Tocqueville Asset Management L.P.

A Contrarian's Dilemma

December 2009

Is gold a "bubble" because it has now become popular or is there still worthwhile upside? As a contrarian, it is more difficult to reconcile the metal's recent popularity with the prospect of future rewards. Is the investment consensus always wrong, or can it be right for extended periods? Does the perceived flood of new investment mean the jig is up?

The ability to remember is sometimes the contrarian's worst enemy. Recall that Tocqueville launched its gold effort in 1998 when the metal was friendless. Central banks were dumping the metal in favor of dollar-denominated assets. In a moment of charity to contrarian investors, the UK dumped most of its bullion reserves at prices below $300/ounce in 1999. Mining companies furiously and confidently hedged their future gold production at unheard of (and unexpected) prices well above $300/ounce. The *Financial Times* published the obituary December 13, 1997: "The Death of Gold" (see Appendix). The Dow Jones Industrial Average was valued at more than 40x an ounce of gold. Credit spreads, a proxy for risk tolerance, were the skinniest in 30 years. Risk—in those heady days, investors couldn't get enough of it. Rodney Dangerfield got more respect than the metal.

In our May, 2009 website article: "A Surplus of Gullibility", we concluded that "the bull market in gold is still young, but that it has(d) crossed an important threshold. No longer laughable and obscure, broader awareness and interest among a wider circle paves the way for capital inflows to come." After backing and filling for most of the summer, the gold price broke through the $1000 ceiling which had held it in check for two years, and to the surprise of many, it has held this ground, even managing further gains.

The effect of four digit gold has been magical on investment psychology. Day after day, the financial media publishes glowing reports on the metal's prospects while never failing to trash the beleaguered U.S. greenback. Hardly a day passes when I do not receive another meticulously researched, solemn tome on the merits of gold written by a market strategist or hedge fund manager. My office has stacks of them, all basically saying the same thing: paper currencies are bad so buy gold. In the parlance of the contrarian, gold is no longer a "thin file" investment idea.

Barrick Gold, once the preeminent hedger of future output, has finally discovered the attractions of gold. In a November 2009 speech, newly installed Barrick CEO Aaron Regent declared that industry production had peaked at the turn of the century and has begun a secular decline. Having discovered a fragment of the bullish case for gold late in the game, the company put its shareholders' money where its management's mouth is by raising $6 billion of new money from investors to neutralize its hedge book. In so doing, the company wrote the final chapter on the most disastrous attempt at financial engineering in the history of the gold mining industry. In perfecting the art of selling low and buying high, Barrick and other gold mining hedgers destroyed billions of dollars of their shareholders' capital.

Not to be outdone, the central bank of India surprised the market when it bought 200 metric tonnes of IMF gold. In so doing, it shattered the long held investment assumption that official sector selling would supply the market forever. A surfeit of low yielding dollars presents a problem for these institutions. India's gold at market now accounts for a less than whopping 7.3%. China is 1.8%, Japan 2.8%, and Brazil 0.6% of total reserves. Still, these countries need to keep their currencies cheap in order to maintain viability for their export markets. In so doing, they accumulate ever greater quantities of dollars. Further buying by central bank institutions underweighted in gold seems like a good bet.

For good measure, we believe that the U.S. Federal Reserve, watch dog of the dollar's purchasing power, no longer seems displeased to see a rise in the metal's price. Their game is reflation and they are not terribly choosy about which assets become overvalued as a result. They are happy to inflate any and all asset classes that would serve as collateral for a renewed binge of bank lending.

The Dow Jones Industrial Average stands at 9.2x an ounce of gold, down from over 40x ten years ago. Credit spreads widened to record levels in the great credit meltdown of 2008. They have since subsided, thanks to gushers of free government money to finance risky assets, but remain high. Risk avoidance has entered the investor lexicon.

