIN (Whip Inflation Now) price controls and it didn’t work for Mugabe. Can we liken Zim to the rest of the world? In Zim people could not hide their wealth in other currencies (logistically difficult due to exchange controls), you couldn’t buy bonds as they were issuing too many, and hard currency was scarce.

*The stock of government domestic debt by mid July (2008) stood at $790. 6 quadrillion, reflecting an increase of 7,417.5 percent from $10.5 quadrillion*

*Reserve Bank of Zimbabwe (RBZ) Governor - Gideon Gono*

*Go Gideon Go Gono.*

Zimbabwe - A microcosm of the world at large. Both are in effect a closed end system. Globally we have every nation issuing bonds to meet budget shortfalls, we have monetisation of credit and government assets globally. If you are Japanese, Swedish, Latvian or American you are not sure which currency is a better alternative and gold is increasingly hard to source (even if you have contemplated it yet - most have not). Those with disposable income buy assets which benefit from the goods price rises you are seeing. You stock up early on winter lumber and food if you have no spare income. You ask for wage increases from your by now government employed car worker or banker because you cannot afford the bus in. Absurd. It all seems rather similar. A global issuance of currency as we are seeing makes it very difficult to find ways to protect your wealth.

The major point to take away from the Zim example is initially inflation is almost universally imperceptible with prices rising invisibly through the stock market mechanism. Later goods price increases explode higher at a greater rate and there is almost no in between. One morning you wake up to a cup of tea costing £1 the next it is £5 and so on and so on..

**Austrian Business Cycle = Gold & Equity rally**

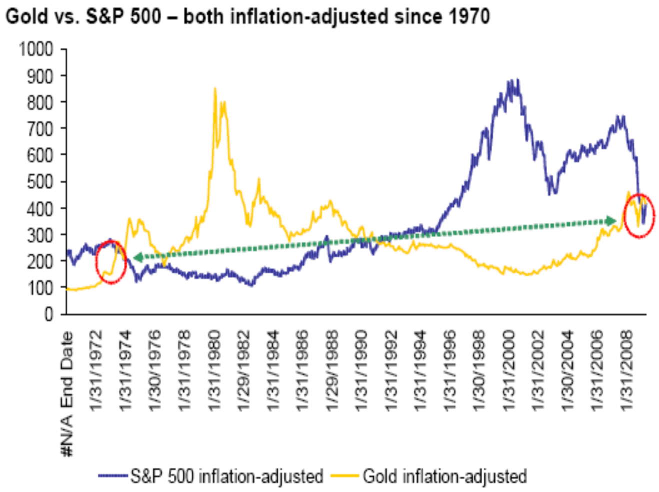



*Chart: Real Gold vs. S&P500 since 1970 (Erste Bank)*

In October 2008 the price of a troy ounce of gold broke through the S&P500 equity index from below for the first time since 1974. In then what we consider the first bull market cycle (1971-1980) under the fiat money system, the 1974 breakthrough led to a powerful seven year bull market with an inflation adjusted 600% appreciation (484% in nominal terms to 1980 high or excluding the spike a 384% increase).

Equity markets are rallying globally, particularly those of a smaller float and market capitalisation such as the emerging markets. They are struggling to transfer stock to willing buyers without prices moving dramatically higher. Its not that 'liquidity' per se is driving prices higher it's just that with more currency in circulation individuals effective exchange price rises as they make purchases. Now whether or not this represents a value proposition misses the point and why equity markets continue to dumbfound most mainstream analysts' expectations. Logically we should experience an erosion of earnings via this "inflation" and that we should resume the course of the often cited 1931 equity trajectory. The charts below actually suggest we could be at a cyclical trough.

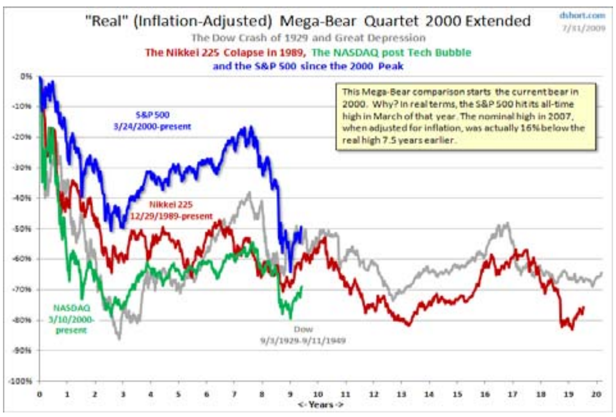



*Chart: "Real" (Inflation- adjusted) Bear Markets*
*(Note trajectory of 1930s bear and today)*


*Chart: 'Real' (Inflation-adjusted) S&P500 Index Price*
*Source- www.dshorts.com*

Certainly this is possible if the rate of money production slows. However we argue that it is quite conceivable that we are experiencing the first pernicious signs of a major currency devaluation, the now visible effect being a rise in all assets, but an invisible impact on overall price levels.

I have read a few pieces by a group called QB partners (a macro fund but not a gold fund like ours and at the danger of indulging in confirmation bias their comment on the monetary relationship boils down to this. Its rather intuitive.

*It comes down to this: bank reserves and currency in float are to gold what growth in the broad monetary aggregates (credit) is to stocks and other leveraged assets. Banks don't have to lend for gold to go to the moon (that's the result of central banks printing money), yet banks do have to lend for stocks and other leveraged assets to recover.*

Couple this with the concept of the Cantillon effect and we think one gets nearer reality. Money has a habit of seeping out surreptitiously, the authorities cannot easily determine or control its destination:

**The Jet Water Effect**

The analogy we often use is that of the householder (government/monetary authorities) trying to unblock detritus (i.e. toxic debt) from his drain pipes by using a water compressor to jet water (i.e. QE, ZIRP money) through them. But so encrusted and compact is this material that the pipes overflow mainly excess water into the guttering, where it sits idle (read banks' excess reserves). It is at this point in his zealousness to alleviate the blockage the householder sprays yet more water (i.e. more stimulus, monetisation of debt and expansion of monetary bases).

