ACCA

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Welcome

Paper Vs Metal

A Collection of Thoughts Presentation

Where Knowledge Shared is Knowledge Gained

ACCA CPD Event

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Recap -

Extracts from December 2009 Presentation

Uncomfortable Choices

•We are in a deflationary, deleveraging world.

•The markets can remain irrational or complacent for a lot longer than most of us think. It could be years. Or not.

•This is not a prescription for a return to normal growth. We are headed for a New Normal that is less than what the market currently believes.

•Can we Muddle Through? We have no choice but to do so.

•But it will not be fun. It will not be long-term 5% growth and employment going back to 6% any time soon.

•Social unrest shall be common.

•Chin-india will continue to provide growth

PAPER Vs METAL

S&P 500: The index kicked off the 21st century at 1,469 points. But it ended the decade at 1,115 points on December 31, 2009 – a drop of 24%.

Gold: The contrast in fortunes couldn't be more marked, with the yellow metal sweeping to a total gain of 275% over the same 10-year period – an annualized return of 14.1% in Dollar terms and 340% in Pound sterling terms .

And if you shorten the time period to gold's performance since the collapse of Lehman Brothers in early 2008, the price has soared by 76%.

The price of gold is up 27% this year in dollar terms.

Adjusted for inflation, the real gold price record was set 30 years ago at $2,318 per ounce.

why has this happened ?

A Brief History of MONEY

Society can't function without money

Even the most primitive developed some kind of payment system. Shells, cocoa beans, various metals, even feathers have been used over the years as money. At one stage Roman soldiers were paid in salt, giving us the word 'salary'.

These early forms of money were 'commodity money'. The most widely and successfully used forms of this money were gold and silver. The words 'silver' and 'money' are interchangeable in 90 or more different languages: 'argent' in French, 'plata' in Spanish, for example.

Trade was facilitated by the casting of gold and silver coins which certified the weight and purity of the metal content.

The names of many modern currencies were originally the names of units of weight. One pound sterling meant a pound of sterling silver. The dollar derives from the world 'thaler', an ounce weight of silver originally coined by one Count Schlick in the 16th century. Even the Thai 'baht' was a unit of weight.

The Birth Of The Modern Banking System

Money should be :

- A medium of Exchange
- And a Storage of Value

As people needed somewhere to store their gold and silver, they turned to the local goldsmith. He would issue a certificate as a receipt for gold placed in his vaults.

Over time, people began to use these certificates in the marketplace as if they were the gold itself.

Governments issued such notes, which in the case of the pound were considered ‘as good as gold’.

World trade had slowly moved from a

‘commodity money’ to a ‘representative money’.

This gave birth to the modern banking as we see & experience

So What's Wrong With The Banking System

Few depositors ever removed their actual gold, using the certificates for trade instead, goldsmiths realized they could make money by lending out certificates against depositors’ gold.

The depositors did not lose anything. As long as there was no bank run, their gold was still safe in the goldsmith’s vault. But depositors soon wanted their share. Rather than taking back their gold, they demanded that the goldsmith, now in effect their banker, pay them a share of the interest. So the goldsmith would pay one rate on deposits, then lend at a higher rate.

The next stage in the development of banking saw goldsmiths lending out more gold than was on deposit. The trouble was that, in times of panic, some borrowers might demand their real gold back, instead of the paper certificates. Then you had the dreaded run on the bank, with the banker not having enough gold and silver to redeem all the paper he had put out.

It would have been straightforward to outlaw this new lending practice, but the large volumes of credit the bankers had issued made huge European commercial expansion and, indeed, the Industrial Revolution, possible. So instead, the practice was legalized and regulated. The monetary system had moved on from representative to ‘debt’.

The fall of the gold standard

By the 20th century, this fractional reserve system, where you need only hold a fraction of the money you lend out, became the world's dominant banking system.

But at the same time, the amount of gold backing the paper money steadily shrank.

Britain came off the Gold Standard in 1914 because the country needed to print money to pay for World War One. So did the Germans. By 1944, the USA and Switzerland were the only major nations left with a currency backed by gold.

With the Bretton Woods agreement of 1944, the dollar became the global reserve currency. It was pegged to gold at $35 an ounce.

Throughout the 1960s, many more dollars were needed to be printed to pay for expensive welfare systems and for the war in Vietnam.

The French, recognized this and began demanding gold in return for their dollars at the agreed rate of $35 per ounce. Initially, the US coughed up, but in 1971, as the run on the dollar sped up, and faced with the rising cost of the Vietnam War, President Nixon removed the dollar from the gold standard altogether.

How Money Changed from Tangible to Intangible

The removal of the dollar from the gold standard changed the very nature of money. No currency of the planet earth was now backed by any tangibles.

We were now in an era where money is money by fiat. That is, by government edict –by the law. That's all. The value of an individual currency is determined by how it trades against other fiat currencies on international currency markets.

