The SA Bullion Gold Report

Q4 2013

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Table 1: Gold Performance to 31 December 2013 (% per annum)[1]

	Quarter[2]	1 Yr	2 Yr	3 Yr	5 Yr	10 Yr
Gold in US Dollar	-9.2	-27.3	-11.3	-5.0	6.7	11.2
Gold in Rand	-8.4	-11.3	0.1	10.0	9.0	16.1
Gold in Euro	-10.9	-30.3	-14.0	-5.9	6.9	10.2

[1] Based on LBMA Afternoon Fixes
[2] not annualized for periods of less than 1 year

Table 2: Quarter-End Gold Prices and Exchange Rates[1]

	Gold in US$/oz	R/$ rate	Gold in R/oz	$/€ rate	Gold in €/oz
31 December 2003	416.25	6.67	2,778.47	1.26	330.00
31 December 2004	435.60	5.63	2,454.06	1.36	320.47
31 December 2005	513.00	6.32	3,253.70	1.18	434.91
31 December 2006	632.00	7.05	4,456.07	1.32	479.28
31 December 2007	833.75	6.83	5,698.14	1.46	570.26
31 December 2008	869.75	9.24	8,040.84	1.39	625.70
31 December 2009	1,087.50	7.36	8,008.08	1.43	757.97
31 December 2010	1,405.50	6.61	9,298.44	1.34	1,047.67
31 December 2011	1,531.00	8.07	12,360.37	1.30	1,179.37
31 December 2012	1,657.50	8.50	14,044.10	1.32	1,253.02
31 December 2013	1,204.50	10.28	12,385.67	1.38	873.14

Note 1: Gold prices in US$ and € are LBMA Afternoon Fix prices
Note 2: Gold price in Rand from Rand Refinery
Note 3: Gold prices at time of writing—$ 1,267.00; R 14,082.71; € 925.90

Table 3: Calendar Year Performance of Gold

	% US Dollar	% ZA Rand	% Euro
2003	19.9	- 6.7	- 0.3
2004	4.6	- 11.7	- 2.9
2005	17.8	32.6	35.7
2006	23.2	37.0	10.2
2007	31.9	27.9	18.9
2008	4.3	41.1	9.7
2009	25.0	- 0.4	21.1
2010	29.2	16.1	38.2
2011	8.9	33.0	12.6
2012	8.3	13.6	6.2
2013	-27.3	-11.8	-30.3

Q4

Figure 1: Ten-Year Chart of Gold Price in US Dollar [LBMA PM Fix]

