NEWS & VIEWS

Summer, 2003

A Quarterly Review of Forecasts, Commentary & Analysis on the Economy and Precious Metals

Celebrating Our 30th Year in the Gold Business / Centennial Precious Metals / Since 1973 / www.usagold.com

"It is related of the illustrious Sandy McHoots that when, on the occasion of winning the British Open Championship, he was interviewed by reporters from the leading daily papers as to his views on Tariff Reform, Bimetallism, the Trial by Jury System, and the Modern Crave for Dancing, all they could extract from him was the single word 'Mphm!' Having uttered which he shouldered his bag and went home to tea. A great man. I wish there were more like him." P.G. Wodehouse

Weak Dollar, Deficits Drive Gold Market, Investor Interest

The first half of 2003 will be remembered for gold's strong comeback from the $320 level achieved in the weeks following the U.S. victory in Iraq. At the time, the conventional wisdom had gold declining once the Gulf War was over. Some predicted it would return to the $250 level; others went so far as to say it would fall below the $200 mark. Abundant oil, a surging dollar, and a rapid economic recovery, they said, would relegate the yellow metal to portfolio insignificance. What we got instead was the exact opposite -- a tight oil market, a profoundly declining dollar, and an economy stuck in the doldrums. Gold confounded the pundits by surging quickly back to the $370 level.

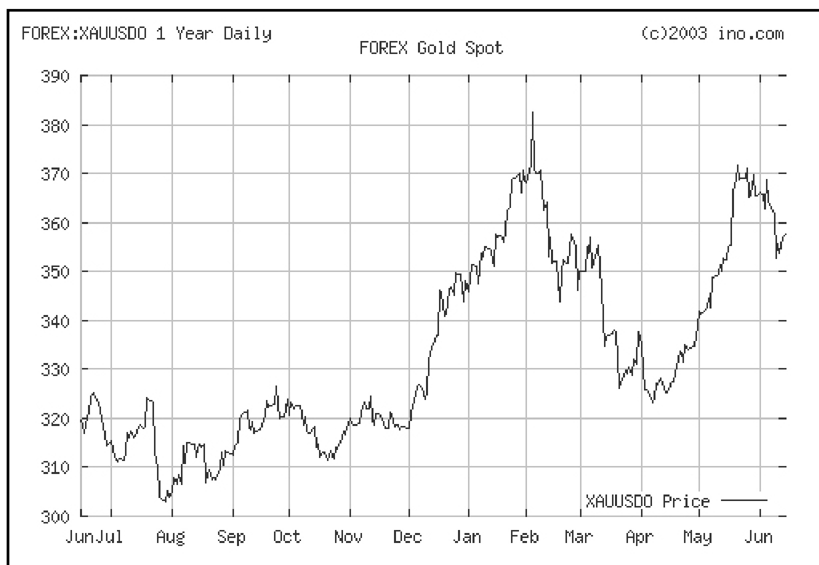
There are some very good reasons for the surprise recovery. The dollar's on-going decline against its competitors -- particularly the euro -- heads that list. Others include mine company de-hedging, large-spec positioning in New York and London, burgeoning international demand, the widening transatlantic rift, potential escalation of the Gulf War to Iran and beyond and, last but not least, very troubling record growth in the budget and trade deficits.

We touch upon all of these factors in this issue. As always, it is our hope that you come away from our quarterly review with a clearer sense of gold's role in helping you weather the times. In keeping with that sentiment, we invite you to pour yourself a cool refresher, make your way to that favorite patio location, and immerse yourself in the always interesting complexities of the gold market.

Those of you who have read this newsletter over the years will recognize the Wodehouse quote gracing this month's banner. It's been there before -- almost always in July, and almost always with a reflection that maybe we should all learn something from McHoots. At the very least, we gold owners can well afford some quality time with friends and family as summer 2003 unfolds. After all, thus far it's been a very good year --a year of profound changes on the world scene and in the investment markets. Gold has performed handily the task for which it was purchased: protecting the overall portfolio. This year we have a right to stop for awhile and smell the roses.

The fact of the matter, though rarely discussed, is that gold ownership has more to do with personal philosophy than it does with finance and economics -- though this is not an attempt to diminish the role of the markets in our everyday lives. Sometimes we all get overly wrapped up in the drama of the day. Things need to be put in perspective and that's where gold plays its most fulfilling role. These days opening the morning newspaper or switching on the evening news can be akin to an assault as the media seem to compete on a daily basis to see who will do the best job of 'shocking and aweing' us. Quite often, we let that assault get the better of us -- the blood pressure rises and the mood sours. McHoots, as Wodehouse describes him, harbored a well-cultivated disdain for that sort of thing. My guess is that McHoots was a gold owner. How could it have been otherwise?

"I am not bound over to swear allegiance to any master; where the storm drives me I turn in for shelter." Horace, 65-8 B.C.



Inside this issue. . . . . *Dollar Devaluation Still Big Gold Story (page two)........Soros, Buffett Buying Gold (pages three and four)................Fuller Says Gold Going to $1500 (page seven).............The Power of Gold Diversification (page eight).........History's Golden Lesson (page nine)............The Inflation/Deflation Debate (page ten) ....Congdon on America's Deficits, the Dollar & Gold (page eleven)............Short & Sweet (page two)*

Dollar Devaluation Still Big Gold Story

With yields in the basement, the dollar poised to fall further and stocks still overvalued, gold might just be what the portfolio ordered.

In the last issue, we emphasized that the decline of the dollar, not the war in Iraq, was the real story behind gold's bullish profile. The most important aspect of the dollar story remains the fact that, despite the 'strong dollar policy' rhetoric to the contrary, dollar devaluation is a determined policy on the part of the Federal Reserve and the Treasury Department. On page fourteen, we publish excerpts from Dr. Tim Congdon's deep background paper titled "America's Deficits, the Dollar and Gold" which argues persuasively that the new dollar policy is not only in play, but a necessity in order to draw the world economy out of this progressively deeper and inclusive recession. Congdon is not to be taken lightly. At one time, he was one of the 'wise men' who advised the British Chancellor of Exchequer on economic policy.

But back to dollar devaluation as *policy*. James Grant, who writes one of the more provocative, out-of-the-mainstream and insightful financial letters, had this to say about the new dollar policy:

"Alan Greenspan may speak in tongues, but the Federal Reserve System is an open book. It publishes a weekly balance sheet, discloses a targeted fund rate and publicizes the collected prose of its senior officers and ranking staff. The single message of these several media is that the dollar will appreciate in domestic purchasing power over the dead bodies of the Federal Open Market Committee. To see the matter another way, the Fed wants to engineer a faster rate of depreciation in the dollar (let the record show that the rate of inflation is currently positive not negative). In the name of fighting 'deflation', it is striving to make the greenback a less desirable store of value."

It is this desire to 'engineer' the fate of the dollar that has reconstituted the financial world both here and abroad. Under such a scenario, it would be difficult to envision a stock market rally with anything approaching long-term staying power. Returns on savings and bond instruments are likely to decay further while the principal itself falls victim to a negative real rate of return. The Federal Reserve, as it turns out, appears to be inadvertently pushing 'risk.' Under such a scenario, gold-- which remains the most underpriced of the primary assets -- looks a very good bet. So as the bear market for the dollar gathers pace, so will the bull market in gold.

Britain's popular magazine *The Spectator* summed up the case for gold this way: "[T]he global economy is set to face its sternest test yet on the long road back to economic recovery. After the great boom and bust of the 1990s, there is a real risk of us slipping back into an unplanned recession, an extended hangover from the mother of all parties. Moreover, it is the US economy that lies at the heart of the trouble, with the dollar (the safe-haven asset of the last century) likely to be a casualty on the path back to economic well-being. This bodes well for gold. The US is in debt, up to the eyeballs in hock, and with inflation so low that the burden is here to stay.

One way out of the problem would be to pull the plug on the debt overhang, to devalue the dollar. In a speech given last November, the federal governor Ben Bernanke discussed just that, saying, 'The US government has a technology called a printing press that allows it to produce as many US dollars as it wishes at essentially no cost. By increasing the number of US dollars in circulation, or even by credibly threatening to do so, the US government can also reduce the value of a dollar.'

