

## On Fire

**With the speculators having run away and physical demand rising, gold was like a tinderbox looking for a spark.**

**The political upheavals in the Middle East provided the spark...and now we're left wondering how long and far the flames might burn.**

**By Brien Lundin**

For those not living under a rock over the past month, it's no surprise to hear that gold and silver took off on a tear, soaring back over \$1,400 in reaction to the parade of turmoil and revolution in North Africa.

For those who have been reading Gold Newsletter over the past few months, however, the only surprising thing about this rally in gold rally was its proximal cause.

In last month's edition of this letter, for example, I noted that "few investors are looking for a rally in gold, yet the charts, sentiment and seasonal factors are all pointing toward one.... So stay tuned...things could soon get very interesting in gold and silver."

Readers of our Gold Newsletter Alert service received some interim commentary that was more specific. On February 2, I noted that "there's lots of potential fuel to fire the next gold rally. It's a big stack of tinder right now, and it's looking for a spark. What will provide that spark? Frankly, there's no way to tell. But we should be prepared for the first signs of a flame."

Of course, when I wrote those words, I had no idea that my metaphor was already horribly apropos: On December 17, a 26-year-old street ven-

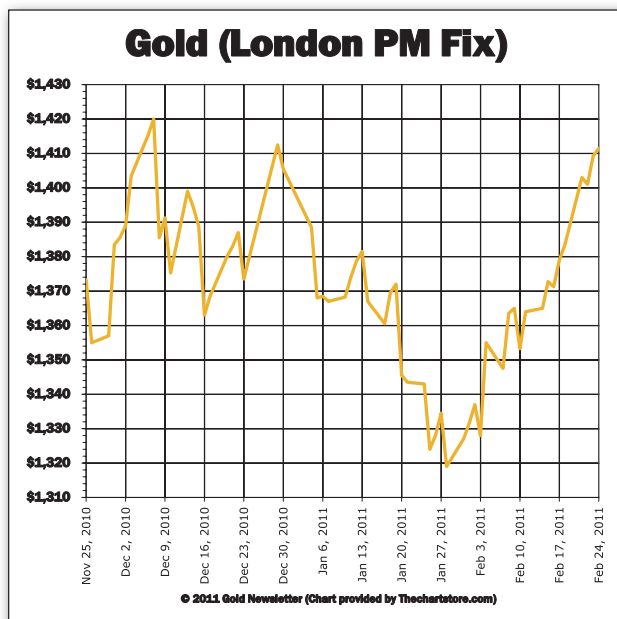
dor named Muhammad Bouazizi — frustrated by his failure to find a job and hopeless after police confiscated his fruit and vegetable cart — had set himself afire.

Of course, I had seen the reports of this incident, and of the protests it had spawned in Tunisia. But no one at the time realized that this single act of desperation would set off a wildfire of revolution that would spread to Egypt, Libya, Bahrain, Yemen, Algeria...and perhaps much further.

As an advocate of liberty for all the world's citizens, I hope these revolutions will lead to freedom for those fighting bravely to throw off the yokes of their dictators. And I believe that they will.

But as investors, we must also look down the road to the longer-term consequences. As I write, the great fear is that the fires of revolution will spread to Saudi Arabia and Algeria, putting some of the world's primary sources of oil in jeopardy. Worries abound, and rumors are flying.