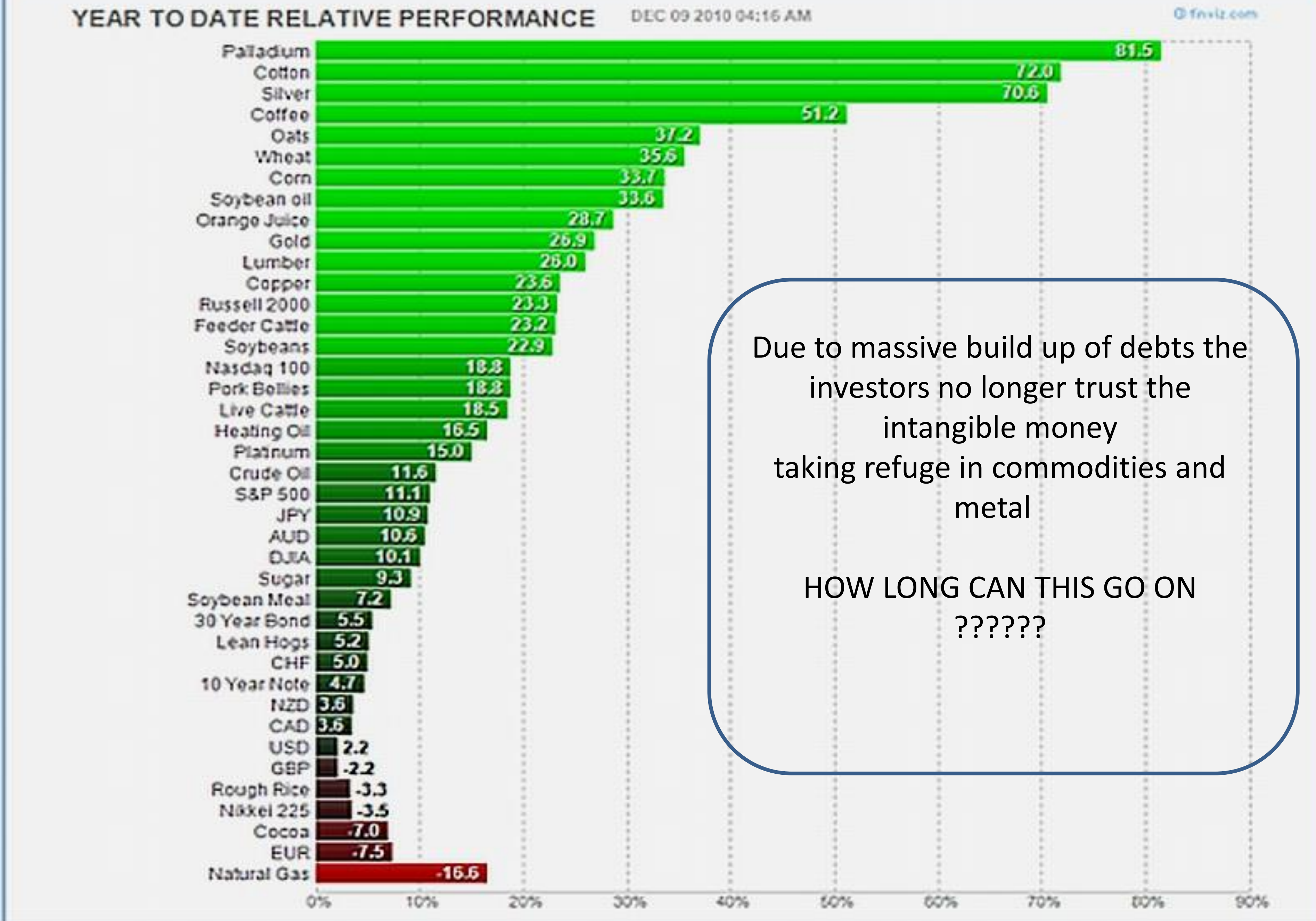
If you look at a modern £20 note, on it is written: "I promise to pay the bearer on demand the sum of twenty pounds."

Modern cash is a promissory note for something that doesn't exist.

There is a finite amount of gold in the world. With gold as money, such expansion would never have been possible because there would not have been the gold to pay for it.

But with modern money that can be endlessly issued, there was no such restriction

Source: European Commission



Due to massive build up of debts the investors no longer trust the intangible money
taking refuge in commodities and metal

HOW LONG CAN THIS GO ON ??????

Lets look at how strong the economy is to back the paper money

European Woes - The Shaking Intangibles

Since the Greek bailout back in May, instead of alleviating fiscal concerns in the Eurozone periphery, contagion risks have actually intensified.

The 10-year bond yields have risen nearly 70bps in Italy, 150bps in Spain, 225bps in Portugal, 420bps in Greece and 460bps in Ireland.

Once the stabilization fund ends in 2013, there is no way these countries can fund themselves at current debt-service cost levels.

“Ireland may have secured funding, but at a 5.8% interest with nominal GDP declining, the situation is untenable in terms of sustaining any balance sheet improvement.

Debt restructuring is inevitable.

Looking at current CDS spreads, we are up to around 80% on default risks in Greece, 60% in Ireland, over 50% in Portugal, nearly 40% in Spain (this is big), nearly 30% in Italy and 20% in Belgium.

The eurozone is asking Germany and the rest of “core” Europe to bailout Greece & much of the rest of the periphery, and to assume massive deficits and rising taxes.

Because for there to be enough money for the deficit nations to borrow cheaply, there must be an AAA rating. Spain or Ireland no longer have the AAA rating.

For all intents and purposes, it is on the back of Germany and, to some extent, France. Will German taxpayers go along with that? Will France?

Will the Germans still finance the Greeks in 2013 when they have not whittled down their deficit and the Greeks still want to retire at 50 on full pensions?