So excessive are these efforts he has not noticed that the water had already begun to leak out of fissures in the guttering (i.e. qualitative easing and currency in circulation) into the walls of the house on which he stands (i.e. capitalist/economic system). The guttering is by now overflowing and the walls and foundations have become sodden even rotten.

Now as the Kondratieff winter turns to spring there is an illusion all is well, the walls look cleaner, drier; the detritus has dried and crumbled somewhat looking leaner. But its an illusion. By the time the summer heat arrives the fabric of the house (society) begins to crack up. It begins to sweat. (money everywhere). The house is crumbling and the householders flee to safety *Flucht in die Sachwerte, or as Vichy France would once have said 'Quel Katastrophenhausse'* **-**(i.e. hyperinflation is now always and everywhere a potential global phenomenon) as Hinde Friedman Capital would say. Throughout the last 40 years we have skipped from one bubble to the next, emerging equities, Nasdaq bubble, property bubbles etc as the Federal Reserve bank has sought to reflate the system. We suspect before all is said and done commodities and gold will experience the euphoria associated with such bubbles. It is completely conceivable that gold's bull run will end when authorities move to an official currency/gold standard at a defined gold weight and price.

# Golden Facts 1970s & 2000s

Since the beginning of the fiat monetary system we have seen one full gold cycle and are in the midst of a second.

Fact - the word ‘carat’ (the measurement for gold purity) comes from ‘carob’; carob seeds were originally used to balance scales in Oriental bazaars. Pure gold is designated 24 carat, which compares with the ‘fineness’ by which a bar gold is defined.

This is as factual as gold having returned 11% annualised from 2000 to present (based on the average returns of an equal weighted basket of currencies depicted below). Indeed you start in 2001, arguably the start of this recent bull surge, and it’s just over 14%.

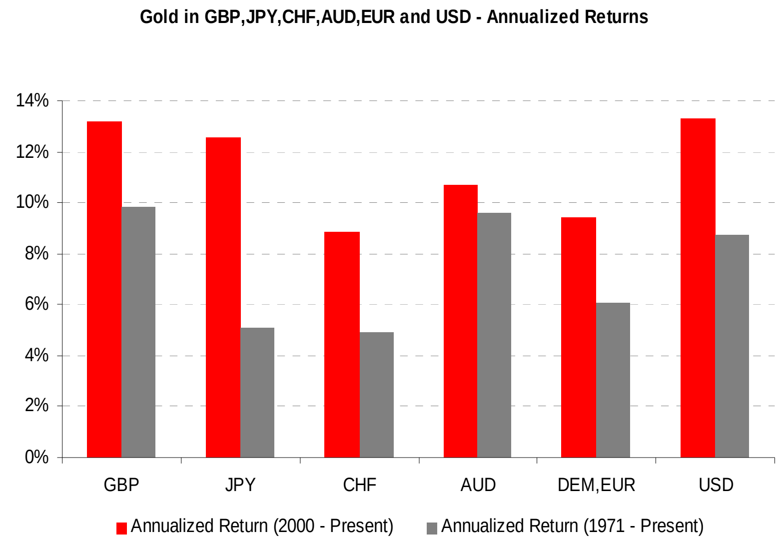

*Chart: Gold Annualised Return 1999- present*


*Chart: Gold Annualised Return 1971-2009*

The bull market from 1971 to 1980 provided an annualised return of 41.6% (2105% total return); 43% or 2447% total return if you include the spike high. Even if you did not exit the market in 1980, from 1971 to 2000 the start of the second bull cycle your annualised return would be 6.8%.

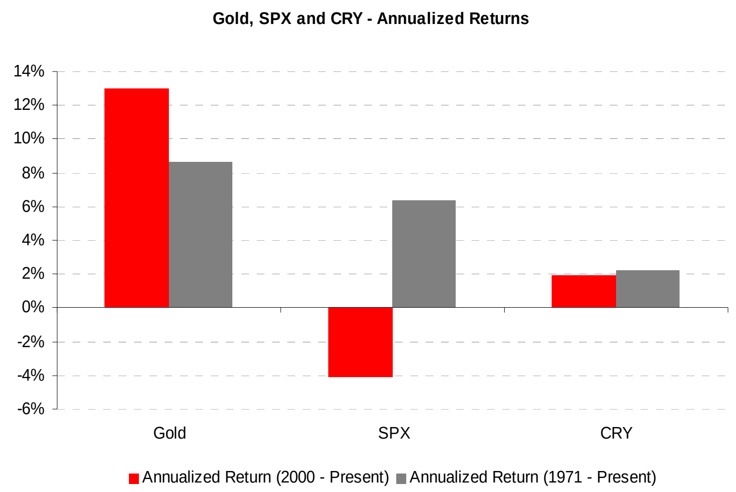

*Chart: Gold Annualised Return 1971-1980*


*Chart: Gold Annualised Return 1971-2000*




*Graph: Annualised Gold Returns in various currencies 2000- present & 1971- present*

Gold Inflation Adjusted Charts – we don't like to look at these as to adjust for inflation is as futile as solving a Rubik's cube blind folded, such is the distortion of price indices, re-based, hedonic and substitution effects, and weighting biases. Instead we highlight the nominal returns of SPX (US stocks; includes stock substitution), gold and the Commodity Research Bureau Index. Hmmm…..




