GOLD NEWSLETTER ALERT #722

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Taper Talk Torpedoes Gold

In typical fashion these days, yesterday's release of Fed minutes was interpreted to be bearish for gold, and that was all the excuse needed to sell the metal down.

Gold tried to recover today, but the near term view remains bearish for now.

Still basking in the afterglow of another successful New Orleans Investment Conference, I found it hard to get too worked up over yesterday's smack-down in gold.

For the record, gold fell $32.40 (2.54%) to $1,242.80 bid yesterday, while silver lost $0.49 (2.41%) to $19.85, platinum shed $23.00 (1.63%) to $1,391 and palladium fell $8.00 (1.11%) to $711.

Today, gold has actually rebounded a bit, although you wouldn't know it from the headlines. Services such as CNBC report the after-market prices for gold following the close of the futures market in their live updates, but mark the next day's gains and losses according to the previous futures market close.

In situations like yesterday's, when the gold market sells off after the COMEX close, this effectively means that CNBC and the like can report a down day for gold two days in a row.

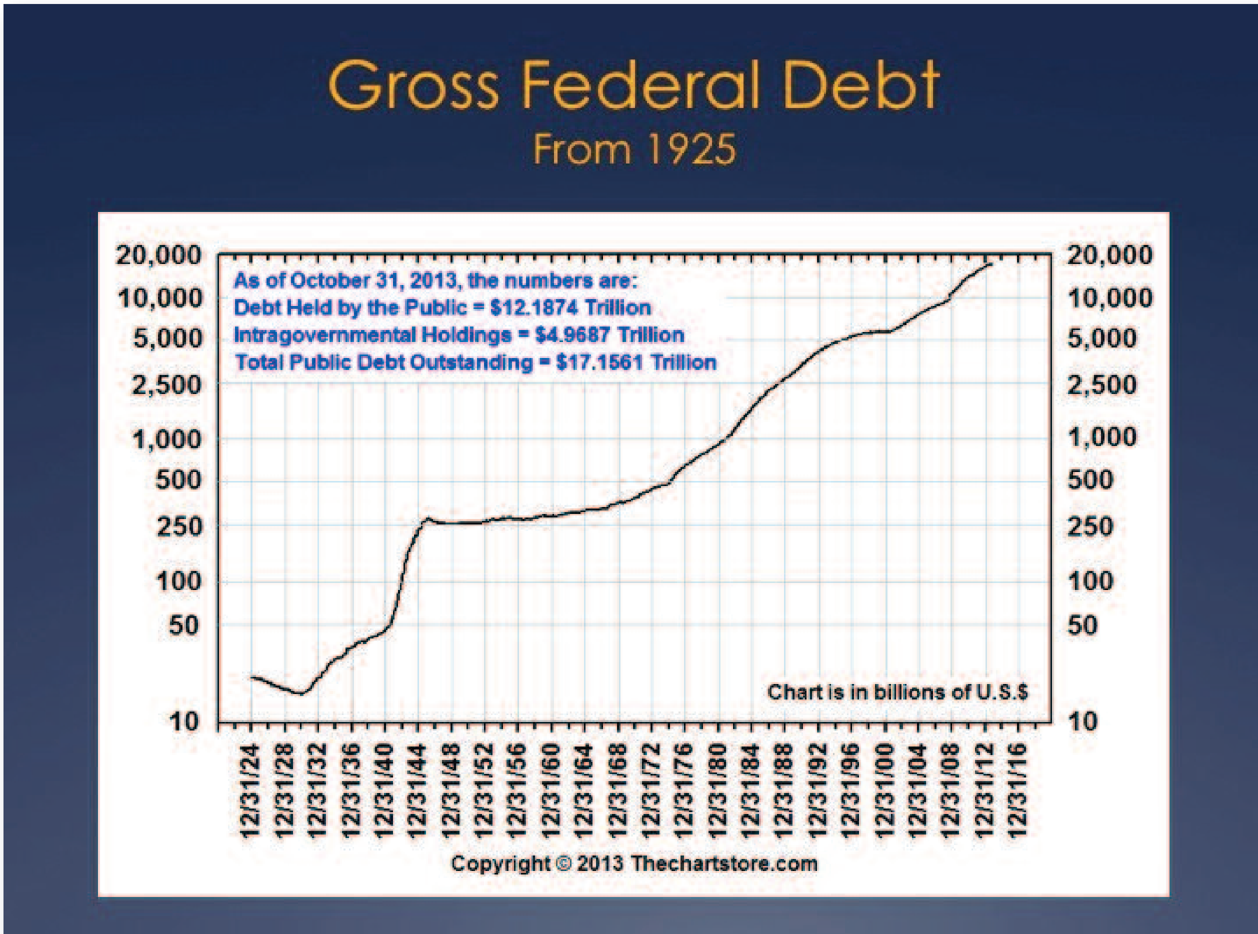
But services like Kitco.com, which mark prices according to the close of the after-COMEX Globex market, provide a more-accurate recording of the metal's price fluctuations.

