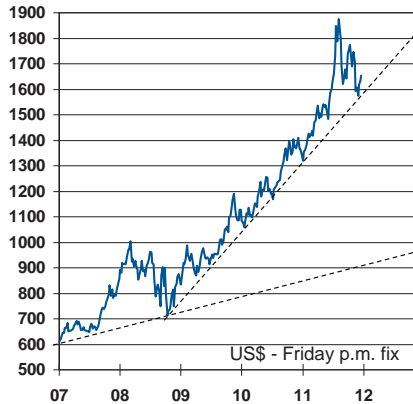


Gold Monitor

by Martin Murenbeeld

January 20, 2012

GOLD PRICE

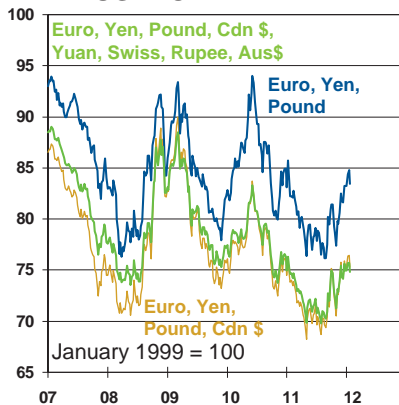


	Jan-16	Jan-17	Jan-18	Jan-19	Jan-20
Gold - 2nd Fix	1641.00	1656.00	1647.00	1655.00	1653.00
Gold - COMEX	-	1655.60	1659.90	1654.50	1658.20
Silver - HH	-	3021.00	3044.00	3055.00	3036.00
Platinum - NYME	-	1528.70	1525.30	1518.00	1525.70
Crude Oil - NYME	-	100.87	100.76	100.54	98.47
CRB Bridge - NYBOT	-	310.83	310.51	311.96	309.82
US \$ (Excluding Cdn.)	79.22	79.05	78.60	78.45	78.54
Fed Funds (Overnight)	0.13	0.10	0.09	0.12	0.09
US Bonds - CBOT	-	145.00	144.19	142.81	142.09
TSX Global Gold Index	381.03	371.65	371.87	364.01	367.13
S&P 500	-	1293.67	1308.04	1314.50	1310.21

Gold Price Average (2nd fix, daily) - 2012 to date

1632.96

US DOLLAR INDEX



TSX GOLD INDEX



Gold prices were quite flat this week, with the pm fix ranging from \$1641 to \$1656 (Monday and Tuesday). Support for gold came from the S&P downgrade of nine Eurozone economies, including France; in so far as the downgrades were well foreshadowed the impact (on all markets) was rather modest however. Even news out of Europe (the S&P also downgraded the EFSF and IMF-ECB-EU negotiations with Greece recommenced) didn't budge the gold market much. Is Euro-fatigue setting in? Or just maybe, because equity markets did better this week, investors

forgot about Europe and focused on the better economic indicators out of the US and the still impressive 8.9% growth rate for China during 2011-Q4. (China produces GDP numbers faster than the US does; makes you wonder...!?)

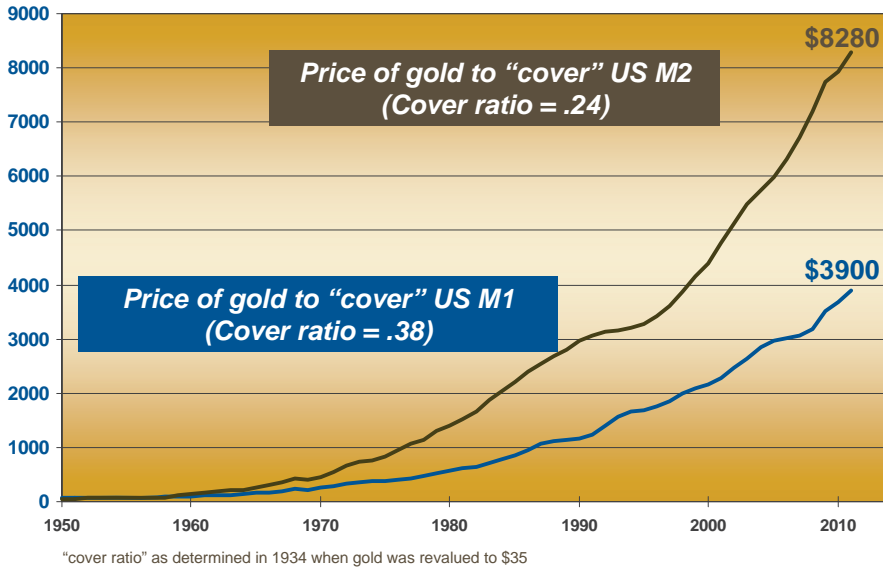
With this momentary calm in the gold market we'd like to focus on two "background" issues this week. The first is Newt Gingrich's call for the creation of a Gold Commission "to look at the whole concept of how to get back to hard money" (CNN.com, 01/18). Long-time gold observers might recall that President Reagan had

