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Market Analysis: How to Prepare for "Economic Depression"

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The week of August 15 was one of the most volatile stock market performances in years. Negative news about the global economy, gloomy forecasts and mixed signals on the jobs front battered stocks and sent gold repeatedly above \$1,800/ounce. *The Gold Report* asked an analyst, two newsletter writers and an economist the following: What should be a precious metals investor's next move?

The Gold Report: John Williams, government economist and editor of *ShadowStats*, put it this way: "The financial markets remain unstable and the U.S. dollar is viewed increasingly as the investment currency of last choice. . . Any cosmetic actions taken pre-2012 election likely only will add to the long-term inflation and dollar-debasement problems." Considering these market conditions, is this a buying opportunity for equities or a good time to take refuge in gold and silver bullion as they continue their climb north? How are you adjusting your investing positions in light of global geopolitical and financial unrest?

Nana Sangmuah, Clarus Securities analyst: All indicators point to weakening global macro-economic framework that has stoked the safe haven demand for the bullion. Despite the good run so far, I expect to see some volatility going forward and there will be some pullbacks in the near term. To stay a winner depends on when you jumped on the bullion band wagon. A better way to reap this upside is to move into gold equities with production and immediate leverage to rising gold prices. Most of these have not re-rated to the \$1,500/oz. gold price environment so pose little risk to the downside, but a lot of upside, as they continue to report record quarterly results.

John Kaiser, producer of Kaiser Research Online: The valuation lag for gold and silver equities relative to the prices of gold and silver bullion reflects an embedded pessimism about the medium- to long-term global economic outlook, which has been exacerbated by the recent debt ceiling debacle. Private sector deleveraging has been underway since 2008, and it now appears that political pressures are forcing a cycle of public sector deleveraging called "austerity." China's fiscal stimulus response to the 2008 curtailment of consumption demand depended on the American economy regaining traction by 2011, but it is now clear that American fiscal stimulus efforts have been ineffectual and China's slowing economy will not receive a boost from a recovery in American demand. This crimps expectations that China's growing economy will continue to incur a rising cost structure as domestic consumption assumes a greater share of Chinese GDP and boosts the competitiveness of American-produced goods and expands the Chinese market for them. A slowing Chinese economy, in turn, reduces the willingness of the private sector to invest in American production capacity and boost employment through manufacturing jobs. That will further encourage private sector deleveraging and result in scaled-back consumption, in effect putting in place an economic death spiral accelerated by ongoing job losses at the state and local government levels as the tax revenue base shrinks.

While the prospect of a dysfunctional global financial system boosts demand for gold and silver prices, the arrival of a double-dip recession possibly deteriorating into a full-blown depression has deflationary implications that will "pop" the so called bubble in gold and silver prices. Equities are not tracking the short-term rise in gold and silver, which could exceed \$2,000/oz. and \$50/oz. respectively, because markets are anticipating a serious medium-term retreat in gold and silver prices. We could see gold and silver head higher while gold and silver equity prices head lower. The buying window would emerge after gold and silver have spiked in the midst of "panic" conditions, with the speculation being that current prices plus or minus 20% are the new long-term reality for gold and silver prices. However, for that to happen there must be signs that the American economy is on a growth track, and that the Eurozone will avoid disintegration. The sharp sell-off in gold and silver prices in the medium term, which current equity prices are discounting, would not happen if the American economy continues its current trend of relative decline within a growing global economy. The latter requires the United States to adopt a fiscal stimulus program that produces assets that flow value to future generations expected to pay off the associated debt.

The negative scenario for gold would be one where the United States, in an effort to postpone or suspend its relative economic decline, engineers a downturn that inflicts considerable suffering on its citizens, but utterly demolishes emerging economies such as China, which represents the biggest displacement threat to the United States. The political discourse seems to suggest that the best way for America to save itself is to submerge itself and drown dependent economies before they are advanced enough to swim on their own.

Ian Gordon, economic forecaster and chair of the Longwave Group: The majority of gold investors are there because they can see the impending collapse of paper money, but some investors, including many hedge funds, are in the gold market simply because they are trend-followers. In ugly markets, such as the one now unfolding, these trend-followers sell their gold. During the stock bear market, which commenced in October 2007, the price of gold continued to rise into March 2008, even though the Dow had lost about 17.5% from October 2007 to March 2008. But after March, gold sold off into October 2008, losing about 35% of its value. We feel that something similar could happen to gold, this time, in the wake of falling stock prices. As for silver, prices fell by 60% between March 2008 and October 2008. A 35% drop from current prices would see the price of gold fall to something like \$1,200/oz. As for the stock market, we are extremely bearish and believe that in the Elliott Wave market cycles, we are entering the third downswing, which should take the Dow Jones Industrial Average well below the March 2009 low of 6,470; perhaps 4,500 will be the target by September 2012.

Jason Hamlin, president of Gold Stock Bull: I am going to continue holding precious metals and buying the dips. *The Gold Stock Bull* portfolio has been short general equities and long precious metals for the past few months, which has paid off handsomely from both angles. Having already hit my 2011 target of \$1,800, I now think gold could end the year above \$2,000 rather easily. I have not closed my short positions against emerging markets and the Nasdaq, despite the current correction. I do not anticipate a healthy rebound anytime soon, only dead cat bounces unless and until a much larger QE3 program is announced. But even with the massive liquidity injections, we are seeing the law of diminishing return take hold. Eventually, the house of cards must tumble. I have been allocating more towards physical metals and towards funds that hold the physical metal such as Central Fund of Canada (AMEX:CEF). I have also increased my allocation of gold versus silver, as I think gold will outperform under weak economic conditions.

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