

# MARKET WATCH

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**Market Stats** 14/10/2008

**Major Indices**

|              |          |
|--------------|----------|
| FTSE 100     | 4,394.21 |
| FTSE 250     | 7,094.45 |
| Eurostoxx 50 | 2,756.74 |
| S&P 500      | 998.01   |
| Nikkei 225   | 9,447.57 |

**Economic Indicators**

Inflation (CPI) % chg on year

|              | current | since      |
|--------------|---------|------------|
| Base Rate-UK | 4.50%   | 08/10/2008 |
| Base Rate-US | 2.00%   | 30/04/2008 |
| Base Rate-EU | 4.25%   | 03/07/2008 |

**Sterling Exchange Rates**

|           | spot     |
|-----------|----------|
| US (\$)   | 1.7607   |
| Euro (€)  | 1.2803   |
| Japan (¥) | 181.1912 |

**Commodities**

|                       | spot   |
|-----------------------|--------|
| Oil Brent (\$/Barrel) | 74.50  |
| Gold (\$/fine oz)     | 846.10 |

## MARKET STATS

**Economic Outlook**

The outlook for UK growth is continuing to deteriorate with a weak housing market, squeezed real incomes curbing consumer spending and the credit crunch weighing on business investment. CPI inflation is likely to peak at more than 5% but we expect this to fall back to the 2% target over the next year. This will enable the BoE to further lower interest rates, benefiting consumers and businesses alike.

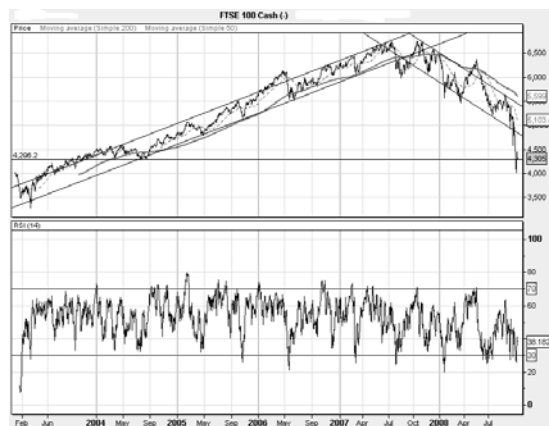
**Equity Technical Outlook**

With the FTSE 100 nearly 35% off its recent high of 6732.40 reached in October 2007, equities are firmly entrenched in a bear market. The main indicator of the movement's strength the RSI (Relative Strength Index) remains weak below the signal level of 50. The index is massively below its bearish trend channel with no technical support until the 3,500 level. In these markets technical analysis is of little use.

## INVESTMENT THEME

**Gold**

With stock markets making fresh lows and volatility at



record highs, investors are understandably fleeing towards the safety of government gilts as well as tangible assets, the most popular of which is gold. Indeed there is no other market in the world that has the universal appeal and allure of the gold market and there are many good reasons for investing in these uncertain times.

**Gold as an asset class**

**1) A hedge against inflation**  
In today's environment of high inflation, gold provides the perfect hedge during the inflationary 70's for example, gold's real purchasing power increased by more than six

times. It is interesting to note that at the time of the American War of Independence an ounce of gold would have bought you a nice suit.

Today an ounce of gold will buy you a nice suit. This perfectly illustrates gold's ability to maintain its purchasing power through the generations, unlike national currencies which are easily manipulated by politicians.

**2) A hedge against deflation**  
Once the current inflationary pressures pass as the economic difficulties unfold, gold will also provide a hedge against deflation. For example, between 1929 and 1934,



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its purchasing power went up by an astonishing seventeen times.

**3) The weak US dollar**

With most market commentators predicting a long-term decline in the value of the US dollar due to the twin deficits, gold-being priced in dollars-provides a hedge against the weak US dollar with an inverse correlation of 93%.

**4) Geopolitical risk**

Geopolitical tension, presently emanating from Russia and the Middle East, is often associated with a flight to gold with its deserved reputation as the ultimate safe haven currency. Being the oldest form of money it should continue to shine given the nasty array of risks to the world economy and its major currencies.

**4) Low correlation to the stock market**

Gold is the least correlated asset class to equities, bar gilts. In every correction since 1979, gold has risen in absolute terms when UK equities have fallen, rising an average of 305.5%.

At its current price of over \$800 per ounce gold is well above its low of \$252 reached in August 1999. However, apart from the looming recession and ongoing geopolitical tensions in the Middle East there are plenty of long-term fundamentals that are likely to drive the gold price higher.

**LONG-TERM FUNDAMENTALS**

**1) Central bank buying**

Central banks in Asia and the Middle East, well known for storing USD dollar reserves, have started to diversify away from the dollar and are purchasing gold as an alternative.

**2) Growth in the jewellery trade**

Demand for gold jewellery will continue to grow as a prosperous middle class emerges in the developing world, where gold is far more popular as a way of storing wealth than in the West.