Executive Summary

1. Along with Ron Paul, Newt Gingrich wants a Gold Standard
2. But at what price would they want to fix the gold price?
3. And will mine output expand sufficiently each year?
4. Regardless, it won't happen!
5. Gold equities suffer more because of a high VIX
6. than because there are gold ETF's

Bullish: (5) Gold Not in a Bubble

To back US money supply higher prices needed

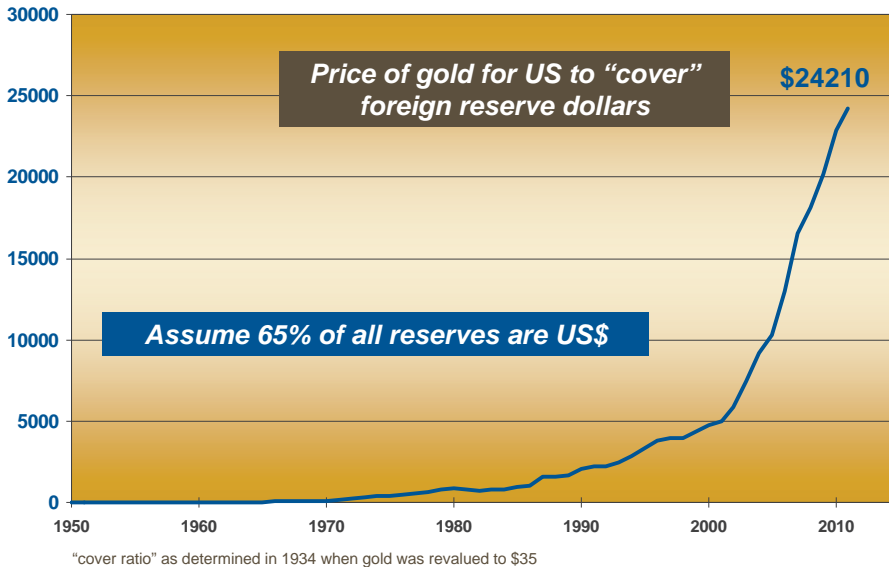


For the US to return to a gold standard, as Newt Gingrich recently called for, the Fed will have to fix the price of gold.

The two charts herewith provide some numbers: the higher the fix, the higher the rate of inflation the fix will set into motion.