In short, the world's perception of gold has changed and the pace of the bull market has quickened. In our "Tocqueville Gold 2005 Year-End Review and Outlook" letter, dated January 26, 2006, we observed that bull markets can be measured in four stages: the beginning, the end of the beginning, the beginning of the end, and the end. At that time, we remarked that the bull market had ended its first phase and entered into a second that would be marked by "noisy and dynamic behavior" that would attract new money flows. Gold was then trading around $550/ounce and we suggested that it would be more correctly priced at $1000. That was before the near death financial market experience of 2008. We believe that the crossing of $1000 marks the end of the second phase and that we have entered the third stage, or the beginning of the end. The first two stages took a full ten years. The latter two stages will take years but we doubt a full decade.

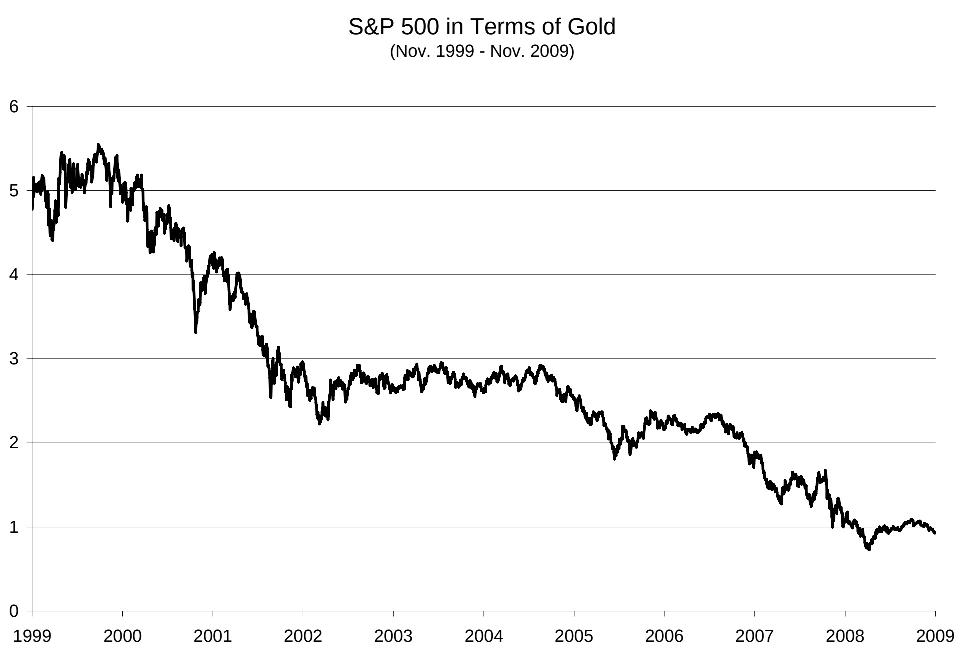
In our web site article, "The Investment Case for Gold," dated January 22, 2002, we suggested that an eventual gold price of four digits would not come as a surprise to us, at a time when the metal was trading below $300/ounce. As outlandish as that forecast seemed then, we did not envision how significantly a credit meltdown of the 2008 magnitude would reset the equation between gold and paper money. Gold seems as undervalued at around $1200 as it did in 2001 at less than $300. The outlook for the dollar and the paper currency system pegged to the dollar has undergone drastic change.

Gold is a bubble only for those who maintain faith in the ability of politicians and financial authorities to swim against the tide of deflation. For the rest of us, it is protection against monetary damage still to come. The bull market in gold still has much going for it, even if it is no longer a contrarian's dream. It may be overbought, as bull markets often become, but we believe it is too soon to jump ship for the next great contrarian idea. The implications of gold's continuing strength remain a mystery, even to most of those who have jumped aboard the bandwagon.

Once fragile, the bull market in the metal has evolved and strengthened. In our view, there are three factors to account for this: cultural lag, impeccable fundamentals, and the persistence of misunderstanding.

