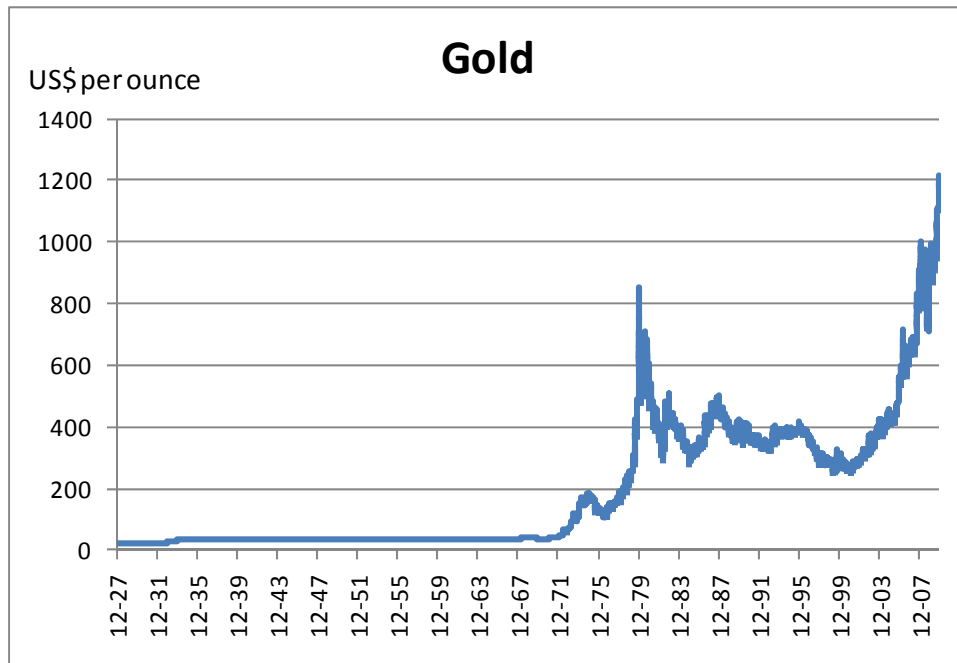


### December 2009: What is gold telling us?

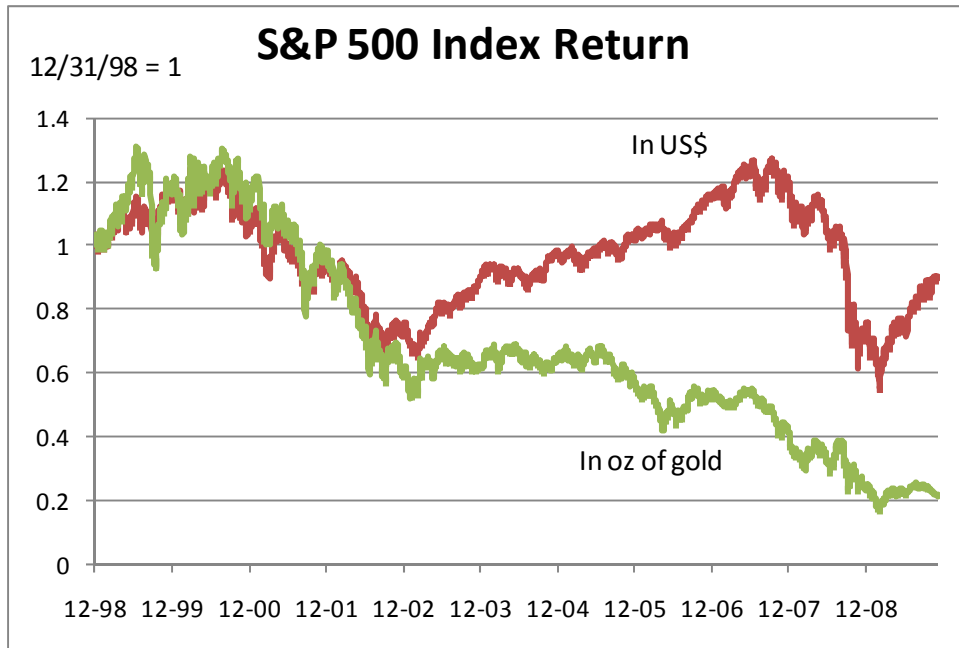
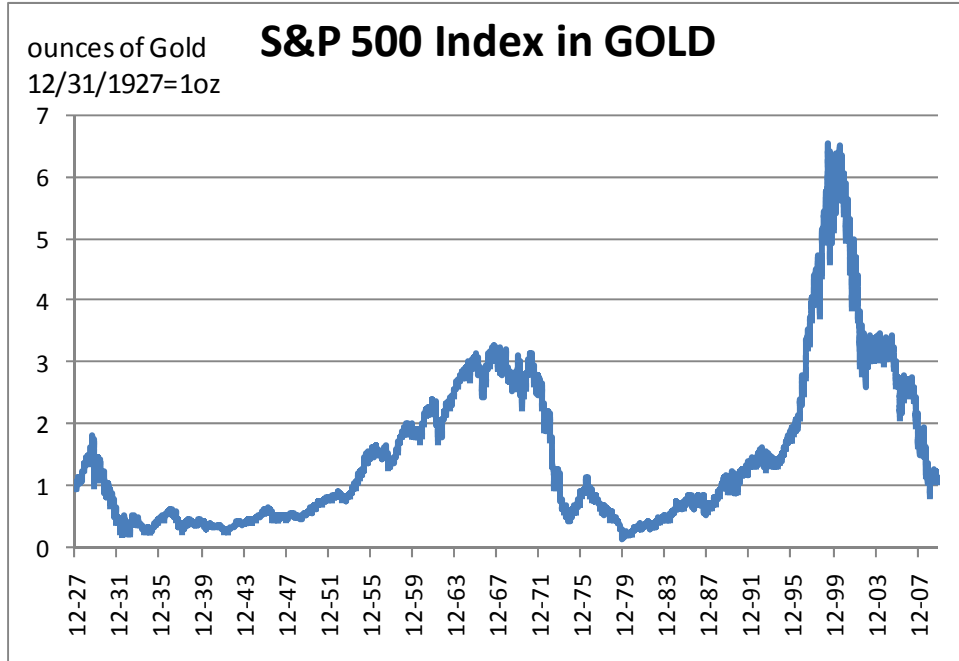


