

NEWS & VIEWS

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CLIENT-ONLY LETTER

“A paradigm shift in the relative valuation of paper and tangible assets is under way. In such a shift, the list of safe havens is short. A new generation of investors, still conditioned by overripe 1990's platitudes extolling paper assets, will discover what a previous generation had learned and forgotten--the merits of gold.” -- John Hathaway, Tocqueville Funds

WELCOMING REMARKS

We are in a new era for gold. Events -- such as the war in Iraq -- will drive the market on a day-to-day basis. Fundamentally though, the undercurrent in the gold market -- the one factor that is likely to remain in place no matter what else happens -- will be global economic and financial uncertainty generated by policies of the U.S. federal government and Federal Reserve. Long after the war in Iraq is decided, the United States will still be faced with what to do about its burgeoning balance of trade problems (at record levels) and its rapidly escalating federal government budget deficits (which may quickly dwarf previous red ink records). These in turn, analysts say, will wreak havoc on the dollar.

The results in the gold market will be what we are now getting accustomed to as gold owners -- volatility, pressure on the already stretched physical bullion market, and a steady influx of investors looking to hedge wobbly portfolios. During February, gold reached a seven-year high at near \$390. As the primary bear market in stocks has taken shape, the primary bull market in gold has gathered strength. Over the past 12 months, gold is up about 17% at \$350/ounce and up over 40% from its cyclical low of \$252/ounce in 1999.

“Fear of further dollar weakness,” says Tocqueville Fund’s John Hathaway, “will be self-reinforcing to the extent it triggers divestment of massive dollar asset positions accumulated by non-US governments and investors over the past two decades. The dollar represents 76% of world central bank reserves. As was the case with the dot-com

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SHORT & SWEET I get requests on a regular basis to update the “Disturbing Trends” section of *The ABCs of Gold Investing: Protecting Your Wealth Through Private Gold Ownership*. It seems that that Table hit home with many readers. Usually the request is accompanied by a question: “Have the trends changed? Are things getting better or worse?” In keeping with the theme of this issue (which is that the underlying economic trends -- not necessarily the impending war in Iraq -- are what’s driving gold demand), I spent some time rooting around the various research-oriented web sites to update the DT table (see bottom of page) and what I discovered is that the trends not only remain in place, they are accelerating Take the time to study the Table below, as it reveals much about where we’ve been and where we’re going. I picked 1970 as the starting date because that is when the current monetary regime was put into place -- the link between the dollar and gold was severed, currencies were freed to float at a free market value, and formal fiscal restraints were removed from the budget process. The results are plain to see. In compiling the Table, here are some of the statistics which jump out at me: Firstly, the 1970 dollar is now worth only 21¢. Another way to frame that statistic is to say that what cost \$100 in 1970 costs \$474 today. Just so you don’t get the erroneous impression that dollar depreciation is an old phenomenon not applicable in today’s economy, the 1994 dollar is now worth roughly 81¢, or what cost \$100 in 1994 now costs \$124 in 2003!! Stock market promoters are fond of telling the public that over the long run stocks are always a good investment. Just buy and hold and all will be well. Usually in the same breath, they talk about how poorly gold -- seemingly stocks most ignominious competitor (in their view) -- has done over the same period. Well, the Table puts that argument to a convincing rest: Since the time of the 1970s paradigm change, it is interesting to note that stocks and gold as of 2/28/03 have recorded similar performances. Stocks are up 1060.5% over the period and gold is up 971.7%. Keep in mind at the same time that experts (the unbiased variety) believe stocks are in the beginning stages of a primary bear market and gold is in the beginning of a primary bull market. Most telling from an investment point of view is a comparison of the two over the past year. Stocks are down 24.8%. Gold is up 15.8%. Bringing that statistic to a meaningful application, \$100,000 invested in stocks over the past year (forgetting past transgressions) would be worth \$75,200. \$100,000 invested in gold would be worth \$115,800. That represents a \$40,600 swing. We are now in the part of the cycle, as John Hathaway points out so concisely in this issue’s masthead quote, where tangibles like gold, will surge to the forefront. In fact to a large degree, the paradigm