Cultural lag far outranks rational analysis in explaining valuation of asset classes. Once popular mythology and the public mood become deep seated, they acquire generational roots that become the "default" mode to set the context and assumptions of analysis. Investment behavior is slow to reflect fundamental change that contradicts embedded beliefs. Generational shifts in outlook and mood cause markets to overshoot within a secular, not cyclical, framework. Cultural lag is the key to understanding why gold, ridiculously undervalued for an extended period, could be on its way to becoming an investment bubble, perhaps several years from now. In our view, public expectations are about to pivot in a way that will ultimately take gold to valuations that cannot be explained by dispassionate and reasoned discourse.

The expectation that investment returns are generally positive has been perhaps fatally damaged for the current generation of investors. Nominal investment returns over the past decade have been puny, and mostly negative. If measured in terms of gold (see chart below) they have been downright disastrous. The repetition of disappointing investment experience is taking hold of expectations. Cynicism is displacing optimism and trust. We do not foresee the bear market in financial assets ending until public expectations are saturated in apathy.



Source: Bloomberg

The idea that paper currency is a poor store of value is just beginning to build up a head of steam among top investment thinkers and has not filtered down into public behavior. Faith in the government's competence to achieve desired outcomes is badly frayed. In its periodic messages to the world of finance, the Fed's open market committee cites inflationary expectations as one of the guideposts for adopting a "tougher" stance on monetary policy. Just how do they determine the precise moment when inflationary expectations become problematic? The economy and its millions of participants are not a lab experiment in which conditions are subject to precise measurement and regulation. Count us as skeptics on their ability to get it right. The Fed's historical tendency has been to overdo easy money. In an "anything goes" policy climate, and going into an election year, we see even less reason to expect anything more than token changes. Should public psychology change, we anticipate that inflation will become impossible to control.

Gold was undervalued in 1999 when it traded in the mid $250's. It was trading below the variable cost of production and well below the level necessary to replace reserves and production infrastructure. The metal stayed undervalued for seven years (1996-2003). At the same time, financial assets were extremely overvalued for an extended period, even if this was apparent to most only in retrospect. Conditions of extreme undervaluation or overvaluation result from the entrenchment of the supportive investment psychology. When these conditions apply, you can throw rational analysis out the window.

The preconditions for a tectonic shift in the investment climate of opinion are just beginning to coalesce. Irrational exuberance lies ahead for gold. It will be a replay of the "nifty fifty" of the 1970's, when sages warned that there would be a "shortage of stocks". The 1980 peak of $860/ounce, set against *BusinessWeek's* August 13, 1979 "Death of Equities" cover and Lee Cooperman's quip that bonds were "certificates of confiscation" will seem quaint. The heights of internet, housing, leverage, hedge funds, and all other financial excesses will pale in comparison to what lies ahead for the U.S. dollar, all currencies tied to it, and how the end game becomes reflected in the price of gold. Warnings of a bubble in gold are coming from the same quarters that failed to spot the aforementioned. We welcome the skepticism.

Impeccable fundamentals. Those fundamentals have generally been in place for decades. They are timeless and simple to grasp. The quantity of above ground gold rarely advances at more than a snail's pace. The credit collapse of 2008 set the stage for a broad reassessment of fiat currencies and accelerated doubts as to the competence of governments to produce desired economic outcomes. If 2008 proved anything, it was that whenever in doubt, governments of all stripes and politicians on both sides of the aisle will clamor to print money. The dynamic is simple. When financial market or general economic conditions become politically uncomfortable, the urge to cheapen the currency is irresistible.

The attraction of gold becomes obvious when the deficiencies of alternatives become inescapable. National currencies are political tools, first and foremost. When political agendas become confined to the preservation of an untenable status quo, the integrity of currency is imperiled. It costs nothing to print more dollars. The estimated cost to produce an additional ounce of gold is $800-$900. Gold is scarce. That is why it is called a "precious" metal. Even though the metal's role as an official monetary asset has long since been written out of the script, its attractions as an alternative currency have been highlighted by the post 2008 flood of paper currencies and the prospects for more of the same.

