Gold Reaches $1,000 Again: This Time It's Different

By Patrick A. Heller, Market Update
February 23, 2009

Last Friday afternoon the spot price of gold in the U.S. reached $1,000. This is only the second time that the gold spot price breached this significant threshold. Although gold may see temporary modest sell-offs before it permanently stays over $1,000, I don't think there will be any more buying opportunities at a significant discount to $1,000.

Here are some of the reasons why.

Last March, when the price of gold topped $1,000 for a few days, the global financial markets in general and those particularly related to gold were much different.

The open interest in the COMEX gold market is now about 40 percent lower than it was last March. That means there are fewer speculative long positions that could be liquidated in short order.

Many hedge funds and other leveraged gold investors have long since liquidated their margin positions. They can no longer sell anywhere near the quantities of gold as they did in 2008.

The number of outstanding shares of GLD, the major gold exchange traded fund, have jumped over 55 percent since last March. This exchange traded fund is selling so many shares that it does not seem possible that it is able to acquire an offsetting amount of physical gold, so much of its new outstanding shares may be covered with gold derivatives.

There are rumors (I have not been able to obtain specifics or to verify the reports) that multiple mainstream pension plans have begun to take small positions in gold within the past two weeks.

Even though the price of gold as measured in U.S. dollars did not hit an all-time high (ignoring inflation) last Friday, it did hit all-time highs against the British pound, the euro, and a number of other world currencies.

The collapses or massive bailouts of Bear Stearns, Indymac, Fannie Mae, Freddie Mac, Lehman, Merrill Lynch, Washington Mutual, Wachovia Bank, AIG, Citigroup, Bank of America, JP Morgan Chase, General Motors, GMAC, Chrysler, General Electric, National City Bank, Goldman Sachs, Morgan Stanley, and many others (including a number of foreign banks and companies) had not yet happened.

The world's investors are tens of trillions of dollars less wealthy than last March, almost all of it lost in stocks, bonds and real estate.

The world's central banks are selling much less gold than they have in years past.

The U.S. government has added trillions of dollars of debt since last March and shows signs of adding much more in the coming months. Current U.S. government debt, including the present value of unfunded Social Security and medical liabilities, exceed the value of all the world's assets.

In sum, the gold market right now is much more concentrated in non-leveraged "strong hands" than it was last March. There has been a tremendous decline in the number of "weak hands" and highly leveraged owners of gold who could flood the market with supply. There are also signs that the investment demand for gold has taken off, even though current demand from India (the world's largest gold consuming nation) has fallen to a trickle.

Last year, the price of gold was clobbered once it climbed just above $1,030 in mid-March. While gold will not go straight up from where it is now, in my judgment I think it is highly likely gold will top $1,200 by the end of April. There is even a significant possibility that it could pass $2,000 by the end of 2009.

Physical gold market notes: In the past two weeks, retail customer demand for gold coins and ingots have roughly quadrupled the levels we saw from November 2008 through January 2009. Until last Friday afternoon, almost this entire surge in demand came from existing long-term gold buyers adding to their positions. As gold was reaching $1,000 on Friday afternoon, we served a number of first time novice buyers who mostly wanted to buy gold right now, with little regard to the prudent questions asked by most people thinking of making their first gold purchase.

At the peak of the gold market in 1980, about the only buyers were these almost reckless novices. There are still a large number of prudent buyers in the market today, so I don't see any sign of a market top on the basis of this indicator.

I predicted that physical gold and silver bullion would become almost impossible to purchase by the spring of 2009. With the strong demand in the past couple of weeks, coin dealers have a lot less inventory for immediate delivery. Premiums are starting to rise and delivery times are starting to stretch out. If you are contemplating the purchase of physical gold or silver, you may not want to wait.