Gold enters new phase of bull market

Investor demand increases tenfold in 10 years showing new phase of bull market

Long-term price target: USD 2,300; upward trend continues

Institutional investors to dominate the next stage of the gold bull market; especially insurance companies and pension funds

Erste Group analysts, in their annual Gold report, find that investor demand for gold has increased tenfold
in 10 years indicating that the commodity is entering a new phase of the gold bull market as China and India drive demand. The price of gold has also been affected by global monetary stimulus programmes and the exchange rate between gold and paper is expected to rise even further, with Erste analysts predicting that the next 12 month target for gold will be USD 2,000.

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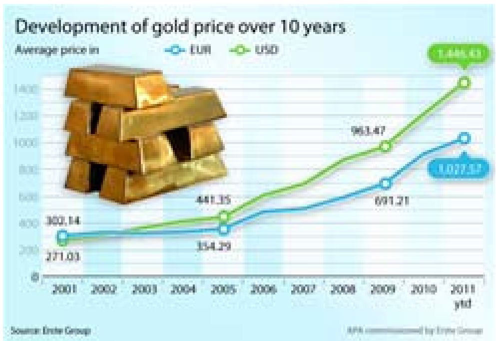
“Since the first Gold Report five years ago, the gold price increased by +140 %. The long-term target of USD 2,300 which experts forecasted three years ago, could even be considered too conservative now”, commented Ronald Stöferle, Erste Group’s gold analyst.

Gold benefits from unsolved debt crisis
Given that the majority of debt has neither been written off nor paid off, the problem of excessive debt is still waiting to be resolved. This is why the low real interest rates will stay low which provides the perfect environment for gold. There are only a few ways out of the debt trap: growing out of one’s debt much like the USA did after WWII, or alternatively drastic spending cuts and rigid budget consolidation like Scandinavia in the 1990s.

Massive tax hikes, the creation of inflation, the depreciation of the currency or ultimately, national bankruptcy are amongst the most painful options. We expect gold to benefit in practically all of these scenarios.

It is also often forgotten that China and India remained the most important factors on the demand side. The higher gold affinity in combination with the increase in disposable income will definitely have a positive effect on gold demand. By 2020 emerging markets will generate 50% of global GDP, up from 19% in 2000.

Price level still attractive – no bubble in sight
In 2000 investor demand accounted for only 4.8% of total demand, while by 2010 that share had increased to almost 40%. According to Erste Group analysts, this indicates a clearly strong upward trend reversal and heralds a new phase of the bull market. It can be expected that institutional investors will dominate the next stage of the gold bull market. Especially insurance companies and pension funds should step up their gold allocation, seeing as the correlation to equities and especially to bonds is low or even negative. Gold is well known as a safe haven as it has never lost its value. The clear downwards trend of most currencies compared to gold is clearly illustrated by the graph. This trend might not mitigate very soon. We expect the gold price upswing to continue“, said Stöferle.



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Gold, as antagonist of uncovered paper currencies, remains an excellent hedge against worst-case scenarios. Moreover, there is a clear correlation between the gold price and trust. A falling gold price would therefore relate to rising or at least stabilising trust. We believe that the trust lost in the past years will not be regained anytime soon, and that therefore gold still commands an excellent risk/return profile.

Gold pillar of a clever investment strategy

Gold should be part of every portfolio because of diversification and insurance aspects. Numerous studies prove that gold as portfolio module reduces overall risk and improves the performance. About 5 to 10% of the portfolio should be allocated to gold. In contrast to shares or bonds, there are no liabilities attached to gold. As such gold is highly recommendable for reasons of diversification. “We still expect the gold price to rise at least to the inflation-adjusted all-time-high of USD 2,300/ounce (dating from 1980) at the end of the bull market”, forecasted Stöferle. Some historical comparisons suggest even higher spheres. Stöferle explains, why gold does not pay any interest, “Gold is pure ownership without any liabilities towards any person or institution. It does not contain any counterpart risk.” In particular the previous month have shown a clear trend which is in favour of gold as an asset class. Gold has been more and more regarded as money of the purest water and increasingly less as commodity.

Returning to the gold standard?

The thought of a currency not pegged to gold would have probably been absurd 100 years ago. Today even the thought that back in 1971 every 35 US dollars were backed by one ounce of gold is absurd. „A return to the gold standard is not realistic at the moment. At least the discussion about it restarts“, said Stöferle. „Before implementing concrete measures, the strain must still increase“. Various studies on currencies show an interesting phenomenon: the stronger the gold pegging, the lower inflation.

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