*Graph: Annualised Returns Gold/SPX/CRB Index comparison (2000- present & 1971- present)*

Now all this analysis is of nominal returns, but if we did a crude back of the envelope calculation and adjusted these for real rates (US Fed Fund rates – Consumer Price Index YOY) one would see gold has the following return profile:

| Gold | Real Annualised Return | FED Target Av. Rate | CPI YOY Av. Rate | Real Rate* |
|---|---|---|---|---|
| 1971-2009 | 7.03% | 6.34 | 4.59 | 1.75 |
| 1971-2000 | 4.57% | 7.36 | 5.14 | 2.22 |
| | | | | |
| 2000-2009 | 14.30% | 2.74 | 2.71 | 0.03 |
| 1971-1980 | 40.60% | 7.79 | 7.87 | -0.08 |

*Table: Real Annualised Returns Gold 1971-2009 & Two secular bull markets 1971-80 & 2000-2009*

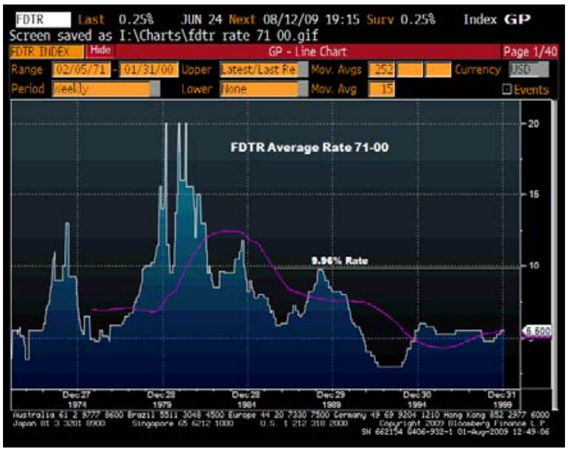



*Chart: US Federal Funds Rate (Average 1971-2000)*
*7.36% (arithmetic average)*


*Chart: US Federal Funds Rate (Average 1971-2009)*
*6.34% (arithmetic average)*


*Chart: CPI YOY (Average 1971-2000)*
*5.14% (arithmetic average)*


*Chart: CPI YOY (Average 1971-2009)*
*4.59% (arithmetic average)*

As interesting as charting relative gold performance is, assessing the long term nominal value of gold can best be observed with regard only to central bank reserves or possible even just USD Federal Reserve Bank liabilities (bank reserves) and money in circulation (AMS) and dividing these by total official world gold holdings (or just US gold holdings).

***Observing the return profile of gold, commodities and US equities it is evident gold has maintained an outstanding operational wealth over the long run and in the inflationary crisis of 1971-80 has exhibited stellar returns.*** 40% real annualised returns to be precise (35% even before the parabolic gold price appreciation). Currently gold in this bull market is experiencing 14.3% real annualised returns. Provocatively it also stands at a similar critical juncture in 2009 as it did in 1974, as evidenced by our gold/S&P chart earlier.

## Seasonality – A Golden Constant?

2009 has seen a solid consolidation of gold versus a basket of raw materials; and as we enter a seasonally attractive period for the metal are we about to experience the next serious leg up of the bull market?



*Chart: Gold/CRB Raw Materials Index*

*Chart: Gold Sept 2007 gold surges through May 2006 highs*

*The CRB Raw Materials Index is arguably a better representation of the "true" price of commodities, as this is the price companies, producer and consumer exchange at. The CRB Index by comparison, listing exchange traded products experienced a catastrophic collapse, a clear representation of the deleveraging of speculation and demise of paper derivatives. We feel this "distortion" misrepresents the true "operational wealth" of gold in commodity terms.*

Gold has retraced 50% versus raw materials in relative terms of the period in autumn 2007 when gold broke above its 2006 highs of $731. So in spite of holding just below its nominal highs of $1032, gold's operational wealth has fallen and perhaps offers an opportune time to increase holdings or invest for the first time.



*Chart: CRB Raw Materials Index – represents non-exchange traded commodities*

*Chart: CRB Commodities Index – represents exchange traded products*

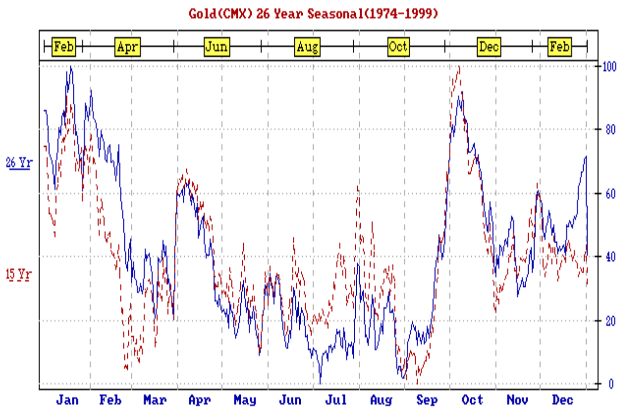



Chart: Gold Seasonality 1974-1999 (Moore Research)

