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# THE NATIONAL INVESTOR



<http://www.nationalinvestor.com>

NUMBER 39

"For where your treasure is, there will your heart be also."—MATTHEW 6:21

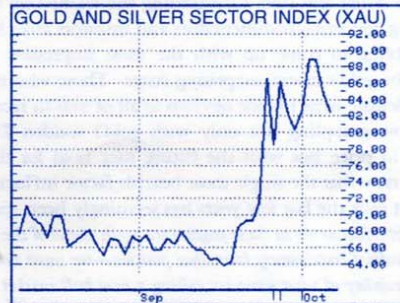
OCTOBER, 1999

# WOW!

As predicted in these pages in the last two issues, gold stages a monster rally—prodded by welcome (and largely unexpected) good news on central bank gold sales and leasing activities.



After dropping again to near \$255 per troy ounce, gold soars to \$330—and then \$340—before pausing for breath.



Already anticipating better news—and under apparent accumulation by certain institutions—gold shares quickly jump

Recommended call options	Purchase Price	Price—October 5	2 Week Gain
Newmont Mining —Nov. 20	2 9/16	9 1/4	+ 261%
—Dec. 22 1/2	1 13/16	7 1/2	+ 314%
Barrick Gold —Nov. 20	1 1/2	5 1/4	+ 250%
—Jan. 20	1 7/8	5	+ 167%
Placer Dome —Jan. 12 1/2	7/8	4 7/8	+ 457%
Homestake Mining —Jan. 10	1/2	1 3/16	+ 138%

And...my September 21 Hotline, fax and e-mail recommendations on the above-listed call options on these mining shares have to date resulted in average gains of 264.5%, translating into a current value of \$36,450 for each \$10,000 invested—  
**IN JUST TWO WEEKS!**

**IS THIS THE LONG-AWAITED BULL MARKET LONG  
PREDICTED BY GOLD BUGS?**

**A POTENTIALLY CATAclySMIC SHORT-COVERING RALLY?**

**OR...ARE LATE-ARRIVING GOLD INVESTORS ABOUT TO BE  
SUCKERED AGAIN, AS IN JANUARY, 1996?**

**READ INSIDE FOR THE SCINTILLATING DETAILS...**

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# Whither the Markets?

An assessment of the past month's activity and trends in the financial markets . . . and what may lie ahead



## GOLD SOARS—BUT HOW MUCH HIGHER WILL IT BE ALLOWED TO GO?

Not since the dramatic scandal surrounding the Bre-X Mining gold scam surfaced nearly two years ago has the financial press been as fixated on precious metals as in the last few weeks. This time—instead of a scandal involving salted assays, the alleged "suicide" of Bre-X's chief geologist and the multi-billion dollar law suits surrounding the washed-up Canadian mining concern—commentators and investors alike have been scrambling to come up with the most impressive words to describe gold's recent surprising surge. Those who had failed to anticipate what I made obvious to all of you in recent weeks are now grappling not only with gold's sudden 25 percent surge in price, but what the future may hold for the yellow metal now that the single most bearish factor influencing this market over the last few years has seemingly been removed.

*Yet—just as we in these pages were again ahead of the curve, and have profited handsomely from that position—we must now question the durability of what some are calling a new bull market for gold at the same time that others are calling for even higher prices.* I am forced to recall the early days of 1996, when gold spiked in almost equally dramatic fashion to a high of \$418 per ounce. Some of you will recall that at the same time a chorus was rising from the precious metals community that "This is it" (the alleged dawning of a long-awaited reversal which, they claimed, would finally carry gold to \$1,000 per ounce and more) I sang a much different tune. Commodity funds at the time were selling into the market's strength, at the same time that a surge in investor demand kept prices aloft. The hand writing was on the wall, though—*speculators were preparing to take gold back down.*

Though I have seen no such pressure on gold prices yet (at least from commodity traders) what follows nevertheless is a sober picture of what this recent spike *really means*, the bullish

factors that indeed still exist and, finally, some of the reasons why I can not yet state with certainty that this is a new bull market for gold.

