

More gold buying likely as commodities continue to perform strongly

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Few investors include gold in their portfolios. The idea of commodities as investments is challenging enough, but gold in particular seems to have little practical use. Gold's strong performance, with a price jump to more than \$1100, has come as a surprise. Is it a trend with further to run, or simply another bubble?

Share prices of gold mining companies have risen even more sharply. Randgold Resources, for example, has gained 60% this year. Even more dramatically, since mid 2007 when the stockmarket peaked, Randgold's shares have more than quadrupled. Over that period, the FTSE 100 Index of major companies has fallen 20%. Clearly, gold mining might offer little dividend income, but has the potential to give portfolios some protection in bear markets, and to add to performance.

The latest move in gold was sparked by a major purchase by India's central bank. That highlighted international concern about the role of the US Dollar as a reserve currency. US deficits, and American willingness to print more Dollars, have unnerved other central banks. Gold is seen as a safer store of value, and China has almost doubled its gold reserves in this decade. Even so, gold represents a much smaller portion of reserves in India and China than in most European countries. More gold buying seems likely.

Gold's role as a store of value can be traced back 6000 years. It may have little intrinsic value, but the fact that the total supply expands at less than 2% each year, helps its stability. It is compact, inert, and can be assayed relatively easily. And, while interest earned by lending gold is minimal, many investments also now have low income. Investors are experiencing very low returns from bank savings. At a time of concern about currency debasement - as quantitative easing and printing money are undermining the Pound and US Dollar - investors are looking for alternatives.

Gold could be part of a redefined global reserve currency, combined with a basket of Asian currencies. While it would be difficult to

create a new reserve currency, China and other countries running big trade surpluses will continue pressure for change. That seems likely to see more gold buying, and US Dollar weakness. In the UK, pressure on further devaluation of the Pound is even more acute. 2010 could bring a crisis in public finances and gilt sales. Overseas assets and earnings can help protect portfolios from this.

2009 has brought new global unity in controlling the financial system. But, the unprecedented economic stimulation brings risks, including inflation. The US Dollar is currently the clear reserve currency globally, representing about 70% of reserve holdings. No other single currency can yet replace its reserve status, but currently Dollars are too easily printed or borrowed. In time, concerted global action seems likely to create a new reserve and control global liquidity.

For UK investors, gold is just one way of helping to protect against a weak Pound. Other internationally traded commodities may also gain. And, many London listed companies, ranging from engineers to insurers, now have substantial international earnings. Gold itself may pose investment risks, but the principle of protecting portfolios against currency debasement is a good one.

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