



The Starboard Side Report

The week ending June 11, 2010

We are finally starting to see some rays of sunshine poke through the storm clouds brought on by the Euro crisis. One good sign towards the end of this week was that the market started to rally late in the day after a long streak of having been hit with heavy late day selling pressure. This means that redemptions from hedge funds and retail investors may be starting to wane. The question remains how long will this stabilization last. Just about every short-term equity indicator we follow remains extremely oversold. This argues for a relief rally of some duration in the weeks ahead. Once that plays itself out, we will reassess our intermediate technical indicators to see what kind of momentum remains in the global economy and the market. The prevailing worry is that the fiscal belt-tightening in Europe will cause a much greater second-half growth scare than the markets have been expecting. To some extent, we believe the recent extreme volatility was the market pricing in this uncertain scenario already.



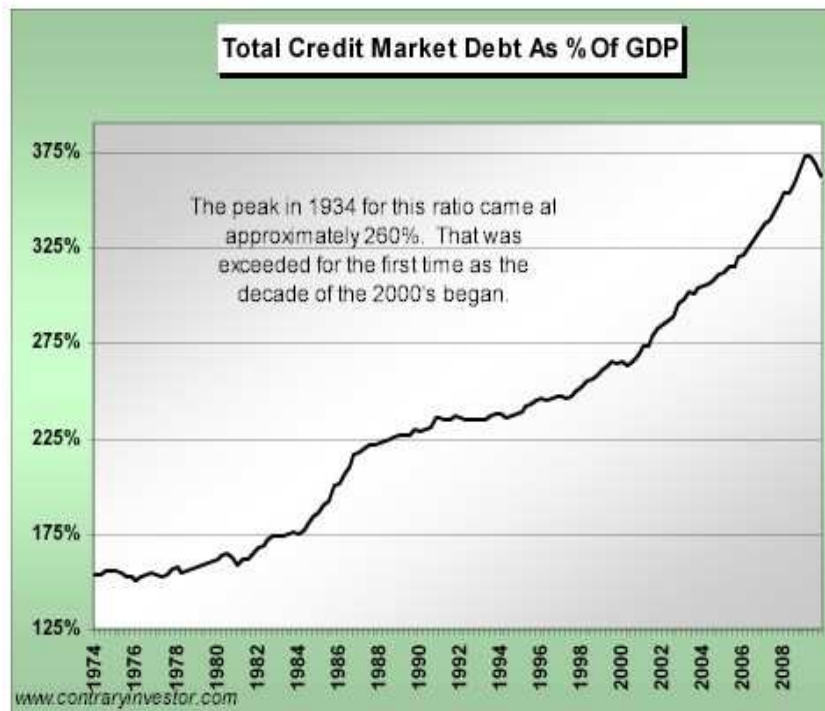
The Euro is close to a key long-term support level that may finally set the stage for a countertrend rally. As you can see in the chart above, the Euro is actually still in an uptrend despite its recent drubbing. In addition, the lows of 2004 and 2005 are now in play as indicated by the two blue arrows in the middle of the chart and the corresponding horizontal line. From a contrarian perspective, the fact that the Euro crisis has been plastered all over every major news media publication (Newsweek and Businessweek in the same week) means that we may be close to a turning point reversal. This old contrarian "magazine cover" indicator often signals the point that bad (or good) news is priced into a stock or the general market. The dollar is exposed to many of the same structural deficiencies as the Euro, so it may return to the doghouse for a spell.

One of the problems that the global economy is facing at present is the fact that perpetual growth is needed in order to fuel a monetary system backed by massive amounts of debt. The international debt-backed money system that is in existence today has been in place since the early 1970's. Uncertainty caused by the potential unraveling of this system may be with us until a new international monetary framework is established. This 37-year central banking experiment based on debt assumes that growth will lead to a future that is larger and more

plentiful than the present. This grow at all cost mentality has led us to a point of depleted natural resources and an over abundance of leverage. When growth goes away the cash flows simply are not enough to pay off the debts. Inflation is a permanent feature of this system because when growth slows, inflation is a more palatable remedy than default in the eyes of policy makers and central bankers. This is why the commercial banks were bailed out instead of being left to fail. The banking class has become too entrenched, too big and too politically connected to fail. The result is trillions of dollars of liabilities being transferred from the private to the public sector. Much of this bailout was funded out of thin air by money printing operations. The reason that we are focusing on this again now is due to the fact that deflation concerns are starting to creep back into the market again. We believe deflation will *never* be allowed to happen in a country that has a 350% credit market debt to GDP ratio *and* the ability to issue its own reserve currency. We may get these periodic deflation scares as growth starts to slow, but when push comes to shove, the printing presses will heat up and attempt to take the pain away by eroding the value of money (debts). This is a tough world for an investor to negotiate, but as long as we keep our focus on the underlying premise, that the US Federal Reserve will inflate at all costs, then we should have a fairly accurate roadmap.