## GOOD NEWS BUILDS PRIOR TO UK AUCTION

Though it did not have any immediate positive effect on gold prices, the increasing evidence in late summer that the planned sale by the International Monetary Fund of 10 million ounces would be canceled began the stream of good news that has lifted prices since. Both House Republican leader Dick Armey (R-TX) and House Banking Committee Chairman Jim Leach (R-IA) had vowed to veto any sale. According to Armey, this proposed sale was "just a way for the IMF to acquire liquidity for more mischief without being accountable;" others similarly criticized the IMF's plan as merely a "back door" way for the IMF to perpetuate what is now almost universally viewed as a flawed structural loan program. Thankfully for a beleaguered gold industry, such sentiment was not limited to conservative law makers in the US; economists and politicians in other nations were also lining up in opposition to the move, if for no other reason than a habitual negative reaction these days to pretty much anything proposed by the discredited IMF.

Just after Labor Day, the IMF officially threw in the towel, opting instead to study a plan to "revalue" its gold holdings in order to free up some cash to throw away *without* having to unsettle the gold market to boot. *Still, however, the gold market remained within a few dollars of its 18-year lows of \$252 per ounce, preoccupied with the next scheduled sale due September 21 of 25 metric tons by the United Kingdom.*

A rally did ensue, however, when the auction came about. The world's two largest mining companies—Anglo Gold and

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*The National Investor* is published monthly and mailed via airmail to subscribers from 410 River Street, Spooner, Wisconsin 54801. The Editor, Christopher L. Temple, may be personally addressed at this address, telephoned at (715) 635-4300 or telefaxed at (715) 635-4302. E-mail may be addressed to NatInvstor@aol.com. The Internet web site can be accessed at <http://www.nationalinvestor.com>. Subscribers may call *The National Investor* recorder Hotline at (715) 635-4333; the message from the Editor is updated as events dictate. Immediate fax and/or e-mail transmissions of each update are available; contact the Editor for more information. To subscribe, mail a check for the appropriate amount to the Spooner office, or use the toll-free ordering line at (888) 345-8869 to charge by VISA or Master Card. Subscription prices: \$295 for two years (24 issues); \$175 for one year (12 issues); \$59 for a one-time, four-month introductory trial subscription. Subscription cost is generally a tax-deductible expense; consult your own tax adviser for specific information. The information contained herein is conscientiously compiled and is correct and accurate to the best of the Editor's knowledge. However, neither it nor any opinion or recommendations can be guaranteed. The Editor may have positions in some securities discussed. Subscribers are encouraged to investigate any situation or recommendation further before investing. The Editor receives no undisclosed kickbacks, fees, commissions, gratuities, honoraria or other emoluments from any companies, brokers or vendors discussed herein. All rights reserved. Copying this proprietary information by any means without written permission is prohibited.

## ***Whither the Markets Cont . . .***

Gold Fields Ltd, both of South Africa—led the bidding in what amounted to a welcome success for the gold market. The auction ended up being eight times overbid, with the 25 tonnes on offer sold at \$255.75, or 55 cents above London's early fix of the day. *It was the likelihood of at least another good technical and short-covering rally on the heels of the auction that prompted me that morning to recommend the option purchases (detailed again on the front page) which have since more than tripled in value.*

While one analyst called the move by the mining concerns a "calculated risk" to put a more secure floor under gold prices, Gold Fields said it bought one-eighth of the 25 metric tons sold by the U.K. central bank simply because it believed the metal was "too cheap" and that rising demand from jewelers will boost prices in the months ahead (gold usually sees its best seasonal demand in the fall.) "Our intention in participating in the auction was primarily because we saw an opportunity and not because we thought we were going to support the gold price," Gold Fields spokesman Willie Jacobsz told Reuters following the auction. "If it has had that effect then we are very pleased by that," he added.

