

Gold and Geopolitics

These last few weeks have acted as a nice reminder that the fundamentals of the gold trade can span beyond the idea of Quantitative Easing and the US Federal Reserve. Ultimately, it was a fear trade that brought an influx of fresh buyers to the gold market since its most recent bottom in June of this year, and thus propelled gold higher surrounding 1,400 US per ounce. Of course investors saw those gains quickly pared back as political gaffes from a defeated US administration allowed investors to see that the dissipating threat of military action on Syria would not jeopardize positions in riskier assets like equities. But without taking a myopic or short term view of the metal, the action in gold reminded us of the role gold plays as a hedge or safe harbour from geopolitical instability.

It purely was the lack of direction and organization of the United States Executive Branch that created a shift in the markets this past week. The inability of the representative of the President of the United States on foreign soil, Secretary of State John Kerry, to deliver a satisfactory press conference by conveying his President's agenda shifted the US to the passenger seat in terms of negotiations with the Russian's. It also illustrated to investors that this would become a mundane process with little influence on financial markets as the United States diplomatic ability not only lacks conviction, yet also follow through.

Now the bigger question for gold investors and also potential gold investors is: when is there going to be an appropriate entry point for this market?

It seems this market has quickly shifted past this idea of a "war premium" or increased demand stemmed from geopolitical uncertainty. Moreover, if gold's role is to act as that hedge when investors lose faith in risk assets and look

for a safe harbour, the goal would be to already holding a fraction of your portfolio in physical metal. Investors may position themselves in the metal, but ultimately those holdings would be for a long term hedge in lieu seeking a profitable short term trade. Thus, the focus of gold from short to medium term horizon (12 to 18 months) shifts back to the taper debate at the US Federal Reserve.

As the Fed begins their two day policy meeting in Washington next Tuesday, it has long been the anticipation of investors that the Fed will commence tapering asset purchases. Personally, I would like to think that this effect was priced into the market when it collapsed back in the second quarter of this year, but more bearish forecasts arise as Goldman Sachs commodity's research chief said Friday he could see the metal dipping below 1,000 US per ounce as the Fed reveals their tapering schedule. UBS AG's Wealth Management commodities research head echoed that message as an advanced taper could ultimately provide a shock to the market. But the message from the investment banks is a signal that the mainstream perspective for gold's outlook is sideways to negative. Nonetheless, this relates back to gold's ultimate role as a hedge.

A hedge is an asset that is negatively correlated or uncorrelated with another asset. An example of this is gold and the US dollar; US dollar strength is often associated with weakness in the gold market and vice versa. Stanley Druckenmiller, George Soros's point man for his infamous Quantum Fund, which brought down the British pound, appeared on Bloomberg recently. According to Druckenmiller, "QE has subsidized all asset prices, and when you end that, all prices will go down."

Gold will act as that hedge, even if it does not go up in value, it will hold its value amidst market turmoil elsewhere. It has throughout history, and it will continue to.

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Robert Levy
MA (Economics)
Director
rlevy@bordergold.com
(604) 535-3287
www.bordergold.com