

Cycles and the Price of Gold

(Commentary on the Gold Market, paper presented for Board Meeting of Randgold Resources Limited on July 29, 2002)

The New Bull Market in Gold

From a low of around \$250 after the announcement of the Bank of England auctions, the price of bullion has recovered to \$330 and is currently in a trading range of \$310 to \$325. Meanwhile the gold mining shares have started an extraordinary rally since November 2000 which, given the fact that the profitability of certain of these companies looks rather suspect, resembles in some ways a mini Nasdaq bubble. While the bullion, in spite of the severe weakness of the stock markets around the world and the fall of the US currency, is surprisingly stable, the prices of the gold mining companies have started a substantial retracement. During the first half of 2002 there has been an increased interest in gold on the part of the media, some mutual funds buying and new players entering the market. News about heavy Japanese and Indian buying on the one hand and uncertainty about actions by central banks are creating a climate of volatility and uncertainty unless one has a firm idea about the future of world markets.

A Road Map for the Decade 2000 to 2010

The secular bull market in financial assets that dominated the markets during the 1980s and 1990s has ended and new secular trends are emerging. Based on evidence gathered over the past two years these new trends will encompass a strengthening gold price and weakening stock markets and US\$. The correction of overvaluation of stock markets, which is still exceptionally high, can be expected to continue and may lead to deflation and economic conditions from which the world will not recover for a long time. According to Robert Shiller, Professor of Economics at Yale University, in his book „Irrational Exuberance“ (Princeton University Press) the outlook for the stock market in the next 10 to twenty years is likely to be rather poor – and perhaps even dangerous. The monetary authorities will therefore be required to keep the supply of fiat currency expanding at all cost which will lead later on to higher inflation. The first decade of this century has therefore more in common

with the decade of the 1970s if not the 1930s. Based on historic experience stock markets might have seen their highs for the next 20 years.

Some Fundamentals – Gold and Global Debt Developments

On the occasion of a recent meeting in Paris of a private Think Tank of some European Economists of which I have been a participant for some years, Dr. Peter Warburton, former Chief Economist of Robert Fleming and author of „Debt and Delusion – Central Bank Follies that threaten Economic Disaster“ made central banks largely responsible for the deterioration in economic and financial management since the early 1980s. In preparation for a disastrous outcome to debt and delusion he developed three positive gold price scenarios. (Encl. 1). He also sees some risks to gold investment including central banks sales to shore up the equity markets. (Encl. 2) Generally it can be said that the increasing lack of confidence in governments, their political and economic leadership and daily news about accounting problems and dishonesty among corporate executives will ultimately lead to a complete distrust and eventually a flight out of paper. It will be a flight to quality, namely to gold. This what happened in the 1930s. It was simply the recognition that gold is the only financial asset that is not someone else's liability, and therefore the only financial asset that cannot be defaulted and become worthless. (The great financier, Bernard Baruch, admitted later that he had been purchasing shares in Alaska Juneau mines since 1928.)

But gold is also a valuable investment because it, more than any other asset is negatively correlated with equities and bonds and in many instances with other tangibles such as real estate. It has exactly the optimum characteristics for optimizing returns and reducing risks as quantified mathematically in Markowitz Portfolio models.

World capital markets are estimated to be \$60 trillion, yet there are only \$70 billion in gold stocks available for purchase.

Cycle Studies

1. The Notley Information Service, Ridgefield, CT

Over the years I have been following cycle analyst Ian Notley's market cycle studies. It has been observed that markets move in three well-defined cyclic movements. For some time

now Notley has felt that after a disinflationary period of 21 years gold stocks were more oversold than at any time in the last 61 years. His view is that golds are completing their first cycle (originating 4th quarter 2000 – 1st quarter 2001) within a new longer term secular advance possibly persisting through this decade and are likely to record price levels eventually above historical highs of 1980. During the first half of 2002 he forecast a correction of 30 to 50% likely through September – October 2002 which is now underway and could last into the 4th quarter 2002.

His conclusion of this first cycle in the new long-term bull market is that gold investments have earned their old places back as asset classes of money management. One of the questions he is mentioning since May 2001: Could gold stocks through this decade take over the interest and public admiration once held by computer technology? (Encl. 3)

2. The Kondratieff Winter

This expression is used by Kondratieff expert Ian A. Gordon of Vancouver who is a well-known analyst of The Long Wave Cycle. Nikolai Kondratieff is the father of the long wave economic cycle. In his major work published in 1925 he suggested that during a period of around 54 years (at that time about a generation) there would be 1) a decade of depression, 2) thirty years of technical innovation and 3) ten years of economic uncertainty. It is important to note that since contra-cyclical policies of Keynes and his followers through government intervention have been applied, the cycle has been stretched out by more than 10 years. In his definitive work „Business Cycles“, Joseph Schumpeter wrote, „The Kondratieff Wave is the single most important tool in economic prognostication.“ Or Hoppe in September 1982: „The virtue of Long Wave Analysis is that it gives one both a timetable and a map of historic events.“ Best investments during the Kondratieff autumn, the period from 1981 to 2000, were stocks, bonds and real estate. During that time gold underperformed. The stock price peak of 2000 is a definitive sign that the Kondratieff winter has begun. Best investments for the Kondratieff winter are gold and cash. (Encl. 4) One of the best charts is the chart which shows the relative values between paper assets and gold. It is calculated by simply dividing the level of the Dow Jones Industrial Average by the price of gold. (Encl. 5)

Summary

In my book „Gold Wars“ I explained why Central Banks are fighting gold. Since America was forced off the last vestiges of a gold dollar standard on August 12, 1971 not only the \$ but the

entire world is on such a system. Therefore, confidence in the dollar is paramount in upholding the world's financial and monetary system. (Encl. 6) While confidence in gold has never been a problem, confidence in the dollar has always been a problem. As stock markets are collapsing and faith in the dollar, which is based on paper, is now rapidly declining. It can be expected that central banks will launch further attacks in order to suppress the price of gold. The Swiss National Bank still has a significant amount (900 tons) to sell and then there is the announcement by the head of the Bundesbank that they might sell gold and buy equities. Although we know from the experience of the Gold Pool of the 1960s that all such attempts will ultimately fail one has to be aware of such dangers and periodic corrections.

What I wanted to say with the present paper is simply, that history repeats itself. That is why I feel, that in order to know and predict the future of anything (in our case the price of gold and its meaning for our company) the Board and Management of Randgold Resources only have to look up what happened in the past and get a correct base or clear view of events to come. I would like to add that the coming period of economic and financial distress might even be worse than the 1930s. At that time the problem of debt was not excessive as it is now and the US was a creditor nation and it is now a debtor nation. Again the cycle has now moved from the Kondratieff autumn to winter, and there is nothing that Alan Greenspan, President Bush or other „powers that be“ can do to bring back autumn. In the introduction to his book The Great Crash of 1929, John Kenneth Galbraith wrote, „These speculative episodes have occurred at intervals throughout history, and the length of the interval is perhaps roughly related to the time that it takes for men to forget what happened before. The useful task of the historian is to keep the memory green.“

Ferdinand Lips

Zurich, July 24, 2002