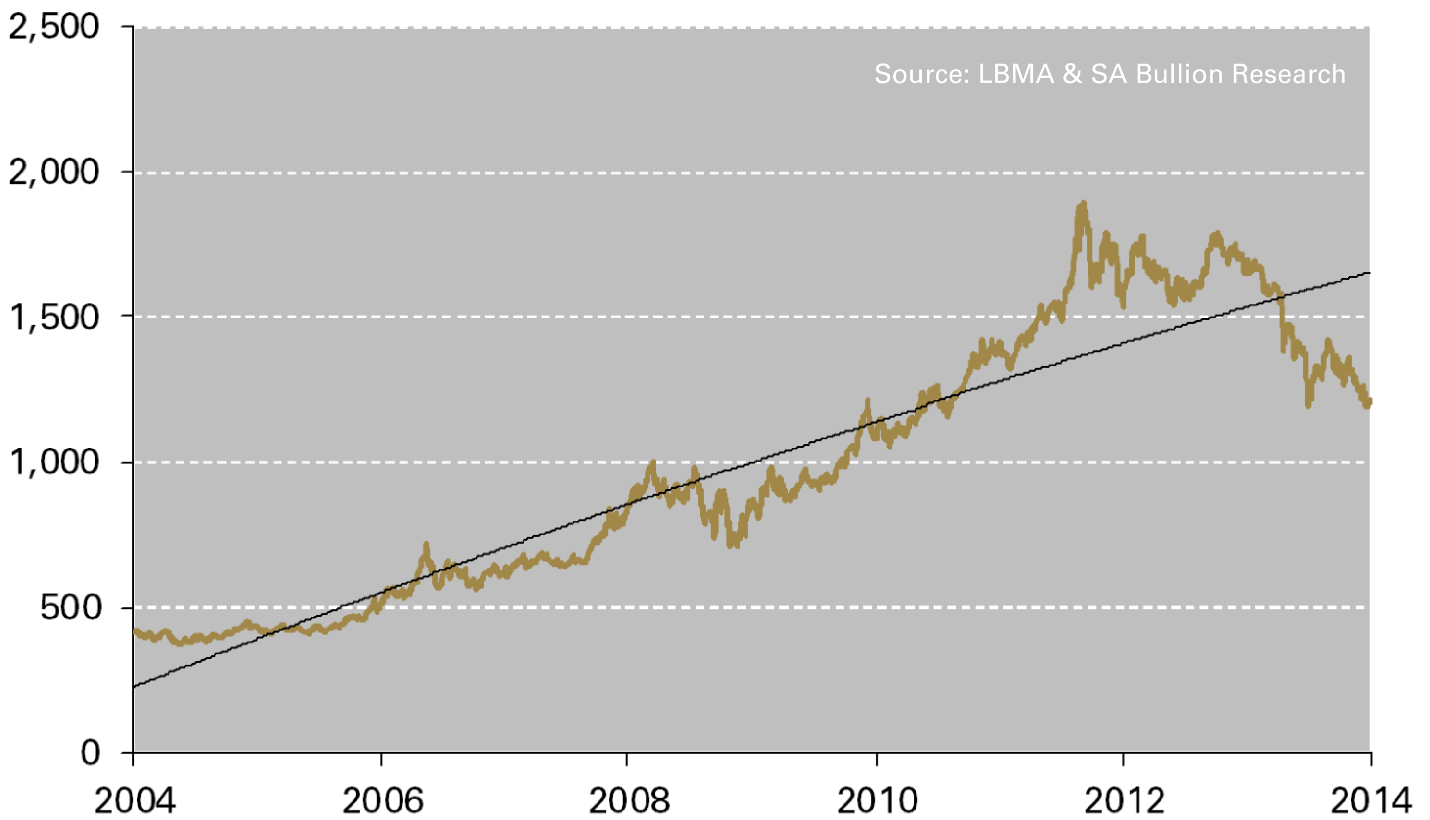
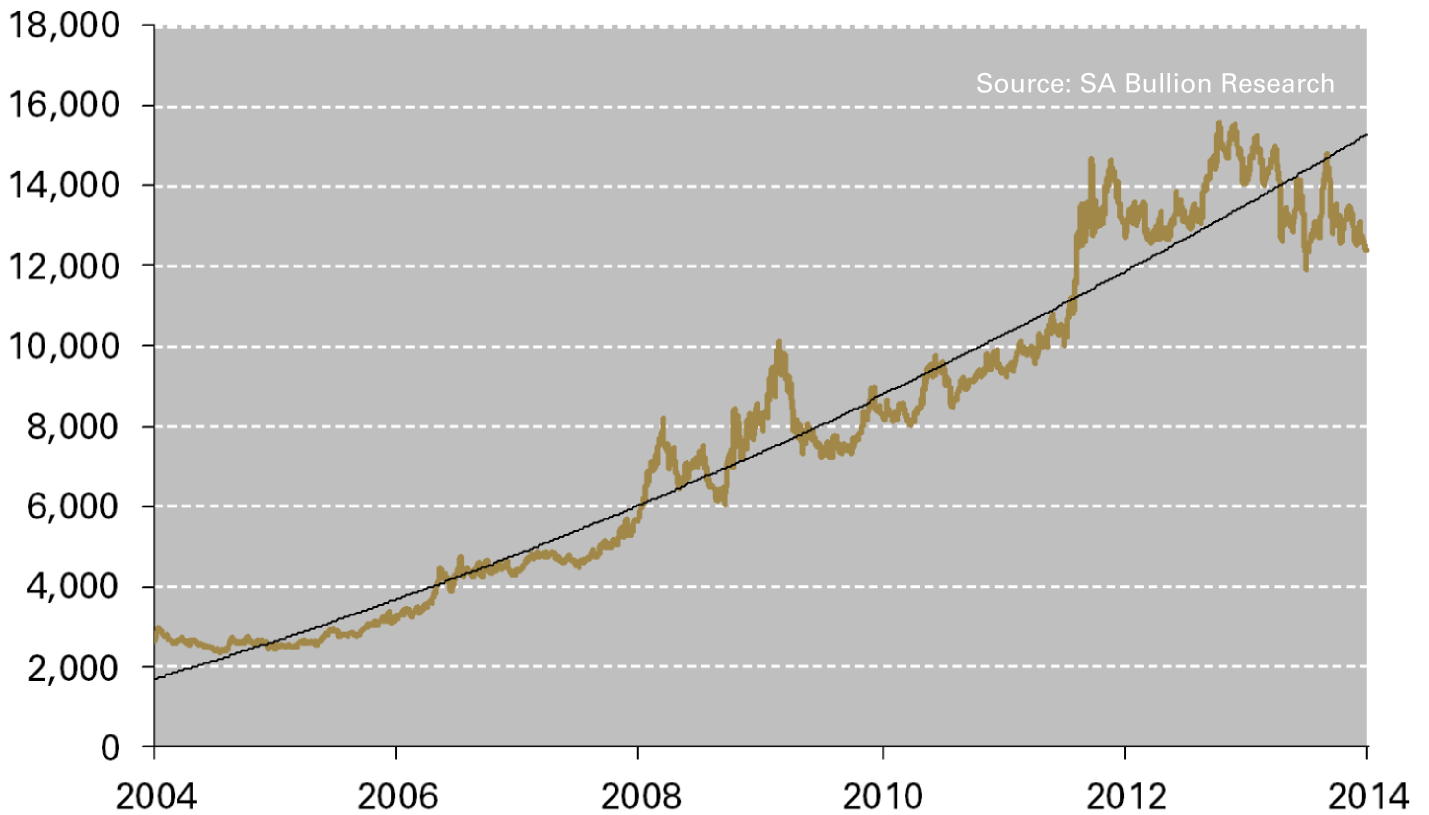


Figure 2: Ten-Year Chart of Gold Price in South African Rand



Gold Price Action

Following a strong third quarter gold had a very weak fourth quarter, losing around $100/oz or approximately 10% in most currencies.