Over the next few days, gold inched its way up to close the week around \$270 per ounce for its best weekly showing in some time. Conspicuously absent from the market were many of the producers who had previously used even tiny rallies in gold to sell even more of their future production. "Producers are looking at the demand side and seeing there's good support at these levels," observed Kevin Crisp, head of precious metal strategy at J.P. Morgan Securities, as the rally moved forward "Previous moves up have been met by producer selling and that hasn't happened this time." Helping gold's cause also was the fact that lease rates were inching up to the four-five percent area, making it less attractive for speculators to try to borrow more of the metal in order to sell it and short-circuit the rally.

"Sentiment appears to be shifting abruptly in the wake of Tuesday's second UK auction," the firm Salomon Smith Barney commented at week's end. "With gold having climbed by \$12 per ounce in the three days following the auction, we are more confident than at any time in the last year that this rally has staying power—at least through year end."

*That was a reasonable observation—yet absolutely nobody (not even me) had any idea of the news that would come a mere 48 hours later.*

### **POLITICAL CORRECTNESS TO THE RESCUE!**

For many weeks, both gold industry groups and several producing nations have been loudly complaining about the destructive gold sale plans of not only the IMF and the UK, but of Switzerland as well (the latter of which is slated to start selling off gold holdings next year.) Where the IMF was concerned specifically, its since-scuttled plan to sell off gold hold-

ings to help finance debt relief for its "HIPC" (Heavily Indebted Poor Countries) program was derided by the World Gold Council as worse than the disease. The Council pointed out that—had the IMF gone through with the sale and invested the proceeds to help fund the debt-relief initiative (only the interest earned from the gold sale would have been made available) those same countries had *already lost* more than that amount in export earnings due to the low gold price.

Warning additionally of the rising unemployment and structural economic problems faced particularly by many African nations due to gold's plunge, the Council stated that, "The future growth of these nations is being undermined by precisely those who wish to proffer a helping hand—the IMF and governments of some well developed countries."

Though you didn't hear anything of this on the nightly news broadcasts, protests were occurring on a regular basis in front of both the UK and Swiss embassies in particular. Impassioned exhortations were coming from the likes of South African President Thabo Mbeki, as well as the Ghanaian Minister of Mines Fred Oshene-Kena, who complained that his country was "reeling" from gold's price slide. Here in the US, some two dozen members of Congress were warning President Clinton that if the price slide continued, "upwards of 800,000 Africans will be plunged into absolute poverty."

It was largely these protests—and, some claim, an increasingly effective (and potentially embarrassing) investigation into gold market activity by the Gold Anti-Trust Action Group—that caused 15 European banks to make the following announcement in Washington on September 26, which has been described as "the most important fundamental news for the gold market in 10 years":

(Mr. Wim Duisenberg, President of the European Central Bank, announced the European agreement in Washington on Sunday, September 26. The signatories are the European Central Bank, together with the central banks of Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, Switzerland and England.)

*In the interest of clarifying their intentions with respect to their gold holdings, the above institutions make the following statement:*

- 1. Gold will remain an important element of global monetary reserves.*
- 2. The above institutions will not enter the market as sellers, with the exception of already decided sales.*
- 3. The gold sales already decided will be achieved through a concerted programme of sales over the next five years. Annual sales will not exceed approximately 400 tonnes and total sales over this period will not exceed 2,000 tonnes.*
- 4. The signatories to this agreement have agreed not to expand their gold leaseings and their use of gold futures and options over this period.*

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5. This agreement will be reviewed after five years.

A jubilant George Milling-Stanley of the World Gold Council stated after the announcement that, "What this amounts to is a five-year moratorium on new sales of gold by all the countries that signed the agreement. The figures of no more than approximately 400 tonnes a year, for a total not exceeding 2,000 tonnes over the next five years, include the potential sale of 1,300 tonnes by Switzerland, and the current sale by the British government of a total 415 tonnes, with 50 tonnes sold so far in two auctions. The signatories also agreed not to expand their gold lending arrangements and derivative operations over the period.

