FideliTrade Incorporated

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Presents...

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The Refined Investor

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FideliTrade Incorporated® is a full-service precious metals company specializing in the sales, trading, custody, and delivery of precious metals bullion products for individual, commercial, and institutional clients worldwide.

The Gold-Dollar Relationship:
The Return to Symmetry

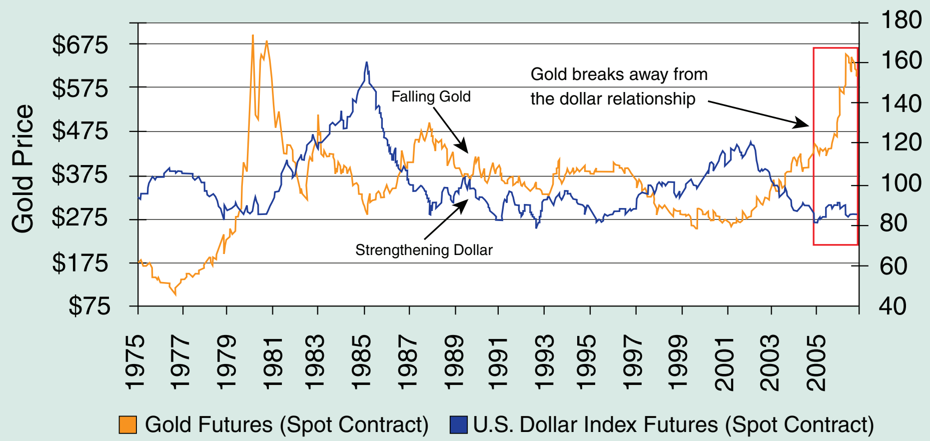
By Tony J. Anzalone, CFA

Gold has always been troubled with a blurred identity. Depending on whom you ask, gold can be referred to as a commodity, a currency, or just something to bury in your backyard. The truth is gold has a unique blend of characteristics which make it all things to all people. Most individual investors, fabricators and jewelers tend to view gold as a commodity. The largest central banks of the world, on the other hand, view gold as a currency. Along with the euro, the yen, and a host of other currencies from the worlds' most industrialized nations, the top 30 central banks held in their vaults a combined 991 million ounces of gold in 2005.

Characterized by ample liquidity, 24-hour global trading access, and universal acceptance, gold clearly is treated as a currency by the central banking community. However, it is not the liquidity and accessibility that makes gold so attractive, it is gold's behavior. Over the last thirty years, gold has displayed a fairly consistent symmetrical pattern to the U.S. dollar. Yet, there are times when the link between the two collapses.

The last 20 months have been a phenomenal period with regard to gold's performance. Gold's aggregate return was over 51%. However, the dollar only declined a slim 1.4%. This is a clear departure from the inverse relationship that is normally seen. This article examines in greater detail this departure and the potential benefit to gold if the symmetrical relationship should return in the New Year.

Gold vs. $U.S.



Source: New York Board of Trade (U.S. Dollar Index) New York Mercantile Exchange – COMEX Division (Gold Futures)

The chart above clearly displays the inverse relationship over the last thirty years between gold and the dollar. When the dollar strengthens, gold tends to fall and vice versa. This certainly was the case in January 2002 when the U.S. Dollar Index, a geometric weighted average that tracks the value of the dollar against a basket of six currencies, began to fall steadily. At the same time, gold began its historic rise. However, for the last few years, gold continued to ascend while the U.S. dollar remained relatively unchanged. This is a change in the usual dollar/gold behavior.

