INVESTING

Gold Meltdown Creates Bargains For Physical Buyers

By TRANG HO, INVESTOR'S BUSINESS DAILY
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Gold prices rallied off their lows for the week, as buyers of the physical metal stepped in after the sharp sell-off to the lowest level in two years... View Enlarged Image

The gold market appears to have stabilized after the yellow metal crashed to a two-year low this week. Gold coin and bullion buyers went on a shopping spree, contending that the sell-off in the futures and ETF market offers a chance to buy at bargain prices.

Spot gold prices fell to as low as $1,320 on Monday but rallied to $1,400 by Friday, down 5% for the week.

SPDR Gold Shares (GLD), tracking a 10th of an ounce of bullion, rallied to 135.37 on the stock market today. It was down 6% for the week — the fourth losing week in a row. Down 12% so far this month, it's on track to book its largest one-month decline since October 2008.

The World Gold Council, an industry group for the metal, released a statement Thursday saying this week's sell-off has sparked an onslaught of physical buying. It saw shortages of gold bars and coins in Dubai and people paying premiums to spot prices in Mumbai and Shanghai.

"There is a current disconnect between the paper markets and the physical market," Scott Carter, CEO of Lear Capital, a Los Angeles-based precious metals dealer, said in an email. "Japan has devalued the yen and many are buying physical gold to hedge against inflation. However, the paper market on Comex is much larger than the physical market. So even though the price can drop dramatically, more investors are buying gold."

"Central banks bought 55 tons of physical gold on Monday the day gold dropped $150," Carter added. "Why would central banks buy gold other than to diversify away from paper currencies like the yen and dollar?"

The fundamentals for owning gold as a hard asset or store of value remains, the gold bugs contend. Governments around the world are debasing their currencies through quantitative easing programs, racking up debts and keeping interest rates low.

"The gold 'crash' was not based on a shift in those fundamentals," John Williams, founder of ShadowStats.com wrote in a client note. "It most likely resulted from a deliberate action and/or from a severe systemic distortion, involving financial and/or fiduciary irregularities."

But the weakness in gold suggests the market doesn't expect hyperinflation to spawn from global QE. The yellow metal has collapsed 28% from its historic high from September 2011, crossing the 20% threshold for a bear market. That's while the Bank of Japan plans to double the bank's balance sheet over the next two years in hopes of lifting inflation to 2%. Even the Cyprus bank bailout failed to rally gold.

"The free-fall in the price of gold could be bad news for stocks if it suggests that traders and investors are starting to lose confidence in the effectiveness of QE monetary policies," Ed Yardeni, president of Yardeni Research wrote in a client note.

Market Vectors Gold Miners ETF (GDX) plunged 12% for the week to its lowest price since December 2008. Having lost 26% this month, it's suffered the largest one-month drop since the 2008 bear market.

Investors pulled $2.7 billion out of commodities precious metals funds in the week ended April 17, according to Lipper Inc. That's the group's biggest weekly outflow on record. GLD, experiencing the group's largest outflow, disgorged $2.2 billion.

PowerShares DB U.S. **Dollar Index Bullish** (UUP), measuring the greenback against a basket of major foreign currencies, was up 0.63% for the week.

Silver Prices

Spot silver prices eased 0.4% Friday to $23.18 an ounce.

IShares Silver Trust (SLV) was down 0.4% to $23.18 Friday. It cratered 10% for the week and 19% month to date.

Global X **Silver Miners ETF** (SIL) was down 15% for the week and 24% month to date.

The Golden Dilemma

This week's volatility is a prime example of how gold is an ineffective inflation hedge, Campbell Harvey, a professor at Duke University's Fuqua School of Business, and Claude Erb, wrote in a research paper released this week titled "The Golden Dilemma."

"Gold is so much more volatile than inflation that it is an undependable hedge unless you measure your investment horizon in centuries," they wrote.

Even after this week's dive, gold would need to drop by 50% to return to its historic relation to inflation. "Given the current value of the consumer price index (CPI), the 'gold as an inflation hedge' argument suggests that the price of gold should currently be around $780 an ounce."

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