That's a long way of saying that, despite the media reporting that gold was off about $15 today, it's actually trading flat-to-slightly-up on the day. According to Kitco, gold at last check was up $0.20 (0.02%) to $1,243.00 bid. Silver had gained $0.14 (0.71%) to $19.99, platinum was unchanged at $1,396 and palladium had added $1.00 (0.14%) to $712.

The gold stocks were, disconcertingly, down on the day. The Gold Bugs Index lost 3.63 points (1.69%) to 211.20, while the XAU had given up 0.96 of a point (1.09%) to 87.12.

Yesterday's fall in gold was pretty substantial but, again, I found it hard to be bothered too much. The adrenaline surge from last week's New Orleans Conference and the flood of investment intelligence it provided has yet to fully wear off.

Of course, another reason for my ambivalence in regard to the sell-off is the simple fact that it was completely unsurprising. Western speculators are pouncing on any excuse to sell gold right now, and the Fed minutes were an



excuse served up on a silver platter.

The market focused on the mention in the minutes that "if economic conditions warranted, the committee could decide to slow the pace of purchases at one of its next few meetings."

Thus, the focus will be squarely on the November nonfarms payroll report due on Friday, December 6. I plan to be out of the office on that day, and I recommend that all gold bugs do the same.

That's because I think the near-term prospects for gold are bearish.

My annual appearance at the New Orleans Conference forces me, like all of our speakers, to come out with clear, unhedged views on the market. And while I've tended to be a bit negative on gold recently, my Conference speech forced me to get completely off the fence.

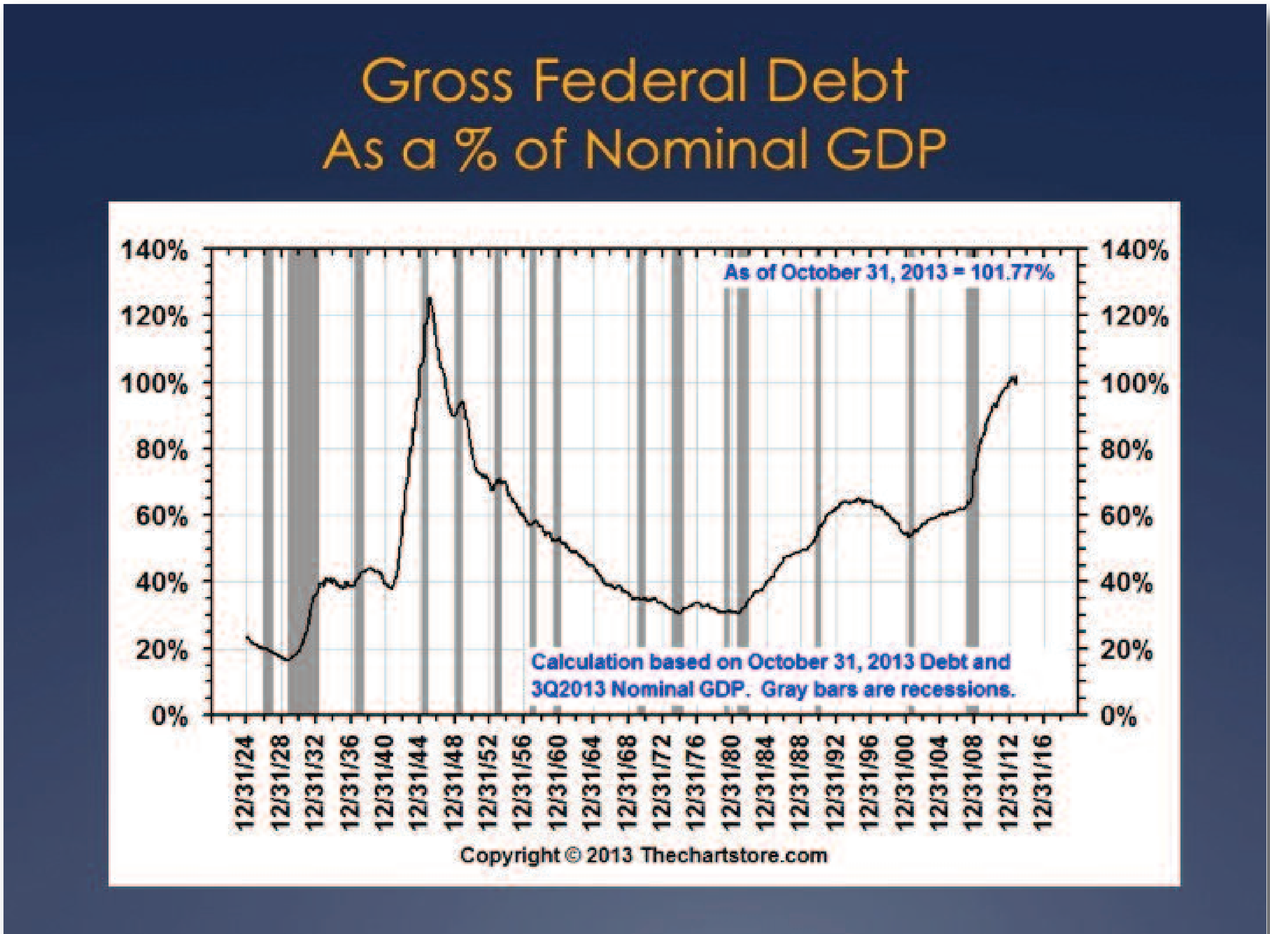
So I warned our audience that the near-term presented little hope for bullish news. Only surprisingly bad employment data, or an Israeli attack on Iranian nuclear facilities, seemed likely to drive gold higher before the end of the year. The latter is a long shot (and nothing an investor should be on in any case), while the former is appearing increasingly unlikely.