What constitutes money is not decreed by government, but rather by the market. The market prefers a monetary asset that is difficult to obtain, and more likely to retain its value by virtue of its scarcity relative to the alternatives. As my friend Tony Deden recently remarked: "If cheaper money is the source of wealth, where has Bangladesh gone wrong? If cheaper money means economic prosperity, why not print as much as we can and hand it out to everyone?" (speech before Zurich Gold Conference-11/17/09) If, on the other hand, such a thing as a credible paper currency were to exist, gold's attractions would go unnoticed.

The supply of gold increases at a far slower rate than that of paper money. Each year, the gold mining industry produces around 2500 metric tonnes of the metal. This quantity adds a puny 1% or 2% to the above ground supply of 163,000 or so metric tonnes. There is little to suggest that this grudging pace is likely to change in the foreseeable future. Unlike economically sensitive commodities, to which it is frequently and incorrectly linked, gold does not get used up. Therefore, traditional supply and demand analysis does little to explain price movement. It is better to think of gold as a multi trillion dollar capital market asset. In theory, all of it (at least that which is held as investment or quasi investment) is potentially for sale at any given time. Price behavior is best explained by macroeconomic considerations and the greater investment climate rather than micro economic considerations such as mine expansions or jewelry consumption. To speak of a rising gold price is technically incorrect. What appears to be a rising metal price is an illusion that signifies the declining value of paper currency and, more important, the wealth that it measures. Gold per se does not excite the investment world. It has not suddenly changed its stripes. What has changed is the world around it. What has come into view is the seemingly real prospect for the dollar and other paper currency to lose future value.

The launch of the gold exchange traded fund (GLD) five years ago was the single most important development in the gold market since Nixon closed the gold window in 1971. Gold ETFs have created an easy, uncomplicated way for investors to hold the metal. By virtue of making gold user friendly, the ETF has connected the metal to the financial markets in a way that was never possible in the past. The global market cap for all gold ETFs is $67 billion. The growth of gold ETFs has had a direct and positive impact on the gold price. We believe the market cap for gold ETFs could multiply by as much as ten fold, if fiscal and monetary policies of Western democracies continue on their current path. It is possible to estimate the penetration of GLD within various investor classifications. We understand, for example, that pension fund holdings of GLD are de minimus. Much of the exposure is to be found in family offices or brokerage accounts. For example, I recently learned that GLD was the 14th largest holding across the board at a major brokerage firm. While this may sound like a large number, the percentage it represented of total assets was a little more than 1%. Even where GLD has achieved its greatest penetration, the exposure is still small. The gold price has broken out to all time highs while gold ETFs are still relatively new. As they become more widely accepted and investors become more comfortable with the idea of gold exposure, capital flows into metal will multiply and the price impact should astonish even the most jaded investment pros.

Gold and its significance are misunderstood. The sudden popularity of the metal does not mean that the reasons for its uptrend are well understood. For many, if not most, it is enough that gold is in the midst of a powerful uptrend. It has suddenly attracted hot money, momentum players, and late comers looking for quick profits. We expect these investors will flee at the first sign of disappointment. Their presence makes the metal's uptrend more prone than ever to shakeouts that will dampen enthusiasm. Corrections are inevitable and could be as frightening as the mid 2008 decline from $1000 to $700. However, the bull market has evolved from early stages marked by apathy and disinterest, where few understood that a bull market was underway. In its current, more dynamic phase, market pullbacks will be regarded as buying opportunities from different quarters, including central banks and other investors that have insufficient exposure. As long as world governments remain locked into the mode of flagrant currency debasement, we are quite comfortable in asserting that gold is under-owned and will be met with buying interest on pullbacks. We regard popular misconceptions as potentially useful aids to separate and whipsaw the superficial from their positions, create future buying opportunities and prolong the uptrend.

What are some of the more important gold myths and half truths?

Gold is an inflation hedge. Historically, gold has held its value while paper currency has depreciated. But, what if inflation remains dormant? If the Fed and other central banks are unable to restart the broken down credit cycle, inflation in the CPI sense will remain subdued.