The weakness appeared in the second half of the quarter, ie from around mid-November, and was largely as a function of US Federal Reserve commentary and actions.

Macro-Commentary

Since 2008 and the start of the financial crisis, the United States has been the largest single source of stimulus in the world. The US stimulus programmes have been nothing short of incredible. In addition to the main fiscal and monetary stimulus programmes there have been a plethora of legislative and regulatory changes, none more important than the accounting rule change that no longer required US banks to mark-to-market their investment positions. More than any other single item, it was the accounting rule change that saved the American banking system in 2009.

Notwithstanding phenomenal stimulus and regulatory changes, the US economy still stutters and refuses to build a *head of steam* even though the US authorities have managed to achieve tremendous reflation of financial assets – largely equities and houses. And therein lies the problem. Assets have reflated, even to *over-cooked* levels, while employment and economic activity are nothing to shout about. At this point we would remind you of our predictions some years ago – that the US would achieve reflation of assets but that the economy would remain in the doldrums even while inflation picked up. I.e. we predicted the likely outcome to be stagflation.

Let's take a cursory look at fiscal and monetary stimulus:

At a national or state level, the US government has been under-collecting taxes and in so doing has been running huge budget deficits each year. Budget deficits of around $1 trillion each year have been adding to the national debt pile and in so doing have taken public debt from a level of around 60% of GDP (Gross Domestic Product) pre-crisis, to around 100% of GDP today.

Numerous monetary stimulus programmes operated by the US Federal Reserve – programmes like Operation Twist, Quantitative Easing, etc – have expanded the Fed's balance sheet 400% from less than $1 trillion in 2008 to $4 trillion by the end of 2013. This process of monetizing debt instruments has forced the unimaginable amount of $3 trillion into the financial system. The intention has been the pumping up of financial assets, the artificial lowering of interest rates, and the stimulation of the economy. The first two achievements have been met but the third and main objective is a case of 'not so much'. Even with all that stimulus the economy has only grown approximately 6% in real terms in the same period. A key reason is that reflation has largely been benefiting the super-rich, and not the middle class, and for this reason consumer spending has not taken off.

So where are we now?

US economic growth is tepid, at levels of around 2 or 3% p.a., even while supported by massive stimulus. The days of 5 or 6% p.a. growth rates are long forgotten. Europe, China and Japan face similar issues. Employment growth in the US is weak and unconvincing as evidenced by recent non-farm payrolls data. And financial assets are in overblown bubble territory!

Where are we headed?

In mid-December the Fed announced the commencement of the lessening, or "tapering", of monetary stimulus. From January 2014 the Fed would reduce its monthly asset purchase programme from $85 billion to $75 billion. The expectation was that this tapering would be a regular occurrence going forward. The Fed's announcement on 18 December had a large negative effect on gold, sending it down $100 an ounce as the implication was that the US was on an upward trajectory and the Dollar would therefore have more value.

The Dollar strengthened and simultaneous to this emerging market currencies weakened. The South African Rand was one of the leading victims due to its easy tradability.

Should Fed-tightening, or QE-tapering, continue, one can expect some big shocks. Several trillion dollars of portfolio money which found its way into emerging markets for yield (the well-known "carry trade") will reverse direction and flow back to whence it came i.e. those developed nations that had pump-primed their systems with stimulus (US, Europe, Japan and China). This action will 'pull the plug' on the affected emerging markets and cause their currencies to tumble. The crumbling currencies will cause inflation to take off in those commodity producing countries, which will in turn set off a series of interest rate hikes. The outcome of all this being very likely an emerging markets crisis, which will ripple through the global system causing all sorts of mayhem.

The US Fed is today in unwind-mode. The consequences of the Fed's unwinding are unknowable but very likely to be dramatic and painful. Equities are likely to experience great and painful drama worldwide as the reflation experiment backtracks and is seen to have been illusionary. Emerging Nations, and more specifically commodity producing countries, face very tough times as their currencies decline but their new higher structural cost bases do not. Big budget deficits and high inflation are probably in store.

Developed nations are likely to experience massive wealth retrenchment as the financial markets bubble deflates and contraction of the monetary base kicks in. A long time ago we speculated that the US faced a long term stagflation cycle and by the day we become more convinced of this likelihood.

Gold

Gold had a dreadful 2013. Fortunately there is every reason to believe, from fundamentals to technicals, that gold has bottomed out and is now on the way up again. It is my strong view that in the future we will look back on this time as a great entry point for gold.

Closing

We have a negative outlook on equities generally – across the world. We are negative on bonds. We are negative on emerging market currencies, especially the Rand.

In these tough times, and at this stage in the great credit contraction, it is terribly important to have one's investments spread around. This is not the time for concentration in one's portfolio as one cannot be sure as to which skittles are going to fall over.

Gold should be one of your skittles.

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