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SHORT & SWEET

"The declining dollar will help rebalance not only the US trade deficit but also the way we think of the world," says Moises Naim, the editor for *Foreign Policy* magazine............"In its Gold Survey 2003," says *Reuters*, "CPM [the New York-based precious metals' analyst] reported that investors bought 26.9 million ounces of gold bullion during 2002. That was the most in any year since 1967, more than doubling the 10 million ounces purchased on a net basis the year before." In 1967, far-sighted international investors were reacting to the first signs that there might be problems with the dollar ....Along these lines, Merrill Lynch World Mining Investment Trust purchased nearly one tonne of gold in May and June, according to a *Mineweb* report. Graham Birch, managing director of sector funds at Merrill/London, said the purchase was triggered by the fall in the value of the US dollar against other trading currencies, which in turn boosted the gold price to $370 an ounce at one stage. "We look at gold [bullion] as cash. It's just a different type of cash," he explains. However, Birch also insists that gold is not an exact proxy for the dollar because "as the dollar falls by one percent, gold is likely to rise by 2 percent.".............It wasn't that long ago that recurrent stories about 'Japanese housewives' purchases served as a driving force for the gold price. With what's going on in the Japanese banking industry (the failure of Resona, Japan's fifth largest bank and severe losses in other top banks), those hard-money housewives may begin showing up again in the daily *Reuters* gold report......As you might recall, the Treasury Department stated bluntly that it was pulling rabbits out of the hat to keep the national debt from going over the $6.4 trillion

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Chart courtesy of INO.com

Dollar & Gold, cont. . . .
Forget poker; this is the real thing! Here we have a senior custodian of the largest repository of global savings (the dollar) arguing that, if push comes to shove, the government will keep the US economy going by devaluing that very supposed store of value. The last time the dollar was devalued (in 1933), private ownership of gold in the US was outlawed because of the crippling demand.

The British love to mock the French for many things, but perhaps we should learn from them by adding gold to our portfolio of assets. A few Sovereigns or Krugerrands in the attic may have looked stupid in the Nineties but, now we are in the Noughties, a bit of diversification out of property and the stock market would be prudent."

I can't add much to that, except to say that when you do get ready for that gold portfolio addition, we have been doing that sort of thing for 30 years now and placed gold with thousands of investors before you. The price is right and the service friendly. And as always. . . please remember it is your purchase of gold from USAGOLD-Centennial Precious Metals that noursishes these pages.

Soros Selling Dollar, Buying Gold

The most interesting news to emerge from the flood of coverage on the new euro/dollar paradigm were reports in various media that George Soros, one of the world's most closely watched investors, had become a gold buyer. Soros is famous for his big bets and big payoffs and nothing, not even the currencies of nation states, escapes his speculative purview. His attack on the British government and the Bank of England by shorting the Pound Sterling will forever remain a keystone of his biography and a strategy that villified him in some quarters.

In an interview aired on most of the day-time news networks in late May, he proclaimed his antipathy for the dollar -- blaming its problems on Treasury Secretary John Snow. He simultaneously expressed his ardor for the euro and gold. The 'Soros Effect' has now taken effect and few in the world of finance and investments will miss the significance -- both in the professional arena and among private investors.

In recent weeks any drop in the gold price has been met with heavy buying. Many believe that this buying is coming from two sources: mining companies buying back their forward hedges and George Soros speculating on higher prices. Reportedly Soros said (in a reference to Secretary of the Treasury John Snow's successful attempts to talk down the dollar): "I have to disclose that I now have a short position against the dollar because I listen to what the Secretary of the Treasury is telling me." MK

Gold Poised for $700 per Ounce

"Buying gold now is the lowest risk investment you can make. And the upside is an once-in-a-lifetime opportunity," says analyst Paul van Eeden.

NEW YORK -- International Speculator newsletter combines piquant political and economic commentary with savvy stock picking. Volume XXIV, No. 4 was a particular highlight for hard-core gold bugs, offering them Paul van Eeden's unusual perspective.

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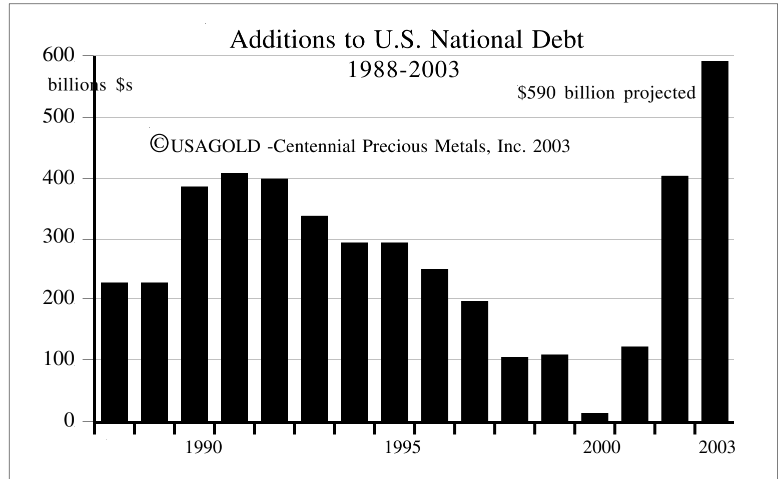
Short & Sweet, cont. . . .



mark -- the Congressionally mandated cap. Recently, Congress officially upped that cap and, you guessed it, the national debt took off on a rocket trajectory. From April 1 through May 23, 2003, the national debt hovered in the vicinity of $6.46 trillion. It went to $6.542 trillion by May 27th and hit $6.557 trillion by the close of business on Friday, May 31st! <u>In case you do not have your calculator handy, that amounts to a $111 billion addition to the national debt in a little over a week</u> (which has to be some kind of record).................. For those who keep track of economic arcana, the U.S. government has added roughly $328 billion to the national debt thus far in fiscal 2003 (ending in September) and we still have four months to go. Making a rough extrapolation, if this trend continues, the federal government could end up adding $592 billion in red ink by September's end -- by far the largest addition to the national debt in history..............What was it that the president said in Poland Saturday about the markets simply not cooperating with his administration's 'strong dollar' policy?................From Lord William Rees-Mogg, former editor-in-chief of the *London Times:* "Put at its simplest, one can say that <u>gold has the same exchange value as it did in 1900</u>. That is approximately true in high-inflation countries, like Germany, which had two wipe-out inflations in the 20th century; in medium-inflation countries like Britain, which lost 98% of the purchasing power of the pound; and in low-inflation countries, like the United States, which lost about 95% of the purchasing power of the dollar."..............<u>Many shrug off the current dollar/euro exchange rate as a temporary phenomenon, but I believe its part of a longer-term quid pro quo between Europe and the United States</u> that will be with us for some time forward. Roles will likely flip-flop with the U.S. attempting to improve its exports through a cheaper dollar, and the Europeans will rebuild their economy via the wealth effect, i.e. a stronger currency and hopefully (from

(Continued on next page. . . .)

Gold $700 Per Ounce, cont. . .

Readers will recall that long before it was fashionable to do so, van Eeden was writing extensively on the inverse relationship between the US dollar and gold, and called the changes we are now experiencing early and accurately.

Even more unusually, van Eeden has no truck with conspiracy theories (a form of witchcraft, he says). In a Mineweb commentary nearly three years ago, he wrote: "The major decline in the gold price did not occur because of central bank sales or producer hedging, as many people believe. Instead, a proper analysis of the gold market, and an understanding of foreign exchange markets with the role played by derivatives, sheds light on the real factors that determine the gold price."

More than $100 an ounce later, van Eeden told subscribers recently that it wasn't too late to get positioned. He expects gold to "at least" double in coming years and possibly triple within five years.

Van Eeden also notes what anyone in South Africa or Brazil could tell you--the greatest defence against their weak currencies and mediocre governments was gold. "Gold has been in a bull market for more than 5 years. On average the gold price worldwide has increased 70% and no one knows it because most people are too fixated by the US dollar denominated gold price."

The International Speculator model suggests that gold was actually worth $700 an ounce in 2002 and van Eeden expects the gap to close as it has in the past--by gold rising in dollar terms.