Gold is a weak dollar hedge. What if the dollar stages a big rally? Nearly everyone is against the greenback. Daily obituaries are posted by the financial media and trading sentiment is 100% negative. Is there a better paper currency alternative? A dollar rally will be a real test for gold.

Gold is a subset of a hard asset/ tangible asset strategy. This is an idea that won't go away. Even though gold rose in 2008 while economically sensitive commodities collapsed, investors cling to the notion that a "hard asset" strategy offers protection against currency debasement. Many investors, especially institutions, regard a gold investment strategy as too narrow and too far out on the fringe. It is far easier for mainstream investors to buy into the idea of never ending growth in the world's emerging economies than irreversible monetary rot.

Gold is just too negative. It is a doomsday strategy predicated on a collapse of the economic system. It is a challenge to cast gold in a sunny light, but what is rational investing without a dose of skepticism? Besides, doomsday concerns do not originate with gold. They are sourced in the legitimate observations of analytical thought. When these concerns become overblown, gold becomes overvalued.

Gold is an efficient diversifier. This is a generally accurate observation over long periods of time, but not necessarily so in the short run. Put another way, when financial assets are generating real positive returns, there is little need to include gold. The investment rationale for gold is not its effect as a diversifier, but as a strategy to generate positive returns when financial assets are not doing so.

Gold is just another commodity and has no productive economic value. This common dismissal of gold reflects a superficial understanding of the essence of money. Without stable and reliable currency, economic calculation becomes difficult, and credit becomes problematic.

Governments hate gold. They only want a low price and will attack the price if it is too high. This is a historical truism, but times have changed. In the aftermath of the 2008 market collapse, the Fed is attempting to reflate credit. A strong gold price signifies that intent. One only need recall the actions of the Franklin Roosevelt administration, a playbook that Bernanke subscribes to. Raising the price of gold in the 1930's was the tool to devalue the dollar, thereby boosting collateral values to revive bank lending.

In our opinion, the investment rationale for gold, in today's circumstances, is deflation. The post World War II economic model of economic growth based on secular credit expansion is broken. We believe the applicable model is a 1930's style credit deflation. Asset prices are pressured by deleveraging. Uncertainty as to collateral values restricts credit despite available liquidity. The contraction of credit hurts economic activity, causing incomes to fall and asset values to fall further. A negative shift in expectations rapidly overtakes behavior. There is little government policy can do about this other than to devalue currency to lessen debt burdens. The Fed understands this and is acting accordingly. Keynesian stimulus packages at best mean that government spending replaces lost private sector activity to stabilize the economy. This is pretty much where things stand at the moment. It remains to be seen whether massive stimulus can offset the headwinds of a negative credit cycle. Since there is no way to know how these wild experiments in monetary and fiscal stimulus will turn out, investors are gravitating to gold, knowing that the integrity of the currency is the last thing on the minds of policy makers. Gold is a wager that these measures will not restore economic health over the longer term and that further currency debasement will be deemed necessary.

The applicable condition of the world economy is deflation, which, in turn, is rooted in the intellectual bankruptcy of policy making:

> …interventionists ascribe to the government the power to correct the operation of the market economy in such a way as to bring about 'economic stability.' These interventionists would be right if their antidepression plans were to aim at radical abandonment of credit expansion policies. However, they reject this idea in advance. What they want is to expand credit more and more and to prevent depressions by the adoption of special contracyclical measures. (*Human Action: A Treatise on Economics*, von Mises, p. 798)

Zero interest rates are designed to encourage a new carry trade. Free money is intended to inflate asset values in hopes of restarting the credit cycle. In other words, our "leaders" in Washington will solve the problem of too much debt with more debt. Decades of credit excesses have brought us to the brink of a credit collapse. Unfortunately, there is little to suggest introspection. Most expect and assume that government intervention will continue to work miracles. Things should get really interesting for gold when government actions are seen to be impotent.

