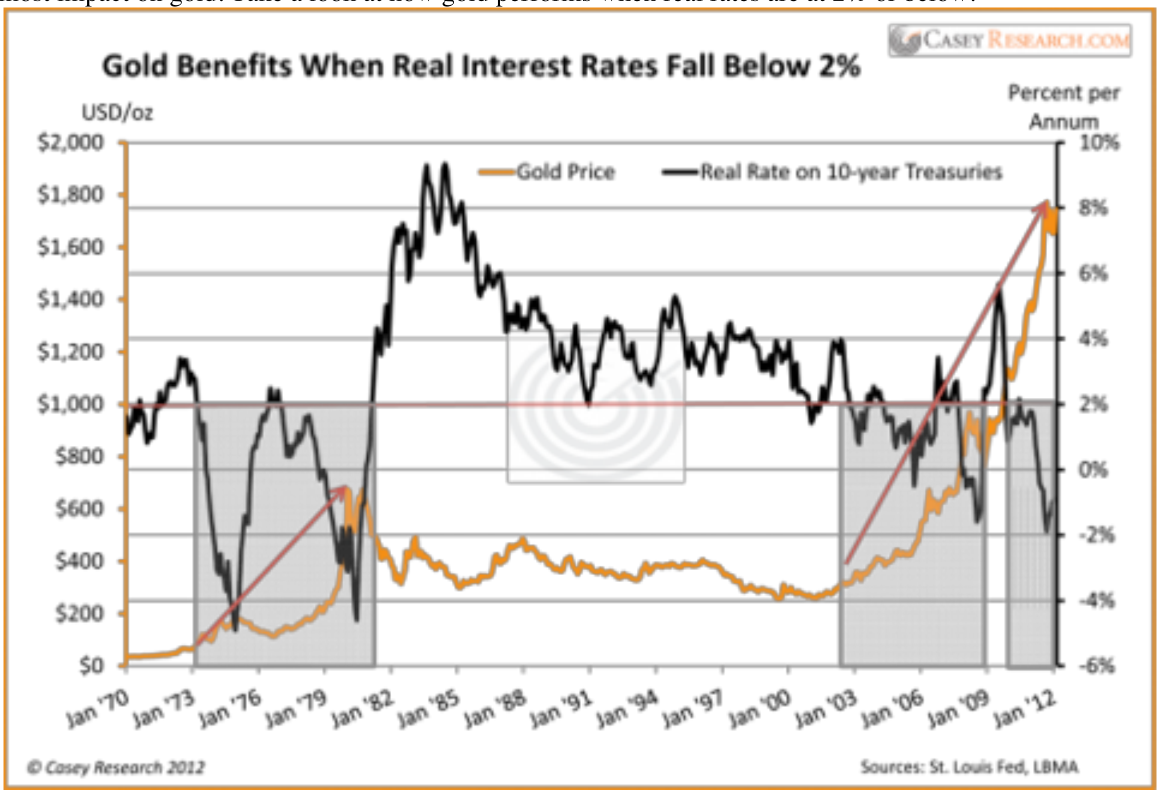
Perspective:
This weekend my husband, Jim, was cleaning out old files and came across two items that really caught my attention:
1979: Receipt for 1 year of college Tuition, Room and Board at Miami University. Total cost: $3200
1982: Copy of a Huntington National Bank CD. Term: 6months, Rate: 12.70%
By comparison, today: College bill at Miami is $22,000 (7.3X increase); 6mo CD rate: 0.25% . Has this world been turned upside down?
Gold, Inflation, & Real Interest Rates:
It would be hard to find many indices that have risen as fast and consistently as College tuition. However, Gold has been a reasonable inflation hedge, as it has risen almost 4 fold from $400 in 1981 to now $1650. There are many reasons why gold has continued to rise: inflation fears, huge expansion of sovereign debt, and legitimate concerns of deeper, systemic economic problems. At this price though, is it really worth continuing to own? YES!