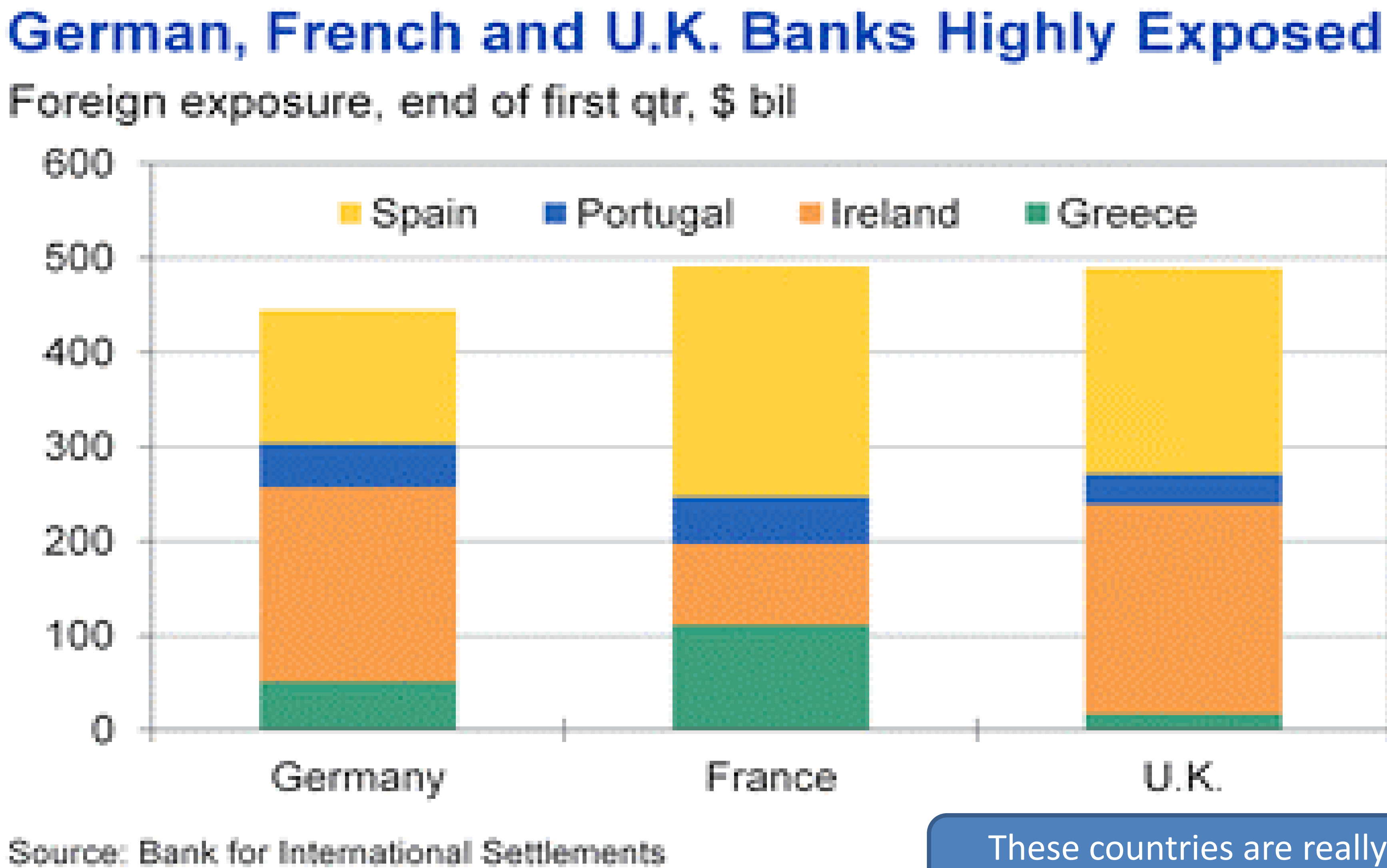
Will the Irish decide that it is in their best interests to take on massive debt so that French and German and UK banks are paid back?

Can the solution to a debt problem be more debt?

For eurozone to survive there must be a huge (as in trillions) stability fund created, and/or the ECB will have to print euros on a level that would make the Fed blush, simply to get the various national debt levels down to where the peripheral countries can actually pay them down.

This is not intangible comfort

Why Ireland Was Saved



These countries are really saving there banks .

Is Portugal next to Fall

Portugal's government debt, at 82% of GDP, currently sits at less than that of Greece (126%) and Ireland (almost 100%).

Adding in corporate and private debt, Portugal's debt-to-GDP ratio rises to over 250%. Portugal needs to raise €51 billion to cover its fiscal deficits (€24 billion) and roll over its debt that is becoming due (€27 billion).

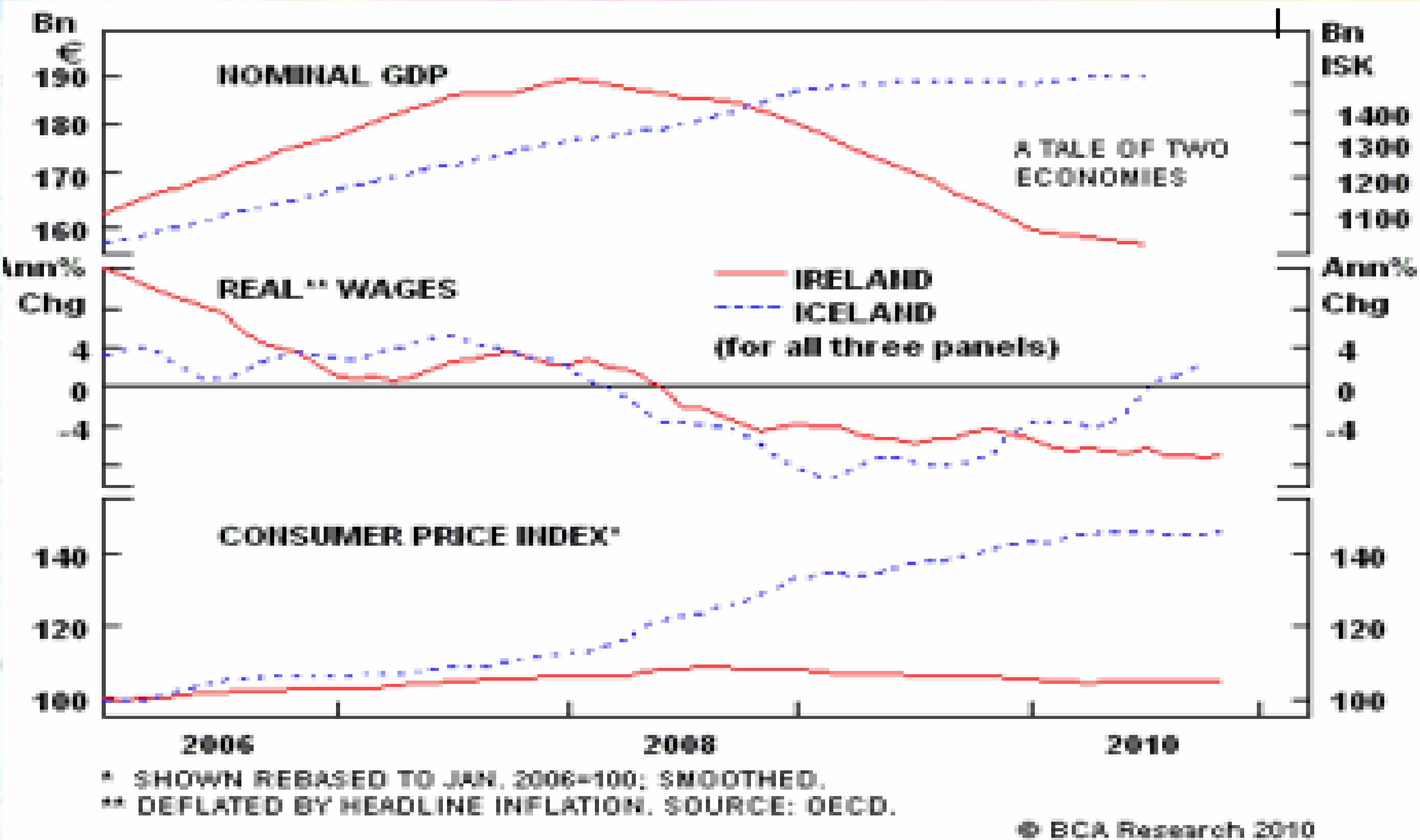
The Portuguese economy is too small to finance that internally. Foreign investors are unlikely to tolerate such situations for much longer.

