



# The GLEASON REPORT

Market Timing for Investors  
Identify Turning Points in Asset Classes

## The Real Gold Standard

April 2010

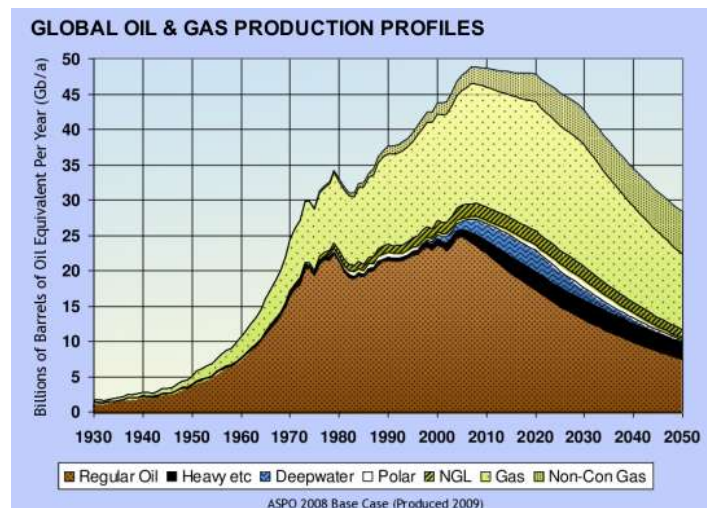
### The Gold Standard You Didn't Know About

In 1971, the US cut the dollar's link to gold for international transactions. From that day forward the dollar was backed by nothing. Or was it? Within a couple years, the Middle East oil producers announced that the only currency they'd accept for oil sales would be the US dollar. Thus, other currencies had to be converted into dollars to buy oil. Uncle Sam thus created a large demand for dollar reserves across the globe because everyone needed dollars to buy oil. These offshore dollars were called Petro Dollars. Even though the dollar was no longer convertible into gold, the US dollar retained its role as the world reserve currency because everyone had to have it for oil and commodity transactions.

The US solidified security agreements with the gulf oil states. They were guaranteed that the US military would fend off any other nation that tried to overthrow the militarily weak monarchies. The agreement has held for almost 50 years. During the first Gulf War, America held up its part of the bargain by kicking Iraq out of Kuwait. Over the years, the Arab states have been reliable suppliers of energy to the world despite vast cultural differences with the West.

Oil prices have swung up and down over the decades. And, OPEC nations often don't stick to production quotas. Overall, the system has worked because Saudi Arabia has acted as the swing producer to keep production in rough balance with demand.

Things are changing. Conventional oil production (excluding tar sands, gas to oil, etc) peaked in 2005. The Saudis are now pumping at capacity. Major oil fields globally are in decline and new production isn't matching the depletion rate. In the chart above, conventional oil is in brown. You can see the predicted production decline rate.



**Does the CPI Set the Fair Value for Gold?**

The Consumer Price Index can roughly be used to gauge fair prices for wages and rents and house prices. It doesn't work well for commodities. That's because commodities are inputs into prices and drive the CPI.

Copper is a good predictor of forward inflation. You can see it started to slump in the first half of 2008 and bottomed in early 2009. The prices of copper and base metals drive the CPI and not the other way around.



The chart below titled Gold Price and TGR Estimate of Fair Value shows the gold priced if based in CPI. If you look at the price of gold in the past and apply the CPI inflation rate to it, you get a fair value for gold of about \$850 for 2010. This may be a reasonable way to determine a fair gold price in a closed dollar system. In real life, it doesn't work.

If you take the price of oil in the 70's and apply the CPI, you get an oil price of about \$54 in 2010. Again, that would be accurate if oil supplies were only impacted by demand. That's not realistic since supply is a big factor and supply is in decline.

The forward prices of oil and gold can't be estimated using CPI. We need a better way to estimate the fair value price of gold. The best way to forecast an asset price is to discover other assets with a high degree of price correlation and observe their price trend. What asset is highly correlated with gold? I can prove gold is highly correlated with oil.