In a presentation before the Fall 2009 *Grant's* Conference, ("What If It's Austrian---Again?") former budget director David Stockman said:

> The bet, then, is that Federal revenues will stall---as the liquidation of debt and malinvestment proceeds apace. This revenue drought, in turn, means a $2 trillion annual deficit as far as the eye can see. It might be fairly wondered whether Mr. Market's patience with the dollar and the Treasury's paper is likely to stretch nearly so far.

As long as deflationary forces prevail, world governments will remain addicted to currency debasement. If currencies are successfully debased through inflation, gold will retain its value. The middle ground between deflation and inflation exists only in the imagination of policy makers and analysts who still believe governments can create wealth..

Gold is a hedge against a world monetary order on its death bed. The events of 2008 gave a preview of a world without credit. When the dollar based paper money regime has gasped its last, what will replace it? Will gold assume an official role? It is impossible to say. Currencies of the future could quite possibly bifurcate, with some taking the form of scrip such as food stamps, medical vouchers, or air miles used strictly for transactional purposes. An optimist would hope that gold could perhaps coexist with government scrip as a vehicle for saving and wealth preservation. However, that remains to be seen. Anything less would imply a world less Austrian and more Orwellian.

For the contrarian, life has become more difficult even as it has become more gratifying. The commotion surrounding gold makes the contrarian strand of thought harder to detect. It is not that we don't welcome the "Johnny come latelys" to the hard money cause. They are, for the most part, elite investment thinkers who have a history of sound decision making. However, we no longer enjoy the luxury of peace and quiet or as much time to reflect. Our periodic sanity checks, based on the makeup of the opposition, are somewhat less frequent and perhaps not as reliable. Still, we perceive that gold continues to be under owned and misunderstood by most. While it is no longer enough to observe that the metal is of interest based on universal apathy, it is safe to say that it has a long way to go before it becomes mainstream.

John Hathaway
Portfolio Manager and Senior Managing Director
© Tocqueville Asset Management L.P.
November 30, 2009

This article reflects the views of the author as of the date or dates cited and may change at any time. The information should not be construed as investment advice. No representation is made concerning the accuracy of cited data, nor is there any guarantee that any projection, forecast or opinion will be realized.

References to stocks, securities or investments should not be considered recommendations to buy or sell. Past performance is not a guide to future performance. Securities that are referenced may be held in portfolios managed by Tocqueville or by principals, employees and associates of Tocqueville, and such references should not be deemed as an understanding of any future *position, buying or selling, that may be taken by Tocqueville. We will periodically reprint charts or quote extensively from articles published by other sources. When we do, we will provide appropriate source information, including hyperlinks to websites we borrowed from. The quotes and material that we reproduce are selected because, in our view, they provide an interesting, provocative or enlightening perspective on current events. Their reproduction in no way implies that we endorse any part of the material or investment recommendations published on those sites.*

Appendix

FINANCIAL TIMES

Death of Gold

13 December 1997
Kenneth Gooding

Gold has always been more than a precious metal - men have even lost their lives for it. But no longer. Gold has fallen from favour and is now a mere metal and a bad investment. Kenneth Gooding explains why most of the glister has disappeared.

Gold, frankincense and myrrh. The three wise men deemed these gifts suitable for the King of Kings two millenniums ago. It says something about gold's staying power that today it is still a suitable gift for a sovereign, though a more thoughtful wise man may swap the precious metal for US Treasury bonds.

Mankind's fascination with gold goes back much further than 2,000 years. For primitive man, the attraction was aesthetic. Gold glinted at him from streams and river beds. He found it so malleable that, even cold, it could be hammered into crude ornaments and artefacts. Beauty and scarcity gave gold mystical appeal, and it became the stuff of temples, icons, idols, and offerings to the gods.

Ancient Egypt and Rome drew much power from gold, mined by slaves in conditions of unbelievable misery. "There is absolutely no consideration nor relaxation for sick or maimed, for aged man or weak woman," wrote the historian Diodorus in the 2nd century BC.