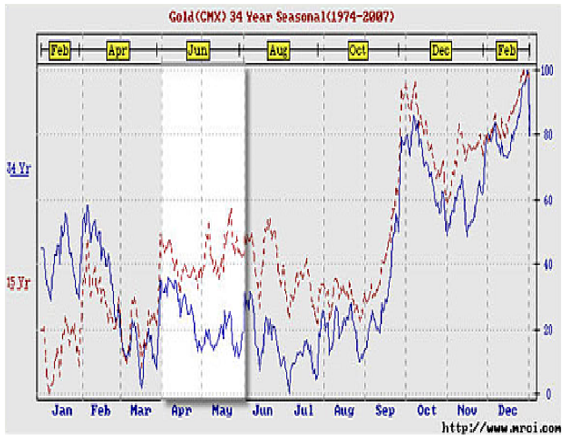
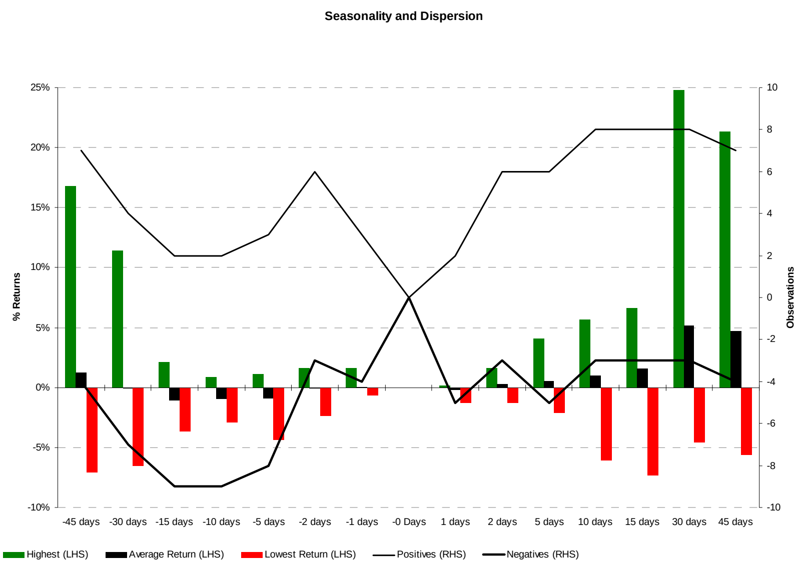



Chart: Gold Seasonality 1974-2007 (Moore Research)

Observing the charts above it would appear pretty conclusively that there is a defined correlation between the calendar and gold. This we call seasonality. It is the tendency for a price to be weaker or stronger at different times during the calendar year. Judging by our analysis it would appear as constant as the Jastram golden constant itself.

In September there is a clear pick up in the relative strength of gold which subsides momentarily in October before rising through to mid January. Thereafter gold tends to falter from February until mid-March whereupon it experiences a revival into April. May to July is the "doldrum" period. This is not to say there isn't immense volatility within these months, but in net nominal terms returns are uninteresting.

It should be noted that perhaps one criticism of long term seasonal analysis is that by treating bulls and bear markets alike, the secular impacts are filtered out. So from a "relative" basis this removes all bias. We include two charts above of seasonality, one from 1974-1999, leading up to the start of this bull market, the other from 1974-2007, thus encompassing the 2000 on bull market. Optically it is evident that the 2000 secular bull market has dramatically altered the performance of gold. There has been a notable trend higher throughout the year from January to December. Our own seasonal and dispersion Model visually picks up the impact of the secular bull market trend.




Graph: Gold Seasonality & Dispersion Model *(Hinde)*

**Seasonal Drivers**

Before we postulate on this secular market impact, let's examine the traditional drivers of this seasonality. Once we have illustrated these, as portfolio managers can we tactically benefit from this seasonality effect?

Every September since 2000 gold prices have risen at what we could arguably define as the start of the gold season. It's the time of year when the developed world returns from summer vacations, and begin to contemplate end of year festivities. Jewellery fabricators begin to accumulate gold just as the CBGA selling season ends (August) and Christmas presents are manufactured right though November. The United States until 2007 had been the second largest market for gold jewellery by volume and the largest by retail value. This is not just Christmas shoppers but immigrant communities, such as the Indians, Turkish and Asians who have maintained their cultural affinity for gold in their new homeland. Since 2007 China has usurped the US as the largest consumer of jewellery. (2008 – China consumption=326.7 tonnes vs. US=179.1 tonnes). We will come back to the Chinese, but first the main driver of gold demand has been in jewellery purchases by India and the subcontinent, with their gold year also beginning in September.

*India & the Subcontinent*

India was up until 2008 the largest market for gold jewellery by volume. Jewellers stock up on gold for the festival periods and wedding seasons. Indian Sub-continent (India inclusive of Pakistan, Bangladesh & Nepal and Sri Lanka) fabrication was 637.3 tonnes, and in this current bull market has been in excess of 800 tonnes. September marks the end of the Monsoon and harvest closure. Proceeds from the harvest are placed into property and gold (often bullion is used to acquire the property) often purchased ahead of the festival and wedding seasons.

One of the most significant of these is Diwali. A festival celebrated in several religious cultures - Hinduism, Sikhism, Buddhism and Jainism. It literally means a row of lamps from the Sanskrit *dipa* for lamp and *awali* for row; hence it's known as the festival of lights throughout the world. This runs throughout October and November and is often the instigation for wedding celebrations – the "marriage season" from November to December and later and to a lesser extent from mid January to May. This helps explain the surge in September and also the drop in October (as Diwali purchases have been already made) and then resumption in November (as wedding season really picks up). A traditional gift for an Indian bride is gold so she can go not only covered from head to toe for her groom, but also bear it as a dowry. An Indian bride cannot own assets but can own cash and so this enduring financial asset makes for a solid financial beginning.

The second most prominent festival is Akshaya Tritiya, a Hindu holy day that falls on a significant lunar day (Tithi). Akshaya means the "never diminishing" in Sanskrit and a day that is believed to bring good luck and success. It is a particularly auspicious time to purchase gold and silver for new ventures as it is believed by legend that all investments on this day will appreciate. They will never diminish in fortune. *We take note.* Often April to May you will see marriages accompany this period (the second period of marriages that lifts gold prices).

*Picture: Diwali, 'a row of lamps'*

*Picture: Akshaya Tritiya, 'never diminishing (in value)'*

Such is the demand impact of this market that with potentially a third of mine supply (approx. 2400 tonnes annual) soaked up by this period that when it ends around May we often see quiet summer months. Indeed crops are planted ahead of the monsoon at this time, which usually by September have ended. A heavy monsoon can reduce crop yields and hence returns available for gold purchases so the timing and intensity of the monsoons can impact the timing and price purchases of gold. (Other notable religious holidays are the ending of Ramadan September/October which sees a period of celebration and gift-giving, and late December Eid ul-Adha, another Muslim festival features the giving of yet more gifts.)