**3) Flat gold-mining production**

Gold-mine production has been flat or declining since 2001. Relentless government

selling of their reserves (think Gordon Brown) drove the price down leading to companies scaling back exploration, reducing spending on existing assets and hedging their output to outrageously low levels. Peak gold has been reached with production stagnating or declining in 8 of the 12 most important gold producers. Major producers have just 10-15 years of gold reserves (iron ore producers have 50-plus years of resources) and it takes approximately 10 years to set up a new mine and deliver gold to the market

**4) Price in real terms**

The previous high of \$875 per oz reached in January 1980 is equal to \$2,279 after taking into account inflation.

**5) Low interest-rate environment**

With real US interest rates negative (interest earned on money in the bank does not cover the rise in inflation) this is traditionally good news for gold: negative inflation-adjusted interest rates point to an inflationary environment and mean investors don't lose out on interest income by holding gold

**6) Gold/Oil ratio**

The gold/oil ratio is currently 11.35 (the price of gold is 11.35 times the price of oil) compared with the post-war historical average of 17.2. With peak oil having been reached and OPEC accustomed to oil prices at \$100 a barrel, the likely scenario points to a rising gold price rather than a falling oil

price. Should the ratio revert to the historical relationship of 17.2 and assuming an oil price of just \$70, the gold price would rise to \$1,204 an ounce.

**HOW TO BUY GOLD**

**1) Gold Bullion**

Traditionally gold bullion as an asset class has been difficult for retail investors to access with its accompanying high costs of brokerage, transportation, storage and insurance. However with the introduction of exchange-traded funds, investors can now buy gold via a single share. The Lyxor Gold Bullion Securities ETF for example can be bought on the London Stock Exchange during normal market hours, in pound

*(Continued on page 25)*

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# MARKET WATCH

## OLYMPICS-LONDON SCALES BACK PLANS AS CREDIT CRUNCH BITES

(Continued from page 23)

sterling as well as US dollars with an annual management fee of just 0.4% which covers the cost of storage (allocated gold is held in a vault by HSBC in New York) and management. The gold price has risen approximately 85% over the last 3 years.

### 2) Mining Shares

Shares in mining companies are regarded as being more risky as they come with the added complications of potentially poor management; economic, nationalisation or environmental risk; the conduct of trade unions and even a company's hedging policy. However this extra risk is compensated for by the extra leverage that can result in higher returns. Mining shares are often referred to as geared plays on the gold price as they have fixed costs. Thus they historically tend to outperform bullion by three times. Gold shares have lagged the underlying gold price over the last couple of years and can fall just as much during broad market sell offs but if the historical trend reasserts itself then equity investors may benefit as share prices race to make up the lost ground. Investors not wishing to spend the time and effort researching each individual company can gain exposure via the BlackRock Gold and General fund, a unit trust run by the renowned fund manager Graham Birch. This has risen approximately 49% over the last 3 years.

### 3) Contract for differences

For speculators looking to trade on margin, contracts for differences offer the perfect vehicle for taking a short-term view either on the underlying spot or futures price. They can be traded online commission-free, 24-hours a day. For further information on these financial instruments you should contact your stock broker.

### House View

What's bad for the economy is good for gold so it is a serious contrarian play. Indeed even without the current market conditions, gold should form part of every diversified portfolio. Successful investing is about diversification and the management of risk and gold is a great way of ensuring wealth preservation and for passing wealth from one generation to the next.

With its low correlation to the

broader equity market (an insignificant correlation of just 0.09 to the FTSE All-Share), we believe that a small allocation will benefit a portfolio from the added diversification it provides, which should provide some protection in the current bear market. Our preferred investment vehicle is the Lyxor Gold Bullion Securities ETF.

You should always seek appropriate investment advice. The value of investments can go down as well as up.

The credit crunch could have a silver lining for the hard-pressed organisers of the London 2012 Olympics who can now scale back their grand designs with the full blessing of the public and the IOC.

The rationing and homemade kit of 1948 when war-weary London's hosting was dubbed the "Austerity Games" should not be necessary this time but athletes arriving in 2012 will not be greeted by the mega-structures of Beijing.

Flat-pack stadiums are likely to be the order of the day while several of the original bid's planned temporary venues could be scrapped for existing buildings in an effort to stay within the 9.3 billion pounds (\$16.31 billion) budget.

In normal circumstances the

International Olympic Committee would frown upon changes to the original bid document. Times have changed, however, and cost-cutting measures could even get a nod of approval from the corridors of power in Lausanne. Chris Higson, professor of accounting at the London Business School, said the credit crisis provided the opportunity to pare down ambitions "without losing face". On Wednesday, cabinet ministers meet to discuss security planning for 2012 primarily but financing the Games is likely to

be very much part of the debate too given the growing concerns surrounding the country's ability to bankroll an Olympics. Fencing has already been moved to a shared venue, while the shooting, basketball and equestrian sites are under review.

"Clearly in the current economic climate it is prudent to look at our temporary venues to see what other alternatives may exist using permanent structures. This process is under way," a 2012 statement said on Tuesday.

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