From the *Mineweb.com*

Is Warren Buffett Buying Gold?

The Sage of Omaha just might be, says Mitsui's gold guru, Andy Smith

In a series of quotes lifted from Buffett's letter--published [recently] in *Forbes*--[Mitsui gold analyst Andy] Smith highlights phrases he says are "familiar in tone to those harangued over a seeming eternity by the tabloid tirade of conspiracy theorists". Smith should know; his dispassionately bearish views on the merits of gold as an investment class have drawn flack from gold bugs on chat forums for years now.

But Smith's astute observations regarding Buffett's next move, will no doubt win him favour with his detractors. His selected quotes from Buffett's text, peppered with references to derivatives and systemic risk, will no doubt have gold bulls smiling. Buffett's reincarnation as a gold bug would also lend serious credibility to the metal's status as a safe-haven asset, given that his investments spin out $5 billion in cash each year. Buffett also staked 2 percent of Berkshire Hathaway's assets on silver in 1998, taking a 4,000 ton long-term bet on the metal's future.

Here is a selection of his quotes: time bombs; madmen; mark-to-myth;

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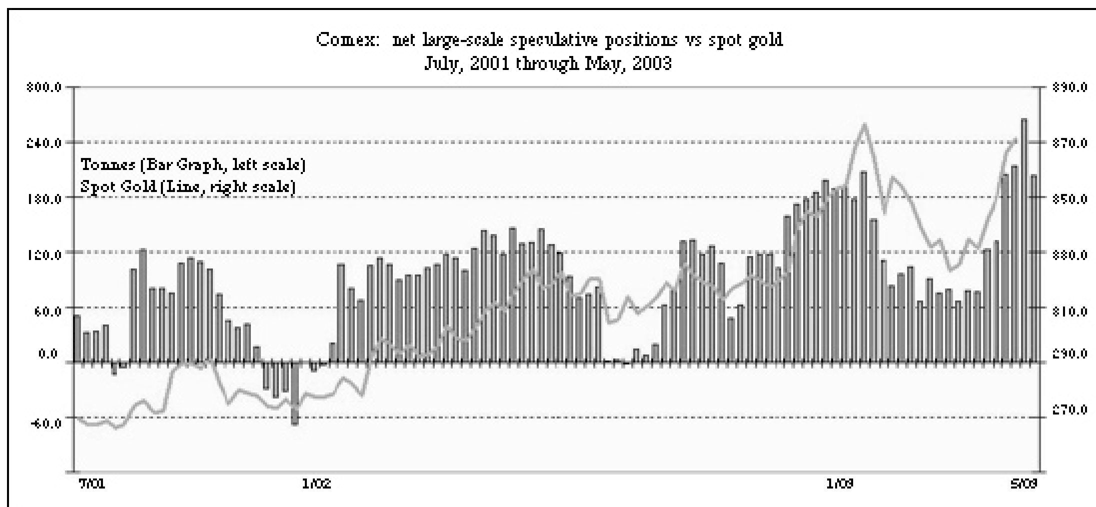
Short & Sweet, cont. . . .



their perspective) stronger equity markets. As I have said before, it's beginning to look alot like the 1970s all over again................"The failure of the industrial group of nations to mention foreign exchange rates in their statement was taken by most to indicate that no coordinated effort to support the dollar is in the wind," said Grady Garrett, chief trading strategist at EnergyTrendAlert (as reported by *Reuters*). [**Ed. Note**: To the contrary it looks like Europe will step aside in favor of a stronger euro.]..........Managed economies. Can't live with them. Can't live without them. At least not in this era. Take a look at the correlation chart directly above. We've reported on this phenomenon before. As you can see by the graph there is a direct, nearly lock-sync correlation between large spec volume and the gold price. In the past, big volume numbers have kept the gold price down. Now they are driving the gold price up (!), hence the title to a more detailed treatment of the subject at our website under the title, *New Gold Market Dynamic Changes Game* (at MK's GOLD COMMENTARY & REVIEW)....................This chart also reveals an interesting possibility: With volumes no where near where we were in the late 2002/early 2003 run-up, this graph suggests we could go much higher still in this latest round of gold price increases -- increases which have occurred by the way while the international political scene has remained fairly quiet. Back in February we were telling people in *NEWS & VIEWS* here and anywhere we could that gold's strength had little to do with the war in Iraq and everything to do with the dollar and dollar policy. We haven't changed that assessment...................Reports that the hedge funds (see *Soros Selling Dollar, Buying Gold*, page three) have renewed their interest in goldhave more to do with this latest move than with any fundamentals...................Gold, at least for the moment, has

(Continued on next page. . . .)

Buffet, cont. . . .
daisy-chain risk; dominoes toppling; it pays to minimize links of any kind; linkage, when it surfaces, can trigger serious systemic problems; derivatives genie is now well out of the bottle; toxicity; alert to any sort of mega-catastrophe risk; derivatives are financial weapons of mass destruction, carrying dangers that while latent, are potentially lethal; hangover may prove proportional to the binge. Music to the ears of any hardened gold bull, despite the fact that bullion doesn't score a single mention.

"True, the 'G' word does not appear. Except between every line," says Smith.

[**Editor's Note**: A handful of commentators have pointed out recently that there seems to be an underlying strength to the gold market that they can't put their finger on. Is China in the market? Japan? Or has Warren Buffett's Berkshire Hathaway with its $5 billion in ready available cash become a player in the gold market? It could be. And if so, I wouldn't be surprised. Beyond the appeal to WB's Nebraska-grown common sense, Howard Buffett, the four-term US Congressman from Nebraska and Warren's father, was a well-known advocate of the United States' return to a gold-backed currency. One can imagine a dinner conversation or two centered around the benefits of the yellow metal. Did the sound money philosophy of the politician father transfer to the financier son? There is no way to know for certain, but Andy Smith's opinion that the 'G' word appears 'between every line' has a ring of truth about it. And then, as well, there's the small matter of WB already being the world's largest private holder of silver.]

From the *Mineweb.com*

Some Sage Advice for Gold Investors from the Aden Sisters

Bet on the big trend in gold. Don't sweat the short-term moves.

Gold's bull market is alive and well. More important, gold formed a major bottom in February, 2001. And despite its ups and downs, the major trend has been up for more than two years now. As long as this continues, and we believe it will, then gold is headed higher.The daily ups and downs in any market can be confusing and they actually detract from what's really important -- as we've seen over the past few months. As gold moved lower, for instance, many investors threw in the towel, feeling that gold's days were over. In other words, these investors were swept into the day-to-day action and news. They got excited and made decisions based on these noisy distractions, which bombard investors every day on TV, in newspapers and the Internet. Every daily movement is emphasized as a big deal when in reality it's not. This information is actually geared to traders, not investors, and we know that traders lose money, something like 90 percent of the time.

Far more important are the major trends. These are the trends that last for months or years and that's where the best profits are consistently made, year after year. If you are with the major trends and stay with them, you'll do far better over the long haul than any short-term trader could ever hope to.

From *The Bull & Bear Financial Report*

Short & Sweet, cont. . . .
become a currency play, and when it comes to currencies, gold is "the only that cannot be replicated on high speed printing presses," as James Grant so aptly put it................. From the Street.com: "Gold is the 'best kept secret' in investing, [Tocqueville's John] Hathaway declared, suggesting gold's five-year outperformance vs. the S&P 500 is just the beginning of a long-term secular upswing that could last as long as 20 years, judging by past cycles. The bottom line is that Hathaway thinks gold can go to $1,000 per ounce before its current bull move ends. .... Pimco's Bill Gross says low interest rates in the US will be with us for a long time to come -- years, as a matter of fact...............Echoing the Cold War rhetoric of by-gone days, Russian president Vladmir Putin said recently that "Russia can exist within its borders only if it is a great power." He also called for a "new generation of strategic (read nuclear) weapons."........ On the day the U.S. government reported the greatest outflow of capital from this country to Mexico ever, 18 migrants -- 'desperate' and 'in search of a better life' died in a tractor trailer in the Texas desert....................Zembei Mizoguchi, vice finance minister for international affairs, told reporters recently: "We don't have the intention of purposely taking the yen higher or lower. We want to prevent excessive moves." A reporter posed the question about exchange rate intervention after it was apparent to everyone except possibly Mr. Mizoguchi that the Japanese government had indeed been active in the forex markets *in favor of the dollar* recently. In fact, I am trying to recall an instance when Japan was on
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News & Views

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Who Will Pick Up the Ball on the Washington Agreement?