Bullish: (5) Gold Not in a Bubble

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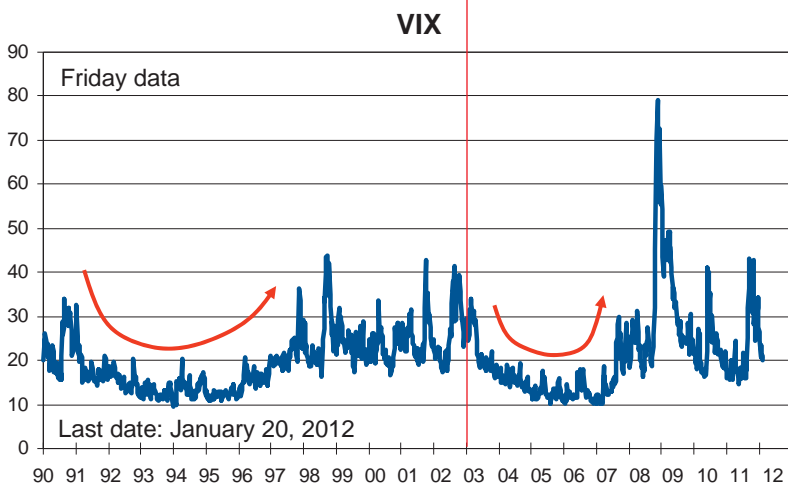
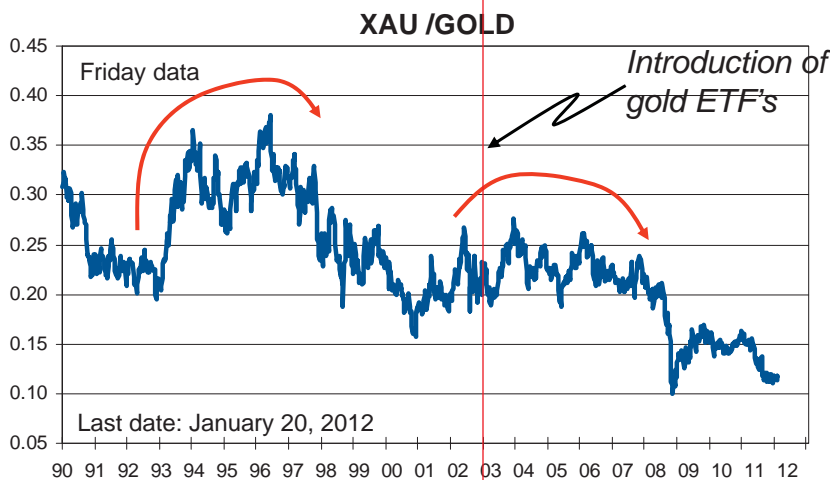
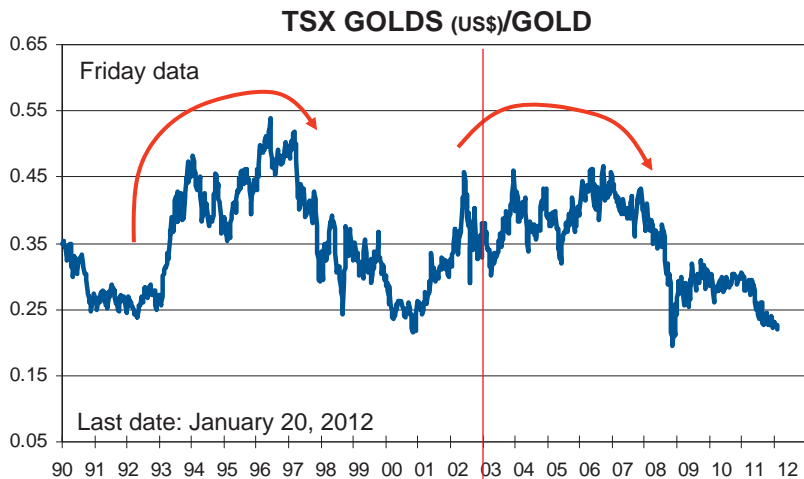
Indeed, to pick the right fix is a difficult as picking the right exchange rate for a currency like the Canadian dollar.

commissioned a similar group in 1981. What did that group conclude? A number of things actually: there are problems with fixing the gold price against the dollar – the base of the new gold standard, and there are inherent problems with new mine supply

- which determines the growth of money supply. New mine supply will determine whether the gold standard will be inflationary or deflationary; historically it was deflationary. The gold fix is critical in determining whether the system starts on an

inflationary or deflationary path.

Put it this way: suppose the US sets the price of gold at \$8280, the price that would "cover" M2 (see chart on page 2). Would then the public sell a massive tonnage of gold



Equity market volatility has a negative impact on the gold equity to gold bullion ratio. Gold ETF's have also had a negative impact, but it is not nearly as visible.

to the Federal Reserve at this price, forcing the Fed to “print” \$8280 for each ounce of gold delivered? If yes, inflation will take off. Indeed, were the US to fix the price at \$24000, the price it would take to “cover” all the reserve dollars held by foreign central banks (see chart), an orgy of inflation would follow (I would sell my coins to the Fed at \$24,000/oz!)

The plus here is that with a gold fix of \$24,000 all US banks will be made good, and all debtors will see their debts shrink to nothing! If a typical US house is worth 200 ounces of gold today, well ... with gold at \$24000 no one need worry about cheap houses and underwater mortgages! In short, if the gold fix is too high, we have a recipe for monetary printing and inflation.

