



**LET'S TALK ABOUT...**

FINANCIAL LEXICON EDITED BY THE SWISS ASSOCIATION OF ASSET MANAGERS

## Wish of Gold

(Part one) Gold price has rallied hugely, together with other commodities, e.g. non-precious and rare metals, agricultural products, energy resources...Despite any commodity sub-class including some items whose prices have increased more than gold's (we can just mention copper among metals, coffee, cocoa or cotton among soft commodities), most attention is devoted to gold, as well as crude oil, by the financial actors, investors and the general public. That is because gold has cultural and artistic features with it, is directly linked to the financial environment due to traditional coining and the past "gold system" (which is now being re-proposed by many, as we will discuss further down). But first of all, in an investment portfolio, gold plays major roles, particularly in times of uncertainty and market turbulence. Even if it does not generate yields, quite on the contrary causing costs for holding it, as critics always remind, it again and again performs historical multiple hedging functions, well present indeed in the Levantine and Jewish traditions, among others. Its hedging roles may be seen in both cyclical and – particularly today – structural terms. The most evident hedging role is against inflation and the connected currency devaluation. The problems in the euro zone for its sovereign debts, the huge money printing in the USA, the deficit and the debt of the US Administration itself, make the future of major currencies worrisome and even the role of the US dollar as global and reserve currency is being put into question. Suffice it to remind that the greenback lost, during the latest 20 years, more than 60% of its purchasing power, while the Swiss Franc was the star in terms of "holding" its relative value along time. Of course such doubts favour gold, which not only has moved up inversely correlated with the USD depreciation, but also during the greenback's upturn phases, according to a well defined "secular" pattern. *(to be continued) - GLT*

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(Part two) If gold is an essential tool of hedging against inflation and the related currency devaluation, that is certainly the main reason of attraction for more and more investors, as well as of its superlative market rally. Indeed its hedging roles are multiple, all of them being pretty valid and timely nowadays: hedging against potential defaults (or restructuring) by financial issuers, all the more likely in consideration of the poor state of many sovereign balance sheets. Hedging against turbulences in the economic, financial and geopolitical scenarios. Moreover the interests for gold has also been fuelled by the creation of many instruments: apart from the Swiss exclusive "gold account" which links the cash value to the precious metal's price, we can now find many mutual funds and ETF's, denominated in different currencies and also allowing the metal's physical delivery, should the investor require it, as well as futures and other sophisticated vehicles. Of course other investors may prefer to hold gold directly in bars, bullions or officially traded coins.

This "return to gold", or "wish of gold", as we have put it in our headline, by many institutional and private investors, may also be seen as part of a more general trend. On one side the precious metals' rallies are linked to the general upturns in the commodity and natural resources areas. On the other side new interest arises for real and tangible investments rather than virtual and paper ones, after the recent financial storms. And where more savings and wealth are being generated, as is the case in many Far Eastern and Gulf regions, the demand of physical gold for jewellery and hoarding is on the rise. Actually, both in the Islamic and Western environments, other interesting trends are fueling debates which could affect the sector of precious metals in the future. We will discuss them next. *(to be continued) - GLT*

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(Part three) The “new world disorder” in the areas of finance, economy and geopolitics, while generating foreign exchange instability, trade unbalances, inflation and devaluation risks, has hugely contributed to the skyrocketing appreciation of gold. Moreover it has fuelled debates on more general subjects, both in the Islamic and Western financial environments. Indeed many have spoken – and all the more are speaking - in favour of a nostalgic return to a sort of “gold standard”, that is an international monetary system to be based on the value of gold itself. Such systems, in different forms, including the ones with current and legal circulations of gold and silver coins, have always been present from ancient times up to the XIX Century. Then paper notes have replaced them but in many countries such banknotes or certificates could still be converted into a fixed amount of gold. Actually such convertibility was often suspended in case of wars or deep crisis, but it formally survived and was ratified again in 1944, as part of the Bretton Woods agreements and the new system then designed by the International Monetary Fund, which fixed the price of gold at 35 USD per ounce and the related value of the convertible greenback. The system operated until President Nixon decided to finally abolish the USD convertibility in 1971.