Will the central bank agreement of 1999--comprising all the big European gold holders--be renewed when it expires in September 2004? Opinions differ on whether it should be renewed: gold producers and gold investors are for it, as it has reduced fear of huge central bank sales, but bullion banks and traders are generally against it. Real market folk don't care what happens to the price so long as they can play with the gold.

But who is going to push for renewal from within the central banking community? The lead has to be taken at governor level --and nobody seems desperately anxious to pick up such a hot potato.

Last time, the issue was raised by Jean-Claude Trichet and Hans Tietmeyer, who told the other governors in 1999 that something had to be done at a time when the price was sinking and the market simply did not believe the central banks' reassurances that they would sell "only a little bit of gold." The last straw was UK Chancellor Gordon Brown's decision to sell half UK's gold stock. The agreement itself was actually cobbled together largely by Andrew Crockett, then general manager of the BIS.

But who is going to take the baton this time? Tietmeyer has retired, and his successor at the Bundesbank, Ernst Welteke, has got his wires crossed with his own Finance Ministry over his proposal last year that Germany should sell some of its gold under a new agreement (a proposal he later half-retracted). Meanwhile, Malcolm Knight, Crockett's successor at the BIS, is busy being briefed by his staff on all the other aspects of his job. Somehow, one feels he is unlikely to give gold much thought.

So perhaps it will be up to Trichet again, assuming he is cleared by the court in June, and takes his due place in Frankfurt. Gold holders will be hoping he makes it.

From the *Central Bank Insider* - www.centralbanknet.com

GFMS Releases 2003 Gold Forecast

Known for their conservative predictions, this highly regarded research firm sees gold going over $400 this year.

The Gold Fields Mineral Services gold report is widely circulated as the authoritative source on gold market statistics and referred to studiously by industry spokesmen throughout the year. GFMS is perennially bearish on the price of gold and even its average prognostication of $369.50 for 2003 will seem a bit squeamish given the fact that gold traded near $390 --a 35% rise from the bottom--long before the report's availability. CitiGroup/Smith Barney gently chided the London firm yesterday issuing their assessment of the 2003 GFMS forecast under the headline: "Their First Bullish Assessment Ever?" Says the GFMS press release linked below: "The consultancy see further stock market weakness, especially in the US, as a strong possibility, chiefly on the basis of disappointment over poor economic growth for the near future triggering a slump in equities. This, in conjunction with a still weak US dollar and low interest rates, was seen as a framework within which investors could return to gold to drive the price back over $350. [Phillip] Klapwijk [GFMS' managing director] also added, 'a return of the rally would be all the more likely and that much stronger if the US decides to extend its war on terror post-Iraq.' " GFMS sees gold gaining strength as the year goes along breaching $370 in the second half, but "not going through $405."

GFMS Press Release

Short & Sweet, cont. . . .

the other side of the market -- trying to drive the dollar down. Well, a few days after Mizoguchi's remarks, *Forbes* magazine, which apparently was scratching its head about that comment, published a mini-study on the subject of Japanese currency intervention. They chronicled at least 14 definable interventions in the last two years -- all to drive the yen lower; none to drive it higher. So much for Japanese intentions. Their policy is pure beggar-thy-neighbor; and why they try to hide the obvious is beyond logical................In a short but interesting article in *Financial Times* under the headline, "Names that Financed the World Refuse to Wither Away," the story is told of three of the banks that built the London financial district and made it what it is today: Fleming (in railroads), Hambro (by financing the reunification of Italy) and Baring. "These names, " says FT, "have vanished as the banks with which they were associated were bought, broken up or brought down by rogue traders." So what has happened to the scions of those banking families? All three of the heirs -- Peter Hambro, Oliver Baring and Roddie Fleming -- have gone to the gold business. All own mining concerns in places like Cuba, Siberia and Africa. All, says the article, have been bitten by the same 'bug'............French wine prices are plunging -- some down as much as 30%. Wine experts, according to a story in the *Australian Review,* spread the blame on a number of factors: the euro, a U.S. boycott, picky buyers, and over-speculation which drove prices into the stratosphere over the last few years. Sound familiar?............ Amro's Carol Wong says the recent interest in gold has to do with safe-haven investing, near-zero interest rates, and an expected decline in mine production. As a result, she says, "the upward trend is very likely to continue." ....In a role flip-flop sure to raise a few eyebrows with military and foreign policy planners in the US, the *Scotsman* reports that Russia is financing the Taliban in Afghanistan..................It seems there is a patriotic squirrel in New Hampshire which confiscated a family flag from the front lawn and used it to line its nest. The homeowner suggested that the squirrel might be 'trying to get a female with that snazzy pad.'...............................Under PERSONAL NOTES at the MK's GOLD COMMENTARY AND REVIEW page at our website, I link a speech by France's Charles DeGaulle (while he served as president) as reminder that, if history doesn't repeat itself, it at least rhymes. It is uncanny how closely the current antagonism between the United States and continental Europe parallels periods in the 1960s and 1970s -- which was also a time of unprecedented gains in the gold price............. In those days, DeGaulle envisioned a monetary system anchored by gold. Though I doubt seriously that the key participants in the present unfolding drama will enact what DeGaulle envisioned in 1965, I hasten to point out that I could argue effectively that the reason

(Continued on next page. . . .)

Fuller Says "Gold Will Go to at Least $1500 over Decade"

Treat the dips as buying opportunities, says one of London's top market analysts.

Investors have only just begun to buy gold. The advance has paused following a recent high at $373.15, in response to a short-term overbought condition. I expect to see a period of ranging, during which recent gains are consolidated. I doubt gold will move much below $350 during this phase, if that. Why? Because China is increasing its gold reserves, and other Asian and perhaps Middle Eastern central banks with large foreign exchange reserves are likely to follow this lead. While a portion of this demand could be offset by European central bank sales, there will be increasing pressure on them to hold dwindling gold reserves in a rising market. Japanese investors will continue to buy, knowing that the next BoJ Governor will weaken the yen. US and European investors hold little gold at present but are a significant source of future demand.

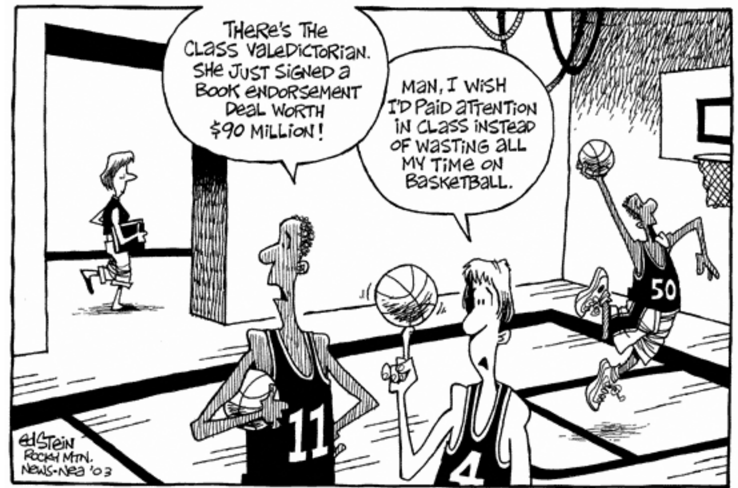
Why should they buy?

Two reasons: they no longer like the alternatives but everyone loves a bull market. Why buy stocks when the biggest bubble in history burst less than 3 years ago? Why buy bonds when they have already seen a high bull market; deficits are rising; the supply is increasing, and debt problems persist? In contrast, gold is cheap relative to other investments; its bull market has only just begun and supply is limited. Much has been made of gold's war premium, estimated from $10 to $50. I think this premium is small, but likely to increase if war against Saddam Hussein becomes inevitable. Consequently, we are likely to see a temporary dip on the gold price if/when war commences, in line with whatever the consensus figure on the war premium happens to be. That should be a buying opportunity. I maintain that gold will move to at least $1500 over the next 10 to 15 years.

