

Steady as She Goes

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High volatility in the markets seems to have become the norm lately. Equity markets around the world have whipsawed investors, as the indices swing wildly up and down in roller-coaster fashion. And the unruly changes from one day to the other are not small. When the Dow shed 520 points in a day last week, it represented a loss of \$1.6 Trillion in capital for equity holders. Likewise, stock market rallies last week were sharp and short-lived, only to reverse in further massive selling. It's no wonder that many investors have decided to head for safe haven assets.

There are many reasons for the recent high volatility in the markets. A major cause was the US debt ceiling deal. The markets sold off sharply when the deal was announced, which surprised some that thought that that raising the US debt ceiling would have a stabilizing effect and save the nation's AAA credit rating. The markets reacted negatively on news of the deal, and by selling off on Thursday, August 4th, correctly anticipated Standard and Poor's decision of Friday, August 5th to downgrade, for the first time ever, the credit rating of US sovereign debt. In its press release, S&P said that "political brinkmanship" in the debate over the debt had made the U.S. government's ability to manage its finances "less stable, less effective and less predictable." It said the bipartisan agreement to find at least \$2.1 trillion in budget savings "fell short" of what was necessary to control the debt over time and predicted that leaders would not likely achieve more savings in the future. The debt deal ducked the central issue, namely reducing runaway government spending.

Failure of the US government to solve its debt crisis was not the only factor that roiled the markets last week. A slew of new unfavorable economic data also pressured stocks. Consumer Sentiment, a key indicator of consumer demand, plunged in August to the lowest level since May 1980, adding to concern that weak employment gains and volatility in the stock market will cause households to retrench. The Thomson Reuters/University of Michigan preliminary index of consumer sentiment slumped to 54.9 from 63.7 the prior month. The measure was expected to decline to 62, according to the median forecast in a Bloomberg News survey. Unemployment remains high at 9.1% with no signs of improving. Food and energy costs continue to rise; buying power of the Dollar is shrinking, and wages are not keeping up with rising household costs. Housing values continue to fall, while rents are rising.

The Federal Reserve signaled its pessimism on the prospects of the US recovery by announcing it would maintain near-zero interest rates to 2013. The markets rallied briefly on the uncommon certainty of the Fed statement, only to sell-off again on the realization that the economy is grinding to a halt. US economic growth for the first quarter was revised down to 0.4%, down from 1.9%. Most economists, including those at the World Bank, see US growth slowing, not accelerating over the next months and years. According to the World Bank, the US is leading the global economy into a "Danger Zone" of likely recession. The odds of a US double-dip recession are now 1 in 3 according to economist survey data.

Fears of insolvency in Italy, Spain and maybe France and the uncertain response by the ECB also weighed on investors. European markets sold off, and the US markets followed with more selling. The question remains whether the EMU will survive chronic bailout measures, or the weaker members are allowed to fail and then cut away from the stronger Eurozone members.