Now the debate about a “gold system” revival has developed and spread, as opposed to the concept of “fiat money”, solely virtual and fiduciary currency with no intrinsic value, whose price only depends on the trust people have in its issuers. Indeed the case of a gold monetary system had already been authoritatively pleaded in 1966, in a famous paper by the then Chairman of the Federal Reserve, Alan Greenspan, and the economist Robert Barro. Recently, in November 2010, the project was even advocated by the President of the World Bank, Robert Zoellick, and his statements caused inflamed reactions, despite the more and more supporters, in consideration of the progressively declining loss of trust in the USD as world reference and reserve currency and the monetary actions carried on by the Federal Reserve in Washington. *(to be continued) - GLT*

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(Part four) A gold centered monetary system, as the one mentioned by Robert Zoellick, President of the World Bank, and supported by many representatives of economic and financial environments, is back in the limelight today in connection with the diffused non-conventional monetary policies that many central banks are carrying on, first of all the Federal Reserve with its massive quantitative easing operations, which hugely increase the monetary base, undermine the US dollar's external value and create the base for potential inflation. Indeed a "gold standard" is effective in protecting from inflation and limiting abuses in monetary policy. It assures price stability on the long run, just because it limits the authority of generating inflation (and the relative money devaluation) through the printing of paper banknotes, that is just fiat money. Such stance may on the contrary be favoured by politicians, whose time perspective is usually more centered on the short term, because, at least apparently, it allows supporting the economic cycle and the prices of financial assets, so to make borrowing easier for families and then stimulating their consumptions. Moreover such policy makes the debt burden lighter, although creditors are obviously damaged in the end. For such reasons a gold standard system performs another positive function, in that it limits public spending, by setting ceilings to public deficits. However many dispute that widening the monetary base, together with causing possible negative outcomes, also supports the cycle strongly and may also prevent dangerous deflative drifts. That is the position claimed by the supporters of the "Bernanke doctrine", however opposed by many. The one certain point is that the role of the US dollar as global reference and reserve currency is more and more put into question at all levels, also originating funny stories. Recently Utah, the US Mormon State, *de facto* restored a "gold standard" system by allowing legal payments in traditional gold and silver coins. The Parliament of Salt Lake City also repealed all taxes on gold transactions, which are still in force in other states. The dissatisfaction towards the Federal Reserve may likely take North Carolina and other States to consider similar moves. *(to be continued) - GLT*

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(Part five) We have note how worried voices have arisen from the top of the World Bank, many economic and financial sectors, some US State Parliaments, about the current monetary system and its faults, the policy of the Federal Reserve and the future of the US dollar as a global reference and reserve currency, as well as any fiat money in general. Those critics often wish going back to a gold-based monetary system, with its roots on durable, intrinsic and tangible values. There are two famous quotations, actually pretty far away one from another in time and space, and from our scenario too, which refer to the worries and perspectives on fiat money. The statement according to which "*paper money eventually return to its intrinsic value, zero*" is by Voltaire in the year 1729. It well couples, on the Islamic side, with the one attributed to no less than the Prophet: "*A time is certainly coming over mankind in which there will be nothing left which will be of use save a dinar and a dirham*". Even if several Gulf countries have paper currencies with such denominations, the quotation refers to the traditional gold dinar, originally created by the Persians and in use throughout the Islamic world from 695 A.D. until the fall of the Caliphate: it is made of 4.25 g. of pure gold. The dirham contains 3 g. of pure silver. These precious and historical coins have come back since many Islamic circles have promoted them and the mints of two major Islamic states, Indonesia and Malaysia, have started to coin and put them into circulation. There is also a cultural reason for that. According to a strict interpretation of the *sha'ria* – the basic Islamic law – for some payments such as the zakat, the charitable donation that every believer must perform yearly, or the marriage dowry, only assets with intrinsic values should be used, and not virtual or fiduciary instruments, such as the banknotes indeed are. As a final note about our short *excursus* on the "gold comeback", may we remind the inversion of trend in many central banks' stances about gold: after selling it in the past years with the justification that it was no longer fashionable and useful, they are now buying it back hugely, maybe as they are some less confident about the role of their nominal money reserves. *(end) - GLT*

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