Similar conditions existed in Siberian gold mines up to the 1960s and miners still descend the deep shafts of South Africa knowing that, even if they obey the safety rules, there is no guarantee they will come out alive.

For the rich, and for the poor who sought it, gold was a tangible, long-term store of wealth, acceptable anywhere, a safe haven at times of disaster.

But gold is not what it once was. The image has been tarnished - apart from a couple of blips, its price has been drifting downwards for more than a decade. This week the price was the lowest for 18 years.

The 1987 stock market crash, the Gulf war and a meltdown of Asia's financial markets did not cause the expected rush for gold.

So, has gold had its day, at least as an investment? Has the glister gone? Is it only the sentimental and the gold obsessed, the bugs, who still seek it out and, as Virgil put it, have the "cursed craving for gold"?

Ted Arnold has no craving. He is a gold bear and metals specialist at the Merrill Lynch financial services group: "The reality is that gold is now a commodity just like any other. Many gold miners still think gold is something special or magical and not subject to the usual laws of supply and demand like copper or zinc or nickel. But it is."

But will everyone everywhere eventually stop viewing gold as an investment? Is the end of the affair an inevitable outcome of modernisation, when money transfers are automatic and unseen, and there is talk that cash itself will disappear? When it became clear that people needed a medium of exchange, gold was the medium of choice. Croesus, King of Lydia, is credited with ordering the first gold coins to be struck in 550 BC.

Gold's great appeal was its indestructability. It does not tarnish like silver and is generally not corroded by acid. Gold coins have been recovered from sunken treasure ships looking as bright as new. And the metal still has its modern moments. There was a rush to gold savings accounts in Japan after television newcasts of the 1995 Kobe earthquake showed an old woman tearing at the rubble of her house and triumphantly pulling out an unscathed, glittering gold bar.

There are estimates, not uncontested, that until 1850 only 10,000 tonnes of gold had ever been mined. The 1848-49 Californian gold rush changed all that, followed by the discovery of huge gold fields in South Africa in the 1890s. There was another belated rush in 1980 after the price jumped to $850 - almost three times its present price.

Miners have been using new techniques and modern technology to locate and remove the gold. Last year, a record 2,350 tonnes were dug from the world's mines, or 75.56m ounces.

A turning point occurred when gold became a standard measure of wealth, personal and national. Formal "gold standards" were introduced by trading nations after the Californian rush ensured there was enough metal available. Britain's began in 1816 and the rest of Europe followed in the 1870s. The US did not finally divorce itself from a silver-gold standard until 1900, about the same time as India.

The gold standard was meant to discipline an economy. The price was fixed and the currency was redeemable in gold. The UK gave up this system in 1919 but it persisted in the US until 1933.

Between the 1930s and 1972 there was an "international gold exchange standard" which involved central banks supplementing their gold reserves with certain key currencies that, in theory, could be redeemed for gold.

All this led to central banks building substantial stocks of gold and caused one Yale professor, Robert Triffin, famously to remark: "Nobody could ever have conceived of a more absurd waste of human resources than to dig gold in distant corners of the earth for the sole purpose of transporting it and reburying it immediately afterwards in other deep holes, especially excavated to receive it and heavily guarded to protect it."

Today, most gold goes to make jewellery rather than into central bank vaults. According to the Gold Fields Mineral Services consultancy, 2,807 tonnes of gold was used by jewellery makers last year.

Unreconstructed gold bulls emphasise that this was far more than the 2,350 tonnes that came out of mines during the year. Demand for gold this year has been at record levels - Indians, for example, bought more in the first nine months than in the whole of 1996 - yet the dollar price of gold has slumped by 20%. The price has fallen because of increasing fears that central banks will steadily sell off gold - they still have 37,000 tonnes tucked away in vaults, equivalent to more than 12 years' supply.

