Why Gold's Resurrection Will Continue

Gold has soared so far in 2016. The recent decision by the Federal Reserve to raise interest rates in the face of a rapidly weakening global economy has given a whole new lease of life to gold.

We'd consistently stated our view that gold would not fall but rise in the wake of a US rate increase - contrary to what many other market-watchers had been predicting. We'd looked at the underlying health of the US economy, along with actual evidence from previous rate-rising cycles over the past 50 years. It's clear that the level of faith that investors have in Central Banks around the world has rapidly diminished – and the reasons are obvious.

For starters, the implementation of a negative interest rate environment should in our view be viewed as a clear signal that Central Banks are well and truly out of ideas. Negative interest rates are an unprecedented phenomenon – and a clearly desperate measure to try and arrest declining economies that are burdened by enormous debt levels.

An article I read just recently quoted a former U.S. Treasury Secretary calling for a cashless society. This was supported by a Citigroup economist who opines that the solution to a slow global economy is to abolish cash.

The consequences of such a move however are chilling however, when combined with the concept of negative interest rates.

With the inability to withdraw large sums of cash, individuals' savings become hostage to the banks. Savers would be charged a negative interest rate that would inevitably result in their savings slowly evaporate over time.

By contrast, gold has retained its role as a proven store of value for centuries.

This is enhanced by the fact that with negative interest rates being implemented in some countries, investor faith in fiat currencies is evaporating.

Negative interest rates are being used as a mechanism by Central Banks to help try and inflate away crushing levels of government debt. Deflation is a nightmare for those carrying a lot of debt, as this recent quote from *The Wall Street Journal* describes:

"Inflation is a vital part of the effort to reduce the heavy burden of debt in European economies. This applies most obviously to the strained government finances of southern Europe, which are vulnerable to another downturn, but also relatively high private-sector borrowing in countries including France, Belgium and the Netherlands… Low inflation, particularly if it proves persistent, means that debt burdens aren't being eroded as borrowers might have expected. That can force them to devote greater resources to deleveraging, hampering growth."

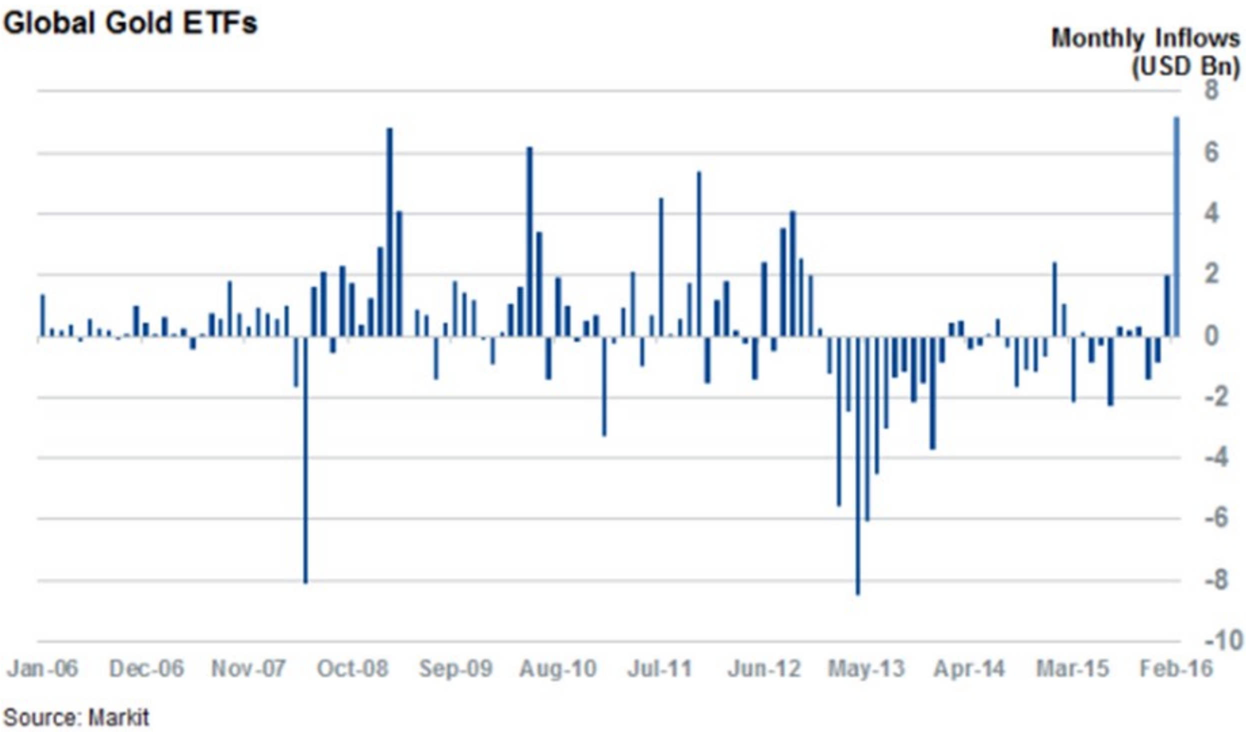
The gold price is however the antithesis of paper money. The last few years have seen gold reaching record levels measured in most emerging economies' currencies, but languishing against the US dollar. However, growing economic uncertainty could well result in a strong rise on gold against all paper currencies – including the US dollar.

As we stated in our previous article on gold in February, gold is breaking its historical correlation with the commodity complex. If one analyses the CRB Index versus gold so far 2016, it's clear that gold is sharply breaking away from commodities – a continuation of a theme that began back in late 2014.

For example, oil and gold are moving in sharply opposite directions.

What's certain is that investor concerns about economic volatility are very real – a situation borne out by the fact that gold ETFs have seen their largest ever inflows over the course of the past month, as investors bid up the asset class in search of a haven from recent volatility.

Gold consolidated its strong January performance during February with its best monthly surge in percentage terms in more than four years. Gold's stunning +10% returns meant it was the best-performing asset class over the month.



Global aggregate fund flows into the asset class came in at $7.9b over the course of the month, beating an inflow record set during the worst of the GFC during 2008.

In my view there are very strong parallels now to where we were back in 1997 to 2001. Back then we had the Asian economic (banking) crisis that took a dramatic toll on commodity prices right across the board, particularly global oil prices (sound familiar?), which fell to $8 a barrel.

This also coincided with a lot of capital leaving the gold sector and which found a home in technology stocks. This was led primarily by the internet paradigm that also led to a very strong US dollar.

However, things reversed from 2002 onwards, with the bursting of the technology bubble - the US dollar fell heavily and the gold price surged, leading to a dramatic flow of capital back into precious metals.

Accordingly, I maintain confidence in our base-case gold price forecast of between $1,100 and $1,300 during 2016.