It is very likely that Portugal will have to apply for an EU/IMF bailout in a matter of weeks rather than months."

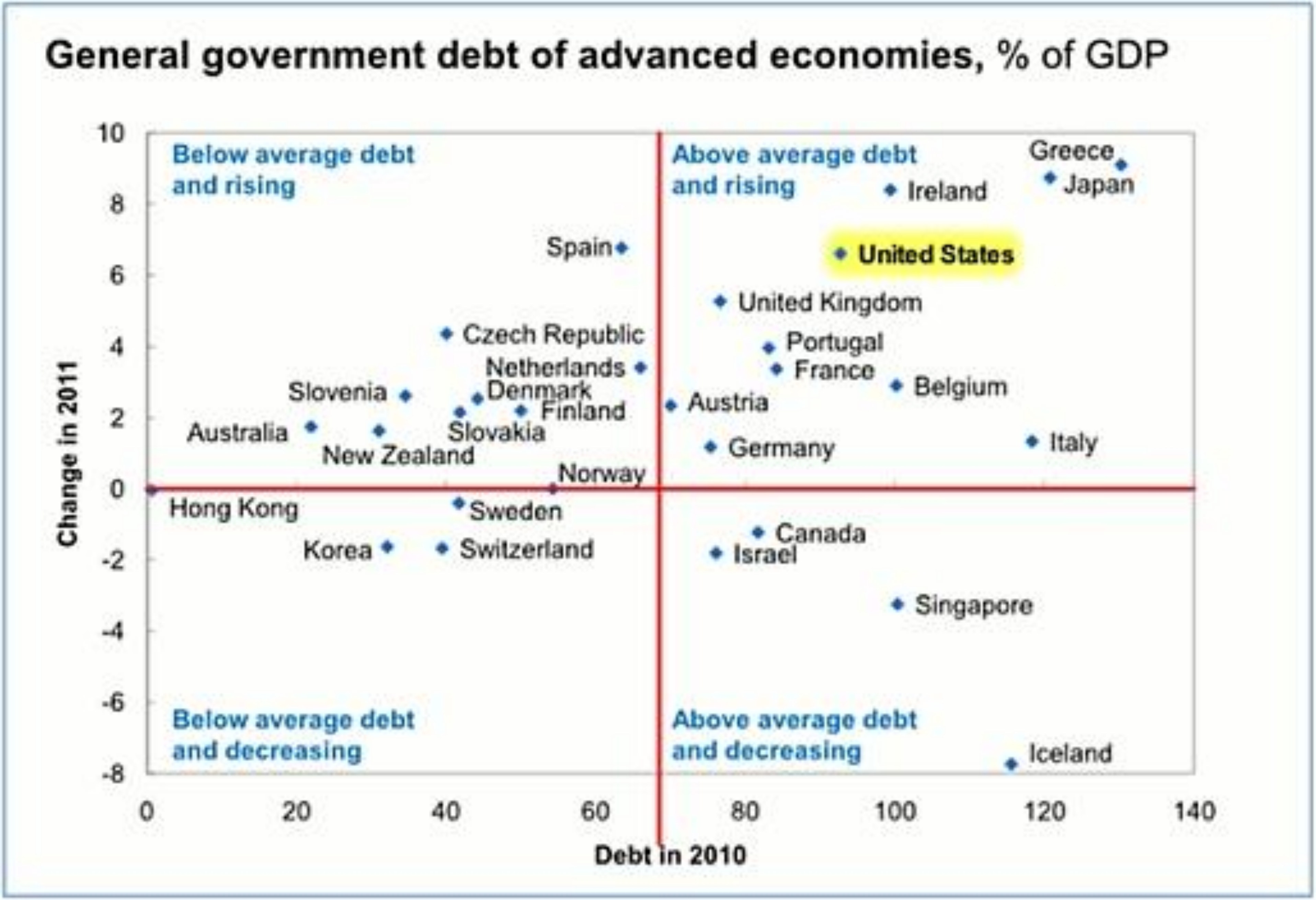
WHAT ABOUT SPAIN?