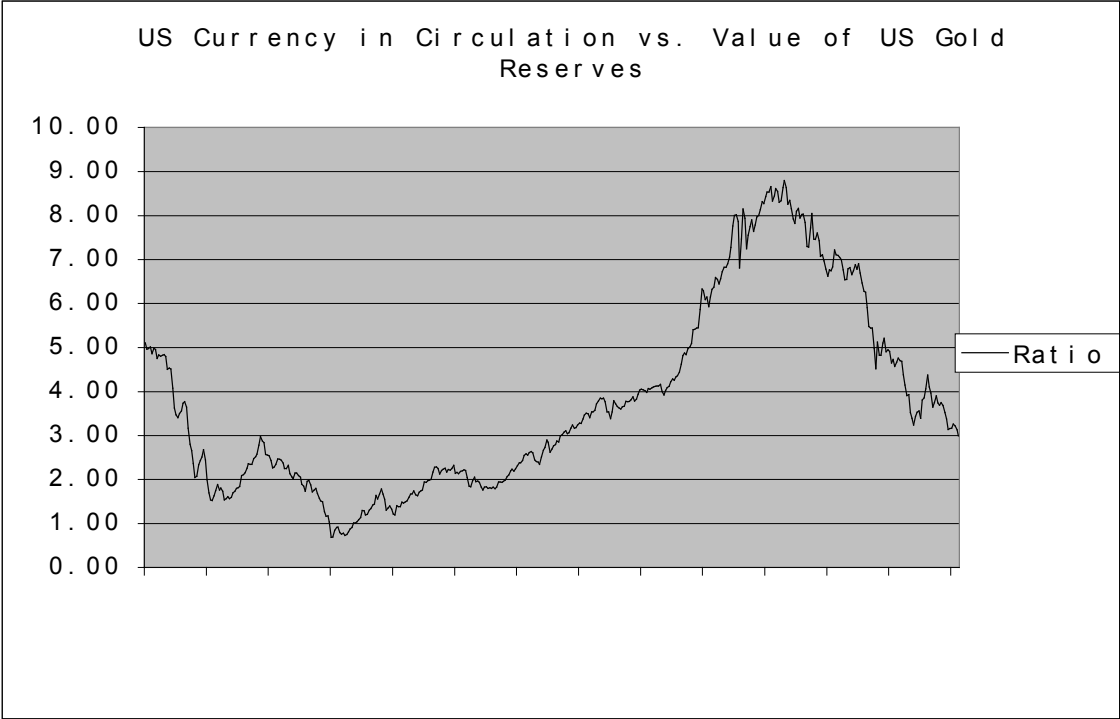
The price action in gold indicates that many more are starting to catch onto the shortcomings of this grand thirty-seven year monetary experiment and the potential for its breakdown in the years ahead. As the picture story in the ratio analysis below illustrates, gold still has a long-way to go before the ramifications of this issue are fully priced into the market. If we take an average of the five bolded price target scenarios below, we get a gold price of \$5,660 per ounce sometime in the next several years. This compares to just \$1,227 at present. It is safe to say, we feel that the bull market in gold is still in the relatively early innings.

The US Federal Reserve will not allow deflation to take hold because of this chart.