This is not what Gingrich has in mind of course. He wants a monetary system in which “*you can't inflate away your difficulties*”. Assuming he can “fix” the gold price at the right price, the next problem will be whether mine supply will allow the Fed to expand money supply in tandem with GDP, which would keep US prices stable. Subpar growth in new gold supplies entering the financial system will force deflation onto the economy. To see how well that works one should study Greece ... today!

In short, Gingrich's gold commission will likely conclude what the last one did: “[it] overwhelmingly rejected the

idea". (Please contact us if you would like a copy of the 1981 commission's report! The reader might also look at the August 28, 2011 *Gold Monitor* for a fuller discussion of the gold standard.)

The second issue is the "undervaluation" of gold equities. The gold equity to gold bullion ratio has been depressed, and many observers blame gold ETF's. There is some truth to this, which we will show with models in a future *Gold Monitor*.

But a thesis that I believe has not had enough play concerns equity market volatility, the VIX. In our view a high VIX reading is indicative of equity market "stress". Equity market stress should also affect gold

equities; indeed, gold equities should sell off along with other equities during periods when equity markets are under severe stress. And if that is true, then the ratio of gold equities to gold bullion should decline during periods of severe equity market stress. The corollary is that when equity market stress subsides (when the VIX declines to a more stable, lower level) gold equities should rise relative to gold bullion.

The charts on page 3 tend to support this thesis. During the mid-1990's, and again in the early 2000's, the VIX was down around 10 - low and stable. The ratio of gold equities to gold bullion (i.e., the TSX Golds(us\$)/Gold ratio

and XAU/Gold ratio) was relatively buoyant throughout those periods.

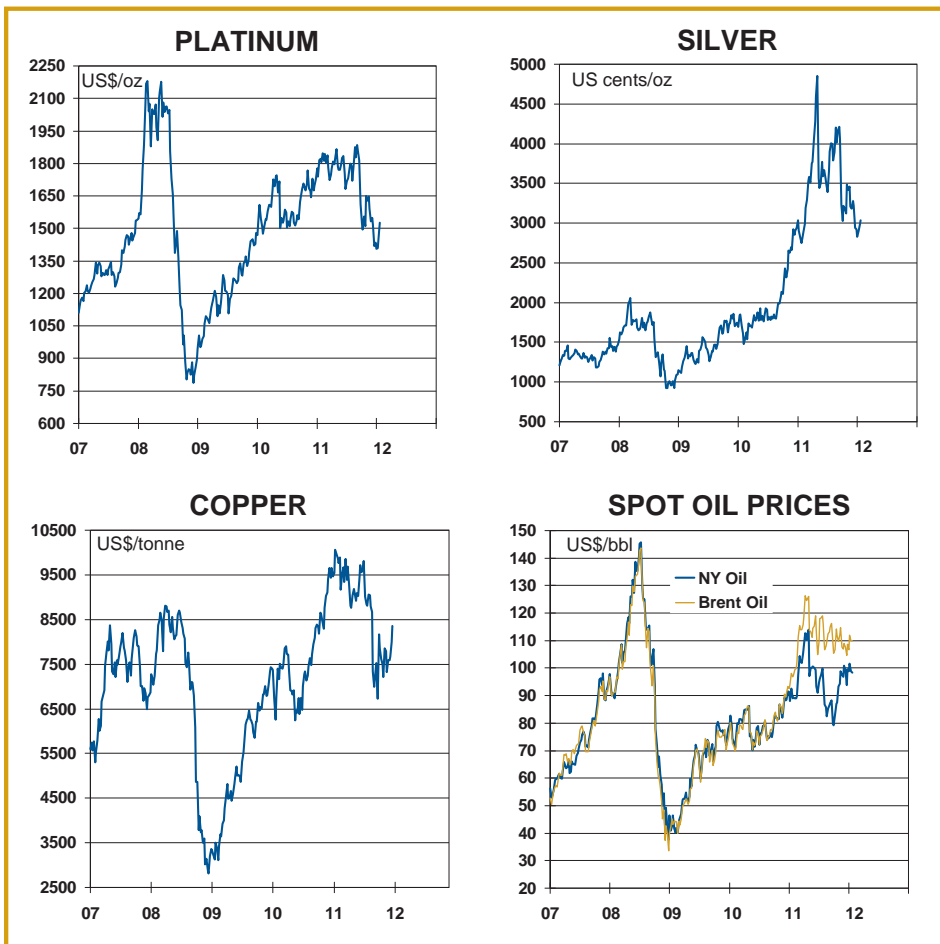
During periods of market stress however, when the VIX would periodically shoot upwards into the 30's and 40's – even into the 70's as in 2008-2009, the gold equity to gold bullion ratio was depressed. Indeed, the current period has seen the VIX shoot upwards into the 30's and 40's from time to time. Ergo, gold equities have remained depressed relative to gold bullion.

