Investing in Precious Metals

The Party in Precious Metals And Currencies is Heating Up...
Look for This Major Bull Market to Push Prices Even Higher in 2006
by Michael Checkan, Investment Advisory Panelist

It's a cold, crisp January day. You step off the Metro in Washington, D.C. and scurry over to the "gold corner" at 18th and K Street. All too soon, you realize that you were not early enough. The line extends around the city block long before the company opens. The marquis is flashing the gold close of yesterday. Once the markets open, nobody knows how high it will jump.

You hurry to your place in line and immediately make offers to buy your way closer to the front. Five days ago, gold jumped $76 an ounce in a day. Spending a few bucks to get closer to the front of the line seems like a good investment.

The day was Monday, January 21, 1980. The previous Friday, gold went up another $85. By day's end, gold would peak at its all-time high of $850 per ounce...

This is a true story. My partner, Glen O. Kirsch, and I saw it firsthand. We were senior managers with a company called Deak-Perera at the time, selling precious metals and foreign currencies. The fervor was intoxicating and absolutely compelling.

Two days after gold peaked, President Jimmy Carter addressed the nation on its State of the Union. I've bulleted the key statements from his address and other headlines of the day below. Do you get a feeling of deja vu?

- "At this time in Iran, 50 Americans are still held captive, innocent victims of terrorism and anarchy."
- "First, we will continue to reduce the deficit and then balance the Federal budget."
- The Cold War was at a crescendo as the Soviet Union amassed troops for military operations in Afghanistan.
- 1979 saw the largest peacetime increase in consumer prices in history…13.3%.
- Of course, the major catalyst to higher prices was the escalating cost of oil.

The similarities to today's events are unnerving, and many lessons from the past are about to replay this year. So let's take a look at what to expect in 2006, starting with investing in precious metals and then moving on to foreign currencies.

The Major Bull Market in Precious Metals Investing Is Confirmed

As predicted, 2005 brought a change from the mini-bull market in precious metals that began in January 2001 to a major bull market. The key indicator in this regard was an appreciation of precious metals against all currencies, not just the U.S. dollar. In fact, the precious metals outpaced a U.S. dollar that was itself surging against the euro and the Swiss franc (more on that in a moment).

In 2006, I see a continuation of appreciation as the major bull market matures. In my estimation, precious metals are appreciating because, fundamentally, they should. Let's look at precious metals gold and silver...and what to expect from investing in them in 2006.

Gold – Increasing Demand Pushing Up Price

After hovering near the cost of production for years, the effect on supplies is being felt. With insufficient revenue, many mines were forced to close down or consolidate, and mining companies had to curtail new exploration. The funds just were not available. The pipeline slowed.

Typically, when there is a shortfall in supply, the demand is met by institutional metal from Central Banks. However, in recognition of the trend, Central Banks are now opting to increase (not decrease) their gold reserves.

Further, several important demand-side factors are putting upward pressure on the price of gold. The advent of Exchange-Traded Funds (ETFs) has pulled a large volume of gold off the market and has increased the public's awareness of gold, an effective alternative to dollar-based investments with a proven track record dating back 6,000 years.

The opening of the Shanghai Gold Exchange in China, and the emergence of middle classes in countries with an affinity for gold (China, India) are building up pressure in the form of increased demand for gold.

Expect gold to build off its 2005 gains. The downside continues to be limited, and the upside is wide open as the furor builds. With the right convergence of factors and events in the coming year, we may well test new high ground. Whether we do or not will play out before our eyes, but I am confident that higher prices are in store.

Silver – A Growing Supply Shortage

Silver continues to be my strongest candidate for investing growth. In fact, based upon recent news, I am even more bullish on the "poor-man's gold."

Sixteen straight years of supply deficits have caused aboveground supplies to dwindle to alarming levels. This idea of supply shortage has been played down over the past few years even as my firm and others have tried to raise awareness.

COMEX warehouse stocks continue to rest at uncomfortably low levels. The U.S. government continues to buy silver on the open market to meet demand of more than 8 million ounces per year for the Silver American Eagle program. Supplies of silver coming out of China have dramatically dwindled over this past year, and (whether it can be believed or not) Chinese government officials are publicly acknowledging the fact that they have exhausted their aboveground supplies. If true, China is now in the same boat as the U.S. government to meet silver needs.

Lastly, if successful, Barclays will launch an ETF for silver that would immediately require it to purchase 130 million ounces of the white metal. In a supply-strapped environment, the effect on silver prices could be astronomical.

Look for silver to continue, and even accelerate, its price appreciation in 2006. A range of $12 to $15 per ounce by year's end is entirely possible.