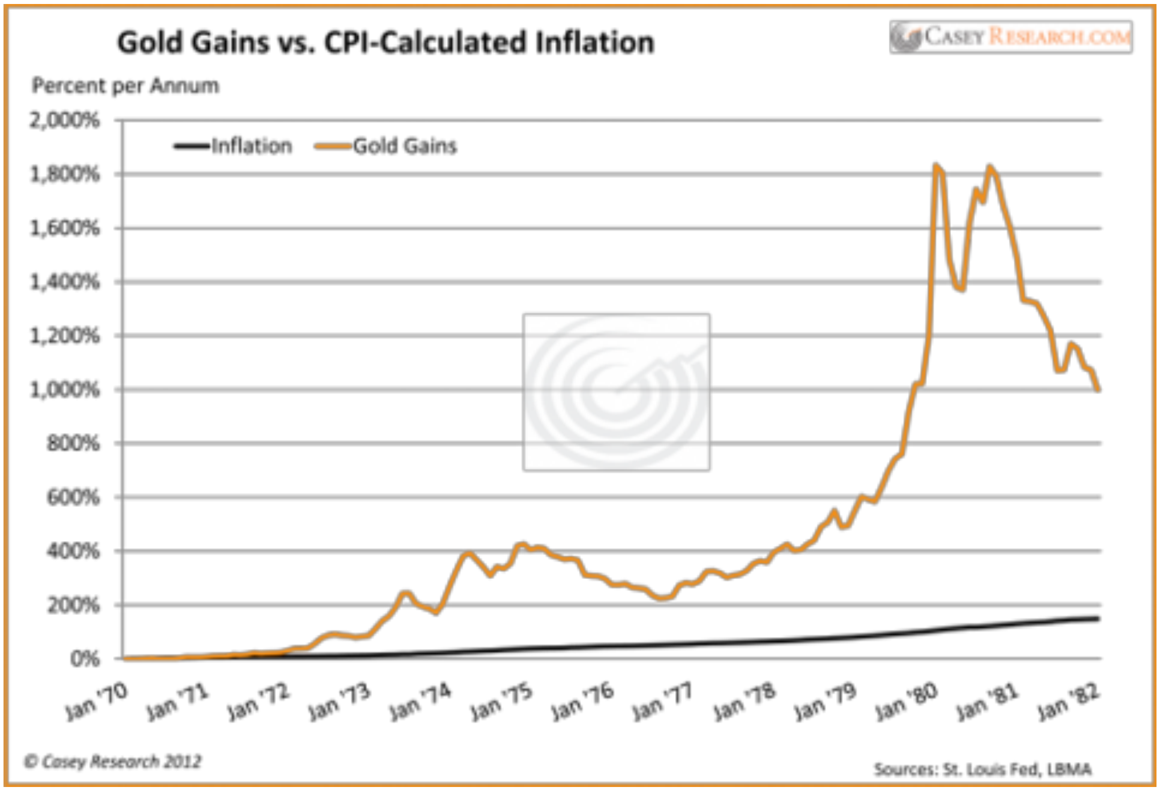
Now more than ever, Gold should have a place in every portfolio. Here's why.......

(The following experts are from "Seeking Alpha") There's one indicator that clearly signals we're still in the bull market - and further, that we can expect prices to continue to rise. That indicator is negative real interest rates. The real interest rate is simply the nominal rate minus inflation. For example, if you earn 4% on an interest-bearing investment and inflation is 2%, your real return is +2%. Conversely, if your investment earns 1% but inflation is 3%, your real rate is -2%. This calculation is the same regardless of how high either rate may be: a 15% interest rate and 13% inflation still nets you 2%. This is why high interest rates are not necessarily negative for gold; it's the *real* rate that impacts what gold will ultimately do.
What History Tells Us
The chart below calculates the real interest rate by extracting annualized inflation from the 10-year Treasury nominal rate. Gray highlighted areas are the periods when the real interest rate was below zero, and as you can see, this is when gold has performed well.
Click images to enlarge.

