



INVESTMENT U RESEARCH REPORT

How to Profit from Gold's Surge

By Investment U Research Team

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Lets face it. These aren't the best of times for the U.S. economy.

The credit markets are still in turmoil. The real estate industry is not yet back on its feet. U.S. employers still aren't hiring. 140 banks failed last year and an even higher number of failures is expected this year. The dollar is losing purchasing power, and the federal stimulus plan failed.

As a result, we can't seem to revive this economy and it looks like the problems will last well into 2011. So how can we protect our assets and stay diversified in this type of environment?

Quite simply, it's time to invest in gold – what many consider the “crisis commodity” – and for very good reason. Gold is the only commodity that has consistently outperformed other investments during periods of world tension. In addition, since the end of World War II, during the five years in which U.S. inflation was at its highest – 1946, 1974, 1975, 1979 and 1980 – the average return on stocks was negative 12.33%, as measured by the Dow. Meanwhile, the average real return on gold was 130.4%!

But gold doesn't have to be “just a hedge” against crisis or inflation. We have moved into a new era, where gold is going to play a major role in generating healthy returns for your portfolio. Here's why:

- ✓ Gold continues to hit new all-time highs as it maintains its upward march. Gold's been on a volatile ride, but the weak economic outlook and massive government deficits is boosting the metals appeal.
- ✓ From its peak in 2001, the U.S. dollar index has declined more than 30%.
- ✓ Gold is seeing skyrocketing demand in the developing nations of India and China.
- ✓ Mounting regulations and increasing taxes is hurting businesses and rattling investors' confidence.
- ✓ Huge government funded bailouts are laying the foundation for tremendous inflation in the years ahead.

With these very big, identifiable and sustainable trends already underway; it is no wonder that the outlook for gold is improving dramatically...

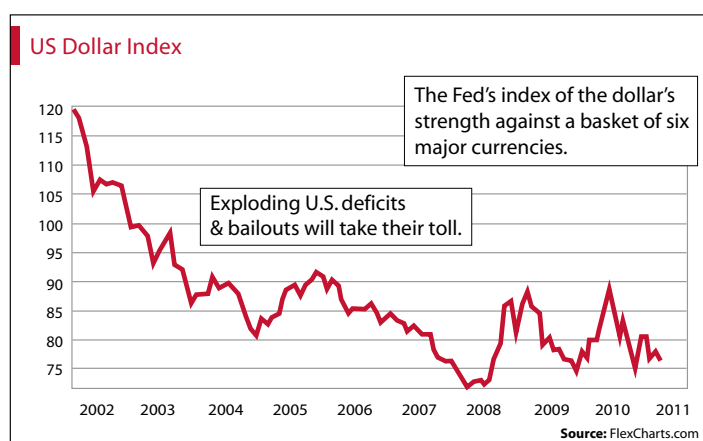
All Aboard, Gold is Leaving The Station

According to Robert McEwen, CEO of U.S. Gold Corporation, *“Gold prices may reach \$2,000 an ounce on demand for an alternative to currencies. You have much more money than there is gold, and as people see their currencies falling relative to gold, they're going to be saying ‘Maybe I should have some of this.’”*

Adam Hamilton of Zeal Intelligence says that, *“If our current gold rally truly unfolds into a Great Gold Rally, \$1,000 gold is merely the first stage. A gold bubble, which will probably ultimately happen as a way*

to climax the coming gold mania, maybe five to seven years out, could easily launch gold above \$5,000 per ounce. The actual top of a new gold bubble at the final pinnacle of another Great Gold Rally could touch \$6,000+ per ounce!”

Just take a look at this chart of the U.S. dollar versus a basket of other currencies. Need we say more? Holding dollars has not been a “good idea” for several years now. Foreign investors are slowly making that realization and are actively looking for investments that are appreciating, not depreciating. Gold fits the bill.



India and China Want More, More, More

The economic fundamentals for gold are also very favorable. Production of gold from South Africa, the United States, Australia and Canada has dwindled every year over this past decade. These countries, which combined to produce two thirds of the global gold through the 1980s, now produce less than half of the gold mined today. South Africa, the world's largest producer of gold up until 2008, has hit its lowest production levels of gold in 84 years and its production costs are now among the highest in the world.