[**Editor's Note**: All paper currencies are suspect -- not just the U.S. dollar (though it's on-going debasement is probably the most far-reaching in the world economy). Orchestrated currency debasement with its attendant misallocations and consequences has become the economic policy of the day, and something investors need to plug into their portfolio planning no matter where they hold citizenship. Beyond that, David Fuller, whose insightful writings I have followed for nearly 20 years, is absolutely correct in saying that the gold market hasn't even begun to feel the effects of the international scramble for gold being joined by American and European investors.]

"[T]here is a secular trend at work, which neither the Fed nor any other government agency can prevent, although they can micromanage it. My long-term script for gold is unchanged. A 10 to 20-year bull market has only just begun. There will be long periods of ranging during the early years, in line with most secular trends. The chart will show a series of steps, with most occurring at higher levels than the previous trading range. The biggest gains are achieved towards the end of bull markets. The bullion price should eventually reach levels several times higher than we see today."

David Fuller/*Fuller Money*



Short & Sweet, cont. . . .

we find ourselves at these crossroads can be traced back to the failure to follow his advice some 40 years ago..............Since that time gold ownership has played a key role in private portfolio management simply because DeGaulle's advice was not taken. It will continue to play that role for the same reasons. Though we again reach an historical crossroads by all accounts, the nations of the world (you can be reasonably assured) will not go to gold as a curative. Private citizens, however, will. After all, zero percent return on one's money isn't all that far away, nor is a stock market seeking an historically relevant valuation. As the losses mount in other areas, so will the interest in gold where it is not far-fetched to envision returns far in excess of the less than 1% drawn on most saving vehicles. That point, more than anything, explains gold's rewarding behavior over the last several months, and why it is likely to remain a key to investor interest in the months to come...................Stephen Leeb/ *Personal Finance Newsletter*: "Back in the mid-1970s a combination of rising inflation, a weak dollar, and low real interest rates helped push gold to well over $600 per ounce. This decade should be no different. In fact, gold could climb even higher due to on-going Middle East uncertainty, diminishing stock market returns and yawn-provoking bond yields."....................We'll bring this edition of SHORT & SWEET in for a landing with this quote from J. David, a *Reuters* financial reporter: "Sayonara, strong-dollar policy. And if you ask most market observers, Godspeed. One recession, two wars and four U.S. Treasury secretaries after it was instituted under the Clinton Administration, the U.S. currency's armor plating appears to have ruptured. The dollar has tumbled to 4-year lows against a broadly stronger euro and the Swiss franc while barely staying afloat against other major currencies . . . Analysts view the dollar's fall as orderly, but say a quick and calamitous slide may wreak havoc in financial markets and could yet spark concern in Washington."...........Until next time. Happy Trails, my fellow goldmeisters.

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Serving Gold Investors Since 1973
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Denver, Colorado 80246-0009
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Portfolio Selections and Client Services

U.S. Gold Eagle Bullion Coins

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U.S. Eagle (please see photo above)
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Canadian Maple Leaf
Australian Nugget/Kangaroo
South African Krugerrand
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Great Britain Sovereign (.2354 ozs.)
Denmark 20 Kronor "Mermaid" (.2592 ozs.)
France 20 Franc "Rooster" (.1867 ozs.)
France 20 Franc "Angel" (.1867 ozs.)
France 20 Franc "Napoleon" (.1867 ozs.)
German 20 Mark (.2304 ozs.)
Italy 20 Lira (.1867 ozs.)
Netherlands 10 Guilder "King" (.1947 ozs.)
Netherlands 10 Guilder "Queen" (.1947 ozs.)
Sweden 20 Kronor (.2592 ozs.)
Switzerland "Helvetia" (.1867 ozs.)
Switzerland "Confederatio" (.1867 ozs.)
Uruguay 5 Peso (.2501 ozs.)

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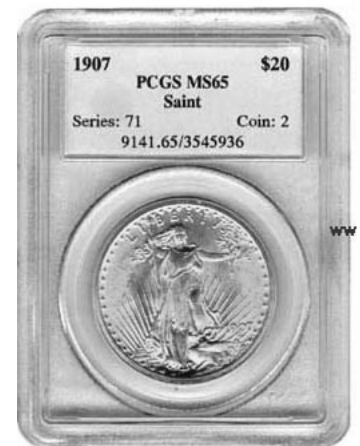
These items offer the same protections as the pre-1933 World Gold Coins, but find a consistently strong market with US-based investors who prefer them for their beauty and familiarity.

$20 Liberty (.9675 ozs.)
$20 St. Gaudens (.9675 ozs.)
$10 Liberty (.48375 ozs.)
$10 Indian (.48375 ozs.)



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We offer US $10 and $20 gold pieces and US silver dollars in collector grades in the higher ranges of uncirculated condition. This area has become a very important portfolio inclusion for those seeking a higher risk-reward ratio in their gold holdings. All the items we offer in this category are authenticated and graded by third-party verification services.

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We maintain a jewelry-ordering desk exclusive to our clientele. You are invited to take advantage of our industry contacts to purchase quality, high-fashion jewelry items at discount prices (also no sales tax). Keep us in mind when that special occasion arises. View items by fax and e-mail. Contact Marie Ballard, Ext. #106.

Client Services

Centennial Precious Metals/USAGOLD maintains a tradition of reliable, friendly, and knowledgeable client service going back to the firm's founding in the early 1970s. Our unblemished record after nearly 30 years in the gold business speaks for itself. With sales of several million dollars annually, we have placed thousands of ounces of gold over the years with thousands of satisfied gold owners, and we remain one of the most widely recommended firms in the industry. Our versatile and utilitarian selection of services is geared to the varied needs of our clientele and range from portfolio consultation and order fulfillment to solid, on-going information services through our newsletter and website.

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Business Hours: 8am to 6pm MDT Monday - Friday

Small Order Desk

For purchases of less than $5000. Ask for Jonathan Kosares, extension #110.

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Easy-to-do rollover packet available. Ask for George Cooper, extension #102.

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We offer solid, on-going informational support to our clientele through the popular USAGOLD website. Considered by many investors as the top gold website on the internet, it receives several thousand visits daily. (See display ad below.)

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We tailor our portfolio advice to your needs and aspirations, not the other way around. No matter your level of interest, we have the knowledge, experience and capability to help you meet your gold investing goals.

Buyers' Group

This popular client service takes advantage of instantaneous e-mail communication to organize group (volume discount) purchasing power on small hoards of scarce and unusual historic gold coins. To be included, please contact Jonathan Kosares, Ext. 110 or <jonathan@usagold.com>

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London-based

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with Michael J. Kosares

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Independent gold market analysis

You are cordially invited to join us!

"I received the gold today and all is in order. As this was my first gold order from USA, I would like to thank you and your company's president Michael Kosares for the courteous, efficient and professional way in which it was handled."
--- MK, Dublin, Ireland

"(Centennial) operates with such a high degree of integrity that I would never even consider doing business anywhere else."
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"Since I've never invested in gold, nor with companies that I'm unfamiliar with, I had some hesitations about 'pay now, get your product later.' A quick check with the Better Business Bureau helped to put my fears to rest."
-- D.H., Denver, CO

"Thanks for the enlightenment. I enjoyed your 'ABCs' book. The chapter on Government debt was almost scary. Even I could understand what I need to be doing for my family's future."
-- MD, Fulton, MO

"I appreciate your approach. That's the reason I am considering investing through you folks. I need education , not hype."
-- DB, New Ulm, TX

The ABCs of Gold Investing

Primary Education for Gold Investors

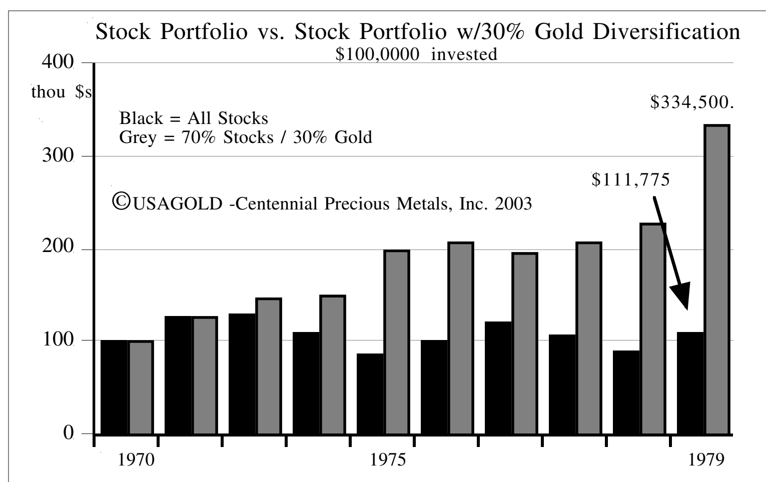
The Power of Gold Diversification

History shows that a prudent diversification can go a long ways when stocks enter a primary bear market.