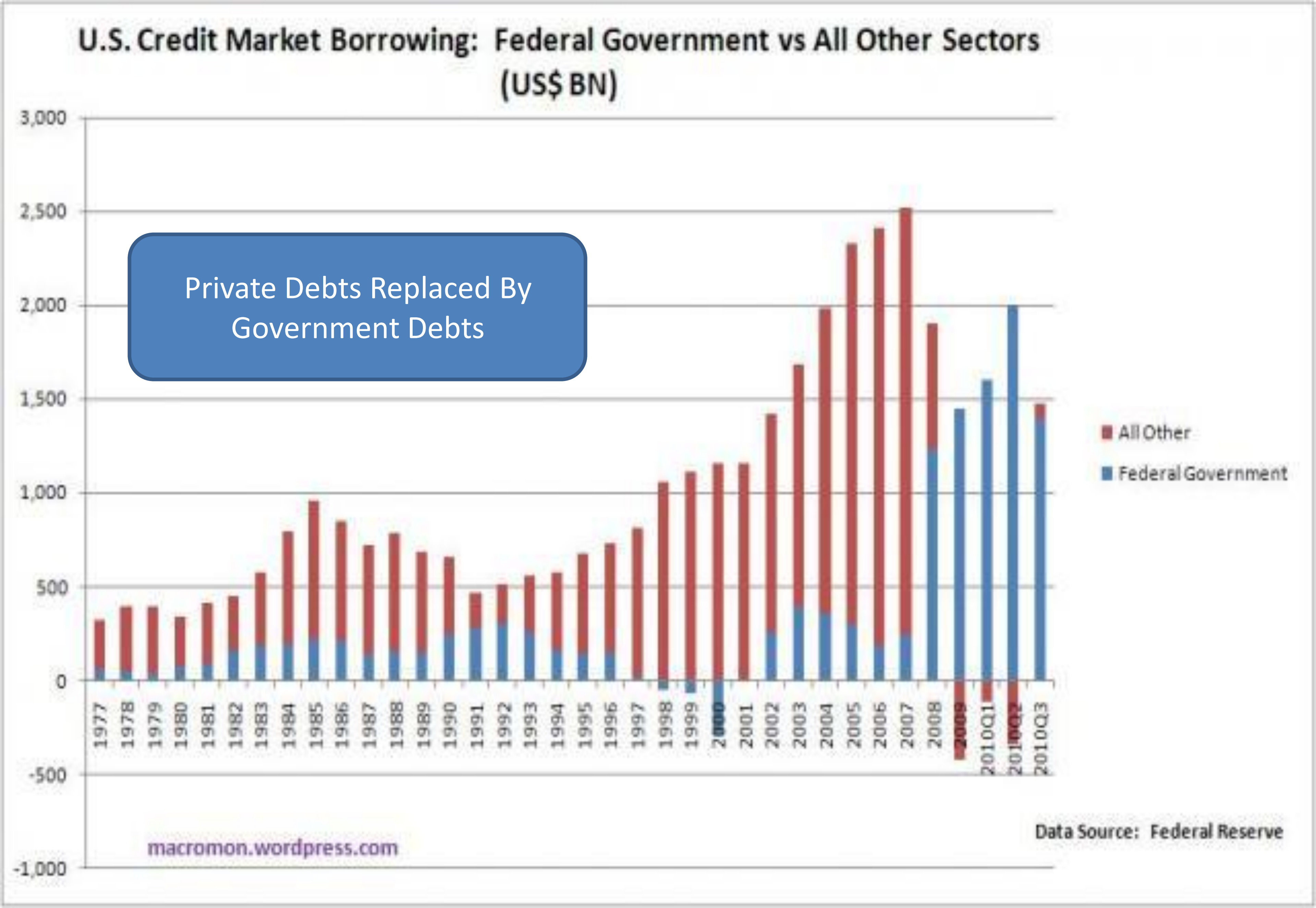
The cost of funding for Spain continues to rise as they sold 10 yr and 15 yr paper. The 10 yr was priced to yield 5.45%, 83 bps above the last one sold in Nov and the 15 yr yielded 5.95%, 141 bps higher than the last one sold in Oct. The existing 10 yr yield is rising to 5.50%, matching the highest since Nov 2000

Spain must figure out how to get €635 billion over the next few years to finance its deficits and bond repayments, which it hopes to roll over into brand new bonds



Iceland example suggests Bankruptcy perhaps is better than taking on more Debts


General government debt of advanced economies, % of GDP
Below average debt and rising
Above average debt and rising
Below average debt and decreasing
Above average debt and decreasing
Greece
Japan
Ireland
Spain
United States
United Kingdom
Czech Republic
Portugal
Netherlands
France
Slovenia
Denmark
Belgium
Finland
Austria
Australia
Slovakia
New Zealand
Germany
Italy
Norway
Hong Kong
Sweden
Canada
Korea
Switzerland
Israel
Singapore
Iceland
Change in 2011
Debt in 2010
10
8
6
4
2
0
-2
-4
-6
-8
0
20
40
60
80
100
120
140