Source: Bloomberg

So why is the price of gold – which is often held up as the Bad News Asset – rising given all the good news in the U.S. economy? Stocks are up, as well are most other assets (except real estate); however, also rising are unemployment, loan delinquencies and Federal assistance to hobbled U.S. consumers. So goes the gold price.

In our opinion, the chart above tells us two things: (1) that there is a drop in confidence in the monetary authority's ability to withdraw the massive amount of stimulus provided to the credit markets before the money supply skyrockets and propels hard good prices into the stratosphere; and (2) that the issuer of the dollar, the U.S. Government, is too far in hock. Participants in the gold market may be right on both counts.

Admittedly, gold is a difficult asset for which to make an investment case because the reality is that gold yields nothing, it earns nothing, it is inert and it doesn't host conference calls. But it also doesn't expropriate shareholder wealth in the form of stock options, it doesn't overleverage itself, it doesn't reinvest in bad projects and it doesn't lobby, pollute or cook the books. Its highest and best use is as money – a store of value.



Source: Bloomberg

The price of gold (in dollar terms) can be thought of as an indicator of the creditworthiness of the U.S. government. Gold can also be thought of as its own currency since it is fungible, durable and precious. When comparing dollars to gold as relative currencies, over the last 10 years the S&P 500 is flat (in dollar terms), but down 75% in gold terms. There is an illusion of relative stability in stock prices over that period because of the debauching of the dollar; but when thought of in real terms (gold terms), investors who limited themselves to U.S. stocks (over the last 10 years) struggled.

**This is why the argument about the relative superiority of indexing or active management misses the point. Much more important is what kind of exposures to own, where there is excessive risk and in what currency terms. Macroeconomic and policy factors matter a lot and need to be considered as part of an overall investment strategy and portfolio design.**

Gold used to provoke derision and scorn from the financial establishment a mere decade ago (not coincidentally, the most scorn was heaped upon gold when stock prices reached their top relative to gold prices in 1999). As is often the case, derision and scorn by the investment establishment became a reliable leading indicator of significant future outperformance. Gold was what the top precious metals analyst at Lehman Brothers in 1999 called “a relic of the past” and professional investors committed career suicide by recommending gold to their clients.

Why does this pure form of money now take 5 times as many dollars as it did 10 years ago to buy the same quantity? Quite simply, it is because of the new unfundable commitments made by the U.S. government. That and the fact that the gold supply is fixed (at least in the short term) relative to the world’s multiplying paper claims.

The era of the Great and Powerful government is back with U.S. Congress’ move to take charge of large portions of the U.S. economy, re-write the regulatory landscape and bestow myriad benefits on non-productive, overbloated segments of our economy at the expense of future earners, entrepreneurs and innovators. Highlights: the recent takeovers of General Motors and Chrysler, a fiscal deficit of 12% of GDP, \$790 billion in handouts and assistance under the rubric of economic stimulus, a proposed costly new national health care system, and a vast array of proposed cap and trade global warming programs whose impact will likely be felt by almost every domestic industry.

We have a rallying stock market today thanks to the future taxpayers of America as Congress has committed to \$9 trillion in new deficits to help shore up the abysmal shape of U.S. citizens’ fiscal position and to replace the large hole left in the balance sheets of private lending institutions that resulted from a false belief system, poor lending practices and reckless profligacy. But \$9 trillion will only be \$9 trillion if interest rates remain substantially the same over the next 10 years and the U.S. economy manages to grow 3% per annum on average (in real terms) *and there are no recessions*. If these dubious assumptions do not hold, the deficit will be much larger.

Obermeyer Asset Management does not have an opinion as to what the ultimate high price will be on the yellow metal, or at what point we will start scaling back. But with central banks around the world converting from net sellers of gold to net buyers, with sketchy finances of OECD countries, we strongly believe gold continues to belong in clients’ portfolios. We continue to evaluate its merit and monitor relevant factors for fundamental change. Gold will certainly have periods when it underperforms other assets, but it will also have periods when it doesn’t.

Past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be suitable for an existing or prospective client's investment portfolio. Therefore, no existing or prospective client should assume that future performance of any specific investment or investment strategy (including the investments or investment strategies recommended herein) will be profitable or equal any historical performance levels. Certain portions of our newsletter may contain discussions of recommendations as of a specific prior date. Due to various factors, including changing market conditions, such discussions may no longer be reflective of current positions or recommendations. Information included herein should not be construed as the receipt of, or a substitute for, personalized individual advice. A copy of our current written disclosure statement discussing our business operations, services, and fees is available upon written request.