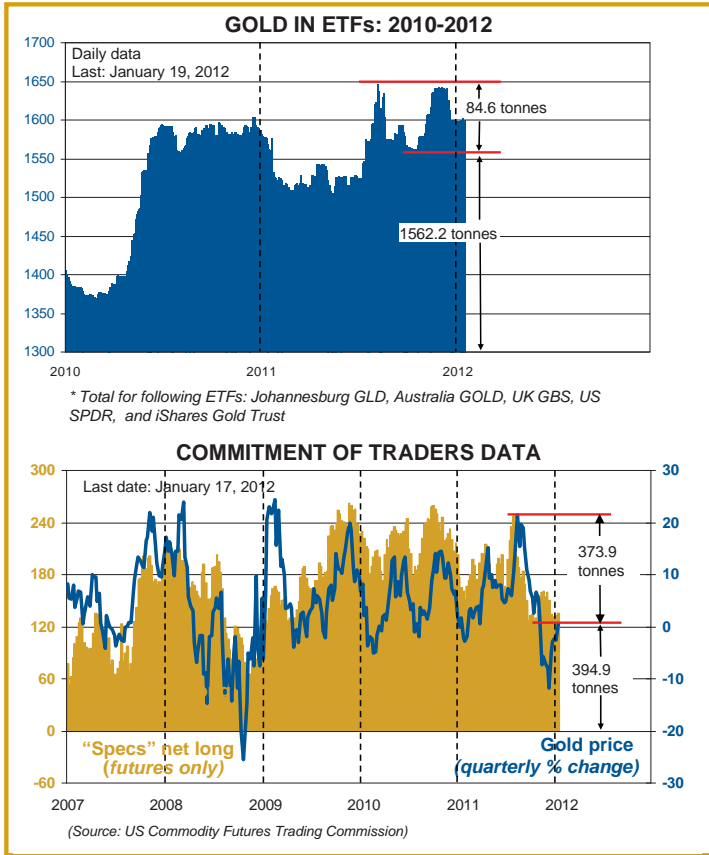
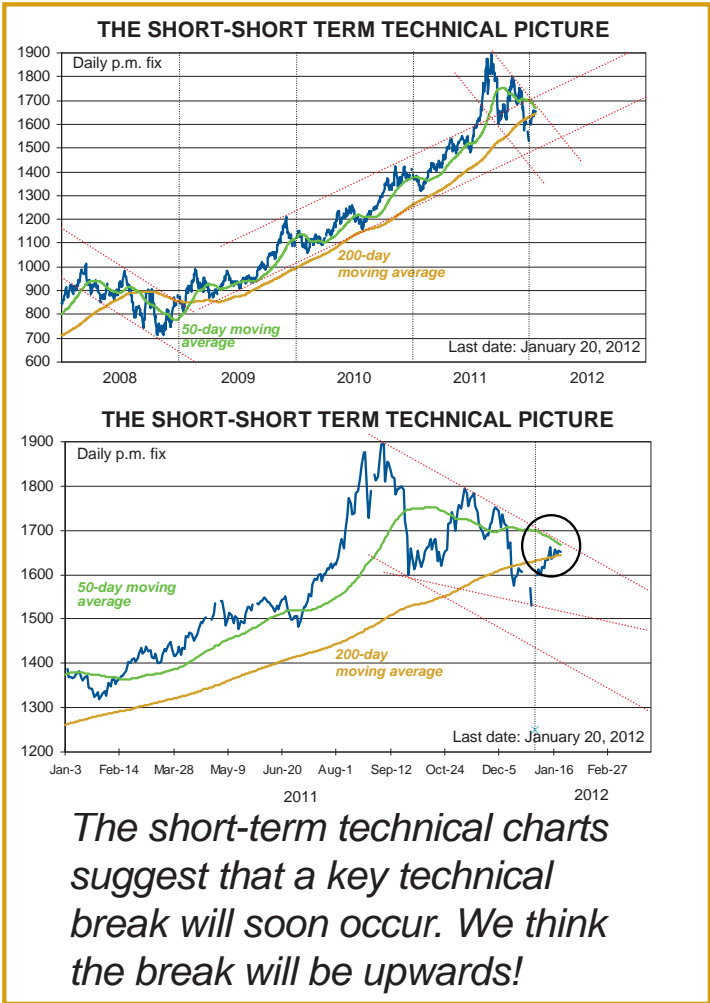
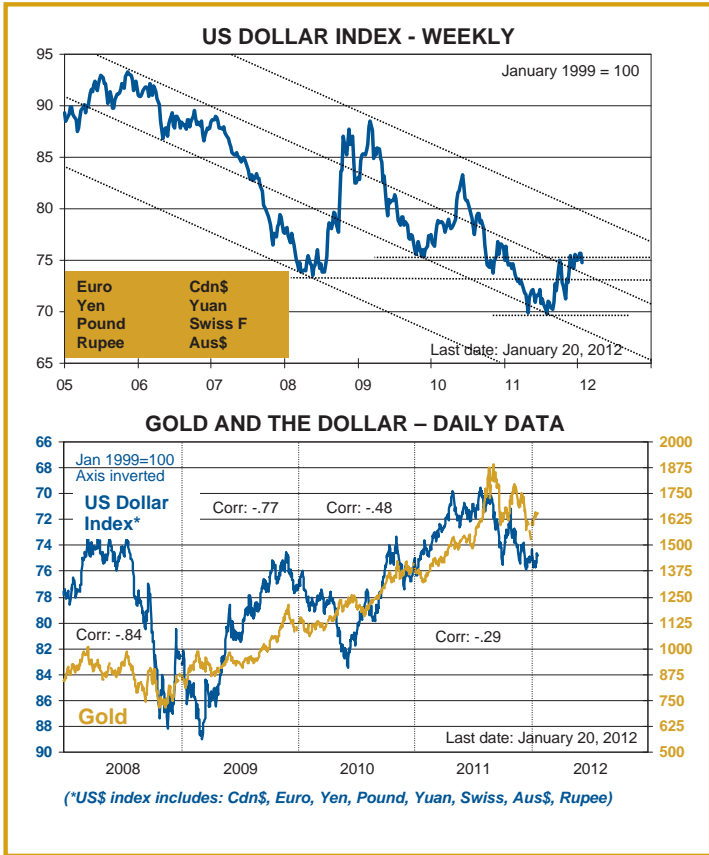
Under this thesis, in other words, gold equities need calmer equity market conditions – a lower and stable VIX – to rise against gold bullion.

The vertical line on the three charts on page 3 is placed at the time gold ETF's were introduced. The reader might note that it is difficult to see to what degree the introduction of gold ETF's have affected the gold equity to gold bullion ratios. This "visual test" points to the likelihood that the VIX may be a more important determinant of the equity/bullion ratio than ETF's per se.

We'll revisit this topic!

Gold Watch (1) Reflation is one of our key bullish factors. In that regard we simply note that there is continuing pressure on the ECB to provide liquidity to European banks, continuing pressure on the ECB to buy government debt directly, increased pressure on the IMF to raise more funds (at least \$500 billion) from its members and to employ those funds in support of European government debt,





and that there are active debates at the Fed as to when to introduce, and how to structure, QE3 in the event it is needed (and it is very likely needed were the actual level of unemployment to become a Fed target in the sense that the rate of inflation is a Fed target).

(2) Risk Ranges: Narrow \$1575-\$1775, Wide \$1525-\$1825. The risk ranges have been revised modestly upwards this week. Gold is coming up to a technical barrier, which we think will be broken in the upward direction.

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