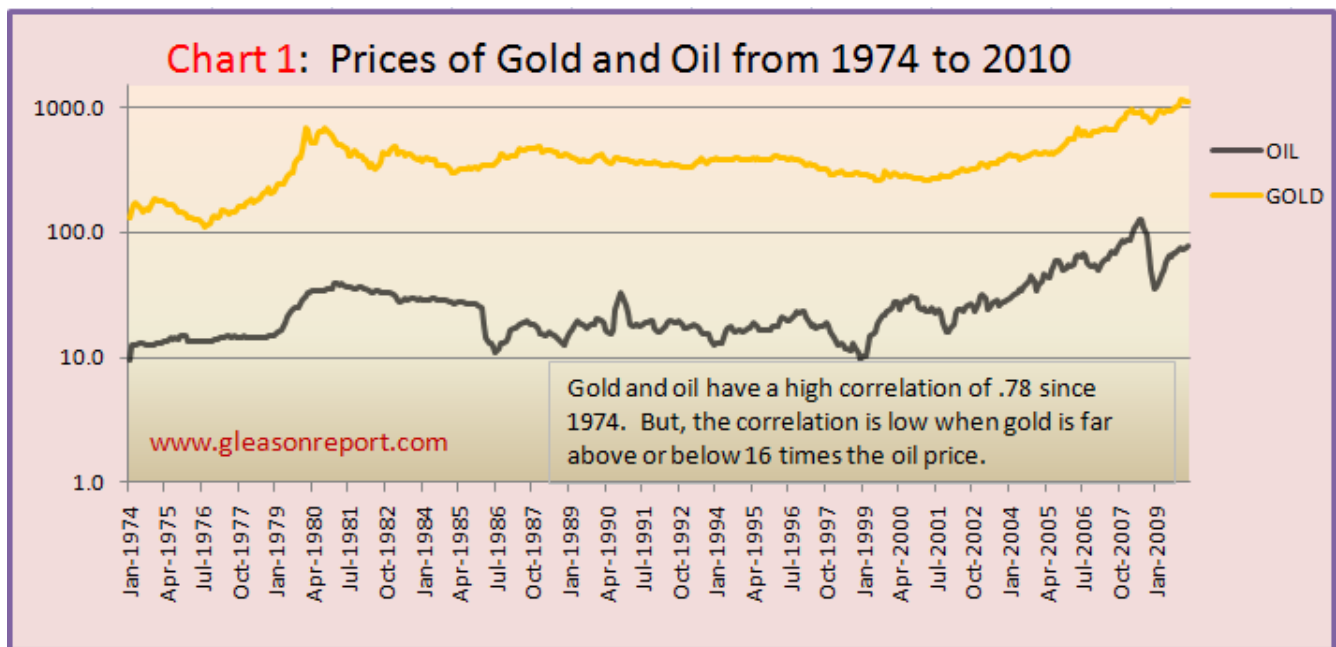
We know that both gold and oil have exceeded their CPI suggested price levels. Oil because of supply constraints and gold because it is actually linked to oil, not the CPI.

Why is gold linked to oil? Because when America went off the gold standard, we went on the oil standard. Gold, however, always trumps oil since it's the premier asset, second to none, and can buy any other.

The world needs a stable oil price as measured in dollars. A weak dollar is of deep concern to commodity nations because they're afraid of being paid with a depreciating asset. Therefore, to maintain value for commodity producers and stable currency relationships, the dollar must not be allowed to crater. In addition, high oil prices can cause global recessions

When gold is high it makes the dollar look over-priced. Thus, a stable or falling gold price conveys a mood of stability to the dollar. The dollar-oil-gold relationship explains why central banks sell gold at times and why gold indirectly still serves as an anchor for the dollar. Without a doubt, governments try to manipulate the gold and silver prices to maintain an appearance of price stability.

