TRUST IN GOLD

Polish your portfolio

WHY YOU SHOULD INVEST IN GOLD

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Investors in gold have to be on alert today. After a secular bull market with more than 10 years of new highs, the gold price has been in correction since spiking at an all-time high of $1,920 per ounce in late 2011. Measured from peak to trough, gold prices fell some 19 percent between then and now. However, a secular bull market will include bear periods and a drop of such a scale is common for a correction, which we have witnessed in the past 12 years with gold prices.

In contrast, gold equities are in a deep bear market. Gold stocks usually overreact to swings in bullion prices and that is exactly what we are currently witnessing. After dropping around 17 percent in 2011 and more than 10 percent in 2012, gold equities have plunged a whopping 20 percent in the first two months of 2013.

This latest, prolonged correction of gold equities has tested the resolve of even the staunchest believers in the inherent value of gold stocks. We believe nonetheless that gold stocks today are a compelling investment proposition, basing our view on two concepts that are crucial for consistent, long-term investment performance, namely value investing and contrarian investing.

Value investing is defined as the purchase of an underlying asset that is extremely undervalued. This value gap is commonly measured by either using profitability as benchmark or by gauging the asset's existing discount to Net Asset Value. In contrarian investing, an investor's decision is based on simply betting against the crowd or the prevalent "common wisdom".

In our view, gold stocks today provide for value investment and contrarian investment strategies. To elaborate on this, we examine the gold price in the context of global monetary trends, under the notion that gold is a currency — one that has been around long before paper money existed.

We are currently in an environment of huge additions in money supplies in three major economies: the United States, Japan and the United Kingdom.

HOT OFF THE PRESSES

In the US, the aggressive quantitative easing (QE) program targeting mortgage-related securities (QE3, announced in September 2012) was followed swiftly by a new program (QE4) targeting US government bonds. The result of these two open-ended programs is the creation of a monetary base at the rate of more than $1 trillion per year.

This amount of liquidity created by the Federal Reserve Bank out of thin air is sufficient to fund the US government's annual trillion dollar budget deficit. In propelling assets higher and stimulating growth in the economy, the American QE programs have found imitators in other parts of the world.

The Bank of Japan (BOJ) has, since early 2000, implemented eight rounds of quantitative easing to no visible effect as they are still suffering from deflationary forces. Nonetheless, the Japanese government has been signaling further easing as the new Prime Minister, Shinzo Abe, came to office on the promise of uninhibited and unlimited money printing.

In the UK, the Bank of England (BOE) is on QE round number six (around $700 billion in total) in an environment where the latest numbers indicate a still very weak economy. As long as this weakness persists, we can expect new rounds of QE.

The dollar is still strong against the yen and the pound. The new wave of money printing from the BOE and BOJ, with the aim of giving their national companies (especially exporters) a competitive edge in a beggar-thy-neighbor approach, has resulted in driving their currencies lower. As other economies have been using the same approach, the world is faced with the constant danger of currency wars.

In conclusion, as a currency holder earning negligible interest rates on the dollar, pound, yen or any other currency, we advocate including gold as a currency in your portfolio. When bullion crossed $1,900, everyone was talking about a target of $2,500. Now when it is at $1,600, sentiment has turned extremely negative and talk is that it could be headed into the vicinity of $1,000.

Judging from recent sales of gold equities, investors are betting on the probability that gold is headed to that low target. Should this prove erroneous — and we strongly believe it will — gold stocks have significant catching up to do and investing in them now could prove to be extremely profitable.

To capture this potential in gold mining companies, we recommend two electronically traded funds that are sufficiently, inherently diversified; namely, GDX (big cap gold miners) and GDXJ (junior mining companies).