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<u>Disturbing Trends</u>			
1970 - Present			
(In billions \$s, except where noted)			
<u>Item</u>	<u>1970</u>	<u>Present</u>	<u>Change</u>
Population	205 million	285 million	+39.0%
Median Income	\$9,867.00	\$42,200.00	+428.0%
Fed Expenditures	\$198.6	\$1936.4	+1202.4%
Fed Interest Paid (annual)	\$16.2	\$206.1	+1272.2%
Accumulated Fed Debt	\$380.9	\$6,446.1	+1692.3%
Budget Deficit (annual)	\$14.4	\$469.5	+3260.4%
Fed Debt as %age of GDP	37.4%	61.0% (est)	
Trade Deficit	Balanced	<\$420.0>	
Consumer Price Index	37.8	184.0 (est)	+486.8%
Money Supply (M3)	\$618.3	\$8,080.9	+1307.0%
Purchasing Power of Dollar	\$1.00	\$0.21	-79.0%
Purchasing Power of Dollar	\$1.00 (1994)	\$0.806	-19.4%
DJIA	744.10	7891.08	+1060.5%
Gold	\$36.02 (avg.)	\$350.00	+971.7%
DJIA (one year thru 2/28/03)	10,500	7891.08	-24.8%
Gold (one year thru 2/28/03)	\$299.00	\$350.00	+15.8%

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WELCOMING REMARKS, CONT. . . .

stocks, the US dollar is over owned and over valued. The dollar will weaken substantially, and lead to higher US inflation along with weaker foreign economic conditions. In its January 3rd, 2003 commentary, Bridgewater noted that 'a drying up of private demand combined with support from official sources is a classic warning sign of an imminent collapse in a currency. We believe we are on the precipice.'

Richard Russell speaks to what's on many gold investors' minds when he says: "[T]he coming battle for world power is just beginning. The battle will obviously include the US and China with Russia and India both very much involved. The battle will be played out over a period, not of weeks or months, but of years. In the light of this coming long-term struggle, the daily and even the weekly and monthly movements of currencies and gold may prove to be insignificant. I'm talking about an historic struggle that will reshape the world for an extended period of time. As for you and me, we take our long-term positions and wait. Patience will pay off in this coming battle for world power-leadership and investment survival."

I might add that the long-term position advocated by the highly respected Mr. Russell includes a strong position in gold coins. Judging from our volumes over the past two months, a good many of you agree with his prescription.

"New buying has come in with the dollar weakening. We're predominately trading on the dollar after the rally spurred by war fears was deemed 'overdone.'"

--- Frank McGhee, Alliance Financial

"If, suddenly, we were to wake up tomorrow to the news that Saddam Hussein has quietly left Iraq, I don't think we'd necessarily see a return to trend growth for the economy."

--- Ed McKelvey, Goldman Sachs and Co.

"You'll find that wars and political tensions give gold prices a short-term run, then they fall to their long-term trend line. The war is really a side show. What's really driving gold prices is the U.S. dollar declining in value. When you leave money in the bank, it's essentially a degrading asset."

--- Chris Braddock, Goldcorp

"For the longer term, though, war may not solve fundamental problems for the U.S. economy and stocks. And that's bullish for gold."

--- Peter McKay, *The Wall Street Journal*

"Most people assume that it is Iraq that is contributing to this gold price and that is wrong,' says Mike Schroeder of Old Mutual Asset Management. His view is based on the premise that gold ran from \$275/oz to \$320/oz before Iraq became an issue. His view chimes with Andy Smith, Mitsui gold analyst, who believes the Iraqi war premium is not the primary factor buoying the gold price."