"These decisive measures by a group which accounts for about 50% of all official gold holdings will reduce dramatically the scope for rumor and speculation that has been such a damaging feature of the gold market in recent years. This agreement reaffirms their unswerving commitment to gold as the bedrock of their reserves.

"The other major holders of gold in the world—the United States, the International Monetary Fund, the Bank of Japan and the Bank for International Settlements—have all associated themselves with the agreement. They were not signatories but they were involved in the discussions that led to the agreement, and it is my understanding that they will abide by it. All are committed to gold."

While Mr. Stanley can be forgiven for putting the most positive industry spin on things, gold watchers and investor were not far behind in their exuberance over the seeming removal of the most significant albatross from around the yellow metal's neck. And the rally begun by the successful UK auction only days earlier immediately became much more urgent.

### GOLD REACTS QUICKLY— MAYBE TOO QUICKLY

As liquidity in the gold market began to dry up more rapidly than had occurred late the preceding week, the gold price spiked more dramatically, soaring over \$300 per ounce. Lease rates—which had been one to two percent for those speculators and hedge funds who had borrowed previously endless amounts of gold from central banks mere weeks before—jumped at one point to over 10 percent. Rumors rapidly escalated of everyone from producers to hedge funds and bullion banks being caught short (you'll recall my prediction of this, of course, over the last two issues.) Suddenly, even those who wanted to quickly close out short positions were finding it quite painful to do so—even if they could find gold to buy.

*Few, it seemed, were ready for such an abrupt change in sentiment.* In prior rallies, hedge funds and even gold producers were quick to, respectively, borrow or sell more gold in order to

lock in higher prices; in the case of hedge funds in particular, these bear raids were successful over the last few years since they were able to still borrow central bank gold at such low interest rates. With this avenue now apparently closed off to them, the funds scrambled for what gold was immediately available. Rumors also began circulating early the week of September 27 of firms such as Goldman Sachs and Republic Bank of New York refusing physical delivery of the metal.

The market was becoming subject to "potentially severe dislocation," according to Jessica Cross, an analyst at Virtual Metals Research, Ltd. in Johannesburg. In the past, she pointed out, European central banks had provided "emergency liquidity by lending more (gold)" though "under this new agreement, that safety valve is no longer an option (when the market's supply becomes tight.)"

Market analysts quickly scurried to upgrade their recommendations on most companies in the gold sector, as well as to push up their gold price forecasts.

Adding to the tightness—and to ward off some speculative activity in what was too quickly becoming more of a fundamentally-based cash market for gold—The New York Mercantile Exchange announced that it was doubling margins for gold futures contracts after the close of trading on September 29.

*Add it all together, and my prediction in the September issue of the coming spike in gold prices being so dramatic as to "roil all other world markets in the process" was mere days from becoming a fact.* Without some kind of a "breather" hedge and other "investment" funds would need to start liquidating speculative positions on stocks, bonds, currencies and more to cover their rear-ends before gold really got into the stratosphere.

### NOW YOU CAN TALK ABOUT A CONSPIRACY!

On my Monday, September 27 Hotline message and updates, I warned, "By rights, gold should race to \$325 per ounce. HOWEVER, WE STILL CANNOT IGNORE THE POSSIBILITY FOR DISAPPOINTMENT. I hate to be a party pooper already—believing as I do that gold should ultimately settle in the \$325-350 area to truly reflect strong fundamentals—but it must be remembered that the U.S. Treasury was NOT a party to this weekend's pact.

"Fed chair Alan Greenspan has himself previously indicated that he would see that a major move in gold were short-circuited. (This was in his July, 1998 Humphrey-Hawkins testimony to Congress.) Don't forget that if we see this strong rally continue, a LOT of hedge funds still short gold will be in trouble. So—while the European news was wonderful and SHOULD be the support of a sustainable new rally—we need to watch the market closely. Stay tuned for any changes to my

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recommendations.”

