



The Refined Investor

Table of Contents



Are We Running Out of Gold?



Notes From the Trade Desk

Are We Running Out of Gold?

By Tony J. Anzalone, CFA

Jim Cramer, the ex-portfolio manager, celebrity financial guru, and host of CNBC's *Mad Money* gave his usual energetic presentation to a packed house at E*Trade Financial's *Trader Forum* last August. Interestingly, while talking about market direction, he mentioned his favoring of gold in his portfolio.

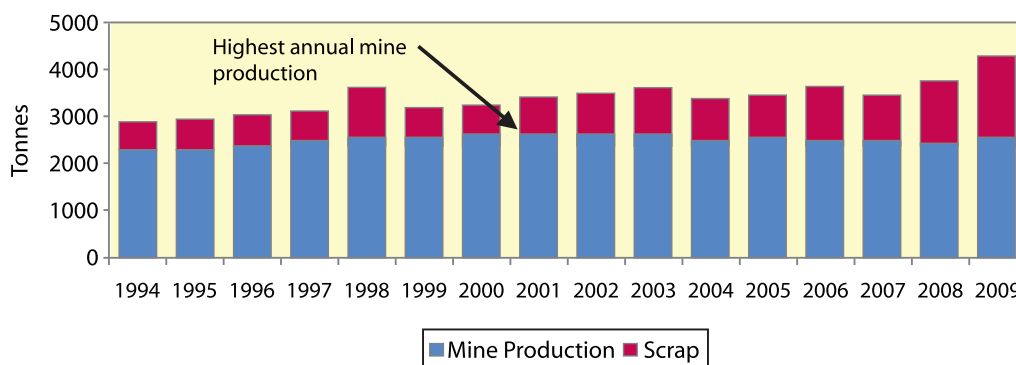
"I am an unabashed believer in gold. Gold can go to \$2,000 in the next few years, and I'm not talking about 2020. The most bullish factor for gold is that we're running out. There are no more big discoveries in the world."

This is an interesting observation that, if it is true, doesn't seem to be getting much attention. Is it possible that our ability to harvest new supplies of gold has reached its plateau? If we look at the supply side of the gold market in greater detail, we see some interesting facts.

Gold supply comes from a limited number of sources. The majority of gold comes from mine production followed by recycling or scrap recovery. After the spike in gold in 1979/1980, annual mine production increased steadily from 1,200t to a peak of roughly 2,600t set in 2001. However, gold production has since decreased, failing to surpass that peak.

Here is a detailed look at the last 16 years of gold supply.

Gold Supply

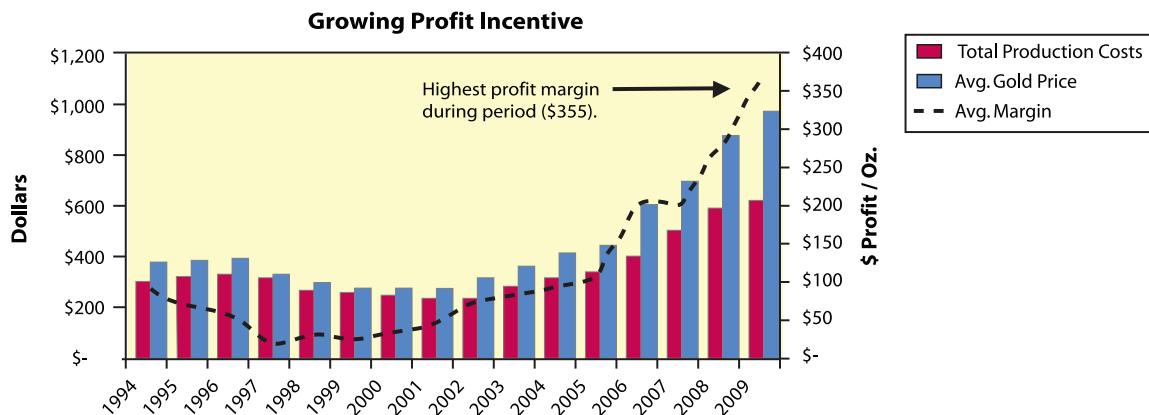


¹Dobosz, John. "Jim Cramer is a Gold Believer, Tech Buyer." *Forbes Scrip Club*. Forbes.com LLC, 19 August 2010
²(t) = Metric Ton = 2,205 lbs.

(cont'd on next page)

As you can see, the average annual mine production remains relatively stable even during one of the largest bullish cycles in the last 30 years. Since we are finishing our 9th year of this cycle, why haven't the mining companies increased production and taken advantage of the increased price of gold? Perhaps *Jim Cramer's* assertion is correct, they can't.

Of the top 4 gold producers in the world, only one (China) was able to consistently increase in production. A new mine on average takes about 5 years to begin production. Overall, there have been few new mine openings as producers have been mainly relying on existing mines. As these mines are continually worked, the quality of the ore degrades. Companies have to dig deeper and in greater quantities to compensate. This also means at a higher cost. Today, the true "all in" cost to produce one ounce of gold is between \$925 - \$950. Since the 200-day moving average for gold is \$1,252.70, there is still a strong profit incentive to find new gold.



The average annual demand for gold over the last 10 years is roughly 4,000t. This includes the recent recessionary decrease in jewelry demand. The data indicates that the mining companies have consistently fallen well short of meeting the level of demand. Today, the shortfall is estimated to be 1,674t. As the significant gap between demand and supply continues, the mining companies seem unwilling or unable to fill this gap. Where the additional gold could not be found below ground, the massive grassroots effort in the form of scrap recovery taking place above ground provided the solution.

On almost every corner and on TV is some kind of "cash for gold" offer. Primarily the result of high prices and a poor economy, recycling surged 27% last year and now accounts for 39% of total supply.

With mine production expected to remain constant at around 2,600t, the future supply will continue to rely heavily on reclaimed scrap. However, this is a precarious position to be in. Scrap by definition is a finite thing. It is very difficult to quantify and there is no way to measure how much remains to be harvested. With such a large percentage of supply coming from scrap recovery, the question becomes: *How many times can you sell grandma's ring?* At some point, it must be exhausted.

Gold has reached historical highs in 2010 propelled primarily by the sinking U.S. dollar, European debt troubles, and rising oil, to name a few. The next wave to propel gold could be from within its own industry; lack of supply.

Mine production over the last decade has been inelastic. The few new discoveries brought on-line only replace the closure of other mines. Gold produced from more stable regions of the world have given way to production from less stable ones. With respect to new discoveries adding to overall supply, *Jim Cramer's* assertion is correct: *There are no new discoveries.* However, there is also a greater risk of a supply decrease due to scrap shortages. If scrap supplies were to decrease by even as little as 1/3rd, that would equal more than a 550t shortfall in supply. Given recent history, the price should rise as this is far more gold than the mines are able to replace.

¹Source: "Gold Survey 2010." GFMS Ltd. April 2010.

FideliTrade Incorporated
3601 N. Market Street
Wilmington, DE 19802

Toll Free: 800-223-1080
Tel: 302-762-6200
Fax: 302-762-7570
www.fidelitrade.com

GOLD \$1,382.80 ▲ \$11.20 SIL \$29.18 ▲ \$.43 PLAT \$1,728.10 ▲ \$5.50 PALLADIUM \$756.05 ▲ \$.55

Notes from the Trade Desk...

FideliTrade is offering reduced commissions until March 31, 2011. Visit our website for more details.

America the Beautiful coin sets are available at FideliTrade Incorporated. Visit our website for more information and to download an order form.