

Gold: 'Inflation will beat deflation and gold will hit \$3,000'

Gold looks set to move substantially higher as governments all around the world embark on a programme of "quantitative easing"

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Last July I wrote an article for telegraph.co.uk suggesting that gold had lagged other commodities in general and oil in particular and that gold would hit \$2,000 an ounce over the next two or three years.

At the time oil was trading at \$140 a barrel and using the gold/oil ratio I suggested that either oil was far too high or gold at around \$900 was too low.

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Since then all other commodities have collapsed in value, with oil showing the most spectacular collapse of all, falling to \$35 a barrel, while gold is now higher with the price having moved up to about \$1,000 an ounce.

How then does this leave the commodity basket in the future?

Gold looks set to move substantially higher as governments all around the world embark on a programme of "quantitative easing" – or printing money, as it could be more simply defined.

In the US for example the US monetary base, the most narrow measure of US money supply, has increased more in the past six months than the aggregate total of the past 20 years.

Meanwhile China is also embarking on a money creation exercise as it is no longer fully sterilising its massive monthly foreign exchange intervention and as a result that country is deliberately inflating its own domestic money supply.

In Britain our own Bank of England is now involved in its own version of quantitative easing, which will probably involve the deliberate underfunding of the public sector deficit with the subsequent boost to the domestic money supply.

Many other countries are certain to follow suit as governments worldwide take a conscious decision not to suffer a 1930s-style economic collapse. This is fair enough but is not a cost-free exercise: the price will be much higher inflation further down the road.

The consequences are crystal clear to most investors – gold is the ultimate safe haven from governments' attempts to debase their various currencies, and will become the asset of choice for many investors wishing to protect themselves from these shenanigans.

Other consequences are that bond market yield curves will steepen significantly as long-term interest rates rise sharply and that index-linked bonds will outperform conventional bonds of similar maturity.

Oil and other commodities which have collapsed will now begin to bottom out before rising exponentially once the economic recovery kicks in. Equities meanwhile will begin a long drawn out recovery process which will result in higher equity indices all over the world. The best performing shares will be found among the gold, oil and base metal producers.

Much of the above is starting to happen now. Gold is outperforming every asset on earth, long-term government bonds collapsed in January and index-linked gilts have been outperforming conventional gilts for the past three months.

Most equity markets are above their cycle lows set last October or November, despite the unremitting bad news, and seem remarkably resilient to the torrent of bad news that is currently unfolding.

Investors should listen to what the markets are saying about themselves rather than be overly reliant on what the economists are saying about the market. The message from the markets is clear and unambiguous: reflation, not deflation, will be the ultimate winner here.

How high can gold rise? Last July I suggested that \$2,000 an ounce on a two to three-year view was possible, as this would bring gold back up to its historical peak in real terms (constant dollars) last seen in 1980.

This could now turn out to be a substantial underestimate as the stage is now set for gold to rise to \$3,000 an ounce or higher as a wave of freshly printed liquidity sparks a renewed global surge into the only asset that investors will trust in these circumstances.

If investors worldwide choose to switch 1pc of their portfolios into gold, the central banks will not have enough supply to meet that demand. Gold from mining has struggled to meet even jewellery demand for the past few years, never mind demand from investors.

At Charteris we have implemented this strategy for the funds and clients that we look after. Our gilt fund, the City Financial Fund, which according to Lipper has been the number one gilt fund in the UK since launch, is heavily weighted towards index-linked gilts.

Our equity fund, the Elite Charteris Premium Growth fund, is heavily exposed to FTSE100 oil and mining shares while our other fund, the Insch Global Macro, is 85pc invested in gold mining shares.

Ian Williams is chairman and chief executive of Charteris Treasury Portfolio Managers

Gold

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