The SA Bullion Gold Report

Q4 2011

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Gold Performance to 31 December 2011 (% per annum)[1]

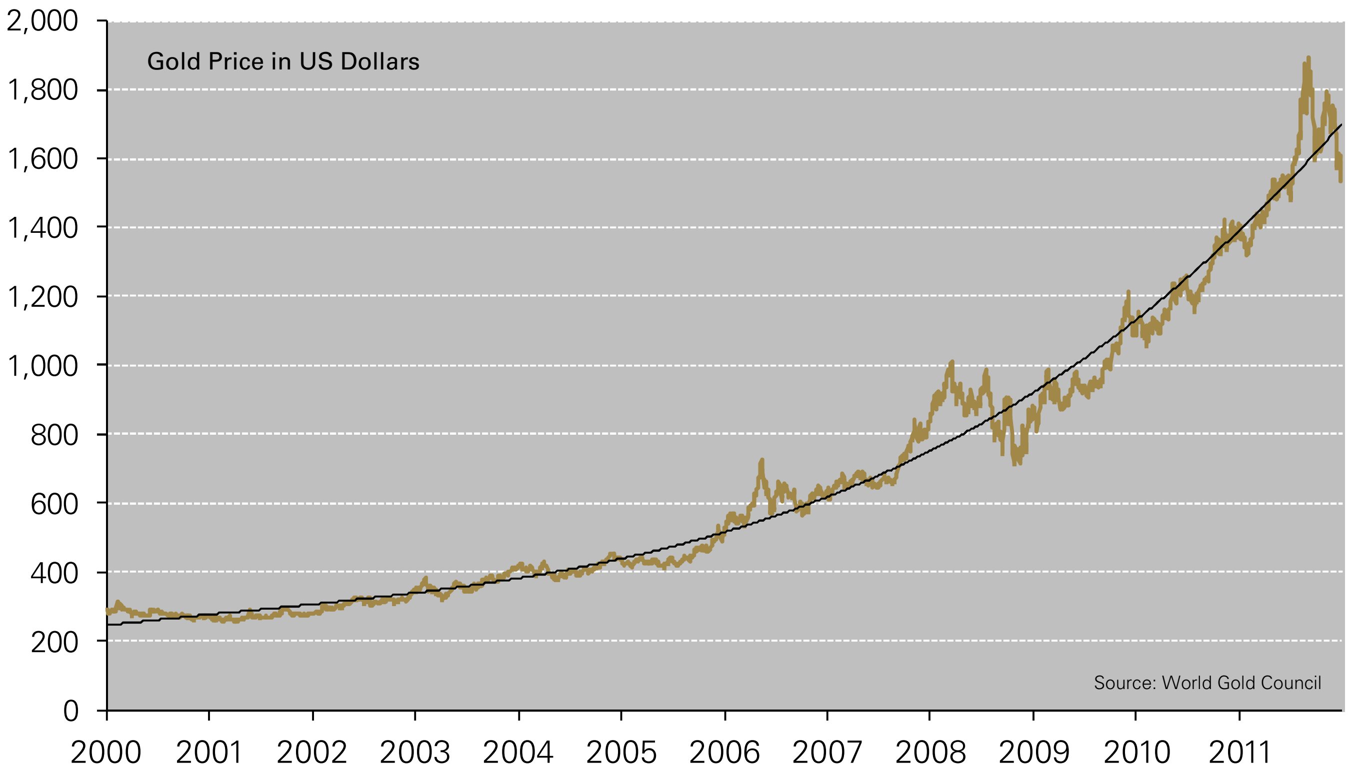
	Quarter[2]	1 Yr	2 Yr	3 Yr	5 Yr	10 Yr
Gold in USD	-2.8	12.0	20.3	21.8	20.0	19.0
Gold in ZAR	-3.0	36.3	25.8	16.4	23.2	14.3

[1] Based on LBMA Afternoon Fixes except for last price of 2011 which was a Morning Fix on 30 December
[2] not annualized for periods of less than 1 year

Gold Prices

	Gold in USD/oz	Gold in ZAR/oz
31 Dec 2001	276.50	3,316.61
31 Dec 2006	632.00	4,456.07
31 Dec 2008	869.75	8,040.84
31 Dec 2009	1,087.50	8,008.07
31 Dec 2010	1,405.50	9,298.44
30 Sep 2011	1,620.00	13,068.70
31 Dec 2011	1,574.50	12,672.52

Note 1: The above prices are LBMA Afternoon Fix prices except for the last price which is a 30/12/2011 AM Fix.
Note 2: At time of writing gold prices were $1,740.00 and R13,363.74



Gold Price Action

The Fourth Quarter of 2011 was essentially a period of two halves. In the first half gold ascended from $1,620 to a high of $1,795 on 8 November. In the second half gold declined to end the quarter at $1,574. (It has subsequently climbed to $1,740 at time of writing). In the last six weeks there was considerable selling of gold futures by Index, Commodity and Hedge funds due to 'portfolio rebalancing'.

The year 2011 saw gold start at $1,405 and end at $1,574 to post a decent return of 12% in US Dollars. In South African Rands the return was a far more dramatic 36.3% as the Rand along with many other currencies felt the negative effects of European concerns and a related slowdown in demand for commodities from China.

For the 2, 3, 5 and 10 year periods ending 31 December 2011 gold has done what we would have expected in this time of trouble for currencies – it provided opposing strength and delivered excellent returns. (Refer to performance table above). Does this mean that gold is now expensive? No. In nominal terms gold is up five or six times but compared to the monetary base gold is cheaper now than what it was ten years ago.

