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Soros Signals Gold Bubble as Goldman Predicts Record (Update2)

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(Updates gold price in eighth paragraph.)

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March 1 (Bloomberg) -- George Soros is helping drive up gold prices by doubling his bet in a market even he considers a “bubble” as Goldman Sachs Group Inc., Barclays Capital and HSBC Holdings Plc predict more gains before it bursts.

Soros Fund Management LLC, which manages about $25 billion, increased its investment in SPDR Gold Trust, the world’s largest exchange-traded fund for the metal, by 152 percent in the fourth quarter, a Feb. 16 Securities and Exchange Commission filing shows. While prices have fallen 9.2 percent since reaching a record on Dec. 3, 15 of 22 analysts in a Bloomberg survey say gold will reach a new high, with the median forecast predicting a 17 percent advance to as much as $1,300 an ounce this year.

“When interest rates are low we have conditions for asset bubbles to develop, and they are developing at the moment,” Soros said at the World Economic Forum’s annual meeting in Davos, Switzerland, in January. “The ultimate asset bubble is gold,” he said.

In a Jan. 28 Bloomberg Television interview, the 79-year- old billionaire recalled that former Federal Reserve Chairman Alan Greenspan warned of “irrational exuberance” in financial markets three years before the technology bubble burst in 2000. The Standard & Poor’s 500 Index rose 89 percent in the period. Buying at the start of a bubble is “rational,” Soros said.

Gold’s fourfold rally since the end of 2000 has also attracted money managers John Paulson, Paul Tudor Jones and David Einhorn. Paulson’s Credit Opportunities Fund soared almost sixfold in 2007 by betting that subprime mortgages would plummet. Einhorn said in October that his Greenlight Capital Inc. bought gold to bet against the dollar.

‘Just an Asset’

Tudor Investment Corp., based in Greenwich, Connecticut, increased its stake in Newmont Mining Corp., the largest U.S. gold producer, almost fourfold in the final quarter of 2009. Gold is “just an asset that, like everything else in life, has its time and place. And now is that time,” Paul Tudor Jones said in an October letter to clients.

Funds of the four-biggest ETF firms hold 1,583 metric tons of the metal, according to data compiled by Bloomberg. Only the central banks or governments of the U.S., Germany, Italy and France and the International Monetary Fund hold more.

Investment demand, including in bars and coins, doubled to 1,820 tons last year as investors sought a refuge from the global recession, according to GFMS Ltd. That exceeded jewelry demand for the first time in three decades, the London-based research firm said Jan. 13. Prices reached the record $1,226.56 a decade after the metal fell to a 20-year low of $251.95 amid sales by central banks. Gold was at $1,113.70 today in London.

Dollar Rally

The price fell as the economic recovery sparked a dollar rally that has pushed the U.S. Dollar Index, a gauge against six counterparts, up 4.1 percent this year. Gold ended last week at $1,117.60, up 18 percent in the past 12 months and 21 percent since the start of the third quarter, when Soros accumulated 2.44 million shares of the SPDR Gold Trust.

“Perhaps Soros thinks gold is going to bubble but the bubble is going to last for a while and he wants to profit from it,” said Jeffrey Nichols, managing director of American Precious Metals Advisors and an adviser to central banks and mining companies. “We could have a bubble but gold can reach $2,000 or $3,000 before it’s over.”

Soros’ New York-based firm became the fourth-biggest investor in the SPDR Gold Trust by the end of 2009, 17 years after he made $1 billion breaking the Bank of England’s defense of the pound. The SPDR fund holds 1,107 tons, more than either Switzerland or China.

Paulson, Einhorn

Paulson & Co. is the ETF’s biggest investor, with 31.5 million shares, regulatory filings show. With each representing almost a 10th of an ounce of gold, the hedge fund firm’s stake is the equivalent of about 96 tons, exceeding the holdings of Australia and Kuwait.

New York-based Paulson is also the biggest investor in Johannesburg-based AngloGold Ashanti Ltd., Africa’s top producer. The Market Vectors Gold Miners ETF is Einhorn’s seventh-largest holding, according to a Feb. 16 filing.

Goldman predicts gold will reach $1,235 in three months and $1,380 in 12 months. Barclays Capital says the metal will average $1,235 in the fourth quarter. HSBC says it may peak at $1,300 this year.