It's been a little over a week since my speech at the New Orleans Conference, and so far my views have been borne out.

Let's hope the long-term view I presented in my speech proves similarly accurate, because that perspective remains exceedingly bullish for gold.

The reasons for my bullishness have to do, as I've said repeatedly, with money and gold. And too much of both.

Simply put, the U.S. and other Western nations have built up debt loads so massive that they cannot be addressed through spending



cuts, tax hikes or economic growth, or any combination thereof.

The situation demands some significant level of currency depreciation to cheapen the value of the debt load in current dollars.

I'm including a few of the charts from my New Orleans Conference speech to illustrate what I'm talking about. (Note: These charts were prepared by my friend Ron Griess at TheChartStore.com, and outstanding service that I highly recommend.)

As you can see from the first accompanying chart, the total public debt outstanding is now well over $17 trillion, and the upward trajectory remains quite steep. This chart demonstrates one of the reasons why we can't address the debt through normal spending cuts or tax hikes: because the debt keeps growing.

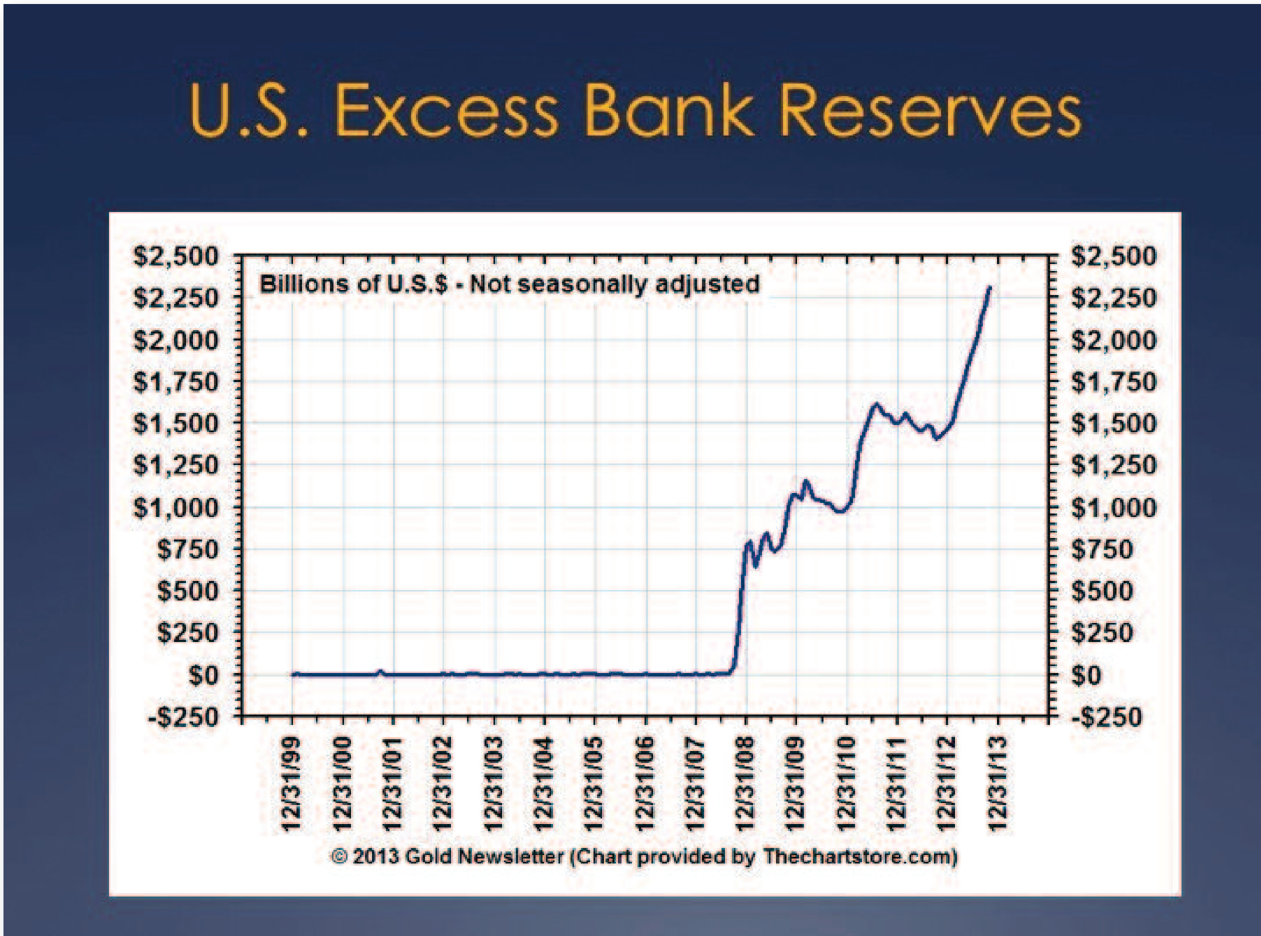
In fact, it is compounding, due to interest costs. And that growth rate will accelerate if/when rates rise.

Of course, the U.S. is not alone in this predicament. The vast majority of Western economies are in the same leaky boat. But it would be a mistake to think that the U.S. is the best-looking leper in the colony.

In fact, as my second chart demonstrates, America's gross federal debt as a percentage of GDP remains well above 100%, which used to be a red-alert level for emerging market economies.

By this measure, the U.S. finds itself in better shape than Japan, Greece, Italy, Portugal and Ireland among the larger developed nations. But that's it. We're actually worse off than the U.K., Spain, or even France, which was just downgraded by S&P.

So we are in an unusual situation, with the greatest debt load since World War II...and no Nazis or Japanese empire to blame.



The Fed's quantitative easing efforts have been the primary method of debasing the dollar so far, with every new dollar created directly lowering the value of the ones preceding it.