Thus, oil prices are being bid

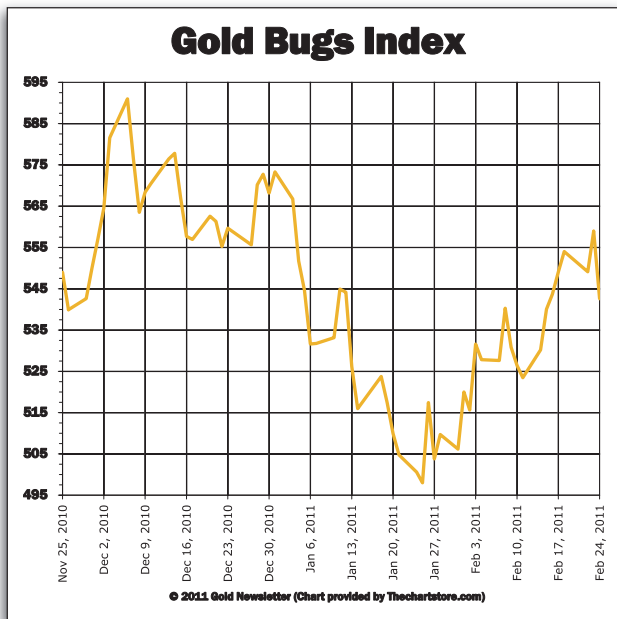


much higher...as are gold and silver, as safe-haven plays. And then, suddenly, the commodities are sold off on rumors of a Gadhafi assassination.

Long-time readers know that when gold gets driven higher because of geopolitical events, I get nervous. These situations offer at best tenuous support to the market. Despite dire fears, these occasional troubles eventually get resolved. Peace breaks out. The sun rises again.

And when that happens, gold

*(Continued...)*



prices can fall just as quickly as they rose. And the case in point serves as a prime example.

Thus, we must also look down the road and consider two factors: 1) How long will the current geopolitical turmoil last, and 2) What, if anything, will replace it as a driver for gold and the metals once things calm down?

### A WILDFIRE OF REVOLUTION

Again, we've yet to see the ultimate outcome of the revolt in Libya (or, for that matter, Egypt) as I put this month's issue to bed.

At this point, there's no telling where this trend goes in the days and weeks ahead. And even if the fires of revolution die down, the coals will simmer for many months, and not only in the Middle East.

China's leaders, always paranoid in regard to social unrest, immediately clamped down on public assembly and expression as events progressed in Egypt. Iranian repression has been brutal, and leaders in Bahrain have shown they are similarly desperate to retain power.

But looking further down the road, as we see rising food inflation and falling economic prospects in developing nations, and as a track record of

successful revolts is established, the fires of revolution could be rekindled in surprising places.

Political unrest could escalate elsewhere in Africa, in Latin America (Venezuela, in particular) and even in more-liberal nations such as India as food inflation escalates. In short, historians may one day trace a new wave of global democracy to a single act of desperation in Tunisia.

This would be a "black swan" event that could elevate the gold price for many months to come. That's one scenario.

The other most obvious, and perhaps most likely, scenario would be one where the Mid East turmoil quickly calms down following the resolution of the situation in Libya. And in this scenario, gold investors will need some other fundamental factors to sustain and advance the price.

### RECESSION, INFLATION...OR BOTH

In mid-January, I amped up my calls for a big rally in gold. Admittedly, I wasn't sure what would spark the rise...but there was no denying that the wholesale departure of speculative funds, the rising strength in physical demand and the technical picture all argued for a big move higher.

As you'll remember from last month's issue, we featured a chart, prepared by Ron Griess at TheChartStore.com, showing how the Bollinger Bands for gold's 50-day moving average had "pinched" once again, foreshadowing an imminent rally in gold.

We've updated this chart and are featuring it once again. This time, though, I want to point out how, in each previous instance when the Bollinger Bands pinched over the last

two years, the gold price touched the lower band.

These instances marked the starting points of very significant rallies that lasted for months. And it's happened once again.

Looking at the previous rallies in gold that were predicted by these indicators, I would expect this rally to last about three months, into May, and to bring gold into the \$1,500 to \$1,550 range. But these previous rallies occurred during more normal times...and these are not normal times.

But if gold *is* to repeat these previous patterns, what could drive it?

It's an axiom in economics that high oil prices are a drag on the economy, and many of the past recessions in the U.S. can be traced to oil-price spikes. So it's very possible that the current oil crisis could send the U.S. back into recession, or at least stunt economic growth enough to prompt the Fed to keep pumping out money.

Also, it's interesting that, so far in this oil crisis, global investors have not been turning to the U.S. dollar as a safe haven. Instead, money is flowing into oil (of course), gold and silver.

Under the current administration, the greenback has already lost much of its status as the world's reserve currency. If this trend continues, and if gold and silver become the preferred safe havens for the world's investors, then all bets are off. The metals simply cannot contain the types of money flows that this would entail...at least not without parabolic price increases.

