



# The Refined Investor

## Next Stop, Inflation Gold's Second Wind in a Cyclical Recovery

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Marked by extraordinary events, this year should go down as one of the most dramatic years in recent memory. The shake up in asset markets has reverberated across the globe. Earthquakes, tsunamis, nuclear meltdowns, sovereign debt collapse, and the death of Bin Laden (to name a few) have boosted volatility and increased uncertainty in the global financial landscape.

Amidst all this uncertainty, gold continues to hold its upward track as a safe haven, alternative investment. Performance reports show gold's continued superior returns relative to other asset classes in the wake of these current events (Figure 1).

As of June 30, 2011

Asset	3 Year Return (Annualized)	5 Year Return (Annualized)
Gold	17.42	19.53
S&P 500	1.05	0.78
Int'l Equities (MSCI EAFE)	-1.30	1.96
Bonds (Barclays Agg Bond)	6.46	6.52

Figure 1

Data provided by eSignal

Once the dust settles however, what's next for gold? When market volatility and uncertainty declines, will gold lose its dominance? Without the need for safe haven assets, will gold continue its annual double digit rise? The answer may depend on where we are in the 'economic cycle' and the post recessionary side effect known as *inflation*.

Inflation is usually the derivative of the expansionary phase found in a typical economic cycle. When we view the economic cycle below, we see the Expansionary Phase begins after a recession ends. This is the period in the economic cycle between the trough and the peak where an economy begins its growth phase (Figure 2).

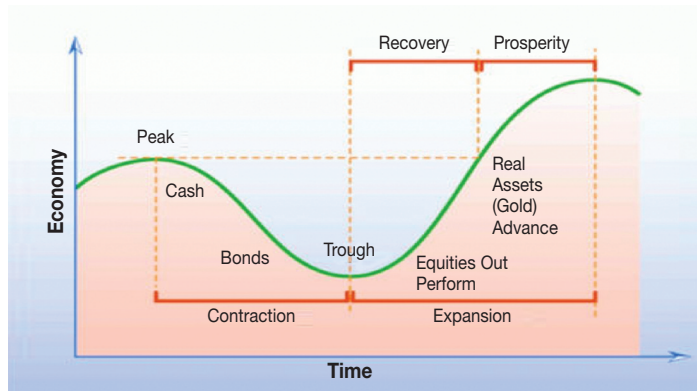


Figure 2

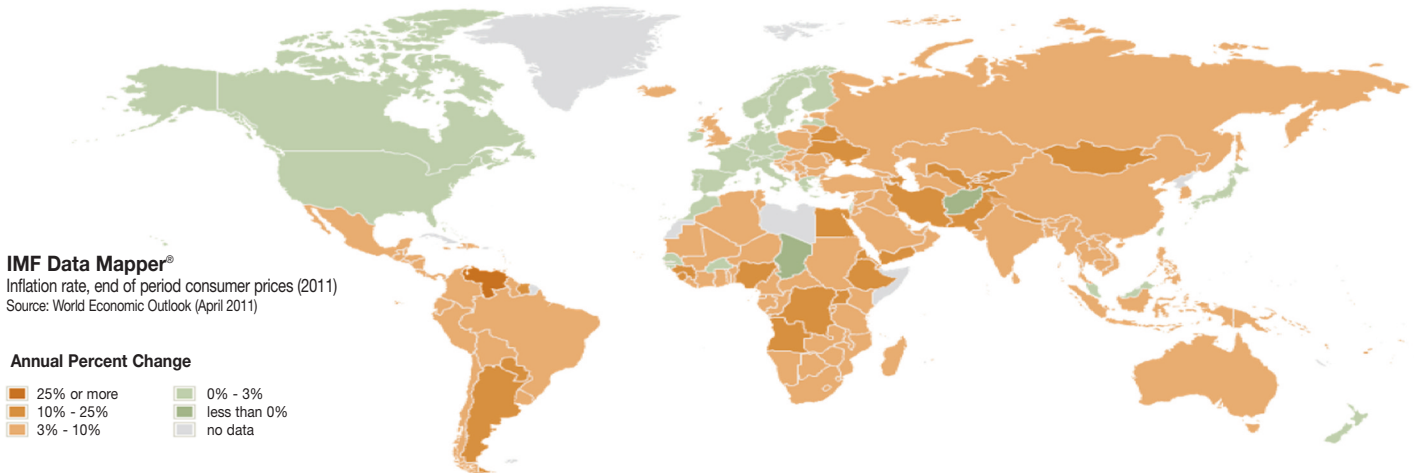
As the world's economies try to forge ahead on their path to some type of normalcy, gold's future moves may come from increased demand for real assets. As the growth phase accelerates, inflation materializes as prices for goods and services begin to rise. Real assets including gold historically do well during this phase.

