

Money Morning Newsletter
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After last week's Money Morning on the troubles at Chinese miner Jinshan, I had a number of concerned emails asking if I had turned bearish on gold miners. Absolutely not.

I remain true to my prediction of late November that gold stocks will be the best performing asset class of the next few years. Here's why...

Printing money just weakens paper currencies

We are in a deflationary depression. Yes, governments are printing money, but that's not much use if it's not getting through to the man on the street. You might have heard the words 'credit crunch'. This is a period of contracting credit. Nobody wants to lend and nobody wants to borrow, so, despite quantitative easing (the central banker's euphemism for "printing money"), the actual money supply is still not growing, but falling. Even Robert Mugabe would struggle to print money at the rate credit has contracted.

All governments are doing by printing money is weakening the quality of their money, and debasing their currencies. Of course, in a deflation cash is king, but currency collapse becomes a very real possibility, so governments should be acting to strengthen their currencies. Sadly, I cannot think of a single one that is doing so.

Money has two uses. One is as a medium of exchange. The other is as a store of wealth. Gold has virtually zero industrial use, and despite sovereigns still being legal tender in the UK, it is no longer a medium of exchange. In fact, its only real use as a commodity is as a means to store wealth.

In other words, it remains a form of money. As we have seen, governments are intent on destroying their own currencies, just as they should be strengthening them, whereas gold is much harder to debase. That is why buyers have been flooding the physical gold markets over the past year. Money does well in deflation. Gold is money. It's that simple.

Gold will rise against weaker currencies

This is a period when the return of your capital is more important than the return on your capital. That's why the bond markets did so well late last year. People were prepared to take very low rates of interest just to ensure they got their money back. Yes, some argue that the gold price is being suppressed. In fact this argument is coming more and more into the mainstream - there was a report this week from the broker Charles Stanley on that very subject.

But, even if the accusations of gold price suppression are true, gold is a much harder form of money to debase than say the pound or the dollar, so it will rise against weaker currencies, just as it has done against the pound these last six months, and sometimes even against stronger currencies such as the dollar and yen. If you own physical gold nobody can debase it. The futures markets can be interfered with, but

not your safely stored bullion coins.

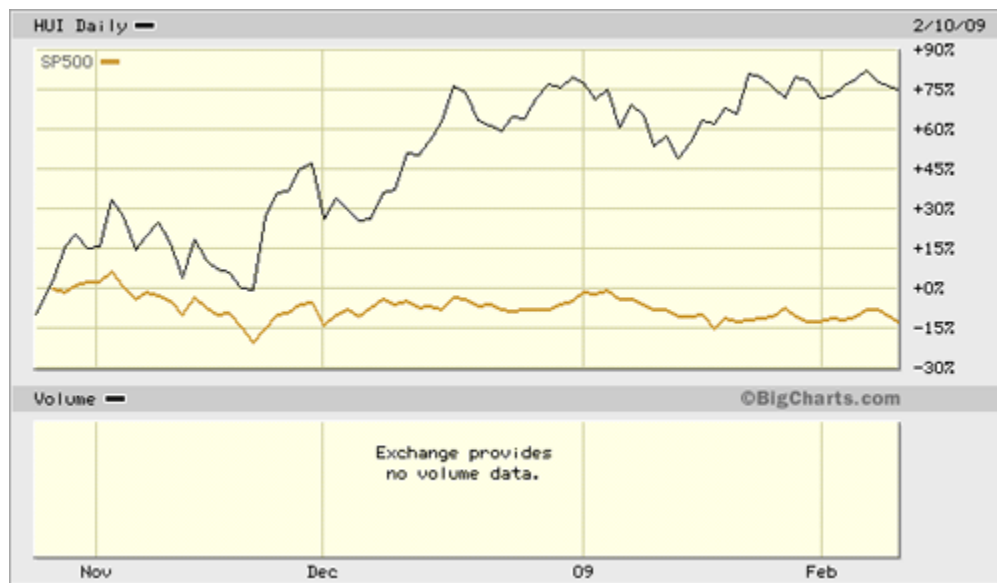
Gold will do well - but gold miners will do better

In this period where gold will do well, gold miners will do even better. Even if the gold price barely moves, the cost of energy (some 25% of mine operating cost) is down; the cost of labour is down; the cost of drill rigs and other equipment is down. This all means that profit margins are up.