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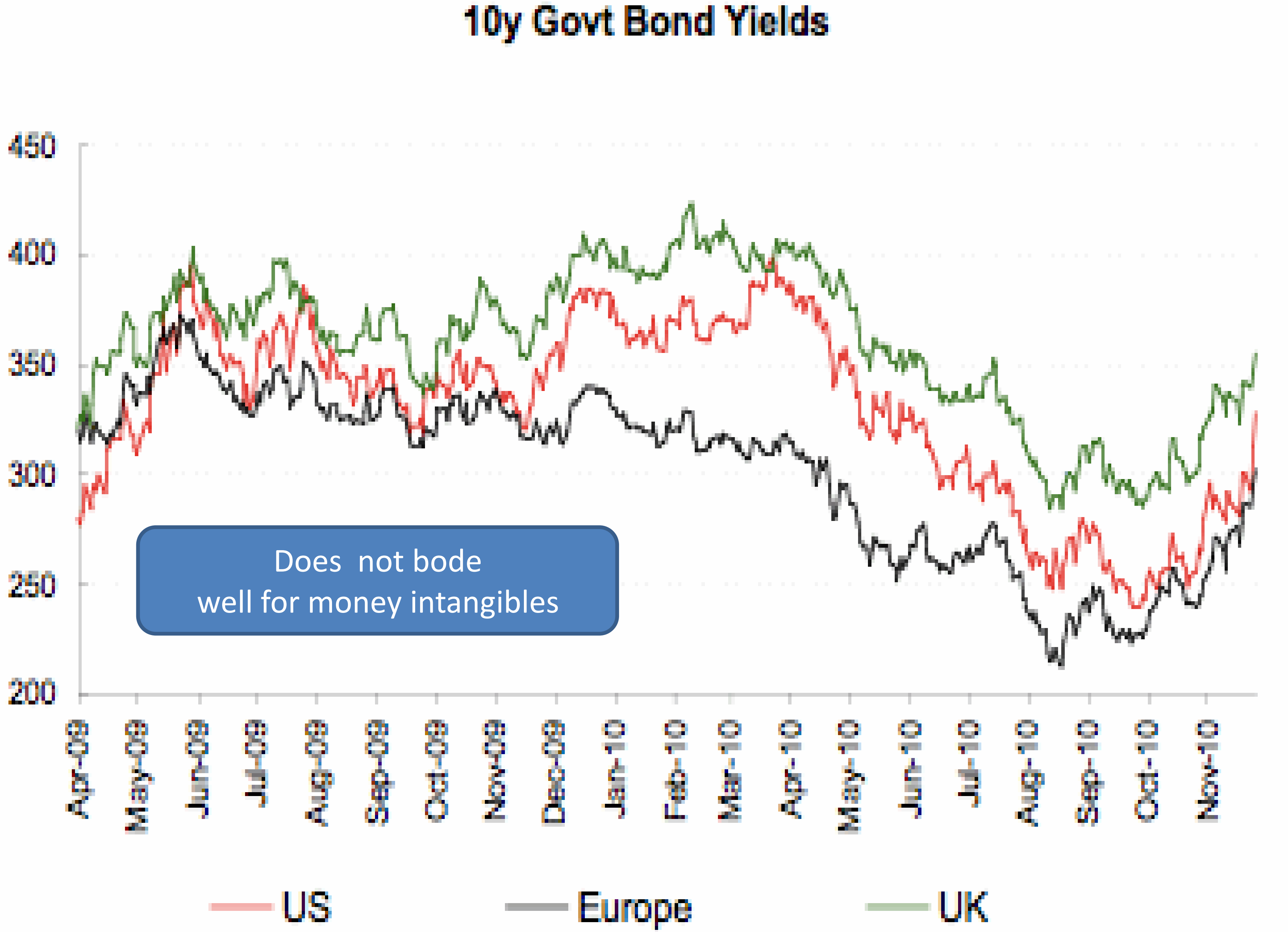
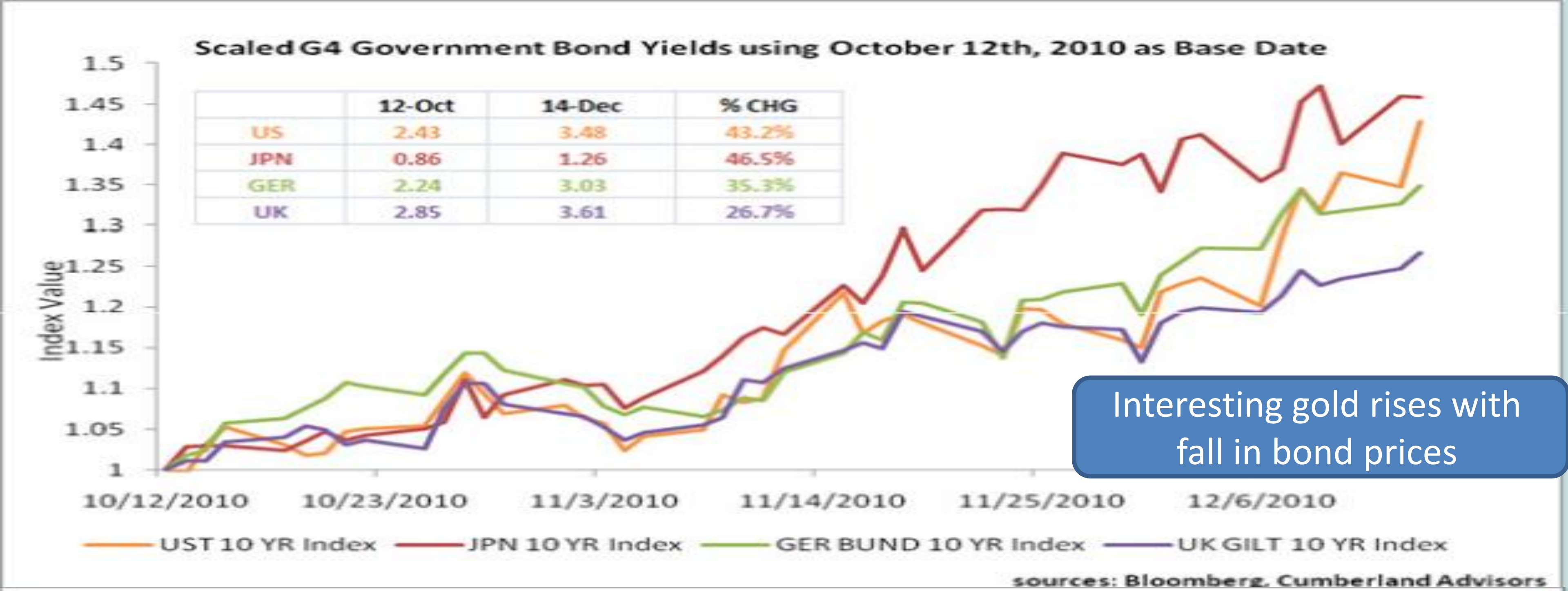

10y Govt Bond Yields
450
400
350
300
250
200
Apr-09
May-09
Jun-09
Jul-09
Aug-09
Sep-09
Oct-09
Nov-09
Dec-09
Jan-10
Feb-10
Mar-10
Apr-10
May-10
Jun-10
Jul-10
Aug-10
Sep-10
Oct-10
Nov-10
Does not bode
well for money intangibles
US
Europe
UK