Sure enough, the Federal Reserve Bank of New York—through Republic Bank, a major bullion bank—entered the market on the afternoon of September 28. As gold was accelerating to over \$330 per ounce in what was truly becoming panic buying, an as-yet undisclosed amount of gold was made available to the market. *Within literally minutes, the price dropped by some \$20 per ounce, and lease rates—which had spiked to over 11 percent—dropped to a still-high five percent.*

Over the next few days, those who had been either entering the market anew or covering short positions hoped for a more meaningful pull back—and seemed to get it when gold briefly dipped below \$300 per ounce. But the absence of any new forward selling by suddenly emboldened producers (in fact, many continued buying back their own previous options) and gold’s good technical behavior to hold in the \$300 per ounce range quickly caused a stampede again. On Tuesday, October 5, gold started running again over \$300 per ounce, and actually at one point touched the key \$340 per ounce level. *A significant breach of this previously key area for gold could have caused—and still might, if it’s allowed to happen—enormous trouble throughout the financial system.* Sensing that gold would be torpedooed yet again, I advised late that morning that you begin liquidating the options recommendations I made on September 21, and even consider trading out of the mining stocks themselves. *That afternoon, gold was again knocked back down, and has now settled in the \$320 per ounce area.*

I have previously discounted many of the claims that the decline in gold of the last three and a half years was a “central bank conspiracy.” As I pointed out in the last issue—and as John Hathaway’s item so expertly described—it’s been more of a case of central bank *stupidity* in allowing unregulated hedge funds to drive gold artificially low. The fact is, however, that central bankers can not—and will not—allow gold’s rebound to bankrupt key banks such as Chase Manhattan and J.P. Morgan, bullion banks such as Republic, and brokerages such as Goldman Sachs, *all of which are already suffering more than anyone realizes.*

### SO WHERE DO WE GO FROM HERE?

Without any doubt, gold’s recent moves should end up sticking for quite some time to come, barring any new, significant fears of a global economic slowdown. The European banks’ new position—if adhered to—has all but removed the ability of hedge funds to conduct any new “bear raids” on the market. Lease rates are unlikely to go back to their previously absurd lows of one to two percent, and instead should stay in a range of four to six percent. “That sure makes people not want to lease it,” observes John Muery, head of bullion trading at MTB Bank in New York. “The general trend for gold prices

is upward.”

Fundamentally, gold should remain strong as long as even the perception remains (or grows) of rebounding economies elsewhere. Demand is expected to remain strong particularly from jewelers in Japan, where the economy is slowly awakening from its slumber. In that nation and elsewhere, the case for buying gold has also been bolstered by the dollar’s recent weakness, making gold relatively less expensive when translated into yen or other local currencies.

So far, as I mentioned earlier, gold producers have largely avoided aborting gold’s rally by staying on the sidelines. However, some analysts are warning that if gold fails at many more attempts to push through the \$340 area, mining companies might feel that the rally is over, and again move to lock in prices by selling more future production. *While such activity would not be likely to knock gold back down anywhere close to its recent lows, it would probably mean that what some are perhaps prematurely calling a bull market could be finished almost as quickly as it started.*

### HEDGE FUNDS STILL A KEY—AND A TICKING TIME BOMB

As I write this, debate is still swirling about how much exposure hedge funds have as a group to the gold market. While some voices in establishment financial circles are claiming that the majority of these funds’ short positions have already been covered over the last few weeks, few experienced gold market watchers believe that. If they’re right—and I happen to think they are—further sudden gains could be in store for gold, until they are also somehow short-circuited.

“The extent to which these short positions are unwound will now help to determine how far the current gold price rally has to run,” said Philip Klapwijk, managing director of Gold Fields Mineral Services Ltd., a London-based consultancy. “Clearly if short positions are anything close to the size some people have rumored, then \$400 or even \$500 an ounce would not be unrealistic targets.” He added, however, his opinion that existing short positions are not as large as some have rumored, meaning that the ultimate extent of the current rally is “likely to be correspondingly less powerful.”