*Price Sensitivity*

Having examined the traditional drivers of this seasonality, what indications are there for a repeat performance in 2009? To examine this eventuality we need to turn the clock back to end of the last year, when the traditional demand drivers went missing.

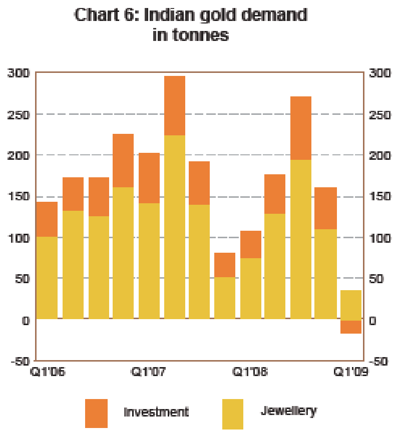
After the continued seasonal bias of September in 2008, the usual October fall away, that occurs before a November/December resurgence, turned from fall away to a veritable free-fall. A function of financial de-leveraging witnessed in all asset classes (excepting US government bonds), it broke the secular trend of rising prices typically associated throughout Q4 (2000 – on). Rather October saw the September lows taken out, before we did then resume the more traditional November and December rally (just not with a cumulative rise in price) of the longer term seasonal patterns 1974-1999.

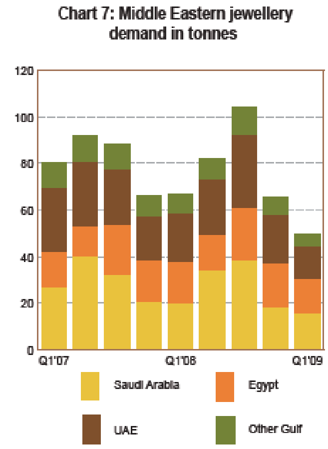

*Chart: Gold 2008 Seasonal Sept – Dec*

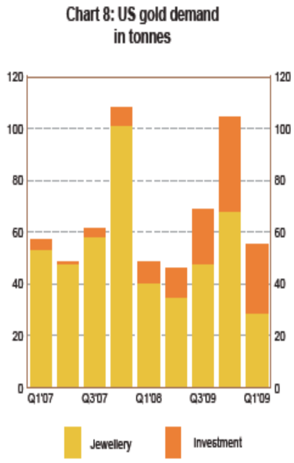
India is particularly price sensitive and lately demand has been negatively affected by the combination of gold-price volatility, and more significantly by its local currency volatility, the Indian rupee. Dramatic weakness in the rupee saw substantial gains for gold price in rupees, which led to not only a reduction in demand in the 2008 autumn period, but also substantial recycling or scrap sales of gold jewellery in Q109.


*Chart: Gold in Indian Rupees - High Price Volatility*

Q1 09 saw the lowest quarterly jewellery demand from India in the last 20 years. On 24th February gold had peaked at Rs15,780 per 10g in the Mumbai market. Rising unemployment exacerbated by returning expatriates and collapsing quarter on quarter GDP dimmed the general outlook so materially that Indians realised (sold) their store of value (gold jewellery) to pay for every day necessities.



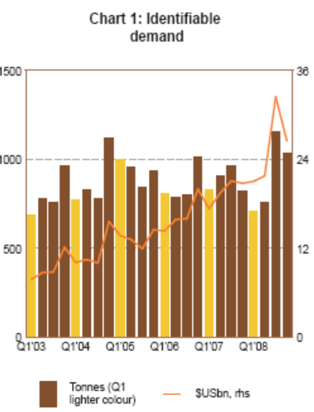




*Graphs: Indian/ Middle Eastern/ US Gold Demand in tonnes*

It could be argued that if demand out of India was so bad at the end of 2008 and Q1 2009 we won't see the traditional summer doldrums as there is no drying up of purchases to come. Note: 2007 saw a far greater fall in Indian demand, but the reasons the seasonals did not fail then are applicable to why they did not fail in 2008. However we have seen that although we didn't retain the seasonal constant of our secular bull market i.e. that of trending higher prices in Q4, we did match the long term seasonal biases. So in reality it could be just that the drivers are changing but not the timing. The slack from a fall in Indian demand was met elsewhere at this time. The data supports two possible avenues, one geographical the other global; namely, China and global investment demand.

*China Demand & Global Investment Demand*

China total off-take in Q4 2008 grew 20% on Q4 2007 to 112.7 tonnes and Q1 2009 this number was 113.9 tonnes versus India's 17.7 (100+tonnes in Q1 2008). As Hou Huimin, the deputy head of the China Gold Association stated "there is a possibility that China might just overtake India as the world's largest gold consumer this year".



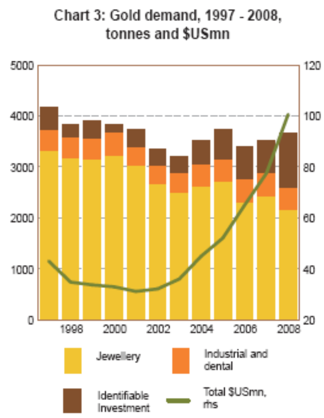




*Chart: Investment Demand (Tonnage/$US bn value)*

*Chart: Gold Demand, 1997-2008*

| | 2006 | 2007 | 2008 | 2008 Q1 | 2008 Q2 | 2008 Q3 | 2008 Q4 |
|---|---|---|---|---|---|---|---|
| ***Investment Demand*** | **664.7** | **663.7** | **1090.7** | **153.7** | **139.4** | **398.6** | **399.0** |

*Table: Global Gold Investment Demand*

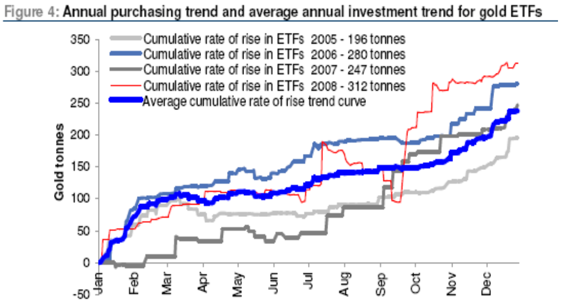
The Bank of Taiwan launched a monthly gold saving plan aimed at retirees in December of last year, and immediately attracted 200,000 new accounts in Q1 09 into the 'gold piggy bank'. With such encouragement from central government, we would not be surprised to see this catch on across Asia; and could well foster the China dynamic as a lead player both in the demand for gold (and supply of it).