But why hasn't the monetary inflation of QE led to price inflation in the U.S. economy? The primary reason is illustrated in my final chart of U.S. excess bank reserves.

You see, most of the money that the Fed has been creating to buy Treasurys and mortgage securities is ending up not in the economy, but in excess reserves of the banking system.

In my speech at last year's New Orleans Conference, I reported on how stunningly large this number had grown, at $1.4 trillion in size.

I was surprised to revisit this number and learn that, today, it's nearly $2.3 trillion.

These excess reserves are held on deposit at the Fed, which pays banks about a half-percent interest on them. That's easy money for the banks. And these funds don't count as "money" until and if they are actually injected into the economy.

But once the Fed begins to exit its low-interest rate policy, the resulting spreads will allow and entice banks to make loans...blowing the dam on this overhanging money supply.

So rising interest rates and/or economic growth is very likely to spark much higher inflation.

There are more longer-term factors involved, such as the trick box the Fed has found itself within -- where it cannot allow interest rates to rise without exploding debt costs and the Federal deficit...and where ending QE could crater the stock market.

In short, it seems that any and every path forward leads to higher gold prices.

So we'll try to ignore the taper talk and resulting volatility in gold over the next month or so, and remain focused on the long-term view. Because that view remains very bullish for gold, silver and resource stocks.

Over the next few weeks, we'll be busy compiling the information presented by our stellar roster of experts at the New Orleans Conference, and I'll be following up on many of the conversations I had with exhibiting companies and fellow analysts.

As we do, we'll be delivering this valuable market intelligence to you, through our upcoming double issue of Gold Newsletter and other means.

So stay tuned. The near future may not be too rewarding for us, but the payoff will only be that much richer as a result.

— Brien Lundin

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