“I absolutely believe it’s heading into a bubble, but that’s why you buy it,” said Charles Morris, who manages $2.5 billion at HSBC Global Asset Management’s Absolute Return Fund in London. “A bubble is good,” he said, forecasting the metal may rise to $5,000 in five years to explain why 11 percent of his fund is in gold.

World Economic Growth

The metal dropped from the record high as recovering economies pushed up the dollar. The Washington-based IMF increased its forecast for world economic growth in 2010 to 3.9 percent in January, from 3.1 percent in October.

Gold may drop 28 percent to $800 this year if the U.S. raises interest rates, said New York-based Tom Winmill, who manages $120 million at the Midas Fund. Gold generally only earns interest for banks that lend it, so its lure over cash diminishes as borrowing costs increase.

Fed Chairman Ben S. Bernanke said Feb. 24 that the U.S. economy is in a “nascent” recovery that still requires low borrowing costs. U.S. policy makers likely will start raising the target rate for overnight loans between banks from the record low range of zero to 0.25 percent in the third quarter, according to the median estimate of 72 economists.

‘Very Expensive’

“Gold looks very expensive right now,” said Brian Nick, an investment strategist at Barclays Wealth in New York, which manages $221 billion. “Yes, rates are low but are they low enough to produce runaway inflation? Actual inflation numbers haven’t pointed to a worrying trend” that would prompt Fed action to cool an overheating economy, he said.

U.S. consumer prices will rise 2.15 percent this year, compared with last year’s 0.35 percent decline, according to the median of 60 estimates.

Stock-option traders are boosting bearish bets against gold-mining companies’ shares, paying the most in more than a year for options to protect them from declines. Bearish options on the Market Vectors Gold Miners ETF, which tracks 31 producers, were 12 percent more expensive than bullish ones last week, the highest premium since December 2008, according to data compiled by Bloomberg.

Hedge funds and speculators are paring bets that gold will keep rising. There were 200,622 more outstanding futures contracts that profit on the metal gaining than wagers that pay when prices fall as of Feb. 23, down from 262,331 in November, U.S. Commodity Futures Trading Commission data show.

More Bullish

Traders remain more bullish than in past years, with speculative long bets on gold on the New York Mercantile Exchange outnumbering short wagers by more than 7-to-1, compared with less than 5-to-1 in the three years before the September 2008 collapse of Lehman Brothers Holdings Inc. spurred demand for gold’s perceived safety.

Central banks likely will expand their reserves for a second straight year, said CPM Group, a New York commodities researcher. The last time they added to stockpiles, in 1988, gold fell 15 percent and then took 15 years to recoup its losses, suggesting they may not be the best indicator of investment timing. Central banks hold about 18 percent of all gold ever mined.

Through the end of last year, gold was up about 29 percent since its 1980 peak. In that same period, Treasuries rose about 1,090 percent. The S&P 500 earned more than 2,300 percent with dividends reinvested over the three decades. Even cash in the average U.S. checking account outdid gold, gaining 92 percent.

Premature Bubble

The combined holdings of the biggest ETF providers -- State Street Corp., ETF Securities Ltd., Zuercher Kantonalbank and Barclays Capital -- rose more than 16 times from 95 tons five years ago.

It may be premature to declare a bubble by the standards of other commodities. Copper rose 188 percent in the year to May 2006 before falling 38 percent in nine months. Crude oil doubled in about 11 months before peaking in July 2008 and slumped 77 percent in the next five. Gold hasn’t had a 12-month gain of more than 55 percent since October 1980. Adjusted for inflation, it’s still worth about half of its 20th century peak of $850 on Jan. 21, 1980.

Touradji Capital Management LP founder Paul Touradji said in a March 2008 letter to his hedge fund clients that the commodity market was a “buying orgy” of inflated prices. Oil, which had gained 80 percent in the previous 12 months, went up 35 percent more in the next four months. Touradji’s largest equity holding at the end of the fourth quarter was a stake in Toronto-based Barrick Gold Corp., the world’s biggest producer of the metal.

“Gold makes sense as an investment,” said Jeffrey Christian, the managing director of CPM Group. “Just because the price of gold is going up for the 10th year doesn’t mean it’s a bubble.”

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