Few would argue against the generally held perception that gold protects against inflation, deflation and/or stagflation and in whatever order they come. Stocks, on the other hand, do not do well during currency crises -- events usually accompanied by any one (or a combination) of those three maladies.

The graph below represents two model portfolios during the 1970s -- one invested 100% in stocks and the other invested 70% in stocks and 30% in gold. The 1970s were characterized by a dollar devaluation and crisis that spawned both high inflation, unemployment and bankruptcies -- one of the most destructive financial periods in modern American economic history. Each portfolio started with $100,000 invested. The all-stocks portfolio did well until 1972, when Wall Street began to react to the dollar crisis. By 1973, the diversified portfolio (with gold breaking to the upside pushed by the building inflation rate) was worth more than the all-stocks portfolio. By 1979, at the peak of the crisis, the diversified portfolio rocketed to $334,500 (over three times where it started in 1970) while the all-stocks portfolio could manage a value of only $111,775-- a meagre 1% annualized return on investment over the period studied. The gold price used for the 1979 valuation was the $300 average, not the $875 top.

The message is that gold diversification is a powerful tool for maintaining assets at times of equity market stress, and that alone offers sufficient argument for its inclusion in the average investor's portfolio. Those who had the wisdom to prudently switch 30% of their portfolios to gold prior to the 1970s financial rout, or even while it was in process, protected their stock market gains. Those who did not, lost money to inflation.



Gold Myths & Realities

Myth: Gold is a speculative investment that should be avoided by conservative investors.

Reality: It is primarily the conservative investor that most cherishes gold. It is not gold that changes in value but the value of paper currencies. What you could purchase with an ounce of gold one hundred years ago, you can purchase today.

Myth: Gold stocks are a better portfolio option than gold itself.

Reality: Gold stocks are stocks first and gold second. Gold stocks are not an investment in gold, but a proxy for the metal which depends upon the management of that particular mining company to make a profit. There is no substitute for owning the real thing.

Myth: Gold is just another commodity, like pork bellies.

Reality: Unlike other commodities, which are produced strictly for consumption, gold is the only commodity that is accumulated and saved. It is used as money to facilitate future consumption. Therefore, it cannot be considered in the class of commodities without paying attention to its role as money.

Myth: Gold is a barbarous relic of past monetary systems irrelevant in today's computerized markets.

Reality: Gold is held as a reserve asset in nearly every central bank in the world. It serves as their asset of last resort to be used for grave international crises such as war, economic troubles, environmental disasters, and the like.

Myth: Central banks control the gold price and they intend to hold it down.

Reality: As the recent central banks' agreement to limit sales and leases implies, some central banks are pro-gold, others are anti-gold. In each instance in modern economic history, when a government and/or its central bank acted to hold down the price of gold, the metal was on the verge of exploding upwards. The restraints turned out to be an act of futility.

"We are old enough to remember Eisenhower. Which means we should be old enough to know that the investment world is full of surprises. In fact, we rather enjoy them. That people should lose the most money from the most popular and fashionable investments seems not only natural to us, but fitting. That they should make the most profit from the most despised investments, too, seems right. It is as if the markets brought a little bit of the kingdom of God down to the ground..."

Bill Bonner, *The Daily Reckoning* (as published at www.lemetropolecafe.com)

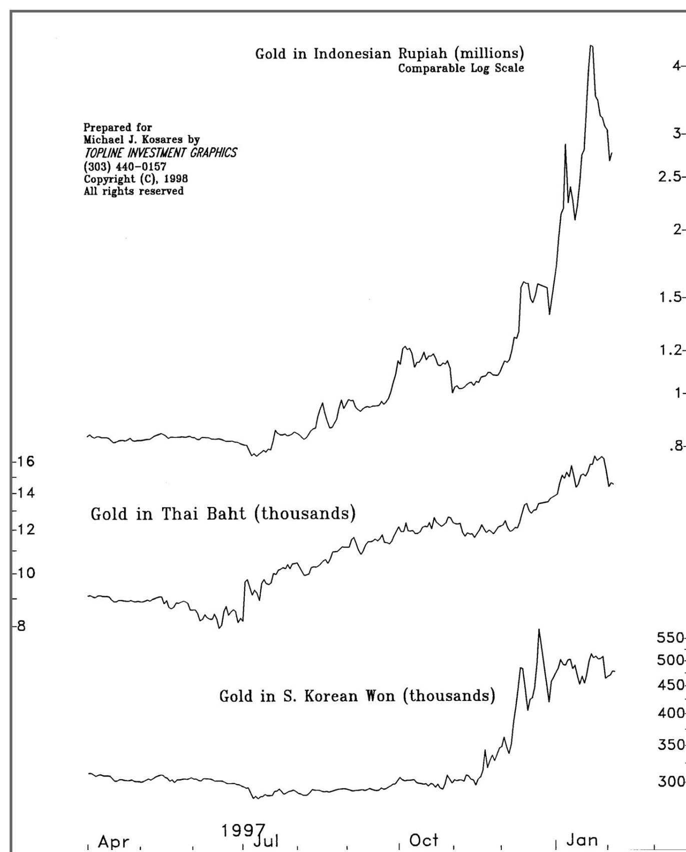
The ABCs of Gold Investing, cont. . . .

History's Golden Lesson

From Rome to the Weimar Republic, gold is the best hedge against currency abuse.

It has been said that: "If history teaches anything, it is that governments cannot be trusted to manage money."* From the earliest times to present, those in political authority have repeatedly abused the public trust by debasing the currency. The Roman emperors' coin shaving....the French government's 18th century assignat debacle....the Weimar Republic's paper currency hyperinflation in the 1920s.....the 1970s inflation disaster in the United States.......to name a few in a long list of currency debacles in which the ordinary citizen paid a dear price for the government's mismanagement of the currency. Gold's primary portfolio function is to act as an insurance policy against such mismanagement.

In the late 1990s, a series of currency breakdowns occurred in the Pacific Rim which provided an education as to how this sort of thing can happen and how the investor can go about insuring his or her financial survival. The Asian Contagion, as it came to be known, was characterized by high unemployment, rampant inflation, collapsing credit, bank runs, crashing equity markets, massive debt defaults, and rapid currency depreciation. The Contagion left little in the way of assets standing in its wake, but individuals who owned gold during the crisis not only survived economic catastrophe, they prevailed (see graph below). In keeping with the old saying, "Fool me once, shame on you; fool me twice, shame on me," Asia last year experienced an all-time record gold demand.



**The Nightmare German Inflation*, Scientific Market Analysis, 1970.

A Real Life Tale of Asset Preservation

The incident is one of the most memorable of my career. Never before or since has the value of gold in preserving assets been made so abundantly clear to me.

It was the mid-1970s. The United States was finally extricating itself from the conflict in South Vietnam. Thousands of South Vietnamese had fled their embattled homeland rather than face the vengeance of the rapidly advancing Communist forces. In my Denver office, a couple from South Vietnam who had been part of that exodus sat across from me. They had come to sell their gold. In broken English the man told me the story of how he and his wife had escaped the fall of Saigon and certain reprisal by North Vietnamese troops. They got out with nothing more than a few personal belongings and the small cache of gold he now spread before me on my desk. His eyes widened as he explained why they were lucky to have survived those last fearful days of the South Vietnamese republic. They had scrambled onto a fishing boat and had sailed into the South China Sea, where they were rescued by the U.S. Navy. These were Vietnamese "boat people," survivors of the final chapter in the tragedy of Indochina. Now they were about to redeem their life savings in gold so that they could start a new business in the United States.

