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NOTES FROM THE (L)EDGE...ON GOLD PERFORMANCE DURING TIMES OF FINANCIAL CRISIS

Now that risk-measurements around the world are rising again, we are getting a lot of questions on gold and how it performs during periods of economic stress.

Investors are particularly concerned that gold may not perform how they expect during the next crisis. Some point to the 2008 financial crisis and ask:

- *Is gold really a 'safe haven'?*
- *Are long gold positions subject to the same financial stresses as stocks and bonds?*

One thing many people forget to consider is that gold is priced in US dollars. So US gold prices are impacted by a) supply and demand for gold and b) supply and demand for the US dollar.

Both of these points are critical to explaining changes in gold prices during economic crises.

This is not a comprehensive examination...but for fun, we decided to look at gold prices during the climax of the late-2008 credit freeze. On the following page, you will see a chart of the S&P 500 (top chart) and a chart of gold priced in US dollars and Canadian dollars (bottom chart). The highlighted section is the period during which credit truly froze in the global economy. During this relatively short period the S&P 500 fell roughly 40% - a financial crisis by anyone's definition.

Gold should have blown the lights out during this period, right?

Many were shocked during this period to find that gold prices fell in US dollars by about 20%.

Why did this happen?

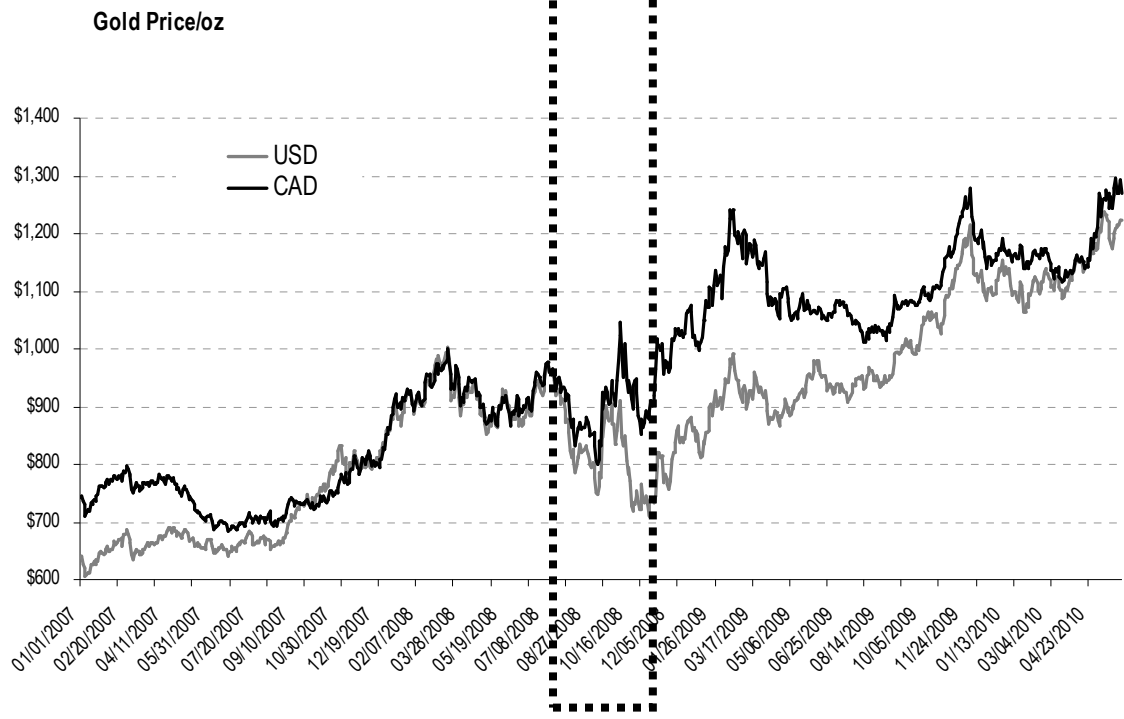
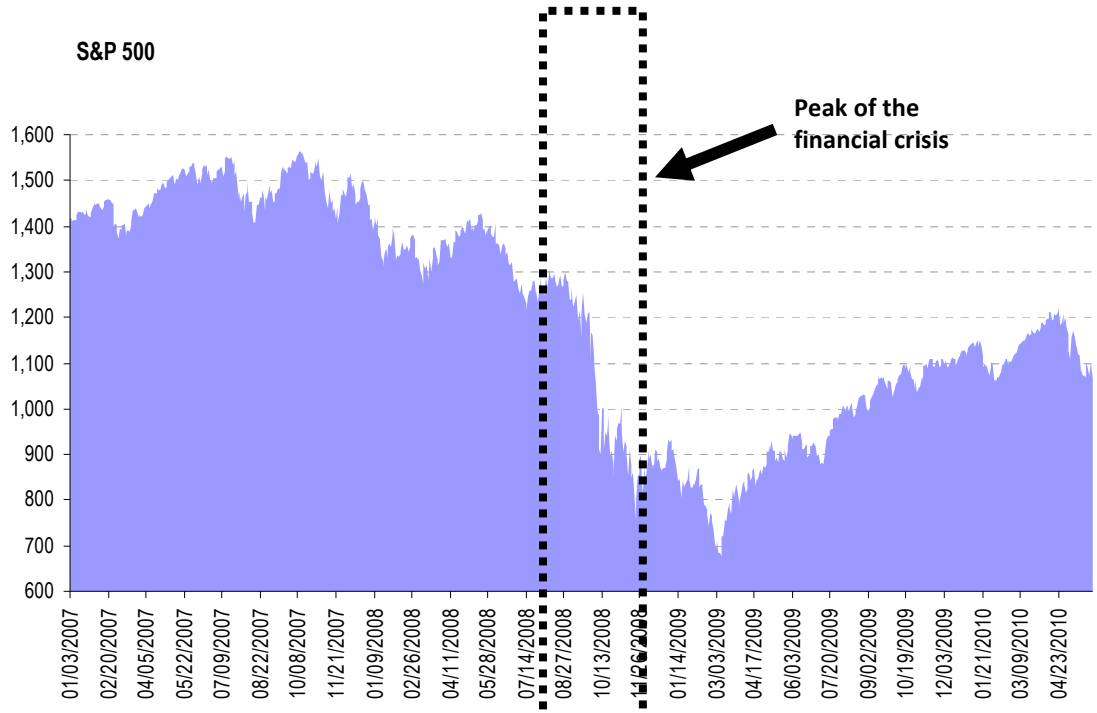
There are two primary reasons:

1) Investors were forced to repay investment loans and the only liquid asset many investors could sell to repay loans was gold. Some referred to this as 'forced liquidation'. Once this liquidity-driven selling stopped, gold quickly rebounded and recovered more than the initial price drop in a fairly short period of time. Gold re-claimed its standing once the short-term need for cash to repay loans subsided.

2) Demand for US dollars skyrocketed as investors flocked to relative safety. The US dollar appreciated quickly during the peak of the crisis as investors fled to the safety of US Treasuries. Because gold is priced in US dollars, the rising dollar put downward pressure on gold prices. However, when priced in foreign currencies that were depreciating - *such as the Canadian dollar* - gold remained fairly flat. For foreign investors, gold maintained its purchasing power while other assets dropped like stones.

After the short-term financial shock subsided, the dramatic need for liquidity and US dollars gradually eased and gold began a steady upward march - in both US dollar and foreign currency terms. This post-crisis trend reinforces the long-standing assumption that gold is able to maintain purchasing power during times of currency debasement, high debt levels and general economic stress.

Bottom line: During the apex of a financial crisis, the immediate need for cash and US dollars (assuming the US Treasuries are still viewed as risk-free) can drive down gold prices for US holders. Conversely, non-US holders may see gold prices rise in local currency terms. As short-term needs evolve into long-term repercussions, the aftermath of the 2008 crisis shows that gold retains its status as a store of value in the face of deficit monetization and fiscal pressures.



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