Interesting gold rises with fall in bond prices

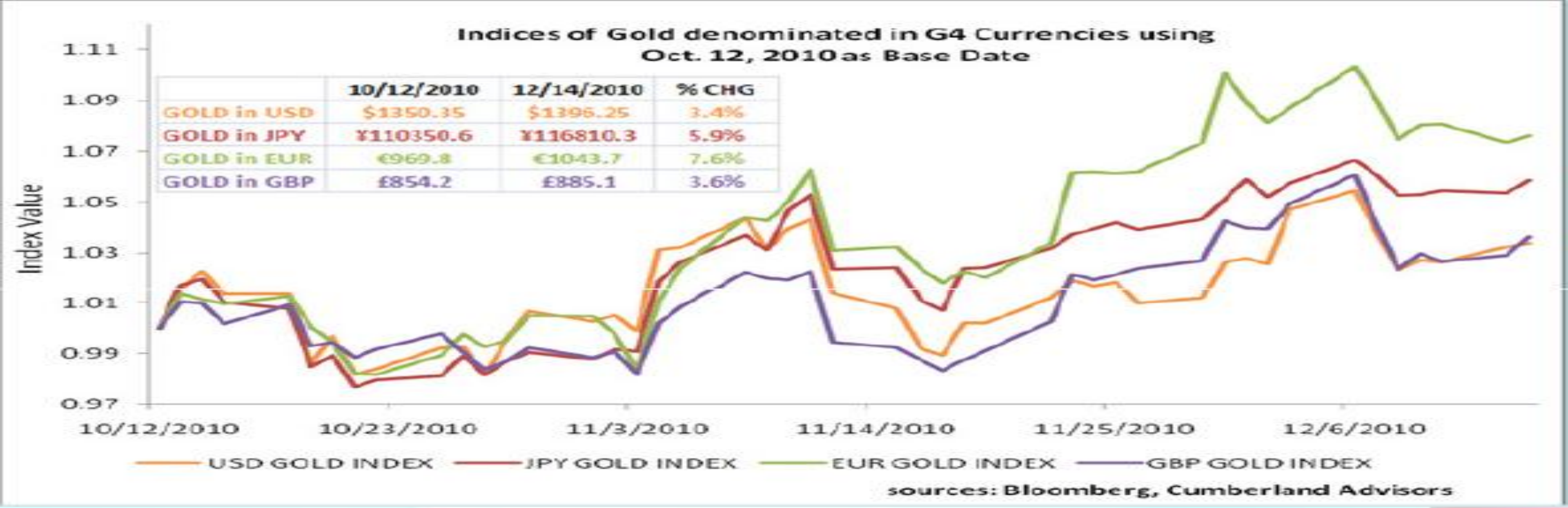
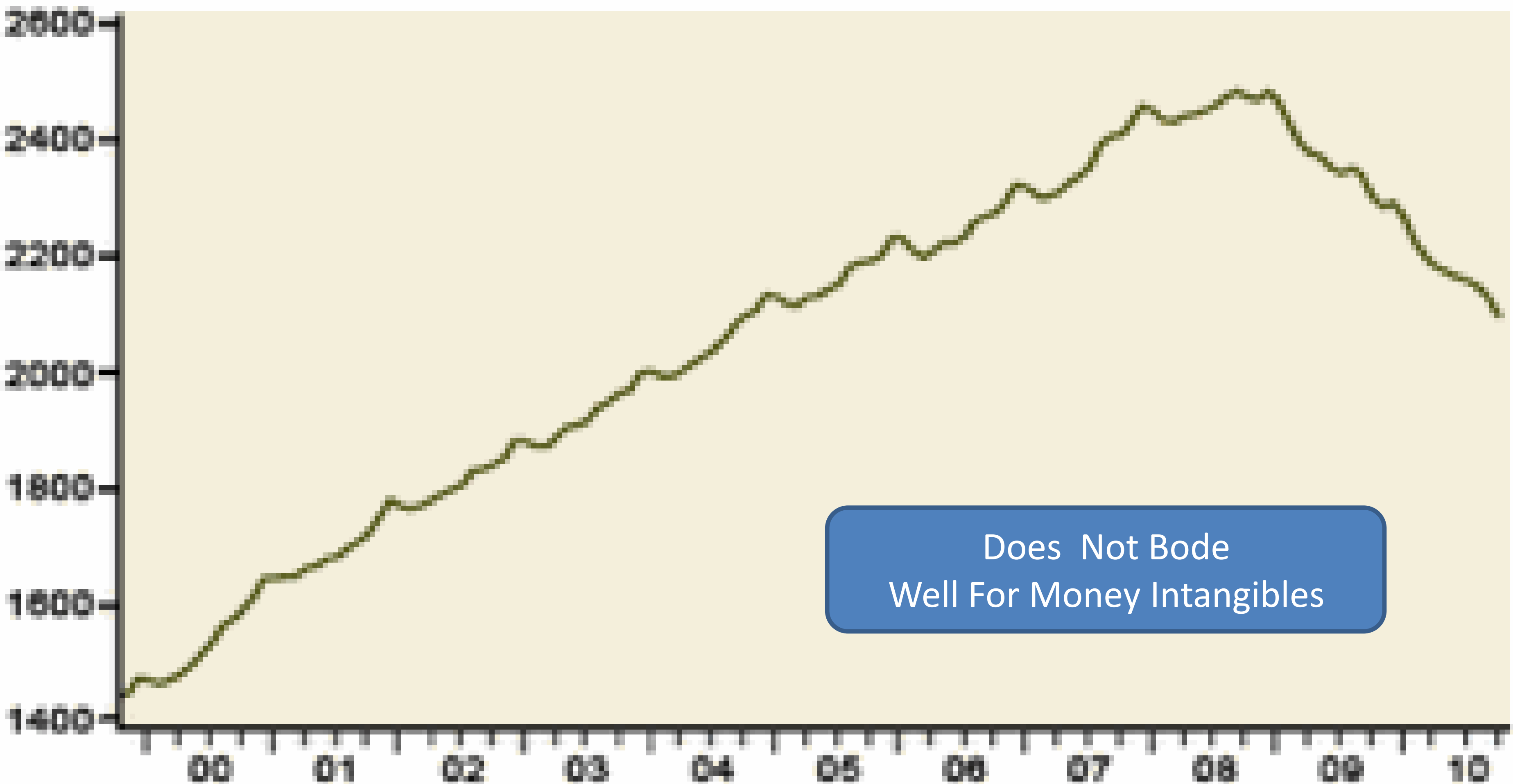


CHART 1: CONSUMER CREDIT IS STILL CONTRACTING

United States: Consumer Credit excluding Federal Loans

($billions)



Source: Haver Analytics, Gluskin Sheff

So what is the verdict ?

And the Winner is METAL

- If all the known debts today were to be backed by the gold standards of 1971, Gold would be today at US $ 9,000 per ounce.
- Adjusted for inflation, the real gold price record was set 30 years ago at $2,318 per ounce.
- Central banks are buying more gold to restructure their reserves.
- Quantitative Easing of the US is likely to further debase the dollar.
- Euro-zone may have no choice but to print money.
- ETF have made access to gold easy for retail investors – new demand for metal.
- Investors have simply lost faith in the intangibles - government promise to pay.
- US politics is now divided thus further blurring the clarity for investors.
- Asian Inflation creates doubts on the growth engine for the last eighteen months.