Their gold, wrapped in rice paper, was a type called Kim Thanh. These are the commonly traded units in Hong Kong and throughout the Far East. Kim Thanh weigh about 1.2 troy ounces, or a tael, as it is called in the Orient. It wasn't much gold—about 30 ounces—but it might as well have been a ton. The couple considered themselves very fortunate to have escaped with this small hoard of gold. They thanked me profusely for buying it. As we talked about Vietnam and their future in the United States, I couldn't help but become caught up in their enthusiasm for the future. These resilient, hard-working, thrifty people now had a new lease on life. I kept those golden Kim Thanh for many years. They became something of a symbol for me—a reminder of the power and importance of gold. Had the couple escaped with South Vietnamese paper money instead of gold, I could have done nothing for them. There was no exchange rate for the South Vietnamese currency because there was no longer a South Vietnam! Wisely, they had converted their savings to gold long before the helicopters lifted U.S. diplomats off the roof of the American embassy in 1975.

The ABCs of Gold Investing : Protecting Your Wealth Through Private Gold Ownership by Michael J. Kosares

[**Editor's Note**: Both the advisories on this page were written some time ago, but their message couldn't be more timely. The most elemental message in this quarterly review is that the Dollar could be in for some rough sailing and, if that is to be the case, you will want to acquire or increase your gold holdings before the public clamor for whatever supply might be available. We think you will find the staff at USAGOLD-Centennial Precious Metals both helpful and knowledgeable. When it comes to assembling a gold portfolio for you particular needs, I think you would be hard-pressed to find a better firm to help you get the job done.]

The ABCs of Gold Investing, cont. . . .

The Inflation/Deflation Debate

Either way gold is a winner for the investor.

[**Editor's Note**: This short essay first appeared in *The ABCs of Gold Investing: Protecting Your Wealth Through Private Gold Ownership.* It seems pertinent to re-publish it at a time when the long-running inflation/deflation debate has resurfaced. The message below is as applicable today as it was first written in 1996. From a recent *Reuters* article: "It is axiomatic in financial markets that gold is a hedge against inflation. But now that investors see a risk of 'deflation' in the weak economy, analysts say gold is still fashionable. Gold is seen just as much a store of value if prices decline, even though such a worrisome economic trend effectively enhances the purchasing power of currencies. 'It's both,' said Frank Holmes, Chief Investment Officer at U.S. Global Investors, which manages gold equity funds. 'If you look over history, whenever you have tremendous stress against a currency -- either inflationary pressures or deflationary pressures -- then gold becomes an attractive investment.' " As you will see below, I agree with Mr. Holmes' assessment.]

Ever since Richard Nixon took the United States (and the world) off the gold standard in 1971, an ongoing debate has been waged between those who believe the American economy is headed for an hyperinflationary breakdown and those who believe that a deflationary collapse is inevitable. Volumes have been written espousing both scenarios. Newsletter writers seem to be divided evenly on the subject. History shows gold, better than any other asset, protects against both calamities. At times (like the 1970s) the inflationists have appeared to be right. At other times (like the early 1990s), the deflationists have appeared to be right.

Thus far we have escaped either extreme. Instead of inflation followed by deflation, we have had inflationary episodes followed by disinflationary or stagflationary episodes wherein the inflation rate has simply been moderated. Today's inflation rate, for example, was enough for Richard Nixon to impose wage and price controls on the economy in 1972. Now it is considered to be a sign that inflation is under control.

The lesson is, there is little doubt the underlying trend in the American economy is inflationary. How this situation is likely to resolve itself is the subject of a great deal of discussion. Deflationists argue that the public and private debt now on the books is approaching $20 trillion and it can never be sustained or paid off. They say it will be liquidated through default. As bankruptcies mount, banks will fail. Fearful investors will scramble to un-load their stocks and bonds. A crash ensues. In such a scenario, gold becomes the asset of last resort and possibly the only asset other than cash ($100 bills) worth owning. Some analysts predict gold prices in the thousands of dollars in such scenarios.

Inflationists paint a different picture. The Federal Reserve could be forced to print money (monetize debt) in ever increasing increments to keep the government in operation. This paper blizzard will wend its way through the economy, pushing prices higher and higher. Exporters to the United States, particularly oil exporters, will be forced to continuously ratchet up prices to receive real value for their oil. Since oil is the lifeblood of the economy and is a cost component of just about everything we consume, all prices will be pushed higher still. Inflation will begin to compound itself. The situation will become exacerbated, much like what occurred in the late 1970s, only this time it gets out of control. Hyperinflation ensues, and gold skyrockets.

A nice-sized pile of old British Sovereigns would go a long way toward protecting you against inflation, deflation or both, and no matter in which order they might arrive.

No one knows off which side of the tightwire—hyperinflation or deflationary crash—the economy will fall. Needless to say, neither proposition is very comforting from an investor's point of view. Yet from the point of view of the gold investor, the inflation/deflation debate is purely academic. Gold will protect and preserve your assets in either instance. Gold is the time-honored, historically proven hedge against economic disasters of all descriptions.

Both deflationists and inflationists recommend gold as the portfolio item to hedge against disaster. In a deflationary crash, gold becomes the only asset left standing after all others are destroyed by default. In an inflationary debacle, gold survives the destruction of the currency and retains its value after all other assets are wiped out. Hedge your portfolio with gold and leave the inflation/deflation argument to the economists.

"We promised to clarify conundrums. And what we clearly see are deflationary symptoms but not the thing itself, inflation to obscure those symptoms, and a lot of talk about productivity growth to obscure the inflation. And now Alan Greenspan's going to get another term as chairman."

James Grant, *Grant's Interest Rate Observer*

"Gold is the 'best kept secret' in investing, [Tocqueville's John] Hathaway declared, suggesting gold's five-year outperformance vs. the S&P 500 is just the beginning of a long-term secular upswing that could last as long as 20 years, judging by past cycles. The bottom line is that Hathaway thinks gold can go to $1,000 per ounce before its current bull move ends."

theStreet.com

America's Deficit, the Dollar & Gold
Can the Dollar Remain the World's Dominant Currency?

by Dr. Tim Congdon

[**Editor's Note**: I recently came across this extraordinary article published last September at the World Gold Council's website and was struck with how quickly and completely Dr. Congdon got to the heart of the matter. Given the limited space available in this newsletter, we decided to reprint the introduction, which frames the situation as the author sees it, and a few snippets to whet your appetite. For the full study, go to The Gilded Opinion section at www.usagold.com. Dr. Congdon's credentials are impressive both in terms of academic standing and more practically as one of so-called 'wise men' advising the United Kingdom's Chancellor of the Exchequer on economic policy.]

INTRODUCTION

With the USA accounting for over a quarter of global output, American economic leadership is an established feature of the international financial scene at the start of the 21st century. The dollar is accepted as the world's main currency, and it dominates both government's reserve holdings and trading on the foreign exchanges. But in one key respect the dollar looks vulnerable. In the last few years, the USA has run a vast current account deficit on its balance of payments. The deficit has been the largest in money terms, and the highest as a share of gross domestic product, in American history; it has also dwarfed the largest deficits incurred by other nations, including nations that have been a by-word for financial mismanagement and bankruptcy. Further, as shown by Chapter 2 in this study, the deficit is not new. The story of the USA's external payments since 1945 is one of a remorseless slide, from a massive trade surplus and a commanding status as the world's biggest creditor in the late 1940s, to the erosion of the surplus and the emergence of a trade deficit in the 1950s, 1960s and 1970s, to an increase in overseas obligations which reduced the surplus on investment income in the 1980s, and finally to the unprecedented trade deficits and the position of the world's biggest debtor today.