The US won't give gold for dollars anymore. But, with its oil producing allies and various Central Banks, it will try to balance the supply of dollars, the price of gold, and the flow of oil to maintain price stability for oil as priced in dollars. This has to be the case because there has to be a medium of exchange that will always be accepted in exchange for oil. It can be a trusted currency. If none is trusted it will be gold.



Something big is happening in the gold market. Oil production is in decline and the Saudis are pumping all they can. Meanwhile, the US government is printing ever more dollars. Since the annual production of gold is quite constant and oil production is falling, that means it's a terrible time for the US to be printing too many dollars. Since the dollar is losing trust, gold is following its historical pattern and is rising as the oil price rises.

Look at Chart 1.

Over the last 45 years, gold and oil have been highly correlated at almost 80% since 1974. Gold and oil move closely together in price 80% of the time. That's high but that correlation is deceiving. Because there were times when the correlation was poor. It happened when gold was over-priced relative to oil.

Let's answer two important questions.

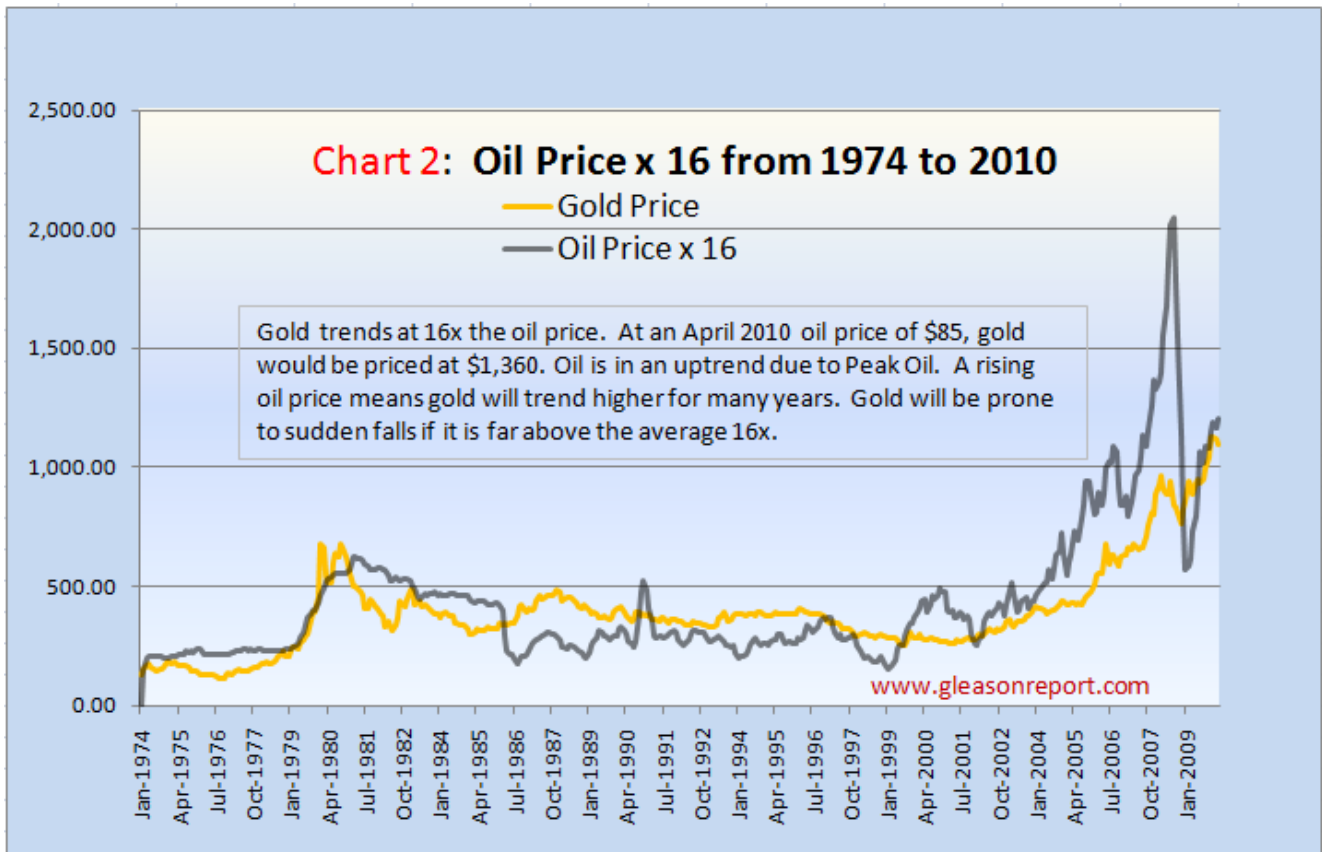
1. Why did gold do so poorly in the late 1980s and throughout the 1990s?
2. Why did gold do so well in the 1970s and after 2000?

