

## Gold: An ultimate safe haven!



## Microscope

In fact, demand for physical gold as a store of value and hedge against inflation has emerged as many governments spend trillions of dollars to combat the worst recession since World War II. The US dollar has long been considered as the safe haven, this is not the case now. Many investors/central banks continue to hold gold as their safe haven asset to protect themselves from worldwide economic shocks or tensions. In addition, the diversification in central banks' reserve is set to continue with the US having such a large foreign debt and weakening economic conditions. Due to the inverse relationship between gold and the US dollar, many people are medium to long term bullish on the gold price. It can be indicated by the fact that bullion holdings in gold-backed exchange-traded products rose to records in the second quarter. For example, holdings in the SPDR Gold Trust, the biggest exchange-traded fund backed by bullion, were 1,120.55 metric tons on June 30, up 74% from a year earlier. Investment in the fund, which reached a record 1,134.03 tons on June 1, was little changed from the first quarter, although has dropped back a little since the end of the quarter.

The slow trading months of summer are usually a time when gold prices decline. However, gold remains range bound at levels above \$900 per ounce recently in the absence of any fresh news that could have had an impact on the precious metal. Although there was a massive short position from the bullion banks, like JP Morgan and HSBC, according to the World Gold Council (WGC), concern over inflation, dollar weakness, and supply/demand fundamentals are all positive for the price of gold toward the end of this summer. The Council reported that gold demand fell 8.6% year-on-year to a six-year low of 719.5 metric tons in the second quarter as recession curbed buying by jewelers and electronics producers. Jewellery demand declined 22% while electronics, the biggest industrial use for gold, slid 26% too. In India, the largest buyer which consistently accounts for just over 22% of world jewellery and investment

demand, its demand fell 38% to 109 tons, while it rose 11% in China, the second-biggest buyer, to 89.6 tons. The WGC said China could overtake India as early as within the next five years as China would increase reserve proportion in gold. Now, gold only accounts for 2% of the total reserves held by China's central bank. If China's reserves continue to grow rapidly, more gold would be required to maintain a constant proportion, let alone the concern over the US dollar. For the past 50 years, the Chinese government has controlled the distribution of all types of gold, and forbade citizens from owning or trading any type of precious metal. Now they are allowed to buy gold bars. In 1950, China had next to nothing in gold reserves. Today they rank in the top 10, and have become the largest producer of gold in the world. This factor will ultimately have a

positive effect on gold. With regard to the overhang that IMF and the European Central Bank's gold sale plans, it appears that the Central Bank Gold Agreement (GBGA) limiting gold sales will begin towards the end of September. The only difference between the new CBGA III and the current CBGA II is that the sales limit will be reduced from 500 tons to 400 tons a year. This lower sales figure suggests that there are fewer eager sellers in the market. Sales of gold from 27<sup>th</sup> September 2008 to end July 2009 have been just over 140 tons, far short of the 500 tons limit. At the moment it appears that the only sellers are France and Sweden, but the quantities have been very small. With Central banks now less inclined to sell their gold reserves than they once were, this changing attitude will have also a positive impact on gold.

### MARKET BRIEFING

#### YTD % (local curr)

<b>US DJ</b>	9,544 (8.7%)
<b>Nasdaq</b>	2,028 (28.6%)
<b>Euro Stoxx 50</b>	2,803 (14.4%)
<b>HSI</b>	20,098 (39.7%)
<b>Japan NK225</b>	10,534 (18.9%)
<b>China Shanghai Composite</b>	2,860 (57.1%)
<b>Singapore</b>	2,642 (50.0%)
<b>India BSE30</b>	15,922 (65.0%)
<b>Brazil BOVESPA</b>	57,700 (53.7%)
<b>Aus All Ord</b>	4,495 (22.9%)
<b>US-10yr Bond</b>	Yield 3.45%

As at 29/08/09

## Insight: "Interest Rate Cycle"

Interest rate cycle is usually branded as the typical result of the economic and business cycle. Yes, it is. Usually, banks and financial institutions play important role to induce the interest rate cycle. For the last 180 years, interest rates, like the US bond yields have gone up and down regularly. The interest rate obviously shows pretty regular upward and downward swings. Statistically speaking, an entire cycle including a decline and an upward move for the US rates takes about 60 years. The two latest ones (1861-1921 and 1921-1980) have a duration of 60 years both. However, the trough level of the interest rate

has not been exactly in the middle of each cycle. In 1900, it happened 39 years after the last major high and in 1944, it happened 25 years after the last major high. As shown in the separate diagram<sup>1</sup>, we are approaching the natural end of a 30 year period of declining interest rates starting from the year of 1980. Experience tells us that we can expect a turning point, which will happen over the next few years or it is about to happen. This means that our economies and financial markets will enter new territory. In case the economic situation does not turn better, higher interest rates make it difficult for enterprises or consumers to borrow money. At high interest rates, investors will rather invest in treasuries or bonds than in the stock market. **Note 1:** please ask for your financial advisor for more information.

## A-Z Financial Tools

**Interest rate spread** is a powerful tool to forecast recessions, derived by subtracting the short term rate from the yield on the 10 year US Treasury bond. The lower the spread, the higher the probability will be the recession. It is because if investors anticipate a recession in the near future, they will sell their short-term bonds and buy longer-term bonds to carry them through the recession.



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