*He pointed out that other nations not a party to the recent agreement limiting sales and leasing activities might take advantage of the current high lease rates to move some of their own gold reserves into the market.* “There is a lot of gold that could be accessed by the gold market,” he added. “These gold lease rates are very attractive, and you see more lending and also short cover. This allows liquidity, and less of (a chance of runaway prices)” he added.

Some are also already calling for the European banks to “rethink” their announcement, obviously afraid of the consequences of an unchecked rally. Writing in the September 30

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## Whither the Markets Cont . . .

issue of the *Financial Times*, Andy Smith of Matsui—one of the most respected gold analysts—warned that, “This is now a disorderly market. . . Gold is still a reserve asset. If you had conditions like this in the bond or foreign exchange markets, it would not be allowed to continue. . . gold has been trading like a commodity, not like money. Volatility has shot up, the cost of options has shot up, the cost of borrowing has shot up. The situation is untenable.”

*Right you are, Andy—and we can all thank the insanity of central banks for allowing unregulated and unaccountable hedge funds to get us all into this mess over the last few years.*

We may not hear the end of this story of the manipulation of the gold market by hedge funds—with an assist from central banks, some Wall Street firms and others—for a while yet. I can tell you this, though—I’d hate to be an accountant at Goldman Sachs, Chase Manhattan, and Republic Bank, for starters, and have to find a way to break the news of some staggering losses in trading activity to both shareholders and regulators.

*One more thing about hedge funds—Claude Resources’ President Neil McMillan recently compared them to the savings and loans, which the federal government was forced to bail out several years ago. S&Ls were—and are—very heavily regulated. Their life is pretty much an open book to regulators. They were—and are—required to report regularly to both banking authorities at the state and local levels, as well as to share holders. Yet they were in such a mess that the eventual price tag to bail them out was well over \$1 TRILLION.*

Hedge funds, by contrast, are unregulated, unaccountable, private pools of investment capital. Yet, an unwinding of their activities—whether related to gold or other assets—could at any moment throw the world’s monetary framework into utter chaos. Remember that it only took one hedge fund’s (I speak of Long-Term Capital Management’s) sour bets last year to cause bankers’ hearts to skip a beat.

### CONCLUSION (?)

I put a question mark up above because I presently do not have the definitive answer as to whether gold’s rally is over—though my sneaking suspicion is that it is, at least for a while. Whatever the outcome or pent-up demand from hedge funds which have still not covered, I have a difficult time believing that the world’s central banks will further risk seeing havoc created in other markets simply to protect their newly-rediscovered desire for more of a demand-driven market in gold.

When asked many times recently where gold *should* be trading, my reply has been to direct people to a chart contained in the October 5 issue of *Forbes* magazine which shows the average price of gold for the last *two centuries* as being \$435 in current dollars. If we modify this for a number of rea-

sons—the general downward trend in production costs on the one hand to allowing for recent commodity price strength in general on the other—gold should *probably* be in the \$380-\$400 area right now. *But whether it is allowed to get there any time soon is another matter.*

For the time being, also keep in mind the following:

— The recent rally in gold does NOT somehow represent the remonetization of gold, nor the metal’s re-emergence (yet) as an inflation hedge. The rebound, so far, is simply a snap back from a very oversold position.

— The rally IS evidence of a major, structural shift in the supply-demand fundamentals for gold, which should in the end *at least* be able to retain the majority of recent gains.

— Y2K looms as a longer-term *threat* to a sustainable gold rally (yes—you read that correctly!) Barring a complete blood bath for the dollar, any fears after the first of the year of major economic weakness will likely prove bearish for gold, as demand would plunge.

**This story is still unfolding—stay tuned for further news and instructions!**