First, let's look at the statistical correlation of gold and oil by decade. By correlation, I mean how the price change in one asset affects another. As you can see, the correlation between gold and oil broke down after 1980 but came back after 2000.

**Gold/Oil Correlation**

1970s	97%
1980s	4%
1990's	29%
2000's	82%

Why was the correlation so high in the 1970s and after 2000? Look at Chart 2. The yellow line is the gold price. The black line is the oil price multiplied by 16. In the 70's gold was selling below the long term average of 16 times the oil price. At the same time, oil prices were rising. The rising oil price caused a boom in gold as it pulled gold up.

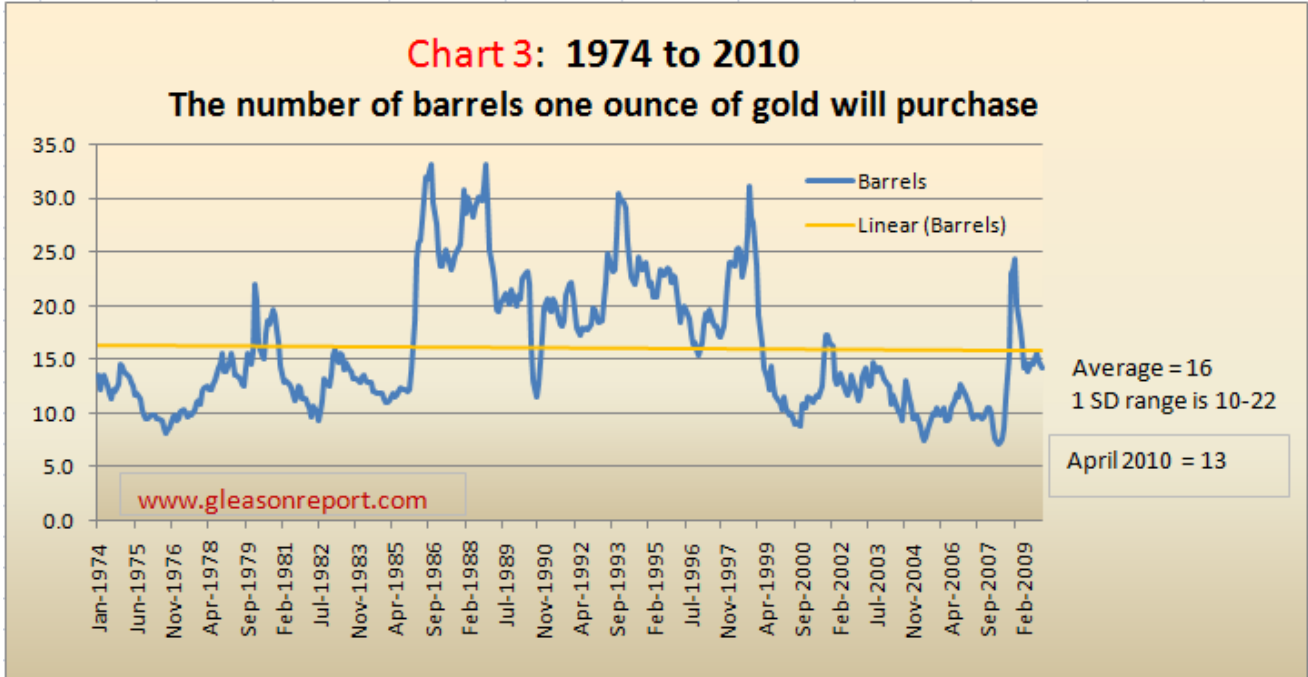


Why did gold do poorly in the 1980s and 1990s and also not correlate well with oil? Gold was selling above the 16x average after 1985. The multiplier was over 25! Way too high. See chart #3. In addition, during those decades the world experienced an oil glut from new production from Alaska, the North Slope, Russia and other locations. New oil discovery technologies and recovery methods caused a bounty of oil production. Gold was pulled down from its high multiplier as the price of oil slumped from surging supplies. This is important, so pay attention. Gold fell and didn't correlate with oil in the 80's and 90's because the gold/oil multiplier was too high. So, gold declined in price until a fair multiplier was reached. Since new oil discoveries were flooding the market, gold kept falling as oil fell.

In 2005, an important event occurred. The world hit Peak Oil and the production of conventional oil has declined since then. Look at the price surge in oil since 2005 on Chart 2. Gold has actually been restrained in its price advance indicating an orderly and cautious bull market.

Chart 3 points out several interesting points. The average gold to oil ratio is 16. There is, however, a wide divergence in what is normal. One standard deviation of the average is plus or minus 6x the oil price. That means the normal range for the gold/oil ratio is between 10 and 22. So, you cannot say that gold should be selling at \$1600 when the price of oil is \$100. Anything between \$1000 and \$2200 is within the range of normal.