---Tim Webb, the MiningWeb.com

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shift he mentions is already well under way. Please feel free to clip the Table and keep it handy for easy reference at family gatherings and other social occasions. Stay tuned. We will update Disturbing Trends from time to time over the coming year *The London Telegraph* reports that "Warren Buffett is poised to issue his most doom-laden forecast for the state of the world economy yet, including a damning verdict on the derivatives industry he fears could cause a global financial crisis. In the upcoming annual letter to shareholders of Berkshire Hathaway, Mr Buffett drops his usual folksy style to warn that banks do not understand the hidden risks lurking on their balance sheets. He labels derivatives 'time bombs, both for the parties that deal in them and the economic system' and 'financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal.' [Buffet] has little optimism for the stock market. 'Despite three years of falling prices which have significantly improved the attractiveness of common stocks, we still find very few that even mildly interest us. That dismal fact is testimony to the insanity of the valuations reached during the Great Bubble. Unfortunately, the hangover may prove to be proportional to the binge,' he said."*New York Times* columnist Thomas L. Friedman voiced the prevailing attitude for many when he wrote recently: "[T]he right response [to the war on terrorism] after a point, is not to demand more and more security, but to learn to live with more and more anxiety. Because the question is not whether there will be more attacks. There will be. The question is whether we can survive them and still maintain an open society. What good is it to have Osama trapped in a basement somewhere if, by just whispering a few threats on al-Jazeera TV, he can trap us in self-sealed rooms?" A UPS-Gallup poll says that investor optimism has fallen to a record low. Incredibly, optimism fell 29 points -- from 38 in January to 9 in February. The baseline was 124 when the index was begun in 1996. In more good news for gold, *Financial Times* reports that the international gold mine hedge book is shrinking. London's *The Guardian* reports that Gordon Brown's Folly -- the dumping of 400 tonnes of United Kingdom's gold -- has the lost the country over a billion pounds so far. "Conservatives," says *The Guardian*, "are calling for Mr. Brown (Chancellor of the Exchequer) to be held to account for his 'bad housekeeping'. The Tory MP Cheryl Gillan said: 'I don't know why 40 per cent of our gold was invested back into euros because it is an untried, untested currency.'" Adrian van Eck (*Money-Forecast Letter*) relays a report from London's David Fuller who argues that China may "swoop on the world's available gold supply." Says Fuller: "China's foreign currency reserves are soar-

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WHEN GOLD WILL REALLY RUN

The US is the largest debtor nation. About \$3 trillion are held by foreigners if calculated at the purchase price, and foreigners are still buying US assets. Last year they bought about \$45 billion of US equities, but that will change at some point. When people realize there are fundamental problems in the US economy, the dollar will begin to decline in a major way. The process actually started in 2001. Other central banks will at some point then try to support the dollar, because if it declines too much, it will hurt their exports. They will be forced to adopt the same policy as the US central bank, and you will have the whole world creating more fiat currency. That's when gold will really run.

--- Felix Zulauf in *Barron's*

LONDON BOOKIES TAKE BETS ON GOLD

City bookmakers are attracting bets as large as UK pound 950,000 on the gold price as war fever makes the yellow metal the latest speculative mania for British private investors. The main vehicle for this latest craze is spread betting, which enables speculators to take long or short positions of almost any size without having to worry about paying capital gains tax on profits. Unofficial estimates are that between 1000 and 2000 clients of spread bookmakers such as IG Index, CMC/deal4free and City Index are betting on gold at present. Most of these trades are up-bets, aimed at taking advantage of further rises in the metal's price but also vulnerable to any sharp setback.