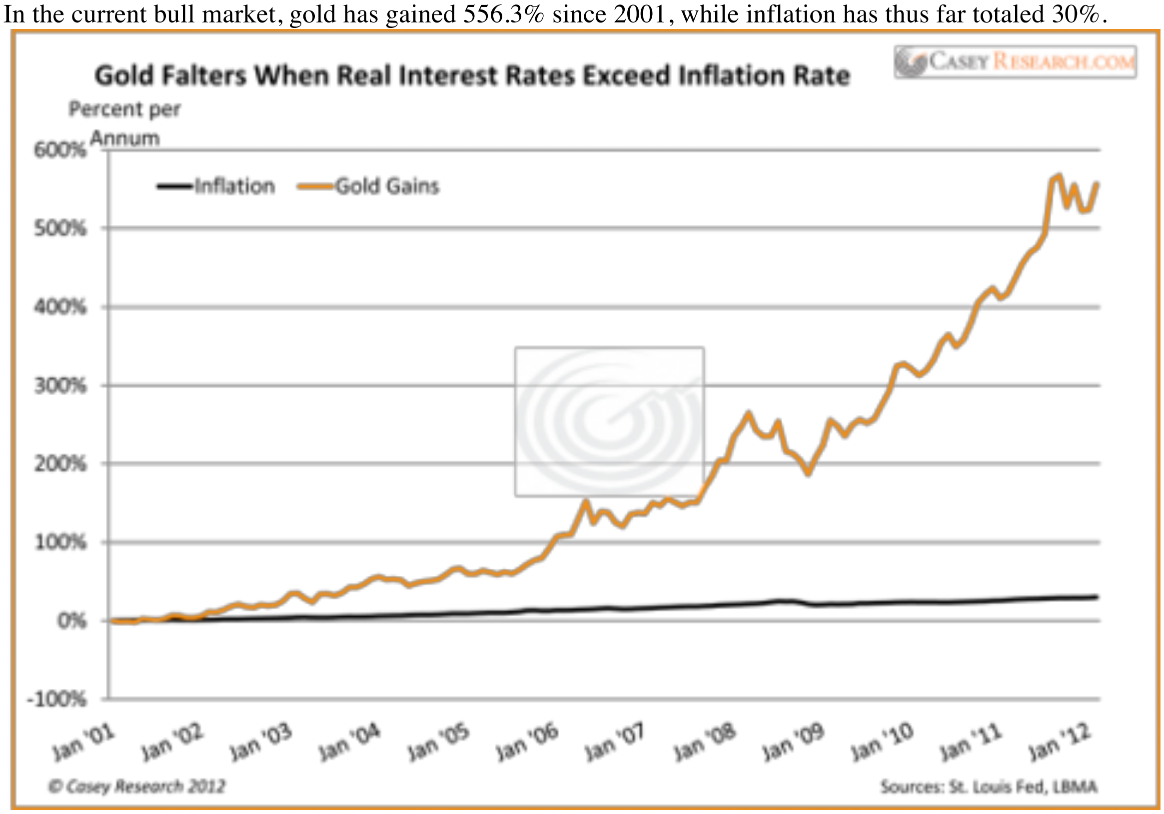
Gold climbs when real interest rates are low or falling, while high or rising real rates negatively impact it. This pattern was true in the 1970s, and it's true today.
A closer study of this chart tells us there's actually a critical number for real rates that seem to have the most impact on gold. Take a look at how gold performs when real rates are at 2% or below.