With China growing as a gold consumer, the Chinese New Year festivals may well extend the Q4 phenomenon into a early Q1. We would expect to see a January rise, followed by February slump after Valentine's Day when the mainland Chinese love to buy 24 carat trinkets as gifts for loved one's. We are certain that with the state owned gold companies offering gold to their public at princely premiums they will be more than happy to encourage such activity. Certainly Q1 in China seasonally sees bank lending at its highest, another boost for incomes, and potential new January seasonals.

*ETF Demand*

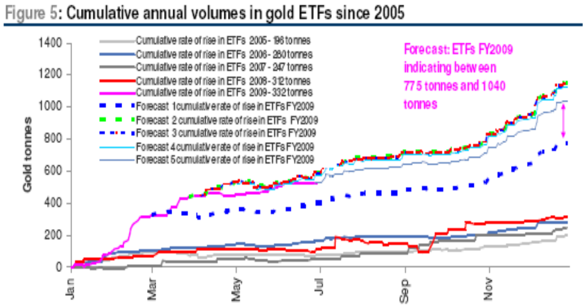
According to CSFB and David Davis analysis -*The annual investment demand for gold ETFs shows signs of seasonal trends with investment following seasonal gold price highs at year end and the beginning of the New Year. We observe mid-year purchases of ETFs are generally subdued. Should investment demand for the rest of 2009 follow the same trend exhibited in previous years we calculate the consumption of gold ETFs for 2009 could easily test 1000 tonnes. If this is the case, investment in gold ETFs will likely be triple that of 2008 and, under these circumstances, points strongly towards a gold price of over US$1 000/oz towards year end.*

Figure 4: Annual purchasing trend and average annual investment trend for gold ETFs




Source: Company data, Credit Suisse Standard Securities estimates

Figure 5: Cumulative annual volumes in gold ETFs since 2005

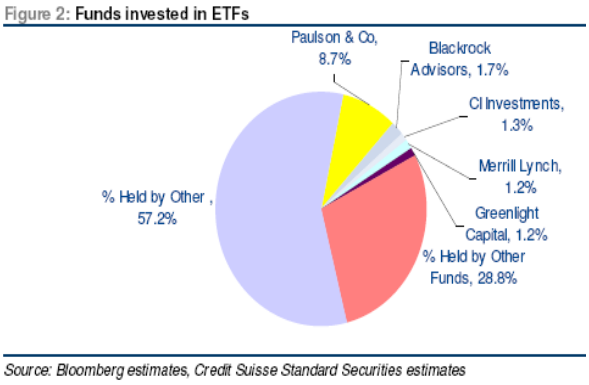



Source: Company data, Credit Suisse Standard Securities estimates

*Chart: Annual Purchasing Trend & Average Investment trend Gold ETFs* *Chart: Cumulative annual volumes in gold ETFs since 2005*

Should investment demand for the rest of 2009 follow the same trend exhibited in previous years, then gold ETFs will surpass 1000 tonnes, a tripling of investment in these instruments, which would go a long way to offsetting annual scrap sales, and the recent slowdown in fabrication demand, specifically jewellery.

CSFB estimate that 43% of the GLD SPDR ETFs (US) is held by investment funds and hedge funds. Paulson & Co., whose founder John Paulson sublimely made a bet on the subprime debacle, holds the largest single investment of around 8.7% (96 tonnes out of 1120 tonnes at time of print). Digging deeper one can see these funds employ investment for the duration of years not months. Of more significance to us, as a fund who holds only allocated bullion and NO bullion ETFs, some of the more famed managers such as David Einhorn of Greenlight Capital have now switched their whole GLD allocation into physical bullion. They diplomatically cite the cost of physical storage is better than GLD fees (there is not a lot in it, trust us). Certainly we suggest this is a trend that will continue. As an aside it would be interesting if all the funds called for delivery of their allocated gold from SPDR the GLD provider, instead of selling their ETF shares to purchase bullion elsewhere. We thought it was so easy to call in your bullion form the ETF. We must have been mistaken. A run on the fractional reserve bullion banking traded equity, sorry GLD ETF would seem inconceivable…wouldn't it.



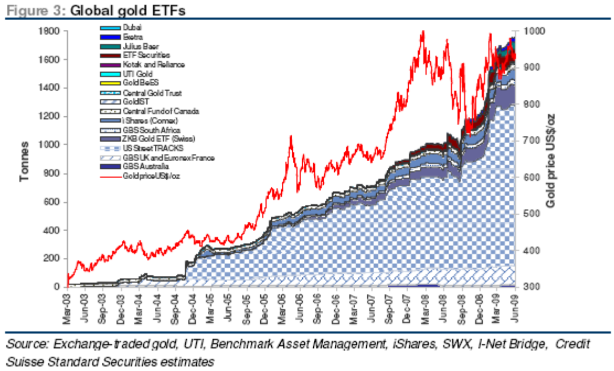




*Chart: Funds invested in GLD ETF (CSFB Source)* *Chart: Global Gold ETFs Tonnage & Value (CSFB)*

Lately, although we have seen reports of poor grain harvests in India, the INR in gold terms has stabilised considerably over the last two quarters and stability will bring back buyers as they become accustomed to these nominal prices. Likewise post the collapse in Q1 demand due to economic fears (compounded perversely by the Mumbai bombings), we believe the election results which sparked hopes of political democratic reform and buoyed the Sensex have helped ameliorate despondency. Couple this with general global optimism (all be it likely misplaced or just a misinterpretation of inflation) will see a resumption of gold purchases, as livelihoods seem more settled and secure.