Meanwhile, physical demand for gold has been going through the roof. Much of the recent explosion in demand can be attributed to retail investors in India, China and Asia developing an appetite for gold as investments, instead of just for jewelry and accessories. Considering that makers of bracelets, necklaces and earrings account for 69% of gold's global demand, this little shift could be a huge boon for the yellow metal.

India is experiencing an 80% growth in gold investment following a loosening of trade and market restrictions. With economic growth running at an annual 9% and plenty of foreign capital entering the country, India can finally afford to gorge at the gold trough. As India develops an increasingly prosperous middle class, investors are purchasing gold. India's gold consumption rose nearly 70% in 2007, 18% in 2008, 16% in 2009, and over 66% in 2010.

Additionally, in India, home to a billion people, gold is more than a traditional store of value; it is an inseparable part of the culture. For example, gold and Indian weddings go together like pasta and Italian weddings. According to India's latest census, more than 47 million girls in the age group of 15 to 29 have yet to tie the knot. Assuming 80% of them do so in the next five years, that's 38 million weddings. At a very modest 10 grams per wedding, or slightly less than one-third of an ounce, that would translate into 76 metric tons of demand a year, enough to buy a fifth of all gold mined in South Africa last year! Imagine the possibilities...

India is now the world's biggest gold consuming nation. Its share of global demand is about one and a half times that of the United States, though its GDP is only one twentieth that of the United States. With its high rate of gold consumption, India accounts for more than 20% of the annual global gold demand, while its share of global GDP on nominal dollar GDP is only 1.6%.

And let's not forget China.

China, which has the fastest-growing economy in modern history, is undergoing major changes in the way it handles gold. Private gold ownership had been outlawed for generations. But in 2002, the Shanghai Gold Exchange opened and started free trade in gold for the first time in the nation's history.

And then in 2004, China legalized gold investment by private citizens.

Considering the high savings rate in China, gold is a logical investment. It's estimated that the equivalent of U.S. \$36 billion in Chinese private investment could move into gold in coming years. Plus, the Chinese government is moving to increase its low gold reserves. Given these recent developments, China alone will consume 40% of the world's entire gold production for years to come.

A Monetary Meltdown

With growing evidence that the problems from the real estate and banking sectors have spread to several areas of our economy, it is no wonder that investors' confidence in the dollar is shaken. Big banking firms have written down billions from subprime-backed securities and there are hundreds of billions of dollars more expected to come over the next several years. The United States is saturated with exploding debt. The U.S. Federal Debt is now more than \$14.1 trillion.

This debt is a major part of the inflationary storm that will further erode the dollar and continue its downward spiral. As the chart on page 3 indicates, the dollar's long-term track record is terrible and recent events will only worsen the situation.

When some of the richest and most knowledgeable moneymen think the dollar is doomed, it's best we sit up and listen:

- ✓ Warren Buffett advises you to "build an ark" to protect against the fallout from the falling U.S. dollar.
- ✓ Paul Volcker, the former head of the Federal Reserve Board, gives a "75% chance of an economic crisis in the next five years."
- ✓ Professor Kenneth Rogoff, a former head researcher at the International Monetary Fund, warns of a potential 40% drop in the greenback's value or more.

The U.S. Federal Reserve has kept interest rates at or near zero for over two years now, but it isn't the only institution to take action to stabilize rates. The entire world has had to enact drastic measures as well, thanks to the U.S. credit problem spreading to the broader global markets. Central banks all over the world have had to coordinate efforts to mitigate the problem. For example, the European Central Bank has pumped a record \$550 billion into the system. Moves like that eventually have to push commodity prices higher, damaging the purchasing power of major currencies as it does.

The Golden Bull

Traditionally, there are several things that have made the price of gold increase in the past. One of the things that have traditionally fueled inflation is the price of commodities. And right now, prices for most commodities are up and set to head higher.

Another telling indicator for higher gold prices is the tremendous increase in the money supply. The federal reserve gave out trillions of dollars in "handouts" to troubled firms and the treasury is printing money at unprecedented levels.

Fact is, gold producers are buying back their hedging contracts so they can fully participate as gold prices head higher. This includes the largest hedge holders, Barrick Gold and Anglo-Gold Ashanti, which are both aggressively eliminating their hedging contracts.

To date, never has a world government spent (or planned to spend) so much... and avoided inflation. With today's strong economic indications for higher gold prices, we expect another 10 years of bull market conditions for gold.