--- CNN Money

GOLD BACK IN FASHION FOR INVESTORS

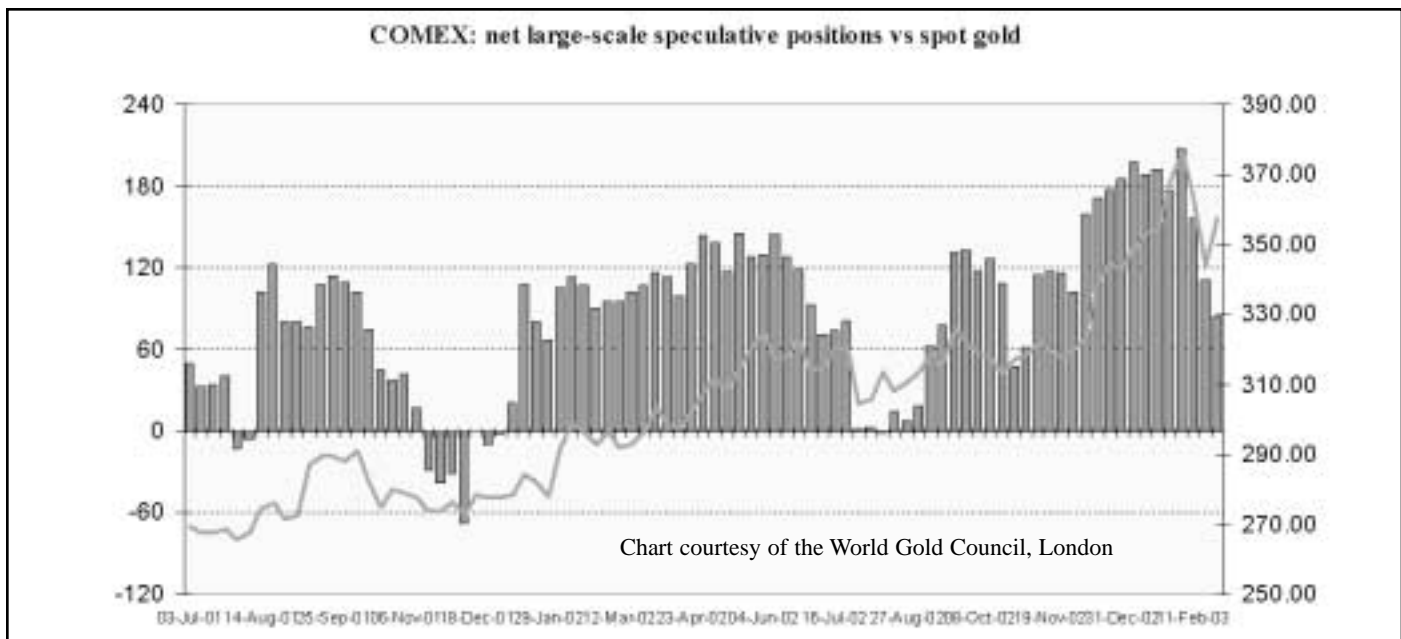
Gold is coming back into fashion, not as jewellery but as bars and sovereigns. More and more people, wearied by plunging share prices, poor returns on savings and a possible crash in the housing market, are looking at gold as an alternative investment. "A lot of people are piling their money into gold at the moment," says Justin Modray, investment manager at the independent financial advisers RJ Temple. For the first time that he can remember, clients have been coming for financial advice and mentioning gold as a possible investment. "It tends to be a relatively good bet at the moment because gold is a good hedge against stock markets, and cash is pay-

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ing as it becomes the global manufacturer of last resort. China's obvious choice is to buy more gold while the price is low. Faced with a declining U.S. dollar and all but certain upward revaluation of the yuan at some future date, China has been buying gold recently. In December it bought about one billion dollar's worth of gold, increasing its reserves by 16.08 million ounces, in November by 19.29 million. Will China buy more gold? Of course, if the country's monetary authorities are smart, as I assume they are. Who would NOT buy gold in their position? Could China swap most of its huge reserves for gold. No. There isn't enough gold available. Van Eck goes on to remind us: "The sum total of all the gold in public and private hands today would fit inside the infield at Yankee Stadium and stand no more than 120 feet high. If the Chinese government ever gets into a bidding war with short sellers trying to cover their massive 'bets' against gold in New York, and with jewelers and private investors from Saudi Arabia, India and the United States, all of the gold held in government vaults around the world will hardly be enough to prevent a gold price that no one can possibly guess the end of." Along these lines the following comment by Pimco's Bill Gross summarizes the threat to the dollar: "Foreigners now hold \$7 trillion of US assets, and they will not take kindly to a devaluing of their investments. 13% of the US stock market, 35% of the US Treasury market, 23% of the US corporate bond market, and 14% direct ownership in US companies are now in the hands of foreign investors. It's a theater crowded with foreigners, and if someone yells 'Fire, Feu, or Kahi' there could be a rather crushing stampede to the exits (quote from my old friend, Charles Almon of Growth Stock Outlook)." One of the primary elements comprising the current gold market that hasn't received much attention over the past few months is the almost certain entry of major hedge funds. Their presence explains a great deal of the volatility now evident in the day-to-day trading. It is not unusual to see \$3, \$5 and \$10 swings in a single day. I can remember days when gold wouldn't move more than 50¢ in intra-day trade. So how do I view the new volatility? I see it as a plus. We now have activity on both sides of the market -- buying and selling. The primary trend though is up with the swings within the rising channel. . . . Over the years we have published on occasion the World Gold Council chart in which they show the price of gold with Comex net large speculative positions as an overlay (see below). For years, when volumes rose, the price generally fell showing that large-scale speculators were placing their bets on the short side of the market. Now, as you can see by the chart, the opposite is true. Speculator volumes are soaring and so is the price. What does this tell us about the new gold market? It says that mind-set which guided the market for so long is no longer in place -- and I consider this very important in terms of the future gold market and a reflection of the times. Former enemies of the gold price are now its ally -- and that transformation lies at the heart of the current bull market. (Please see the chart at the bottom of the page). We'll end this issue of *NEWS & VIEWS* by returning to the words of the man who heads up the gigantic Pimco bond fund: Bill Gross. I find it interesting that as we go through this difficult period that some of the most thoughtful prose is not coming out of academia or journalism or even the writing art, but out of the financial community. Maybe that's because -- for better or worse -- so much of what is going in the United States today plays a direct role in the financier's daily life. Bill Gross caught me off-guard with his poignant assessment published in early March. I thought I'd share it with you: "One of the benefits of writing a book," says Gross, "is that it serves as a snapshot of time. Thoughts, feelings, philosophies of living change as we funnel down through the hourglass and the printed word is near immutable