Foreign Currencies: A Bear-Market Rally

The foreign currency markets have followed a different path in 2005. Here, we have seen modest gains by the U.S. dollar versus the commodity currencies such as the Canadian, Australian and New Zealand dollars. The real story for currencies has been the appreciation of the U.S. dollar versus the Swiss franc, euro and British pound, up anywhere from 11% to 14%.

So Has the Dollar Bear Market Turned Around?

Absolutely not. This is simply a bear-market rally in the U.S. dollar. Its impact is only felt, to a small extent, by the commodity currencies (CAD, AUD, NZD) because they are benefiting from the demand in precious metals and other commodities. And, in general, they enjoy an interest rate advantage to the U.S. dollar.

But Why is the Dollar Rallying?

Interest rate differentials (to a lesser extent) and capital repatriation (more notably) explain the phenomena. Short-term money still flocks to the currencies with the best rates. Here, euro and Swiss francs are at a disadvantage to the U.S. dollar.

Additionally, the second half of 2005 saw an increase in repatriation of funds from U.S. companies with a presence abroad. There are tax benefits afforded to these companies on repatriated profits. That is the good news for the dollar. The bad news is that this window of opportunity closed December 30. Therefore, since the dollar has not solved any of its fundamental weaknesses in the past year, expect money to flow back out as quickly as it flowed in.

When this exodus begins, I expect all five currencies mentioned above to benefit. The commodity-based currencies will reap the rewards of a precious metals market gathering steam. I expect the euro and the Swiss franc to once again test their recent highs in 2006.

2006: Here Is Where the Fun Begins in Precious Metals and Foreign Currencies

As we go one year deeper into the "Decade of Commodities," those who have acted should see even greater appreciation as a reward for their move out of the U.S. dollar. Those who have not acted yet should consider doing something soon.

The potential for appreciation in currencies, based on the flow of repatriated U.S. dollars, is strong. Even stronger is the chance for further appreciation of precious metals, one of investing's best-performing asset classes of 2005.

There will be bumps along the wild coaster ride over the next few years. Precious metals and foreign currencies may actually fall from time to time, and fall sharply.

However, such corrections are not signals of the end of the bull market. They are, just as the word implies, corrections in an overall trend that remains intact.

Famed investor Bernard Baruch, as I have mentioned in previous articles, was not concerned with the first 20% or the last 20% of appreciation of an asset. He only looked to make the 60% appreciation in the middle – after the trend is established and before the signals of a trend change appear. This 60% range is where we find ourselves investing in precious metals in 2006.

The party is not over… it is just continuing.

I hope to see you there.

Good investing,

Michael Checkan

FOUR WAYS TO BENEFIT FROM GOLD & SILVER IN 2006

- Bullion Bars and Coins.* Purchase bullion (small bars of gold or silver) from a trusted source. Common gold coins are known as "bullion" coins, like the Canadian Maple Leafs. You can store metals in a safe at home or in a safe deposit box at the bank. Or, for an IRA account, you can have an approved IRA custodian store them for you.
- Perth Mint Certificates.* Buy your physical precious metals in the form of a Perth Mint Certificate. Your precious metals are stored at the Perth Mint in Western Australia, with a government guarantee. You receive a Certificate that shows title to the precious metals held on your behalf. Perth Certificates are highly recommended for safety and are extremely liquid.
- Gold & Silver Blue-Chip Mining Stocks.* Buy shares in corporations that are in the business of exploration and mining precious metals. I don't recommend junior mining stocks (exploration companies) – a little too risky for my blood.
- Futures and Options. Buy contracts through a licensed commodities broker. This is a leveraged approach to buying precious metals, and you can make hefty percentage gains. Yet, they present the highest risk, and I don't recommend them for novice investors.

*IRA Acceptable

FOUR WAYS TO BENEFIT FROM APPRECIATING FOREIGN CURRENCIES

- Banknotes & Traveler's Checks. This is the least cost-effective in terms of rate of exchange, but it is safe in that you hold the currency. Gains are limited to currency appreciation.
- International Certificates of Deposit.* Electronic transfer offers best rates of exchange. In addition to currency appreciation, there is a small guaranteed rate of return on the CD.
- Swiss Annuities* Electronic transfer offers best rates of exchange. This is the insurance industry's answer to the bank CD, with annuities offering both interest and dividends. Additionally, there is a small amount of asset protection.

- Securities (stocks, bonds, etc.) Denominated in Foreign Currencies.* Electronic transfer offers best rates of exchange. Your gains reflect currency appreciation as well as the appreciation of the share price plus dividends.

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