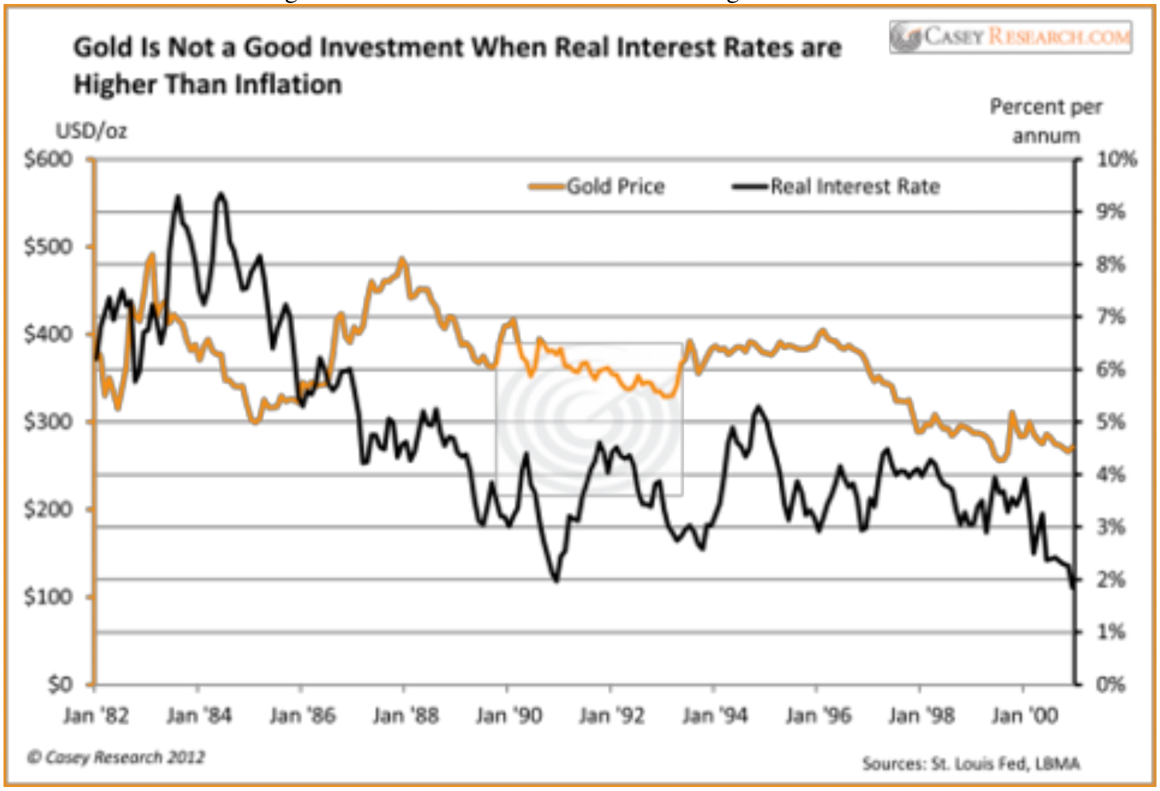
The reason for this phenomenon is straightforward. When real interest rates are at or below zero, cash or debt instruments (like bonds) cease being effective because the return is lower than inflation. In these cases, the investment is actually losing purchasing power - regardless of what the investment pays. An investor's interest thus shifts to assets that offer returns above inflation… or at least a vehicle where money doesn't lose value. Gold is one of the most reliable and proven tools in this scenario.
Politicians in the US, EU, and a range of other countries are keeping interest rates low, which, in spite of a low CPI, pushes real rates below zero. This makes cash and Treasuries guaranteed losers right now. Not only are investors maintaining purchasing power with gold, they're outpacing most interest-bearing investments due to the rising price of the metal.
Here's another way to verify this trend. As the following chart shows, from January 1970 through January 1980 gold returned a total of 1,832.6%. This is much higher than inflation during that decade, which totaled 105.8%.



In the current bull market, gold has gained 556.3% since 2001, while inflation has thus far totaled 30%.



Further supporting this thesis is the fact that <u>when real rates are positive, gold has not performed well</u>. You can see this in the following chart of when real interest rates were higher than inflation.



How Much Longer Will Negative Real Rates Last?

US Federal Reserve Chairman Ben Bernanke stated in January that he expects to keep short-term interest rates close to zero "at least through late 2014." This low-rate, loose-money policy is intended to "support a stronger economic recovery and reduce unemployment." <u>While his strategy is debatable, this implies that almost any inflation at all will continue to keep the real rate negative and thus gold will stay in a bull market.</u>

What if the economy improves? After all, there are economic data showing the economy may be finding its footing, making some believe interest rates could be raised earlier, as soon as next year. Based on the data above, the answer to the question is, "What does inflation do?" In other words, interest-rate fluctuations alone aren't important; it's how the rate interacts with the inflation rate. If inflation simultaneously rises and keeps the real rate negative, we should expect gold to remain in a bull market.

With the obscene amount of money that's already been printed, high inflation seems almost certain at some point, *even if there isn't any more money creation*. This is why the end to the gold bull market is not yet in sight.

One more point. You'll notice in the above charts that this trend doesn't reverse on a dime. It takes anywhere from months to years for investors to shift from interest-bearing investments to metals - and vice versa. And the longer the trend, the slower the change. Real rates have been negative for a decade now, and with broad institutional investment in gold largely absent, it seems reasonable to expect that the trend in gold won't shift anytime soon.

There are a lot of reasons to own gold today, and there will likely be more before it's time to say goodbye. In the meantime, keep watch on the strongest historical indicator of all tells us the gold bull market is alive and well.

Please contact me with any questions or concerns.

Have a great week!

Kind Regards,
Barbara