

5 reasons gold is headed for \$3,000

Recent dips are giving us another chance to get in on the great gold rush. The factors driving the metal higher -- broken governments and fragile economies -- aren't going away.

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PSPFX	10.82	+0.10	+0.93
TGLDX	90.51	+1.83	+2.06

Is the next stop for gold \$3,000 -- or \$1,000?

With the precious metal seeing some weakness since posting an all-time high of more than \$1,900 an ounce -- though it rebounded Tuesday to about \$1,800 -- that's the critical question for anyone who caught gold's big run or who is wondering if it's too late to get in.

Few investments bring out more passion than gold does. The folks known as **gold bugs** never seem to think the price is high enough, while their critics have been waiting since \$1,000 for the bugs to get their comeuppance.

But for the rest of us, the challenge is figuring out whether gold's move can go on. Analyzing that involves looking at the reasons gold has been on a tear, and whether they'll continue to be in play.

A careful look tells me \$3,000 could indeed be in gold's future, making upcoming dips buying opportunities. Here's why I think gold is headed higher after a correction that could send gold down to \$1,600 or lower -- and the best ways to buy in if you agree.

Why gold is heading on up

A \$3,000 price tag would have seemed farfetched a decade ago, when the price was around \$300, or even when gold first crossed \$1,000 an ounce in 2009. But the political and economic uncertainty pushing gold higher isn't over, because debt and spending problems around the developed world look so entrenched.

JPMorgan Chase analyst Colin Fenton just predicted gold could spike to \$2,500 an ounce over the next four months. And Tom Winmill, who manages the **Midas Fund (MIDXS +2.06%)**, thinks gold could trade as high as \$2,200 next year, largely due to national budget issues and economic uncertainty. Then in early 2013 after the U.S. presidential elections, an ongoing inability to deal with national spending and debt issues may push it even higher, he believes.

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Is gold really a safe haven?

Winmill won't put a number on how high a budget crisis at that point would drive gold. But think of it this way: To get to \$3,000, it takes a spike of less than 30% from his projected 2012 high of \$2,200. And as we've seen this year, a 30% spike in gold is not unusual when uncertainty drives investors to the perceived "safe haven" of gold. This year, gold rose from less than \$1,400 an ounce to more than \$1,900 an ounce, a move of greater than 30%.



Michael Brush

That makes \$3,000 not just possible, but in reach.

Why I'm a believer

This isn't the first time I've made a prediction that befuddled the gold bears.

I've twice before published bullish outlooks for gold -- in a November 2007 column, "Why gold is going straight to \$1,000," and in an April 2008 piece, "5 reasons gold is headed to \$1,500." (Editor's note: Those columns are no longer available.)

Both those targets felt distant, and both times I heard from the doubters -- mainly because in both cases gold had already seen a big run-up, and they thought it was already overpriced.

By now, those targets have been topped by wide margins. That doesn't mean I'll be right a third time. But there are still compelling reasons to think gold could go much higher.

"The long-term drivers for gold are still intact," says Brian Hicks, co-manager of **U.S. Global Investors Global Resources Fund** ([PSPFX +0.93%](#), [news](#)), the top-performing Lipper global natural resources fund in 2010. "I don't believe it is in a bubble."

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Here's a look at what will drive gold prices higher:

Driver No. 1: Fears of out-of-control governments

You know the litany by now. In the U.S. and Europe, excessive government promises and debt are creating a financial storm. There are no easy solutions. "I am not sure there is the political will to really address the problems," says Hicks. At some point, though, a more serious crisis will hit "and that is when you are going to see gold take off," he says.

And one of the solutions tried so far -- increasing the money supply to spur growth and tax revenue -- may well create lot of inflation, which is bullish for gold. "All of these factors create great conditions for gold, which people rightly or wrongly perceive to be a safe haven in uncertain times," says John Hathaway, the manager of the **Tocqueville Gold** ([TGLDX +2.06%](#)).

Driver No. 2: Negative interest rates

When the best you can do with your cash is pay someone to hold it -- as opposed to earning interest -- owning gold looks a lot more attractive. And with inflation at 2% or so, and U.S. Treasuries earning around that amount and money market funds earning far less, that's what we have right now. "Negative real interest rates (after inflation) are a big inducement for investors to look some other place to protect value. Gold is going to be one those places," says Hathaway.

Driver No. 3: Central bankers are buying again

Central banks, especially in South Korea, Thailand, Russia and Mexico, are buying gold again, adding to demand. By the middle of July, central banks had bought more gold this year than in all of last year, according to the World Gold Council. For the first time since the 1980s, central banks have been net buyers of gold for three years in a row, points out Deutsche Bank analyst Michael Lewis. And it's not over. "Central banks are likely to remain net purchasers of gold," says the council. Central bank demand could grow even more if China decides to replace dollar-denominated debt with gold as a hedge against a dollar that gets torpedoed by U.S. debt and economic problems. This is likely.

