

## Is a Golden Opportunity Finally Presenting Itself?

There is a bizarre dichotomy between financial markets and the economy. According to Gillian Tett of the Financial Times, this stage of a global economic recovery would normally be associated with much more volatile stock markets as interest rates rise and there breeds a divergence of investor opinions on growth expectations. Instead lackluster economic growth reported for the first quarter in both Canada and the US are paired with muted market reactions and record low measures of both volatility and forecasted volatility in the days ahead.

This really is the first time investors have had to grapple with the question surrounding what role policy makers play in the financial markets. The shift between public to the private has many questioning whether the underlying economy on its own can assume this role. And naturally, this should be a point where the economy is reaching escape velocity (to borrow the words of superstar Bank of England, and former Bank of Canada Governor Mark Carney). Instead though, we are at a crossroads.

The sovereign bond market is telling a much different story than what is going on in the equity arena. While the S&P500 continued to make record highs through the final trading week in May, the US 10 year Treasury bond is sitting on its lowest yield in a year. Some analysts attribute this to the potential for credit easing in Europe pending future actions from the ECB Thursday of next week. Potentially, forward looking yield hungry investors are shifting across the Atlantic. But an additional scenario, again from the Financial Times this past week suggests China's appetite for US debt is once again growing, having just recently peaked in November of last year. And with gold being the natural hedge to the US dollar, growing demand for Treasuries should be accompanied by stronger demand for the yellow metal from China.

Demand from Asia will always create a natural support for the price of gold. But given that growth in demand from China has been almost exponential, it's hard to envision this will be the catalyst that sees the price of gold surge in the months and years ahead, accounting for the negative price action beginning in September of 2011. The price of gold, however, has two strong natural drivers, and they are inflation expectations and economic uncertainty. Economic uncertainty is almost an ex post or after the fact type of idea; it adds momentum to the market. Despite every doom and gloom analyst repeatedly trying to predict the next great recession since 2008, these past six years have illustrated their lack of skill in forecasting. Black Swans are a lot more apparent in hindsight.

It is inflation expectations, preceding actual future inflation that will sustain a rally in the price of gold. This did not occur immediately following the US Federal Reserve expanding their balance sheet. Inflation expectations were high; inflation did not ensue. One reason was the velocity of the money supply remains at record lows as money is not changing hands. With an uptick in the economy, which by expectations could come in the second quarter, and the velocity of money increasing, this could lead to inflation and will begin the renewal of the bull market in gold.

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