*Chart: Gold in Indian Rupee terms stabilised 2009 Q2 & Q3*

Evidence in Q2 suggests this to be very possible as the Akashaya Thritiya festival this last April and summer wedding season of May have undoubtedly provided some support to jewellery demand and helped underpin gold prices, judging by our conversations anyway.

## Seasonal Sensitivity

India, China (East Asia), the Middle East (Turkey), USA, and Italy are the primary players in the consumption of gold. We are not referring to the Central Banks here.

Observing the dynamics of these geographics with regard investment and fabrication demand will go a long way to influencing seasonals.

Right now Seasonality is still a Golden Constant

- China has consumed more gold every year since the liberalization of gold markets in 2002, when individuals were allowed to have gold ownership. They are on course to displace India as the largest consumer in the world by volume and value.
- Investment demand both via ETFs and identifiable demand on quarterly trend dynamics can conservatively offset the reduction in recent Indian jewellery demand alone
- India, Turkey and areas of the world impacted by sensitivities to volatilities of gold in local currency terms have seen marked stabilisation which coupled with “equity” optimism has led to purchases in seasonal festivals mentioned.
- China, ETF and investment bullion purchases are extending the seasonal bias into January. One to observe for the future.
- Known Unknowns – China, Brazil, Russia the main protagonists of a new global reserve currency are systematically accumulating gold reserves. This is known, what is Unknown as to the impact on seasonal biases. Will there be quarterly re-balancing of reserves, may be even monthly; but surely not yearly?

| Rank | Central Bank holdings | Tonnes G |
|---|---|---|
| 1 | United States | 8133.5 |
| 2 | Germany | 3412.6 |
| 3 | IMF | 3217.3 |
| 4 | Italy | 2451.8 |
| 5 | France | 2450.7 |
| 6 | **ETF (current)** | **1747.1** |
| 7 | China | 1054.0 |
| 8 | Switzerland | 1040.1 |
| 9 | Japan | 765.2 |
| 10 | Netherlands | 612.5 |
| 11 | Russia | 536.9 |
| 12 | ECB | 501.4 |
| 13 | Taiwan | 423.6 |
| | **ETF (31 Jan 2006)** | **414.0** |
| 14 | Portugal | 382.5 |
| 15 | India | 357.7 |
| 16 | Venezuela | 363.9 |
| | **ETF (27 Dec 2005)** | **337.1** |

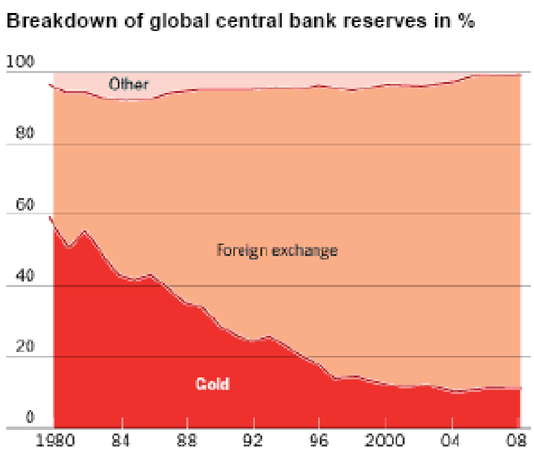



Chart: Gold Central Bank Holdings & Total ETF holdings

Chart: Breakdown of global central bank reserves in %

**Central Bank Gold Reserves**

At the end of the 70s, gold held as a percentage of central bank reserves was almost 60%. Since then it has fallen to 10%, a function of foreign exchange reserve expansion under the fiat system and western central bank’s (CB) selling their gold (mostly to short derivative players we might add). Ten central banks hold almost 80% of the world’s CB gold reserves (interestingly holding to Pareto’s 80:20 principle). 36 nations hold under 1% of reserves, among which some of the largest holders of foreign exchange reserves (i.e. USDs) are Brazil, China, Korea, Japan and Singapore. Incidentally 51 nations have none.

China would have to accumulate 5,600 tonnes to achieve just a 10% share, to be in line with the average shown in the chart above. To have a 50% weighting comparable to some of the western central banks such as France they would have to purchase nearly 32,000 tonnes. This at current mine supply rates of 2400 tonnes annual would take 13.5 years of mine supply. For Japan, Russia, Taiwan, India and Singapore to follow suit to the 10% mark, would take almost 7000 tonnes. Putin has declared that to be his minimum intention. So much for the 'Muraviev Margin'. Even little old Ecuador doubled its reserves to 54.7 tonnes of gold.
I think we get the picture.

**Scrap Supply**

Scrap supply has risen as countries such as the Middle East and India with a proclivity for owning gold as a store of wealth, have exercised their right to that wealth by selling existing supplies of jewellery. It is unknown whether this has been spare jewellery, the odd single earring (the other lost) or odd spare bangle. We suspect it is. We also suspect it will take considerably higher prices for individuals to consider selling their family heirlooms, passed from generation to generation or part with their sentimental birthday gifts and wedding dowries. Certainly a large amount of scrap supply over 500 tonnes came on to the market, so it is more conceivable again that the next wave of investment demand will not be nullified by this, leaving time and an appreciable price increase to see selling. Even then this may be dependent on economic sentiment at the time.

