The Fundamental Case for Gold and Gold Equities Remains Unchanged

Over the past few days the gold market experienced tremendous volatility. In our view it is important to separate short-term technical factors from long-term trends. Cleary, the market is currently dominated by short-term technical trading.

One key element to gold's weakness is the escalating liquidity crunch and deleveraging which causes a huge demand for US Dollars. As history suggests, the response by the FED to a rising Dollar will be more Dollar devaluation because the FED needs to expand the US monetary base to prevent the banking system from collapsing.

The second reason for the weakening gold price was the statement of legendary trader Dennis Gartman's on CNBC on December 13th that he sold all his gold in his personal account. We assume that this statement has triggered liquidations of long positions and short selling of gold by hedge funds. It should be considered that Gartman has cut his gold positions before in early June when gold was trading around $1520 per ounce just before it went up to over $1900 in the middle of August.

Thirdly, over the last few days gold was smashed regularly and within minutes. These intense declines in price repeated with remarkable fidelity. No rational investor would sell his gold in the biggest economic and monetary crisis since the 1930s in such a manner. We believe that the price of gold is artificially suppressed as it becomes clear that all the monetary interventions will eventually fail to prevent the system from deflating.

Another reason we see for gold's weakness is a deflationary fear trade whereas investors have pulled out of gold since the yellow metal is wrongly seen as a commodity rather than money. The fact of the matter is that gold does well in times of deflation and credit stress.

We are not concerned about the current correction in the gold price. To fight deflation, central banks will maintain record low interest rates. Low interest rates mean more cheap money. More cheap money means higher gold prices in the future.

Forced liquidations, a weak gold price and tax loss selling have resulted in a steep correction for gold mining equities which are trading back to their 2009 levels. Gold equities (GDXJ) have underperformed bank stocks (BKX) this year.

We increased our holdings in our favourite gold producers over the last few days. With tremendous deflationary pressure in the system, the flight to liquidity will go on and further increase the real price of gold versus other assets. Profit margins will continue to expand in the gold mining industry in this environment. Our long-term view remains unchanged.

Below we have summarized some key headlines of this week which support our views and which we consider to be critical in these difficult times:

On Gold

- Net gold purchases by central banks are at a 40-year high, rising to 148.4 tonnes in the third quarter 2011 *(World Gold Council)*
- Gold investment in Europe increased 135% year-on-year (YoY) to a record quarterly value of €4.6 billion. Nearly all markets saw double-digit growth in demand for gold bars and coins *(World Gold Council)*
- Chinese investment demand for gold bars and coins was up by 24% YoY as per the third quarter 2011 *(World Gold Council)*

- Gold ETFs and similar products saw inflows of 77.6 tons in the third quarter, 58% higher than a year ago *(World Gold Council)*
- Citi Predicts Gold At $3,400 In "The Next Two Years", Potential For Move As High As $6,000 *(Casey Research)*
- HSBC Sues MF Global Over Disputed Ownership Of Physical Gold *(zero hedge)*
- Bad publicity bullish for gold, John Hathaway says *(King World News)*

On Bank Stress and Debt Deleveraging

- Fitch Downgrades Viability Ratings of Eight Global Trading and Universal Banks *(Fitch)*
- Australian Banks Given One Week To Prepare For European "Meltdown" *(zero hedge)*
- Europe's Top Bank Regulator: 'The Crisis Has Reached a Systemic Level' *(Spiegel Online)*
- Founder Of $30 Billion Hedge Fund BlueCrest Says Most Euro Banks Are Insolvent; Euro Situation Much "Worse Than 2008" *(Bloomberg)*
- Sovereign Financial Support for U.S. Banks Declining *(Fitch)*
- Thousands of Latvians lined up at bank counters and ATMs over the weekend in an attempt to withdraw their savings from Swedbank, the country's largest banking institution. (*SHTF Plan*)
- "There is a massive run on the banks globally. It is primarily centered in Europe, but also around the world. The ECB will print when they see some deflation." *(Jim Rickards)*
- David Rosenberg sees Europe's Liquidity Crisis Becoming Solvency In Q1 2012 *(zero hedge)*
- Credit Agricole quits commodity trade as crisis bites *(Reuters)*
- Anxious Greeks Emptying Their Bank Accounts (*Spiegel Online*)
- "If I were Greece or Portugal or Spain, I would say 'bye-bye.' I exit the EU. And the debts in EU, that's your problem." (*Marc Faber on Fox Business News)*

On the Economy

- IMF Chief warns over 1930s-style threats *(Financial Times)*
- IMF Says Europe Crisis Escalating, Needs External Assistance; Russia Will Use Proceeds From Sale Of US Treasuries To Help Europe *(zero hedge)*
- China's epic hangover begins *(The Telegraph)*
- Japan Tankan Slides as Investment in China Drops on Global Slump: Economy *(Bloomberg)*
- China Affirms Property Curbs Amid 'Grim' Outlook *(Bloomberg)*
- France enters Recession *(La Tribune)*
- Italy in Recession: Confindustria slashes 2012 Italian growth forecast *(Reuters)*

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