But, ratios close to 10 and near 22 are low and high risk points. When the gold/oil ratio is close to 10, it's quite safe to buy gold. When it's above 22, it's probably a good idea to sell some gold if the oil price is falling.



After 1985 new oil production swamped the market for years. An ounce of gold purchased over 30 barrels of oil in 1985. The gold to oil ratio stayed far above 16 until 1999. As the price of oil fell, gold had to fall. This was a bad time to own gold with the price falling from \$800 in 1980 to the mid \$200s in the 1990s.

People who don't understand gold often point to 1980-1999 era as why gold is a bad investment. In reality, low oil prices were a huge boon to the global economy and money was better invested in stocks. Money always seeks the highest rate of return. For almost 20 years that was stocks and bonds so money left gold.

After 2000, the oil price started to rise. Still, gold spent most of the 2000s far below the 16x average. Gold rose from \$260 to over \$1200. In 2008, gold fell along with the rest of the financial markets. High oil prices hurt economic activity and, as oil declined, gold fell too. The ratio was up near 25 at the peak during 2008. This was a clear warning that the gold price was a risky levels.

Here in April 2010, with gold at \$1100, many people say gold is in a price bubble. I say absolutely not true. The ratio is presently at 13 and the oil price is moving up. In this environment of Peak Oil and money printing, I believe gold is not in danger. We'll see what happens but, I'm advising you, don't bet against me. Yes, it could go lower – maybe to \$850 in a hard to imagine situation where energy becomes cheap again. Ask yourself, do you think oil will be cheaper in five years? There's your answer.

The safest time to buy gold is when oil is rising and the gold-oil ratio is between 10 – 14; the lower 1/3 of its standard deviation price range. At a ratio of 14, gold would be priced at \$1190 – not far from the present price. That's why I believe gold is a safe investment at this time.

I sent subscribers an alert in 2009 when journalist Robert Fisk had discussions with Middle East oil nations. A fluent Arabic speaker and trusted by key people in the region, his exclusive report was dismissed by the deflationists. I said it was extraordinarily important.