United States of America

Financial Markets

Whereas gold returned 12% in 2011, for the same period the S&P 500 returned 0%. Banking stocks in particular were hammered. Bank of America had a dreadful year and saw its share price decline by 58%. And while US corporate earnings have been boosted by cost cutting they are trading at 21 times average earnings of the last ten years. We would hazard a guess and say that US stocks do not on the whole appear very inviting. Their prices predict an economic boom, rapidly rising employment and falling spare capacity. Any disappointment is likely to have unhappy consequences for stocks and as much as we torture the data to give us answers, we cannot get the data to confess to great times ahead.

US bonds tell a different story in this bi-polar land. Ten-year treasuries yield less than 2% and thirty-year treasuries yield less than 3%. These bonds are predicting a sluggish economy and steady or falling prices (ie dis-inflation or deflation). They are saying that the future of the US is an economic slump with increasing excess capacity and flat prices.

To really make things interesting one then takes a look at inflation-linked bonds. In the US these are called TIPS (Treasury Inflation-Protected Securities). TIPS have locked in negative real yields. This predicts rising inflation, no spare capacity (as it becomes permanently eliminated) and an economic slump.

So you might well ask what we make of all this. Well our long term readers will know that we have been advocating stagflation as the long term outcome of this great credit contraction. We are with the TIPS. Which is why we advocate gold as the smart currency position.

Federal Reserve Board

Last year saw a divided Federal Open Markets Committee with some strong dissenters to the Bernanke-inspired monetary-easing grouping. This year, in keeping with the Fed's policy of rotation, four past members make way for four new members - Jeffrey Lacker, Sandra Pianalto, Dennis Lockhart and John Williams. Lacker excluded, this group are seen as moderates or inflation doves, meaning they are likely to favour stimulative policies that promote economic growth even at the risk of setting off inflation.

A third round of quantitative easing becomes far more likely with this new grouping as the central bank attempts to assist in bringing unemployment down, even at the risk of triggering a rapid rise in prices.

The Fed recently announced that the exceptionally low rates will be held at least until 2014.

Economy

Slowing economic activity, poor labour markets and restrained inflation probably sums up the US economic picture today. Much the same can be said of Europe and China.

Washington's Super Committee has failed to come to a consensus position on budget deficits and federal debt. We are not surprised. This leaves a huge question mark hanging over an important issue that played a big role in S&P's rating downgrade of long term US government debt last year.

"Just to replace all the jobs lost in the recession and keep up with the population growth, the economy would have to add 275,000 jobs per month for the next 5 years" – New York Times.

Europe

European Central Bank

On 30 November in an unprecedented action the US Fed and ECB announced that the Fed would slash the cost of emergency dollar loans to the European Central Bank and other central banks in the region as part of a coordinated action to prevent Europe's debt crisis from triggering a run on European commercial banks - and thereby triggering a global liquidity crunch. Cheap US Dollars would be available to these central banks for on-lending to commercial banks in their countries for a 15-month period.

The dollar sagged on the Fed/ECB announcement and stocks rallied. We see this as yet another step of many to come where leading central banks intervene as they are the last in line with any ammunition to deal with European sovereign debt and European bank debt. The casualties will be the currencies.

Economy

The Eurozone is now in a double-dip recession right to the core and we are seeing the rise of sovereign spreads in some parts of the core.

In the midst of a sovereign debt crisis most European nations (even the Netherlands!) have had their debt ratings downgraded. Leading nations face very tough challenges ahead. Not only do governments have to raise new borrowings to cover gaping budget deficits, but they also face a tidal wave of maturing bonds that will have to be rolled over in the next four months.

A selection in billions of Euros:

	Jan	Feb	March	April
France	52.9	35.9	17.4	34.4
Italy	15.6	53.1	44.2	44.5
Spain	9.2	14.5	44.2	22.7

Europe faces an exceptionally difficult period ahead and is likely to look to the deep pockets for assistance. China has these deep pockets and Europe, being China's major customer, is a likely candidate. We expect the world order to continue to evolve and power to continue to shift east.

In the World Today Money has become Ultra-Cheap. Can this continually Create Expansions or could it Destroy Liquidity, Foster Deleveraging and Hinder Recovery?

Popular Keynesian economics has been pursued by central bankers for many decades now. The bankers have steadfastly believed that by employing easy money policies (making credit cheap and plentiful) they could stimulate expansion of the real economy.

With nominal rates now approaching zero, and real interest rates way into negative territory, we have our doubts. It has long been our belief that by the time negative real rates are reached, the central bankers have lost control of stimulative powers. Our readers are familiar with us talking about a 'liquidity trap' and the effects of negative real rates.

At the heart of the problem is a return on money of zero. At this point the game changes and normal functioning breaks down. It just doesn't make sense to hold cash in a bank for no return. The cash is after all at risk. In addition to the investor the bank also has a problem. As the yield curve flattens so it earns an ever decreasing spread on its long terms loans. With rates for short term deposits essentially at zero, there is no scope for reducing interest paid to depositors. Meanwhile long term borrowers are paying ever decreasing interest and therefore squeezing banks into financial hardship. With such terms there is little incentive for banks to lend long and thereby assist economic growth. This leads to economic contraction, not expansion. And Keynesian economics ceases to work.

Ultra-cheap money does have affects, but not necessarily as one might expect. It is likely to be good for stocks, precious metals and commodities but awful for economic growth, inflation, employment, national revenue collections and currencies.

Do we think that policy makers will amend their ways? To this question we give a resounding 'no'! We think that more monetary easing and less prosperity is on its way – for many years to come. And if stock markets or housing were to fall expect rampant easing. And of course governments are running huge budget deficits so expect to see a lot more monetizing of debt.

We cannot predict the future and it is incredibly uncertain these days since the markets have become so distorted by the intervention of governments, but we are confident in advocating a policy of diversification, which includes a healthy exposure to gold.