The new breed of central banker is not dazzled by gold and sees little point in having an asset that just takes up storage space. Some have been getting a modest return by lending gold to bullion banks, earning 1 or 2% and adding to market liquidity.

That did not satisfy performance-oriented bankers, economic rationalists who were not charmed by the romance of gold. For them, as for the 14th century Scottish poet Andrew of Wyntoun, "Oure gold wes changyd into lede". So the central bankers started selling.

The Netherlands said in January that it had sold 300 tonnes, the fourth disposal since 1989; since then it has cut gold reserves by 20%. In July, Australia shook the market by announcing that it had reduced its gold reserves by two-thirds - even a leading gold producer seemed to have lost the faith.

And, two weeks ago, Argentina revealed it had sold its entire gold reserves in the first half of this year, all 124 tonnes, and invested the proceeds, $1.46bn, in US Treasury bonds.
Echoing the views of other central banks that complain gold is an unproductive asset, Argentina's bank pointed out the bonds would yield an average of 5% and were expected to bring in $81m a year.

The biggest shock of all - and one that triggered the biggest one-day fall in the gold price for four years - came in October when a panel of Swiss experts suggested their country should sell more than half its reserves. Switzerland, which has a law forbidding such sales, had fervently supported the idea that prudent countries should have a reasonable stock of gold and had refused to sell an ounce.

There have been big pro-fits made from gold's fall from grace. Some big US commercial banks have made a killing in the last year or so by selling gold short - selling gold they do not own in the expectation they can buy it at a lower price before they have to deliver.

The gold market is now very much in the hands of these banks and New York investment funds, according to Timothy Green, who has been tracking the gold business for 30 years. He suggests that the trade has changed more in that time than in the preceding 4,000 years.

In his book World of Gold*, Green argues that the ending of a fixed price for gold by international governments in 1968 and the transformation in communications have combined to change the gold market. "For many new players in the market, volatility, not stability, was the chief attraction; to them it did not matter whether the price went up or down, as long as it moved. The communications network brought everyone together, round the world, round the clock and made the gold price a moveable feast."

Nevertheless, there are still many millions of people who retain a deep faith in gold. There are large parts of Asia where only a social revolution could change the gold habit. In India, a farmer buys gold when the monsoons bring good harvests and he sells it when the rains don't come.

Gold rings and necklaces are lavished on newborn Indian children and an Indian bride is weighed down with gold jewellery. For an Indian woman, prevented by Hindu law from having any proprietary rights over her father's or husband's property, personal gold ornaments and jewellery offer financial security.

Gold has retained symbolic value in the straight-forward transactions of rural India, but it has been diminished by the modern trading techniques in exchanges in the US and Europe. The money flowing into physical gold - more than $27bn this year - is overwhelmed by amounts ploughed into securities that are derived from gold.

In London in October, for example, gold worth $13.6bn a day was traded. Using exotic cocktails of options, futures and warrants, the banks and funds are "relieved of the acute embarrassment of having to take delivery of a single ounce," according to Timothy Green.
But how long will gold's reserve of appeal last in developing countries? "Gold," says Rob Weinberg, analyst at Deutsche Morgan Grenfell, "fills many different roles simultaneously. It can be an adornment and an industrial metal; a means of displaying wealth and an anonymous form of saving; an insurance policy and a gambling chip; it is an international reserve asset yet officially it is not money."

In the western world more people are buying gold to wear, as jewellery or watches, because it makes them feel good and they can pretend to themselves that these objects will hold their value. They conveniently ignore the fact that the cost of design, production, profit and taxes usually far outstrips the value of the gold content.

But when it comes to bullion as an investment, and as a measure of national wealth, gold is a goner. The reverse alchemy is almost complete. Eddie George, governor of the Bank of England, like Fort Knox, one of the great citadels of gold, recently told a European parliamentary committee: "Whereas gold used to be seen as a good asset, it is now seen as the bottom of the pile."

**World of Gold, Rosendale Press, #21.*

Copyright Financial Times Limited 1997. All Rights Reserved.