A vital question raised by the USA's external debt and deficits is, "can the dollar remain the world's dominant currency, and in particular the favourite asset in government holdings of foreign exchange reserves, while the USA continues to build up external liabilities at the recent rate?" Further, if the dollar's pre-eminence is weakened by the USA's external imbalances, "what other reserve asset can compete with it?" These questions have become more relevant with the introduction of the single European currency, the euro. Several leading European statesmen have said--openly and in forthright terms--that one aim of the euro is to supplant the dollar as the world's principal currency.

The dollar's prospects are also fundamental to the future monetary role of gold. Gold has diminished sharply as a share of international reserves since the 1970s. Although many explanations could be provided for the reduced official demand for gold, undoubtedly important have been the decline in inflation and the restoration of respect for paper currencies. Under the guidance of two outstanding chairmen of the Federal Reserve, Paul Volcker and Alan Greenspan, American monetary policy has successfully lowered the USA's inflation rate and so, by example, played a central role in the reduction of inflation around the world. Are the USA's large external deficits a sign of a weakening of anti-inflationary resolve? Do they foreshadow a collapse in the dollar? And would a collapse in the dollar not only benefit the euro's international prestige, but also renew gold's monetary role?

These are the some of the questions which the present study tries to answer. The questions are not new. Indeed, an argument could be made that they have been inherent in the post-war international financial system. The USA has been expected to create easily traded financial instruments, including large and ever-growing dollar balances, to meet the world's rising demand for liquidity. But to create such balances it has to incur external deficits and the deficits undermine the dollar's credibility. This tension – between the need for deficits to provide the world with claims on the USA and the risk that such deficits make the claims unattractive to hold –was brilliantly described in Triffin's *Gold and the Dollar Crisis*. The book emphasized "the Triffin paradox", that the USA could not indefinitely expand the world's dollar holdings and maintain the convertibility of the dollars into gold at the fixed price of $35 an ounce. Published in 1960, Triffin's book anticipated the suspension of the dollar's convertibility into gold (in August 1971) over a decade.

Of course, the situation today is very different from that in the late 1950s and early 1960s when Triffin was writing, but a link remains between the quality of the USA's management of its currency and the appeal of non-dollar assets, including gold, to international investors. As this study will demonstrate, the scale of the USA's external deficits in recent years has undoubtedly given new relevance to long-standing questions about the dollar's international role.

EXCERPTS

Chapter 3 showed that, to restore sustainability to its external accounts, the USA has to shift 4%-5% of its GDP into net exports. By reviewing key contributions to the literature, this chapter has demonstrated that –realistically –the shift can only happen if the dollar falls heavily against the other major currencies. The major currencies in the context are the euro and the yen. As in the previous chapter, it is helpful to recall the 1980s. After the sharp increase in the USA's trade and current deficits in the early 1980s (which occurred in conjunction with substantial dollar appreciation), the dollar slumped between 1985 and 1988. Economists were baffled by the strength of the dollar in 1983 and 1984, but eventually they were right that a major devaluation was needed to put the USA's external payments back onto a viable path. The same sort of comment, backed up by the same kind of analyses, is being made today. The economists will again be right,with the big uncertainties being the length of time over which the adjustment proceeds and the scale of the dollar devaluation needed to correct the disequilibrium. It may be that

Congdon Excerpts, cont. . . .
the adjustment lasts over a decade and that the fall in the dollar is only 10% or 20% from its level in early 2002. But a more plausible assessment is that the adjustment will occur in under a decade and require the dollar to fall by between a quarter and a half (against competitor currencies, on a trade-weighted basis) from its peaks.

A reasonable case can therefore be made, on institutional and strategic grounds, that the euro will not rival the dollar as a reserve asset in coming decades. Yet this study has argued that the dollar has to fall heavily against other leading currencies, with its exchange rate down by perhaps between a quarter and a half, to facilitate a resource shift of 4%-5% of GDP into the USA's balance of payments. On the one hand, the dollar seems irreplaceable; on the other hand, it looks thoroughly unattractive. How is the conundrum to be resolved? And is this where gold can make a comeback?

Much will depend on the return on dollar assets. It is worth emphasizing that the dollar may be losing value relative to, say, the yen, but dollar bonds could still give a better overall return than their yen-denominated alternatives because they have a higher yield. If the yield on dollar assets rises to persuade international money managers to keep them, dollar assets will remain worthwhile investments even in a weak-dollar environment. Gold has the serious disadvantage that, by itself, it offers no yield. It is true that an income return can be secured nowadays by gold loans in the derivatives market, but the return is modest compared with that available in dollar bonds. Gold could overcome this drawback only if the real return on dollar paper assets were to be hit by rapid inflation. If inflation were to exceed the interest rates on dollar deposits and bonds (as it did in the1970s), the negative real return on dollar assets would cause wealth-holders around the world – including governments and central banks – to reconsider the investment merits of gold. If the gold price were rising in line with or faster than the general price level, the return on gold would be above that on dollar paper assets. Gold would again be a more attractive reserve asset.

The key issue here is whether dollar depreciation is associated with high American inflation. As the double-digit annual inflation rates of the 1970s came as a shock to savers, it took them time to catch up with the different investment context. Interest rates lagged behind inflation and real interest rates became negative, creating the ideal conditions for rising prices of gold and other so-called "hard assets" (oil, real estate, commodities). No one can say for certain whether the dollar's coming fall will be accompanied, once again, by an upturn in inflation. Crucial will be central banks'– and particularly the Federal Reserve's – attitude towards the causes of inflation. The intellectual underpinnings of Volcker's assault on inflation in the early 1980s, that inflation is caused by excessive growth of the quantity of money, is now profoundly unfashionable in the USA and other English-speaking countries.

Perhaps the greatest imponderable of all is whether the global, political, and economic stability of the 1990s will prove to be transient or more lasting. Tension between Western values and Islamic fundamentalism has been a background theme in much geo-political discussion for many years, but the events of 11th September 2001 made the subject more urgent and problematic. The Middle East has traditionally been a significant importer and holder of gold, and the demand for gold in jewellery remains stronger in Saudi Arabia and the Gulf states than in other societies with a similar level of income per head. If these nations were to weaken their military and economic alliances with the USA, there could be a reduction in the official reserve demand for the dollar as well as an increased private sector interest in gold as a safe haven asset.

At any rate, it must be true that a sudden collapse in the dollar's external value is likely to feed back to the USA's domestic inflation rate. As Preeg has warned in *The Trade Deficit, the Dollar and the US National Interest*, the most serious threat from the payments deficits is "the familiar syndrome of financial markets tending to overshoot equilibrium levels when reacting to perceived imbalances," with the result being "an excessively large decline in the dollar." Although policy-makers around the world accept that exchange rates are set by market forces and are understandably reluctant to meddle with currency fluctuations, they need to be alert to the dangers of continued large American payments deficits. They cannot avoid the message that such deficits will have to be countered--sooner or later--by a fall in the dollar; they also cannot deny that, if the dollar's fall is too large and compressed into too short a time-scale, it will raise American inflation and shatter the confidence in paper assets built up in the 1980s and 1990s.

[**Editor's Note**: Since Congdon's article was written in September, 2002 two of his requirements for a rising gold price have been met. Firstly, the real rate of return on the dollar has evaporated, not from inflation rising, but from the inverse -- rates of return falling. Secondly, public policy statements by Fed governor Ben Bernanke and Chairman Alan Greenspan indicate the Fed's determination to utilize the printing press in order to overcome the forces of 'deflation'. The most intriguing of Congdon's questions -- whether or not nation states will add formally to their gold reserves in response to the dollar's fall -- remains unanswered as of this writing. Even so, rumors continue to circulate that China and Russia are adding to their reserves and demand in the Middle East has skyrocketed though it is unclear whether or not some those gold acquisitions are 'official' in nature. Whether other central banks will play the gold card remains to be seen, but one thing is clear: unlike the period of the 1960s when European institutional gold demand was met out of U.S. gold reserves, there is no large supplier of gold--not on the scale that will be required to meet the demand Congdon theorizes. Such supplies will have to come from either new mine production or private investor hoards. To be sure, this will have an effect on the price and one can safely assume it will be positive.]

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