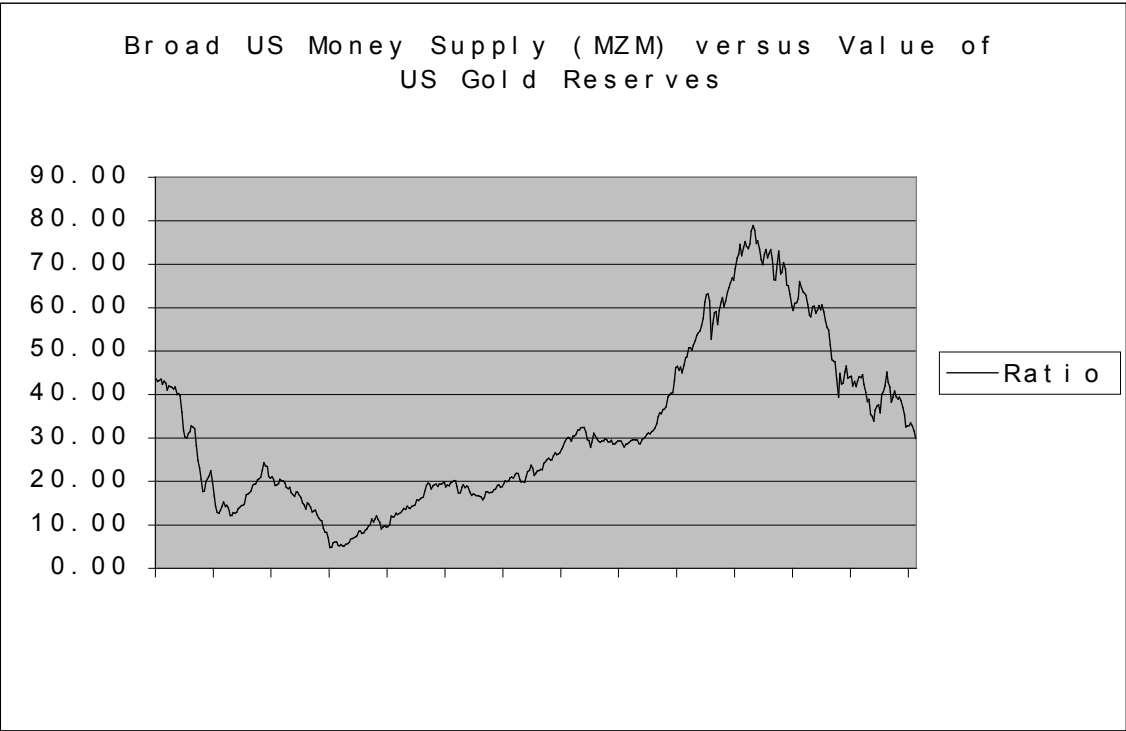
Source: Contrary Investor

To equal the ratio in 1980, gold would be worth **\$5,000 p/oz.**



Data Source: St Louis Fed, World Gold Council

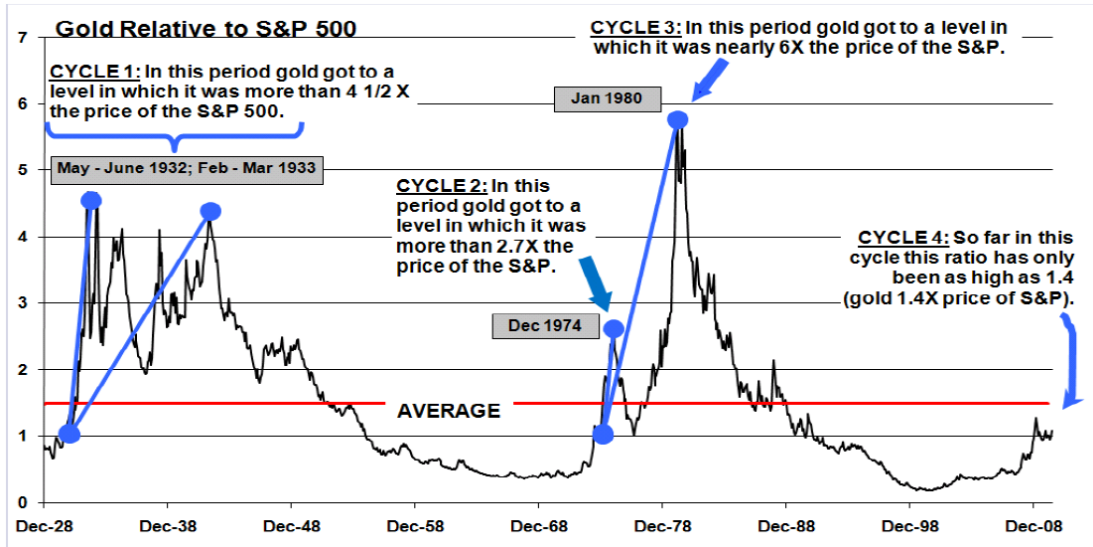
To equal the ratio in 1980, gold would be worth **\$7,000 p/oz.**



