

The Starboard Side Report

The week ending November 06, 2009

We thought it was fitting that two of the biggest financial news stories this week were the US Federal Reserve promising to keep interest rates at zero and the Indian central bank buying 200 tons of gold from the IMF (International Monetary Fund). Below is a good quote from Iacono Research about the events that transpired in India.

"While economists in the West may cling to their *"money is just a unit of account and gold is nothing special"* way of thinking, central bank staff half way around the world are now starting to look at things *very* differently after the events of this week.

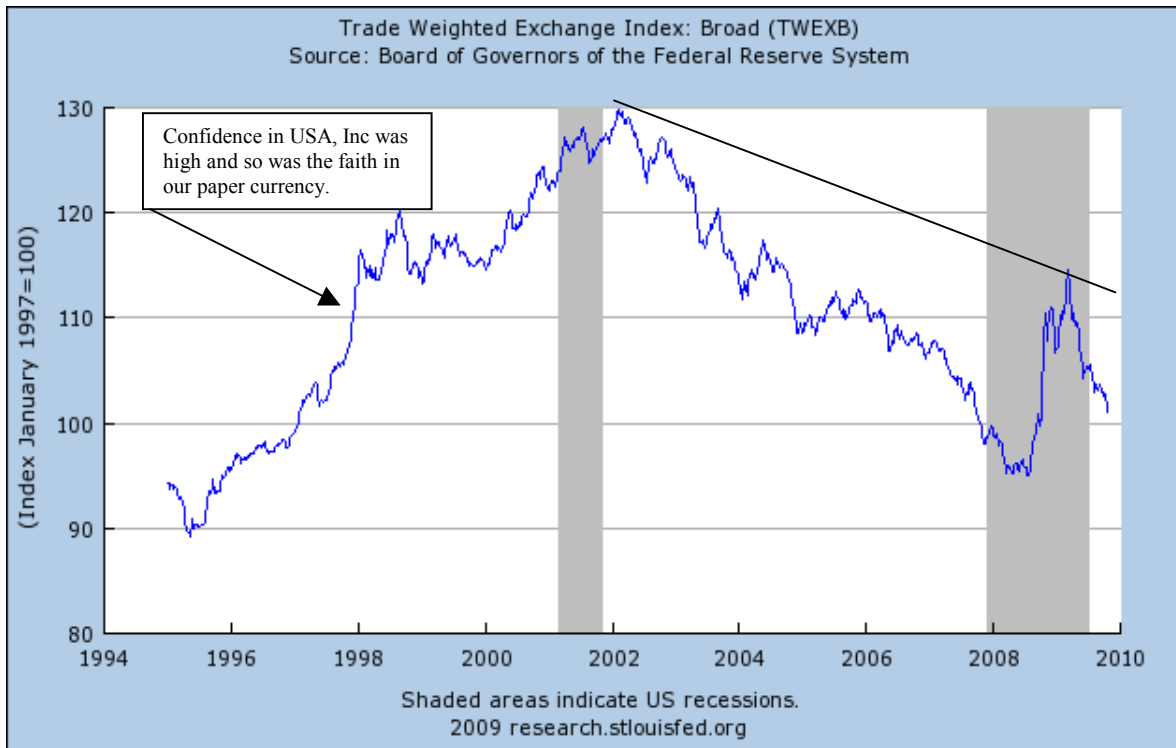
If inflation begins to heat up in the months ahead, then we might just see central banks scramble to buy gold along with the rest of the world.

In a pure fiat (faith based) money system, there is nothing to back a national currency other than faith in the government that issues it and confidence in the central bank that prints it."

Well, what we are seeing is a clear decline of confidence in the US Government and its Federal Reserve Bank as they debase our currency through reckless monetary and fiscal policy. This waning faith can be observed in the strength of the price of gold and the weakness of the US dollar. We are going to repeat a chart we included in this report two weeks ago because it is relevant to this discussion. The S&P 500 has lost 82% of its value over the past ten years when priced in a long-term store of value such as gold instead of our easily printed paper currency!



The next chart below is the long-term look at the trade weighted US Dollar. We can view this as another US government confidence index or a chart of USA, Inc. as coined by Eric Jansen of iTulip.com. Aside from the credit crisis last year, when the dollar rallied as investors scrambled to pay down debts denominated in US Dollars, the paper currency backing USA, Inc. has taken it on the chin. Many are expecting a big rally in the US dollar from these levels, but we are not one of them. A short-term bounce is possible, but the long-term trend is clearly down in our view.



We believe demand from emerging market central banks will be a source of demand for gold for years to come. Some statistics should bear this out. Even with India adding 200 tons or \$6.7 billion worth of gold this week, the yellow metal now only makes up 6.2% of their foreign reserves. The rest is mainly held as foreign exchange in the form of US Treasuries. If we go down the updated list below from Iacano Research, we see emerging markets as very small holders of gold versus the developed world. The most striking is that China, India and Russia only have 4% of their foreign reserves in gold on average. On the other hand, the three top western economic powers- US, Germany and France average over 72% of reserves in gold. The bottom line is that the emerging world is awash in US Dollars and needs to diversify away from this depreciating asset. In fact, according to the *Financial Times*, the composition of world official reserves has changed radically from almost 60% gold in 1980 down to 10.3% by last year. Most of the worlds excess dollar reserves sit in US Treasuries, so a move away from US Dollars towards gold will also have the effect of driving bond yields in the US higher. We can't emphasize enough the importance of three decades of central bank anti-gold sentiment coming to an end.

WORLD GOLD COUNCIL

WORLD OFFICIAL GOLD HOLDINGS September 2009

		Tonnes	% of reserves
1	United States	8,133.5	77.4%
2	Germany	3,408.3	69.2%
3	IMF	3,247.3 3017.3	1)
4	Italy	2,451.8	66.6%
5	France	2,445.1	70.6%
6	China	1,054.0	1.9%
7	Switzerland	1,040.1	29.1%
8	Japan	765.2	2.3%
9	Netherlands	612.5	59.6%
10	Russia	568.4	4.3%
11 12	ECB	501.4	18.8%
12 13	Taiwan	423.6	3.9%
13 14	Portugal	382.5	90.9%
14 15	Venezuela	356.4	36.1%
15 11	India	357.7 557.7	4.0% 6.2%

Last week's study on seasonality pointed to a very strong six month period ahead for the oil service sector. The average return for the group during the seasonally strong November through June period has been 15.4% this decade. Below are some charts that help us see where we stand at present. The first is a look at oil service stocks versus oil itself. As we see, the commodity has performed better than the stocks over the past fifteen years. Yet, we see an orderly channel that appears to leave some nice upside in the months ahead.

Oil Service to Oil Relative Strength Ratio



Philadelphia Oil Service Index



The doubling of oil prices from their lows and the thawing out of the credit markets should free up capital for drilling and provide some sunnier days ahead for this sector.