And we're not alone in this thought; John Hathaway, Portfolio Manager for the Tocqueville Gold Fund, says, *"Gold is in a bull-market trend, and there are a lot of reasons for that, and we will see higher prices. People shouldn't be surprised to see gold trade in the four digits. Investors should worry less about whether this particular moment is a good or bad entry point and ponder the implications of sailing through uncharted waters without a lifeboat."*

Billionaire John Paulson – hedge fund manager and one of the most successful speculators of the last 15 years – is recommending investing in gold. He's already placed more than \$4 billion of his firm's assets in the metal.

J. Taylor of J. Taylor's Gold and Technology Stocks advises: *"This is a different gold bull market and most bullish of all is the fact that it is still a stealth bull market. The voice of the global market is just starting to express a declining confidence in the dollar. I believe we are still in the very early stages of a major gold bull market. We have a long, long ways to go toward \$3,000 and beyond."*

How To Add Gold To Your Portfolio

Our Oxford Asset Allocation Model recommends that you keep 5% of your assets invested in precious metals. And although we have had great success investing in individual gold stocks – Placer Dome, 33% gain; Newmont Mining, a 54% gain; and Barrick Gold, a 61% profit – the volatile nature of gold shares can make it difficult to hold on to individual stocks. So, we've found a better, and what's turned out to be more profitable, way to meet our allocations in precious metals.

These days, we use precious metals funds or exchange traded funds. For instance, we have the Vanguard Precious Metals & Mining fund in our Gone Fishin' Portfolio. The fund typically invests at least 80% of assets in the stocks of precious metals companies, primarily gold stocks. It may also invest up to 20% of assets directly in gold, silver, or other precious metals bullion and coins. And it has done extremely well for us: Up 307% since being recommended. The one drawback of the Vanguard Gold & Precious Metals Fund is that it has a \$10,000 minimum investment. And for some people, that just didn't fit with their allocation model. So we have a different recommendation for you now.

Our alternative is the Market Vectors-Gold Miners ETF (AMEX: GDX). But before we jump into the benefits of this fund, let me give you an example of a situation that came up with one of our gold stock recommendations, which illustrates the problem with holding individual gold and precious metal stocks as part of your allocation model.

The problems we ran into with Newmont a few years ago are a good example of the difficulties of selecting individual mining stocks. Newmont was plagued by higher-than-anticipated costs for energy and raw materials, labor problems at its Yanacocha mine in Peru and the closure of several mines in the United States, leading to an announcement that it would produce less gold. And that in turn caused analysts to drop earnings estimates by 30%, which led to a 25% decline in the share price.

In other words, you may find yourselves invested in a company facing problems specific to its operations, where concerns lead to a decline in share price, even in the midst of a gold bull market.

Although we are certainly advocates of holding individual stocks, when we see a big positive trend unfolding for a specific industry, it's a good strategy to "play the field." That's why we're recommending purchasing **Market Vectors-Gold Miners** (AMEX: GDX), an exchange-traded fund.

This ETF Is Golden

The Market Vectors Gold Miners ETF is linked to the AMEX Gold Miners Index, and owns all of the world's leading gold and silver mining companies. That means you can capture the performance of the

entire sector with a single, well-diversified investment.

The Gold Miners index is comprised of 45 publicly traded mining stocks of various weight and size. For investors who are not up to the task of individual stock picking but want to take part in any run in gold stocks, GDX certainly provides good market exposure to the gold mining sector.

This ETF is truly a wise way to play gold. It eliminates the vagaries associated with selecting individual stocks, including mines shutting down and price volatility. And the performance has been impressive... up more than 33% over the last 12 months.

The annual expense ratio is a little over one half of one percent. The shares can be margined or sold short – and there are options available for traders who prefer to play gold more aggressively.

If you currently have less than 5% of your assets in precious metals, Market Vectors Gold Miners ETF is an excellent addition to your portfolio.

Though we fully expect the price of gold to rise more than 100% from current levels, the recent peaks and corrections in the gold market show this won't be a strictly vertical climb. Brace for ups and downs... but when all is said and done, you'll be all the richer for it.

Action to Take: Buy *Market Vectors Gold Miners* (AMEX: GDX) at market. As with our other gold shares, we're using a 35% trailing stop here due to the higher beta of this sector. GDX is not currently part of any of our Oxford Club portfolios.

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