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ing not particularly good returns at the moment.”
 --- British Broadcasting Company

GOLD/PAPER ASSET RATIOS

World financial wealth held in the form of paper assets stands conservatively at \$50 trillion. The investment stock of gold, including central bank reserves, amounts to slightly more than \$900 billion at the recent price. Central bank reserves of 33,000 tonnes account for slightly less than half of a very conservatively estimated investment stock of gold. Physical gold theoretically available to the market is at most \$500 billion. Central banks, once feared as relentless sellers of the metal, are beginning to rethink their past folly. The net supply of central bank gold has been diminishing. The well publicized 400 tonnes being divested according to the Washington Agreement is being partially offset by the quiet accumulation of others, including the People's Republic of China. Iraq related hype notwithstanding, a significantly higher price target for gold seems appropriate. A reallocation of 1/10th of 1% of world financial assets, or \$50 billion, would swamp the physical market, especially if it coincided with recognition by the central bank community that the dollar, rather than gold, is their least attractive asset. A mere \$50 billion equates to more than two years of annual gold production, a quantity that could not clear the market within several hundred dollars of today's price.

--- John Hathaway, Tocqueville Funds

SHORT & SWEET, CONT. . . .

proof of such transformations. One thing that strikes me about 'me' as I infrequently pick up *Everything You've Heard About Investing Is Wrong* is how absorbed I was in my late forties and early fifties with religion and the meaning of life. My stories describing St. Catherine's Church and the fictional Father Guido Sarducci were numerous, and filled with frequent references to religion and the search for a higher authority. Nearly a decade later in 2003, I must confide that I am no nearer to resolving the conundrum. Like Virginia Woolf in *The Hours*, I cannot remember where I came from, and I lack certainty in where I am going. We have company - Virginia and I. Still there are those who have found answers to their individual quests and I accept their certitude if not their conclusions. In the absence of personal resolution, I fall back on the thinking of Tennyson: 'There lives more faith in honest doubt,' he wrote, 'than in half the creeds.' Perhaps. My life seems sprinkled with such self-consolations as the conclusion to my multi-act play comes rushing towards me faster than I care to acknowledge. And my current faith, if it could be described as such, would be a near resignation, suggesting that in the absence of certainty, the best we can do is to encircle our loved ones, display empathy and compassion to the billions that share a world with us, and hold on tight as we descend into the maelstrom. Answers, if any, await in the density of that great black hole beyond." In talking with so many over the last several months, I know that Mr. Gross and Virginia Woolf have plenty of company. And so we bring this issue of *NEWS & VIEWS* to a close. On a happier note, it's been a busy, eventful first two months of the year. We wish you Happy Trails, my fellow goldmeisters, until we meet again. . . . Please join us daily at our highly visited USAGOLD website. Have a golden Spring and many thanks for your continued patronage.

NOTE: 2002 was a big year for gold, as most of you know, and 2003 is off to a strong start. The graph below published by the World Gold Council is an educational look back at a great year. Enjoy.

"The possession of gold has ruined fewer men than the lack of it."
 - Thomas Bailey Aldrich



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