In May 1999, Gordon Brown, the Chancellor with the Midas touch, made the decision to sell 400 tons worth of the country’s gold reserves. At the time gold prices were at a twenty year low of $270 per troy ounce. The announcement of the sale pushed it lower still to $255. By 2003 following in the wake of the collapse of the high tech bubble, this looked like a bad decision as investors turned to gold, pushing up its price to $400. By the collapse of Lehman Brothers in October 2008, as gold prices nudged $900, it seemed like a dreadful investment decision. And now that the price of gold has powered through $1,500, representing a 458% increase since May 1999, it must rank as one of the most calamitous investment decisions of all time.

There are currently two factors driving the price of gold: US monetary policy and the sovereign debt crisis festering at the heart of the grand Euro project.

In response to the credit crisis the US authorities cut interest rates to zero. But the economy failed to respond. As a result they next tried quantitative easing – which is a fancy name for “printing cash”. But unemployment remained stubbornly high. So they tried a second round of QE – affectionately referred to as QE2 – which involved “printing” and then pumping in a further $600bn. Although the US economy is currently showing some signs of life, its labour market is still a source of grave concern: astonishingly, nearly 16% of the US workforce are still either registered as unemployed or are actively seeking work. This is one of the reasons why many believe that a third wave of QE - QE3 – will start soon after QE2 runs out of steam this summer.

Printing money like it’s going out of fashion is not good for the currency and runs the risk of stoking up inflation. So investors need to consider investing in another currency. What about the Euro?

In creating the Euro, one of the over ambitious goals of Euroland politicians was to create a currency that could challenge the mighty US dollar. The problem now is that their Economic and Monetary Union is facing a crisis every bit as grave as that facing the US economy and its dollar. In our view it is now inevitable that Greece, Ireland and Portugal will default on their debts. They simply cannot grow their way out of them. We calculate that Ireland and Portugal will need to renege on 50% of their debts, while Greece will have to renege on nearly 70% of theirs. Worse still, Spain is on a knife edge. If the markets decide to charge the Spanish government much more for their debt they too will have to default. So the Spanish must have been particularly pleased with the recent ECB rate hike!

The truth is that the world’s two most important currencies are currently vying for the title of the “most ugly horse in the glue factory”. Which, in the minds’ of investors, leaves only gold as a viable hedge against the potential ravages of inflation and as a safe haven from sovereign insolvency.
In our view gold prices will remain elevated, and may rise further, until the US central bank stops printing cash and until Euro area politicians sort out their fiscal mess, and stop shooting themselves in the foot at every opportunity.

However, we might change our view if someone told us that Gordon Brown had started buying gold again!