World Gold Reserves
1 = 12.5kg
[2009 data showing gold holdings in kilograms per country]
* International Monetary Fund 3,217,300
* SPDR Gold Shares ETF 1,120,600
Netherlands 612,500
Germany 3,412,600
U.S.A 8,133,500
France 2,450,700
Italy 2,451,800
Switzerland 1,040,100
China 1,054,000
Japan 765,200
* IMF reserves held in USA
* SPDR Gold Shares ETF Gold Bullion reserves are vaulted in London by HSBC and their sub-custodians.
USA 8,133,500
Germany 3,412,600
IMF 3,217,300
Italy 2,451,800
France 2,450,700
SPDR 1,120,600
China 1,054,000
Switzerland 1,040,000
Japan 765,200
Netherlands 612,500
reserves in Kilograms :
0 kgs
1 Million kgs
2 Million kgs
3 Million kgs
4 Million kgs
5 Million kgs
6 Million kgs
7 Million kgs
8 Million kgs
9 Million kgs
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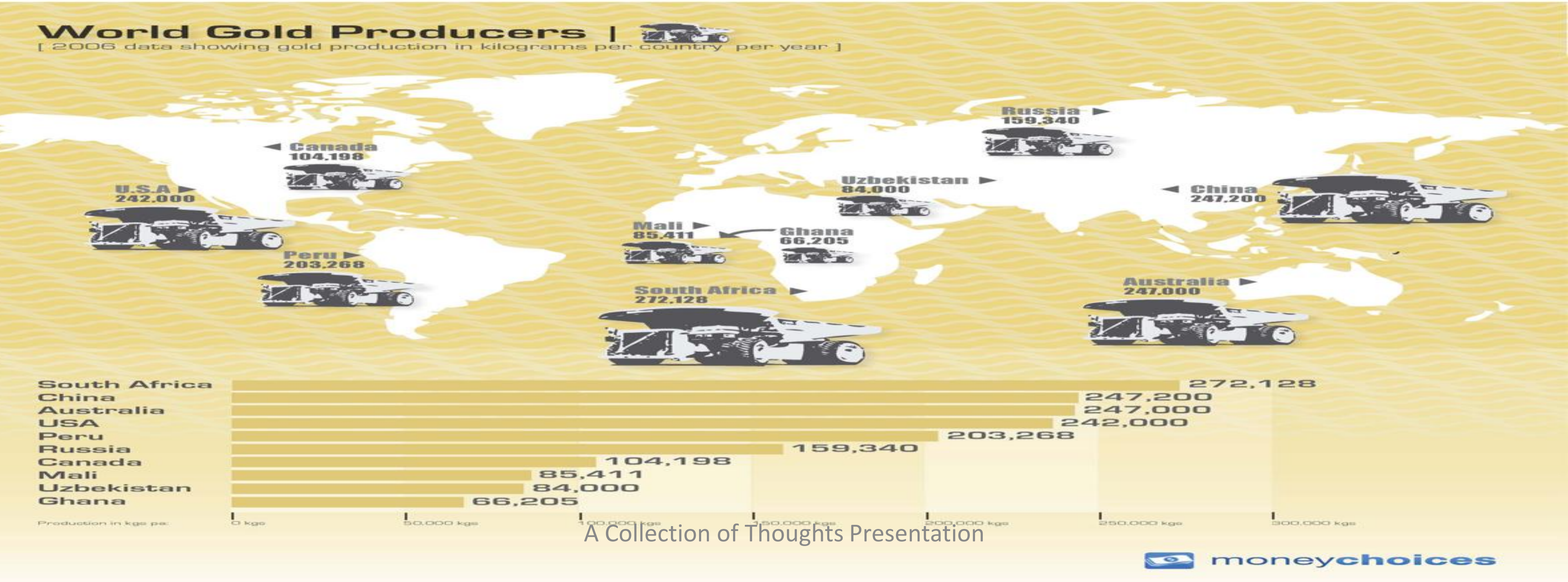
World Gold Producers
[2006 data showing gold production in kilograms per country per year]
Russia 159,340
Canada 104,198
U.S.A 242,000
Uzbekistan 84,000
China 247,200
Mali 85,411
Ghana 66,205
Peru 203,268
South Africa 272,128
Australia 247,000
South Africa 272,128
China 247,200
Australia 247,000
USA 242,000
Peru 203,268
Russia 159,340
Canada 104,198
Mali 85,411
Uzbekistan 84,000
Ghana 66,205
Production in kgs pa:
0 kgs
50,000 kgs
100,000 kgs
150,000 kgs
200,000 kgs
250,000 kgs
300,000 kgs
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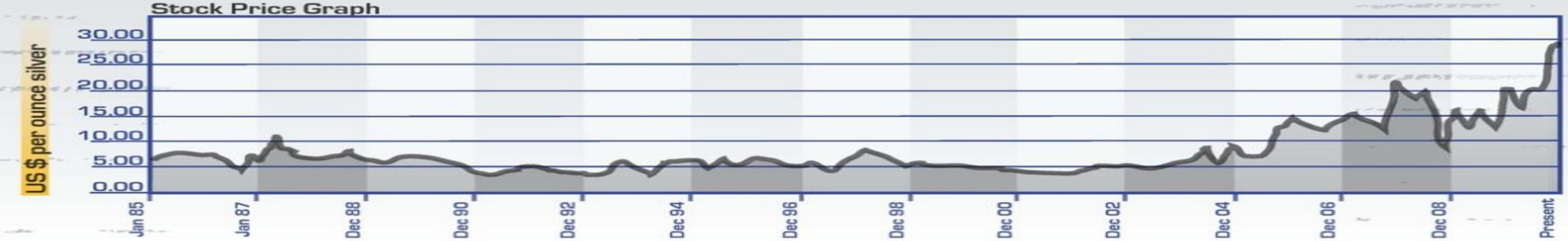
World Silver Production by Country : in millions of ounces

Stock Price Graph



Sources :
[2009 data according to the Silver Institute]
London PM Fix Silver 1985 to the present

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GOLDCORE moneychoices

Final Words

The views expressed in this presentation are purely of the presenter and does not represent the views of either the ACCA or Ministry of Finance.

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QUESTIONS

THANKS