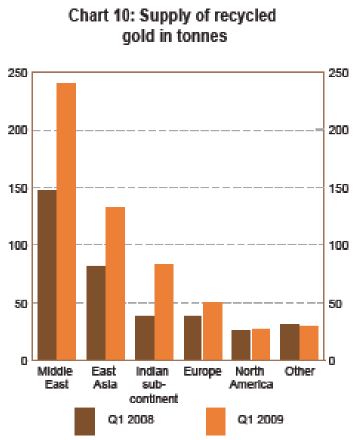



Chart: Supply of recycled/scrap gold 2008 & Q1 2009

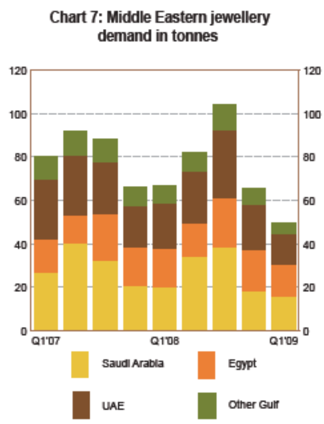



Chart: Middle Eastern Jewellery demand (Tonnes)

Whether this threatens the seasonal golden constant remains to be seen, but observing price trends of gold in various currencies and global sentiment we will be ready to observe the changes and act accordingly. For now despite the rising optimism of a seasonal Q4 rally we too expect the *constant*. One comment we would make is actually the season may get a head start from our belief of what 'inflation' is. Our Hinde Gold Model is trend-ready and we have not observed this level of consolidation for sometime. A break higher would seem the most consistent with all we have put before you.

Seasonality is not a primary driver of the underlying themes for gold appreciation both in 'operational and nominal wealth terms', but it does provide us with tactical ammunition by which to capture the ebbs and flows of a secular bull market in gold.

Our purpose here was not to address the long term drivers of gold or provide a definitive valuation of where we think gold should be or could be priced – there are a multitude of possibilities. But what we would state is:

*Put 100 diverse individuals in a room and ask them to independently write down their gold target for the next 5 years. What do you think the responses would be? I suspect you would find both a wide range and dispersion. Most would not know where to begin to create a valuation; we have sympathy. An inability to value securities or asset classes is one of the key recipes for the instigation of a bubble, price discovery takes place. Arguably this is exactly the defining precursor to a bubble. We suspect that junior gold mining equities will have a comparable experience to internet start ups of the late 90s and early 2000s, whilst gold maintains a steady real annualised return superior to other assets.*

## Epilogue:

It should be noted that there is potentially an endless supply of paper money, but that there is a finite supply of commodities. However gold supply is a misnomer as it is not destroyed or consumed. It lasts forever and does not degrade. Almost all the 160,000 tonnes of gold mined (almost the size of a tennis court cubed) exists in some form, jewellery, bullion, coins, ancient Egyptian artefacts or scrap. At $900 an ounce this cube is worth some $4.5 trillion, a mere 3% of the $150 trillion pool of available financial assets. Half of this cube is comprised of national and artistic treasures, religious artefacts, heirlooms and treasured possessions that will never come back into the 'market' - i.e. the area of exchange – so gold only comprises a derisory 1.5% of the pool of financial assets. The market capitalisation of gold producers is also a paltry $200 billion and they can only produce gold annually at close to 2.5% of the existing world supply. This falls far short of the increases of money supply that run into double digits for most leading countries.

Government has by and large managed to nullify the impact of gold's fiduciary value in the mindset of society (mostly the 'developed' world.). But now that individuals begin to obsess about the validity of the current capitalist structure, the weight of trillions upon trillions of printed money will eventually overwhelm a small and ultimately finite supply of gold and silver. Government will not want to relinquish control of money, however the free market is once again dictating that gold is money. This will ultimately overwhelm any governmental suppression. Since 1971 gold has returned 9% annualised and throughout that time government has had the will and gold with which to hold back its ascent to fair value. Now western central banks are running low of gold whilst others wish to increase their holdings against the potential devaluation of their dollar currency reserves. Remember there are many governments in the world today who will ultimately pursue their own interests. It's the nature of the beast – man is his own enemy. If they do not buy gold the man in the street will begin to. *Gold is a UNIVERSAL currency. Gold is MONEY*. It is undervalued, under-owned and mis(understood). It is not only advisable to own gold, it is a must.

### Aurophobia & a Fine Affinity for Troy Ounces

Aurophobia – a fear of gold. A medically defined condition of leading western central banks. You can choose to stand by your faith in government that daily subverts the rule of law. You need not be a gold bug, you must just have an awareness that all assets or currencies have a time and a place and right now it is still gold's. Until such time as there is a satisfactory monetary system where capital is invested correctly so as to increase the productive good, gold is where we will have a core of our own operational wealth.

We greatly respect the writings of Sean Corrigan at Diapason Commodities who had a piece of advice for investors with regard to recent designs of the CFTC to curb speculation in commodities:

*If those wishing to hide from financial manipulation, currency debauchery, political feckleness, and the loss of privacy and discretion in managing one's affairs such as is being brought about through the loss of banking secrecy and the bullying of 'tax havens' can no longer invest in the derivatives of a wide range of hard assets, perhaps they will avail themselves of one of the remaining, physically-tractable outlet for their needs. Far from furthering the interests of Goldman Sachs- as he did during his 18 year poacher-turned –gamekeeper may be the man who does the most this year for gold instead.*

**We consider gold and silver assets not subject to confidence of the faith and credit of anyone. It cannot be printed or subject to some (mis)interpretation of accounting rules. Neither is it subject to bankruptcy of banks or governments. The physical is not subject to the rules and subversion of exchanges, regulators, ratings agencies or clearing systems. We, like many others, see gold as money, defined in terms of troy ounces, a fine 0.999 ounces at that. We own the same number of bars held in allocated form in Zurich vaults now as we did 6 months ago.**

**To learn more about Hinde Capital and Why Gold & Why Hinde Gold Fund access is freely available at www.hindecapital.com**

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