Driver No. 4: Gold supplies are limited

Mining adds only a small percentage to overall gold supplies above ground each year, so the supply is limited. Over the nine years through the end of last year, gold above ground grew at an annual rate of just 1.7% to an estimated 166.6 tons, according to my calculations using numbers from the World Gold Council. "There's so little physical gold, it just takes a small increase in demand to have a big impact on prices," says Hathaway.

Driver No. 5: Gold still looks cheap, by some measures

Unlike a stock, gold has no earnings or cash flow. So how do you decide if it's overvalued? By comparing its value to common benchmarks. And by several comparisons, gold still looks cheap.

(Continued ...)

TICKERS IN THIS ARTICLE

NAME	LAST	CHNG	% CHNG
\$INX	1,223.27	+10.35	+0.85



SGGDGX	36.60	+0.73	+2.04
GLD	178.30	-0.80	-0.45
NEM	63.55	+0.42	+0.67
ABX	51.33	+0.48	+0.94

Gold would have to hit \$6,400 an ounce for it to match its value relative to the **Standard & Poor's 500 Index** ([\\$INX +0.85%](#)) when it was at highs in 1980, points out Lewis. And at current prices, gold's value relative to oil and copper is at around the historical average, says Lewis.

So, is this a buying opportunity?

Make no mistake, Hicks and other analysts think gold looks topy, with the recent bouts of weakness indicating the start of a price correction that's not over.

Using technical signals like relative strength, a measure of how far an asset has moved in price compared to recent history, Michael Painchaud, of Market Profile Theorems, believes gold could correct -- fall in price -- for several months, taking the metal down to around \$1,630 an ounce. That's its 50-day moving average, a common support level in corrections. A worst-case scenario would send gold down to its 200-day moving average, or just below \$1,500 an ounce.

"Our technical indicators still show gold as being extremely overbought, or trading somewhere between the stratosphere and the ionosphere," agrees Fred Dickson, the chief investment strategist at Davidson Companies.

But if the gold bugs are right about the potential for a medium-term move up to the low \$2,000 range and on toward \$3,000, you should be buying on the correction. At the very least, given all the uncertainty, it pays to have around 10% of your overall portfolio in gold as a hedge, says Rachel Benepe, co-manager of the **First Eagle Gold** ([SGGDGX +2.04%](#)). Any upcoming move down might be a good time to get it, if you don't have it already.

How to buy gold

So, how to get this exposure?

Any of the gold mutual funds mentioned in this column will do the trick. I've talked with managers at all of these funds over the years, and they've made good calls. So will the gold exchange-traded fund, **SPDR Gold Shares** ([GLD -0.45%](#), [news](#)).

Hicks, at U.S. Global Investors Global Resources Fund, suggests mining stocks such as **Newmont Mining** ([NEM +0.67%](#), [news](#)), **Barrick Gold** ([ABX +0.94%](#), [news](#)) and **Goldcorp** ([GG +0.27%](#), [news](#)). They should move up when gold prices head higher. And as blue-chip names in the sector, they should hold up better in any further pullbacks in the broader stock market caused by financial instability in Europe.

Benepe thinks mining companies with exposure to South Africa look cheap because fears about nationalization and political risk there are overblown. She cites **Goldfield** ([GV 0.00%](#), [news](#)), and **AngloGold Ashanti** ([AU +0.60%](#), [news](#)), in part because they both have a lot of exposure to mining outside of South Africa. For exposure to a blue-chip name with mines in countries with minimal political risk, she suggests Goldcorp, which operates in North America.

Winmill, at the Midas Fund, also likes Newmont Mining, as a high-quality, medium-cost producer with decent growth prospects, whose shares look cheap. And he suggests **Eldorado Gold** ([EGO +0.25%](#), [news](#)), a high-quality mid-cap gold mining company whose production could double by 2015.

What I don't suggest, despite the barrage of advertisements from gloom-and-doomers like **Glenn Beck**, is that you buy actual gold as an investment. The reasons: It's hard to find a reputable dealer with a fair price. Plus you may have to pay to store your gold. "Owning physical (gold) is a dumb idea," says Hathaway, of the Tocqueville Gold Fund. "I don't recommend it."

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Is gold really a safe haven?

But if you're in love with the idea of gold you can touch and hold, knock yourself out. Just try to avoid paying a big markup; that can wipe out any investment value.



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Of course, the biggest risk to the bullish case for gold is that governments get their act together and come up with a credible way to deal with excessive spending and debt. But that's about as likely as finding a pot of gold at the end of a rainbow, respond the gold bugs.

They just might be right.

At the time of publication, Michael Brush did not own or control shares of any company or fund mentioned in this column.

Michael Brush is the editor of [Brush Up on Stocks](#), an investment newsletter. [Click here to find Brush's most recent articles and blog posts.](#)