Data Source: St Louis Fed, World Gold Council

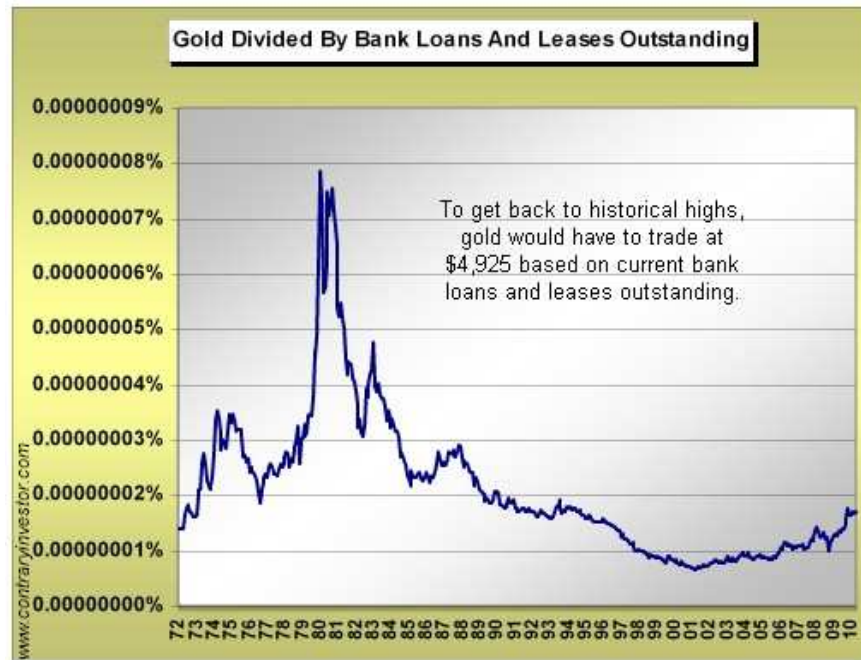
Gold Relative to the S&P 500 Index 1928 to Present

Using these historical metrics (and the present value of the S&P 500), gold could go as high as either **\$4,900** or **\$6,500** during this bull cycle.



Source: John Roque, WJB Capital

To equal the ratio in 1980, gold would be worth **\$4,925 p/oz.**



Source: Contrary Investor

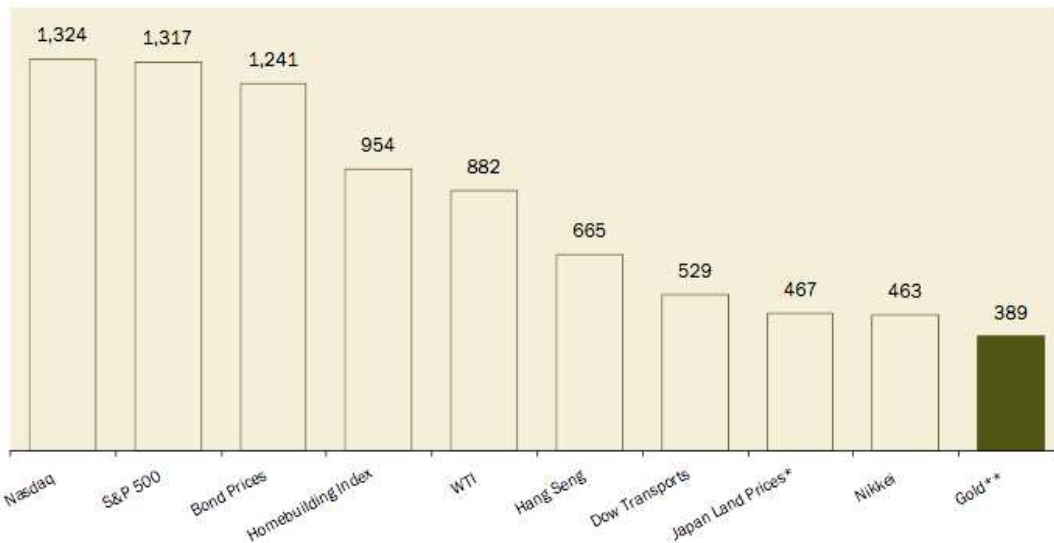
We have said many times that bull markets do not end until the asset class in question has exceeded the prior inflation adjusted peak. This would strongly refute those that say gold prices are presently at bubble levels.



Source: Contrary Investor

GOLD RALLY IN CONTEXT WITH PRIOR SECULAR BULL MARKETS measuring trough-to-peak percent change

Compared with other long-term bull markets of recent history, gold still has the potential for a lot more upside.



*Residential Japan land price index of the six big cities. **From July 20, 1999 to current
Source: Haver Analytics, Bloomberg