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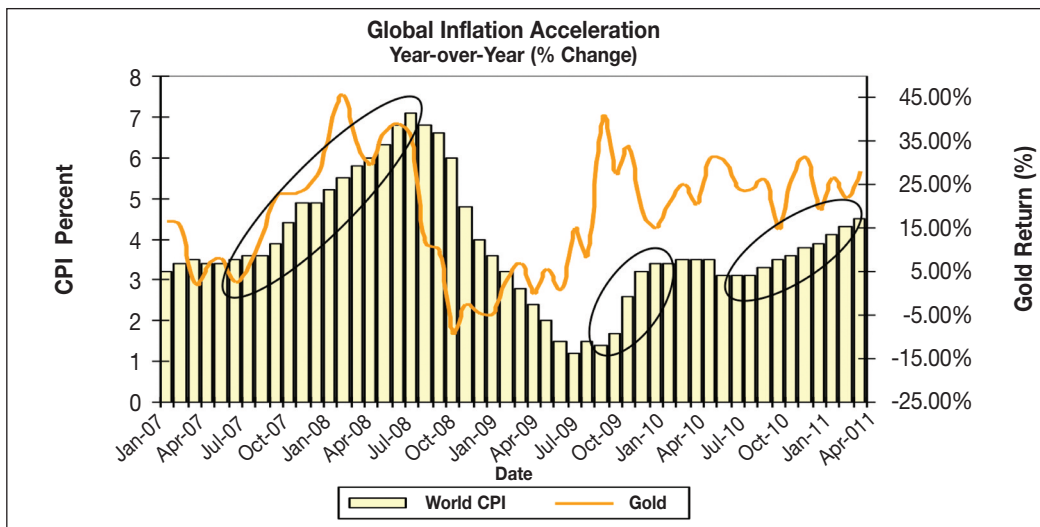
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The U.S. still appears to be stuck in the trough as it tries to pull itself back on the road of economic recovery. What may be surprising to know is many countries have already advanced into the early stages of their expansionary phase.

As Americans, it's easy to not recognize the advances of our global partners relative to our own. In fact, it wasn't that long ago that U.S. cycles ran parallel to global economic cycles. Today, this is no longer the case as much of the world is well underway in their expansion. Lead by the emerging market economies, these countries are now fueling global inflation.



The countries displayed in orange have already begun their expansionary phase. Some have already displayed inflation rates well above 10%. This increase in global inflation has already influenced gold prices.



This chart represents the year-over-year rolling percentage changes in World CPI relative to changes in Gold Return. Note how gold responded to these surges in global inflation.

Since late 2007, there have been three pronounced accelerations in global inflation as measured by the IMF. Interestingly, gold's price movements are almost identical to the movements of global inflation.

Acceleration	Begin Date	End Date	Gold Return (Cumulative)
# 1	Sept. 2007	July 2008	32.67
# 2	Oct. 2009	April 2010	17.09
# 3	Sept. 2010	April 2011	22.81

With surges in inflationary pressures, gold has reaffirmed, on 3 separate occasions, its long-time claim as the only true hedge against rising inflation.

Absent from this inflation picture however has been the U.S. At some point in the future, the U.S. will join its peers in a sustainable recovery. Backed by a \$14T GDP, a recovering U.S. economy should easily contribute to these accelerations and further enhance global inflation. Gold prices should benefit from this as the yellow metal transitions from being the safe haven investment in a world in turmoil to being the ultimate hedge against rising global inflation.