The significant demand for their end product, gold, will remain and that product will be sold in dollars. The dollar, despite what you may read elsewhere, is not set to collapse imminently. It is the senior global currency and people have turned and will continue to turn to stronger forms of cash as this depression unfolds. While miners' end product is sold in dollars, their operating costs will be in weaker foreign currencies – the Mexican peso, the South African rand , for example.

I was talking to Bill Reid of Gold Resource Corp (US:GORO), one of my favourite juniors, yesterday and he explained how the peso has fallen from 10 to 14 against the dollar. All his costs are in pesos while his profits are in dollars . That currency play is a very significant 40% mark up in profits. The strong dollar, ironically, is another source of increased profit margins for gold miners.

This outperformance by gold stocks has been in place since last October. The HUI, the index of unhedged gold miners is up some 75%, while the S&P is down some 15%.



The best way to play gold stocks

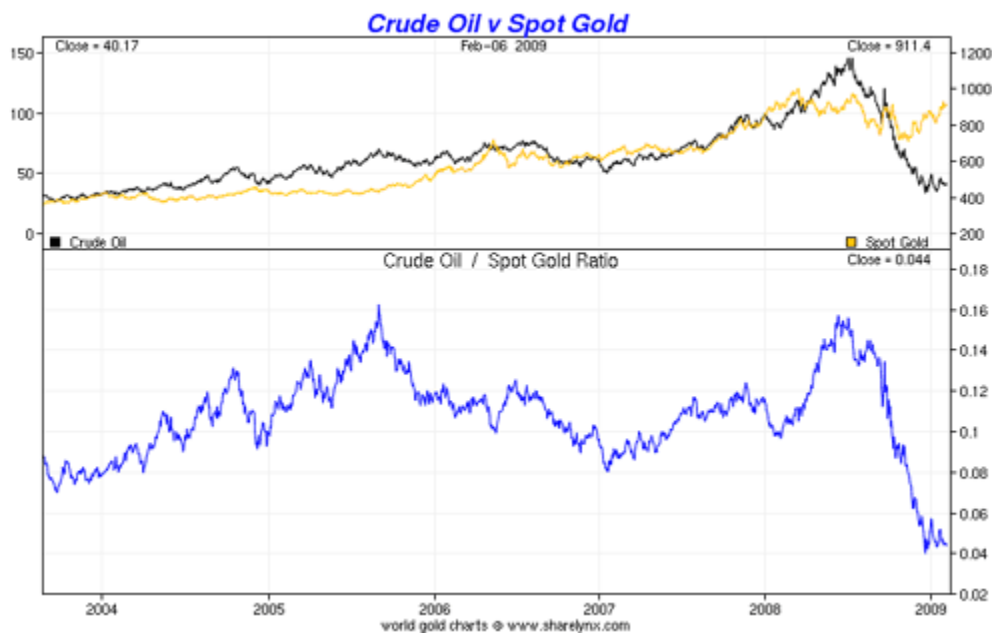
Physical gold is about protecting your wealth. Investing in gold stocks is more about speculating and attempting to grow it, and investing in juniors even more so. Some will be multi-baggers (stocks that will rise many times) – they already have been – but you will be taking on substantial individual company risk if you invest in them, in a way that you won't be by buying physical gold. As we found with Jinshan, the reason you invest in a company – perhaps for its management or its strategy - can

quickly change. If you don't want to take on the individual company risk, the best way to play gold stocks is via the ETFs – US:GDX or UK:AUCO – or by funds such as the Blackrock Gold and General.

On a final note, despite my medium and long-term bullishness on gold and gold stocks, now may not be the time to dive in if you don't already have a position. Both have had a good run and could pull back as traders take profits. Gold is struggling to break through the trendline, though it does seem to be consolidating nicely around the \$900 mark.



In fact, the oil-to-gold ratio is at extreme levels (see blue line below), suggesting that at this point, oil is the better play of the two.



But in the longer term, both gold and gold stocks have much further to climb.