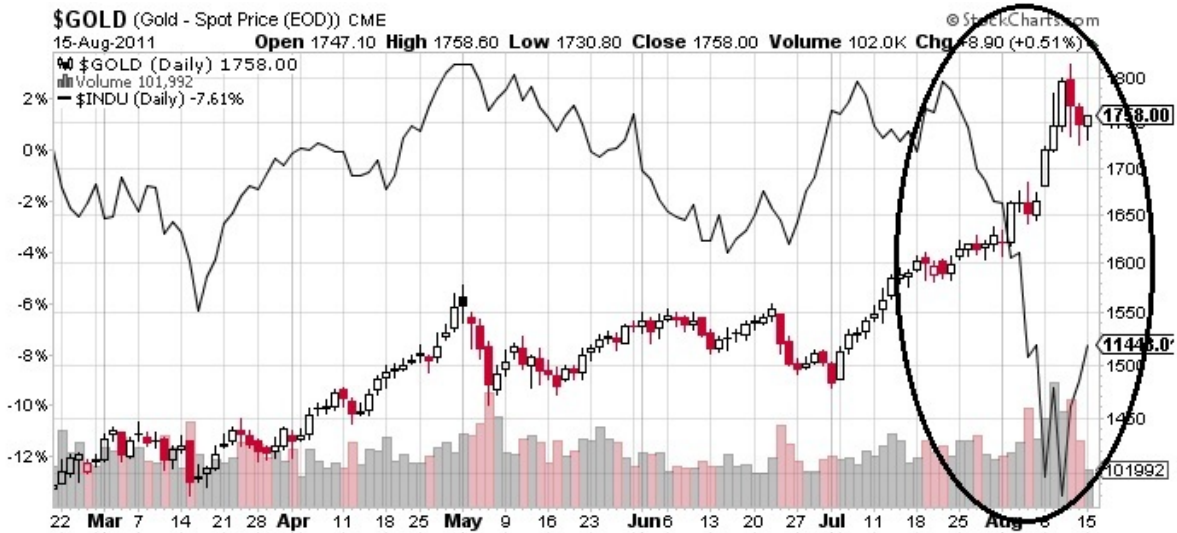
One reliable measure of market volatility is the VIX Index. VIX is the ticker symbol for the Chicago Board Options Exchange Market Volatility Index; it measures the implied volatility of S&P 500 index options. We can see at once that the VIX reflects market sentiment. When the VIX is high, markets tend to swoon. When the VIX is down, the markets tend to gain. We see this dynamic in the chart below. Just before the market sell-off of 2008, the VIX reached 80. The VIX also climbed to 48 in May 2010 and reached 48 again last week, each time corresponding to big sell-offs in the S&P 500.



The *Sturm und Drang* that plays out in wild swings in the markets that ruin portfolio values and destroys wealth does not affect those that have prepared themselves against the onslaught. The key to the preservation of wealth is diversification. In today's volatile economic environment, investors are finding once again, that owning gold provides stability as well as a store of value.

We can see how a portfolio that is diversified with gold performs well when the markets are volatile. Gold tends to be much less volatile than the general markets. Because gold has intrinsic value, gold is considered the premiere safe-haven asset. In uncertain economic times, investors cash out of stocks and low-yielding bonds and purchase gold. Significantly, today we are seeing the central banks are buying bullion. The World Gold Council's most recent figures show central banks are net buyers of bullion. In the first half of this year central banks net purchases totaled 208 tonnes of gold. In 1981, ten years after the end of Bretton Woods, the largest annual net gold purchase by central banks was 276 tonnes of gold bullion. Gold is proving once more it is the universal reserve currency. By the way, it was 40 years ago today that President Nixon took the US off the gold standard.

So how does gold hold up for the individual investor in volatile times? The answer is straightforward: Gold outperforms the markets in turbulent times. We can see the evidence in the chart below. It compares price action of the Dow vs spot gold over the last few months.



What is significant here is highlighted in the oval. It shows the 13% decline in the Dow in last week's big sell-off, and gold climbing to over \$1800/oz. Investors that have owned gold in a diversified portfolio protected their wealth, while those that relied on stocks were savaged by the sell-off. The DJIA has lost 1.18% year-to-date. The S&P 500 has lost 4.54% year-to-date. The Model Conservative Portfolio available to subscribers of *The Gold Speculator* has returned 43% year-to-date. So for us, in these turbulent and volatile economic times, the order of the day is "Steady as She Goes."

Investors from around the world benefit from timely market analysis on gold and silver and portfolio recommendations contained in *The Gold Speculator* investment newsletter, which is based on the principles of free markets, private property, sound money and Austrian School economics.

The question for you to consider is how are you going to protect yourself from the vagaries of the fiat money and economic uncertainty? We publish *The Gold Speculator* to help people make better decisions about their money. Our Model Conservative Portfolio gained 66.7% in 2010, and 55% for 1Q2011. Subscribe at our web site www.thegoldspeculatorllc.com with credit card or PayPal (\$300/yr) or by sending your check for \$290 (\$10 cash discount) The Gold Speculator, 614 Nashua St. #142 Milford, NH 03055