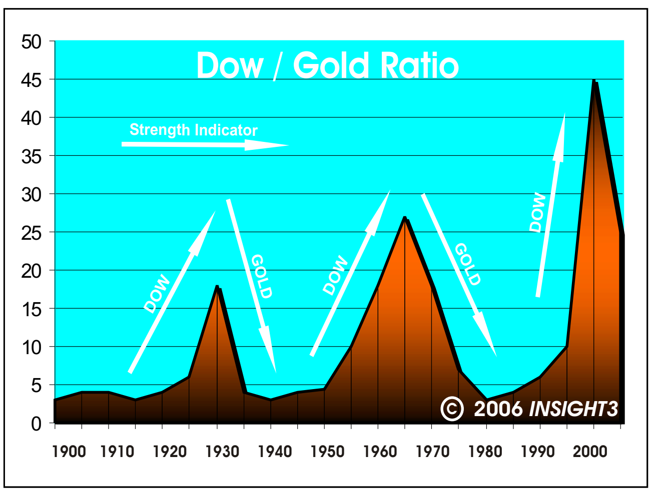
# GOLD:
# THE TARGET OF FINANCIAL HEDGING

BY JEFFREY R. PAUNICKA

If you think gold prices in the mid $500 range are high, from an economics perspective, you may want to think again! The question is, what should the price of gold be? To answer that, consider these factors: 1) stock market, 2) U.S. Dollar in the global economy 3) Inflation and 4) Oil.

## Gold Vs Equities

The Dow/gold ratio is an indicator that relates to the great cycles of the international economy. The Dow is a standardized measure of the value in U.S. dollars put on the ownership of leading American establishments. Companies in it change over time and are not weighted for capitalization. In contrast, gold is permanent, natural and the international money. The Dow is affected by the domestic credit environment, optimism and the impression of prosperity. While gold is affected by both national and international monetary and credit conditions. Thus the Dow/gold ratio gives an international perspective on the value of U.S. stocks that domestic indices cannot provide.




In the spring of 2000 at the a peak in the stock market the DOW/Gold ratio was at 45 (45 ounces of gold to buy a unit of the DOW). Since the stock collapse into the fall of 2002 the DOW/Gold ratio declined to 25. Gold gained value in comparison to equities. Since the Fall of 2002 the DOW has increased 3000 pts or 40%. In comparison, gold has seen a more modest growth rate of 30%. The DOW/Gold ratio has continued to drop.

## *Devaluation*

At the current price of gold tied with the stock market prices, some economists believe that the DOW should be in the range of $20,000! Why is that? The answer is the devaluation of the U.S. Dollar in the global economy. Foreign currencies have been gaining over the US dollar for several years. We have seen a large influx of foreign capital into our equity markets. This flood of foreign investors combined with our ever increasing deficit spending is spiraling our dollar down. Each Americans share of the US Public debt today is $26,700. To add more downward pressure, it is a guarantee the Fed will print more money so that our purchasing power in America will not be diminished.

## *Black Gold*

Now consider the spike of oil prices in the last year. Our former Chief Economist, Alan Greenspan has indicated this to be a "temporary" situation. Well, every time I fill my gas tank up with fuel costing $2.35 a gallon, my suspicions take a review of the term "temporary". Today the Gold/Oil price ratio is at an extreme low that exceeds 3 decades. I do not think the price of oil will crash soon. Do you?

## *Prediction*

Gold is the true global currency. It is the foundation of all currencies traded. The demand for gold is increasing, significantly in the Asian and Indian markets where their economy is robust and gaining every month. If I am looking for a way to hedge against declining equity values, continued elevated oil prices and a declining US dollar, I would be certain to consider gold. We have already seen an increase in gold from $380 to $550 per ounce (45%) in the last 18 months. If our stock market goes bearish, I would still be protected at these prices. But on a conservative note and "ceteris paribus" (all other things being equal), I would not be surprised to see gold go to $650 - $700 per ounce in 18 months.

**About the Author**

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