POLLITT & CO.

COMMENT

Hyperbolic

1) 2010 was the year we saw the transition of Jean-Claude Trichet, head of the European Central Bank, from a hard money tough guy to a soft money clone of Ben Bernanke.

2) An armada of Eurocrats demonstrated that they will do anything to save the Euro and, of course, their own skins.

3) Copper outperformed gold in 2010. Sure, some of this was investment buying, but the economic message is clear.

4) The controversy over gold continued, often driven more by emotion than fact. And moves in precious metals partially eclipsed notice of wheat, sugar and dozens of other commodities which had wild rides. Still governments argue that inflation is not a problem – the hope, as always, being father to the thought.

5) 2010 was the year that gold as money, gold as an investment, really took over from gold as a commodity.

6) Gold ETFs received a lot of attention in 2010, but their total assets are still probably less than five per cent of assets administered by PIMCO.

7) It was also the year the bond market tipped over – we expect for a long, long time.

8) The levels of promotion for many prospective Canadian gold mining companies reached extraordinary heights. Proponents of the more excessive valuations coined the term "optionality" to justify share pricing, although it's not exactly clear what that means. Valuing companies on the basis of hazy, even mythical, "inferred" ounces in the ground will lead to tears.

9) Canada's strong loonie has helped lead to a $50 billion annual deterioration in its balance of trade over the two years ending in 2010. We now have a serious problem with the trade as well as the current accounts, but nobody seems to care.

10) In the wider Western world, the vast majority of people steadfastly refuse to accept reality. They say copper and wheat are up; they cannot (or will not) grasp that copper and wheat don't change but, rather, money is changing for the worse. Economists are no better – the other day one said "Sure, gas is up, but TVs are down." The problem is that many of us buy gas once a week and a TV once every five years.

11) Even the doyen of market letter writers (Richard Russell) may not get it. In his year-end comment he said the bull move in gold will end with an "explosion." But it won't end at all unless governments put serious backbone back into the monetary system. What are the chances? We may already be past the point of no return on that score, in which case charts for gold and much else will become hyperbolic – a thought which leads us into 2011.

2011 will be generally more of the same, but even more dramatic than 2010.

1) Gold will lead, not lag, other commodities and will outperform all currencies.

2) China will celebrate the year of the rabbit by becoming stronger and more agile.

3) The four biggest gold mining companies produce a quarter of the world's gold. In the past several years their share prices have lagged the bullion price as they have digested lower grades, higher waste-to-ore ratios, development costs, electricity costs and so on. (The same happened in the 1970s. Then the first gold price double just permitted mines to become healthy again; thereafter higher prices benefitted shareholders and tax collectors a lot.) Likewise we expect most of the next move up in the gold price will have a relatively higher impact on the big boys' earnings and share prices than in the past.

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4) 2011 will bring disappointment to some of the promotional gold mining dream merchants.

5) Solid asset equities will again do well. (We have said this for twenty-six years.)

6) As in last year, short interest rates will stay low, but long rates will climb and the bond market will fall under its own weight.

7) The loonie flying over par will prove a little too close to the sun. It has partially de-industrialized Ontario (which is over 40% of Canada's GNP) and is fast turning the province into North America's Greece.

8) 2011 may see some governments' sticky-fingered financial bureaucrats start scheming (if they haven't already) on ways to get their hooks into the ETF gold. That would be unwise because a) too many people in high places would scream and b) it would send a wildly bullish signal to the market. Still, the bureaucratic mind…

9) 2011 will be the year in which policy makers discover that austerity reduces both business activity and tax revenue. To the consternation of all, nobody's budget problems will be solved and some will be exacerbated.

10) The US has a vested interest in other countries having strong currencies, but fewer and fewer countries take marching orders from Washington and more and more are intervening (buying dollars, selling their own paper) in order to keep the jobs at home. The list of these countries (some developed, some emerging) is growing and will continue to grow in 2011. *Sauve qui peut* and all that.

11) Returning to point 11) above (in discussion about 2010), the subject of the monetary system, or lack of a defined monetary system, is a touchy one. We raise it from time to time, but nobody appears to really care. But without a monetary system we do not see how the current trend towards ever easier and ever weaker money can be stopped let alone reversed. Anybody with a shred of interest in the economy can name at least half a dozen accidents waiting to happen throughout the world. Residential real estate in Toronto or China, commercial real estate almost everywhere, one banking system or another, several countries, provinces and states plus God knows what problems hidden behind God knows which balance sheets. The one thing we do know is that, whatever the problem, it will be dealt with by somebody printing more money.

At a pre-Christmas lunch the undersigned and some old friends were talking markets when one shrewd old chap with lots of dependants said, on the subject of a flight out of money, "Well, in my family, a flight out of money means Dad is out of town!"

Happy New Year!

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