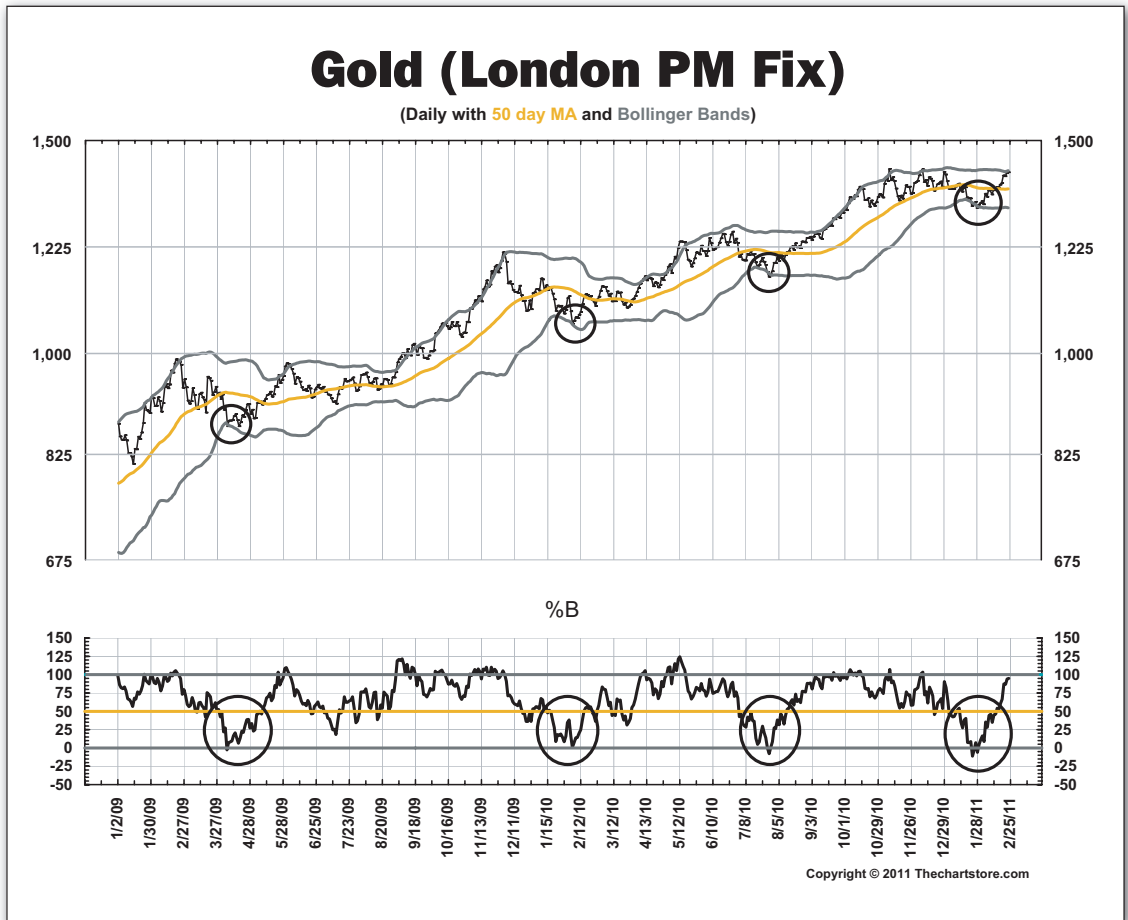
Absent these developments, I continue to believe that investors will eventually recognize that the monetary easing already done, and the huge debt already amassed, make it certain that the dollar and other fiat currencies will become considerably less valuable in terms of gold. There is no other answer to the arithmetic equation.

However, it will take some time for investors to transition to this understanding. And in the meantime, gold

and silver will be very vulnerable and volatile.

Putting it all together, this is a time to tighten your seatbelts, hang on for the ride, and take profits when price and volume allow. The near-term is more cloudy than ever but, regardless of how long the current situation lasts, I continue to believe we'll hit a soft patch at some point — likely in June-July — with a stronger period in the fall as inflation hits home.

**Editor's Note:**  
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