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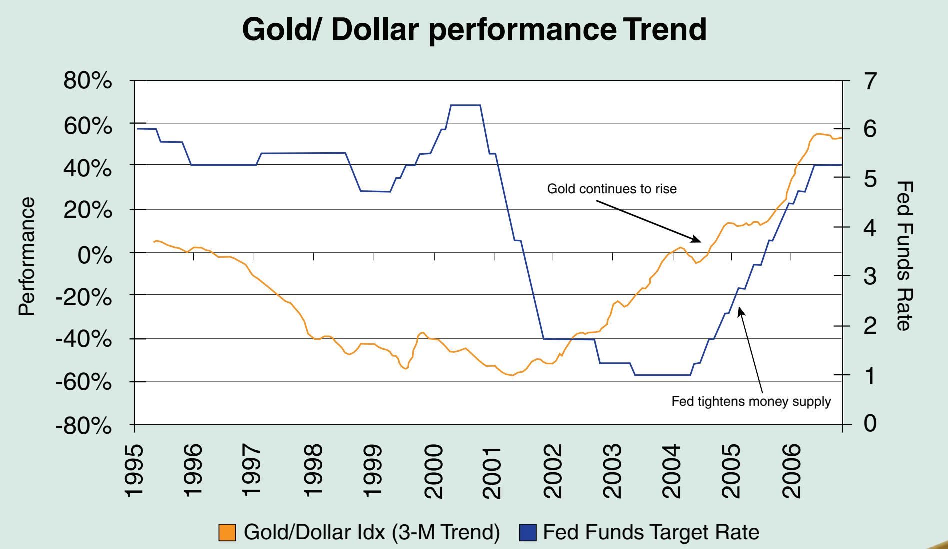

Source: Federal Reserve Bank of New York

The Gold/Dollar Index tracks the monthly differential between the percentage performance of gold relative to the percentage performance of the dollar. When the index moves upward, gold's performance exceeds the dollar's performance. Inversely, when the index moves lower, gold underperforms relative to the dollar. A 3-month moving average was used to smooth the graph.

Gold's performance relative to the dollar can best be seen by viewing the Gold/Dollar Index above. Gold's ascension continues unabated in spite of the Federal Reserve's attempt to strengthen the dollar in June 2004. It was here that the Federal Reserve began what would be 17 consecutive rate increases in an effort to slow down a booming U.S. economy. When the Fed increases rates, it pulls dollars out of circulation as general borrowing decreases and dollar denominated government securities become more attractive. This usually results in a strengthening of the dollar and weakening of the gold price. Although the dollar did not respond as anticipated, gold surprisingly breaks from the traditional relationship to venture to new highs. This departure worked out well for gold as the metal finished 2006 in a far better place. Should gold renew its classic relationship with the dollar now, it may be poised to seek higher levels as further weakening of the dollar as well as other bullish factors stack up in the New Year.

Other bullish factors include:

China

Continued demand for the physical metals caused by extraordinary economic growth in China creates an explosive need for commodities including gold, silver, and copper.

Central Banks

Increased demand for gold as most banks are dumping U.S. dollars. Since banks hold massive amounts of U.S. currency worldwide, the only realistic alternate currencies with enough liquidity is the Euro and Gold.

Federal Reserve (U.S.)

Are the Fed's rate hikes near an end? Most economists feel that this is the case. If so, the U.S. economy may be in a tricky spot. Some analysts feel the economy has been artificially fueled by massive consumer spending driven by favorable home equity financing, prolonged low interest rates and a declining personal savings rate. If the U.S. economy slows down enough in 2007, the Fed may be forced to stimulate the economy by moderately decreasing interest rates thus further weakening the dollar.

Gold clearly has had another very good year returning close to 23%. Rising oil, war, solid investment demand and geopolitical unrest all played a part in gold's performance in 2006. Uncharacteristically, the dollar had a much smaller influence than is typical.

2007 is developing into a fundamentally good environment for gold. With the exception of waning demand from the jewelry sector, typical when prices climb, continued consumption from China, rising personal incomes in India, and increased investment interest will help gold in the New Year. Combine these events, a weakening dollar, and a return of the "symmetrical link", and gold could be propelled to new highs.

Precious Metals Factoid

Silver ions attach to the thin walls of bacteria, disrupting key chemical reactions without affecting surrounding human cells. A new line of bandages and ointments laced with silver have been successful in fighting infection.

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