*"In the most profound financial change in recent Middle East history, Gulf Arabs are planning – along with China, Russia, Japan and France – to end dollar dealings for oil, moving instead to a basket of currencies including the Japanese yen and Chinese yuan, the euro, gold and a new, unified currency planned for nations in the Gulf Co-operation Council, including Saudi Arabia, Abu Dhabi, Kuwait and Qatar. Secret meetings have already been held by finance ministers and central bank governors in Russia, China, Japan and Brazil to work on the scheme, which will mean that oil will no longer be priced in dollars."*

*They plan to switch to a basket of currencies by 2018 and the use of gold for oil perhaps prior to that. The release of this information and the deadline indicate an ultimatum has been delivered to America's leadership. China also predicts economic conflict is directly ahead. Source: <http://www.independent.co.uk/news/business/news/the-demise-of-the-dollar-1798175.html>*

*The gold-oil-dollar tri-linkage is going to be discarded. America knows that. The only way to maintain the US empire and to buy more time is to bring more oil production under the dollar's control; thus the Iraq/Iran/Caspian oil wars. This would delay the move away from the dollar.*

The massive US debt being accumulated to pay for these wars and to prop up the financial markets is impossible to sustain. They buy some time – a short amount of time. It also gives us time to get

prepared. Don't waste this precious time in angst or with second-guessing your own good judgment. Look at the facts and then act in a sensible and balanced way to protect yourself.

### Implications of Peak Oil

As oil depletes and the price rises, we'll see more frequent recessions in America and other western nations. A high and rising oil price era would create a market environment that's the reverse of 1985-1999. Stock indexes and long term bonds will not be a great investment if consumers are squeezed. Some stocks will do very well but not the general market.

During recessions the oil price will fall back temporarily. Over time the oil price chart will appear like a jagged rising slope with ever higher lows.

Gold will maintain its upward price momentum. If the gold to oil ratio is over 20 when a recession hits, we could see a sharp slump in the price. If the ratio is close to 16, the decline will be minimal. Again, the chart pattern will resemble oil.

I believe the oil price will exceed \$150 within 5 years or less. I suspect gold will track close to 16x the oil price or a bit lower. That price level implies gold will be \$1500 (10x) to \$2400 (16x) and possibly higher by 2015. The market is not psychologically ready for a higher multiple but it could happen during war or political upheaval.

High oil prices will incite resource wars. The Iraq/Afghan wars are about energy. War with Iran is likely. Iran has 9% of the world's remaining oil reserves and borders the coveted Caspian Sea reserves. The West wants Iran's oil on the market and Europe wants pipeline alternatives to those owned by Russia. This is an economic survival issue for the western economies.

The American economy and dollar dominance depend on affordable oil. The political stakes are high and the forward risks are ominous. America is already a fascist state with Patriot Act police powers and capital controls waiting in the wings. Obama has extended the Patriot Act. I've detailed in prior reports how the government is closing off the exits out of the dollar.

### What About Silver

The US Coinage Act of 1794 set the Gold-Silver ratio at 15:1. In the 1960s, America demonetized silver. The ratio is now at 63:1. Expectations of an exploding silver price will require the use of silver as money again. This could happen. I suspect this will occur after a devastating economic problem or world war. The world will go back to sound money when no one trusts paper.



Bad money has enabled the war junkies and the corrupt politicians. True political reform and peace will require good money again.

### **Is Paper Gold Leveraged 100:1?**

Recent reports suggest that the paper gold market is rigged with high leverage. Some say the custodian banks don't have all the gold they claim. When you look at the players and their connections to D.C., it's a safe bet there's something bad going on. I have no idea what the actual leverage is. Own physical gold and silver or invest a fund that holds allocated metal.

### **Conclusion**

I believe gold and silver are undervalued here in April 2010. Considering the faltering dollar and Peak Oil, I expect the price of gold and silver to rise dramatically. Even after gold reaches 16x the oil price, the long term upward pressures on oil prices will cause gold to rise – possibly for the rest of your life. Just pay attention to the gold/oil ratio and don't buy when the ratio strays too far above the long term average.

If the dollar should be discarded as the world reserve currency, gold could positively explode upward as world gold/currency relationships are reset.

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