

## **End of a Golden Era?**

The 25% fall in the gold price since mid-May has prompted many to ask the question – is the bull market over? Having risen over the last 6 years to a 25 year high some commentators were beginning to question whether the up-move was overdone. In the short-term it was, but to really understand where the gold price is in terms of its long-term cycle, one needs to know a little bit about its history. During much of the twentieth century the gold price was effectively fixed in relation to either sterling, or latterly, the US dollar. In the late 1960's the fixed relationship broke down due to the pressure of market forces and an effective cap on the gold price at \$35 per ounce was removed. From this point on a bull market developed, one which gathered pace in the late 1970's as inflation became rampant in the major developed countries. A big speculative squeeze in late 1979/early 1980 culminated in the gold price touching a high of \$880 per ounce.

A twenty-year bear market followed, during the late stages of which gold lost all credibility as not only an investment, but as a hedge against inflation. Such was the loss of credibility that many central banks (including the Bank of England) sold down their gold reserves and the majority of gold mines sold their production forward at prices which barely gave them a profit. The price bottomed (imperceptibly) in 2000 at \$250 per ounce. The first two or three years of recovery were met with scepticism and disbelief, but quietly, without fanfare, the supply/demand balance shifted back in favour of demand. Most market participants were short of gold and once the price started to recover were forced to buy at the prevailing price to cover these positions. The move eventually became self-fulfilling, but has it run its course? Bulls will point out that there is a 1,500/2,000 tonne annual supply/demand deficit, which can only be met by more central bank selling. This seems unlikely – given that they have run down their own reserves to historically low levels and are now looking to replenish. Taking a longer-term perspective, the ratio of the Dow Jones Index to the gold price hit a peak of 45 in 1999, at the top of the equity bull market. Since then it has been in the process of reverting back to its long-term average (of around 10) currently standing at about 18. Assuming equities are not about to embark on another major advance, then the gold price has further to rise.

In our view the bull market in gold is not over it is just taking a breather (possibly for twelve months). This is normal in longer-term bull or bear markets.