

News Release

FOR IMMEDIATE RELEASE
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Why is Gold going up and the U.S.Dollar going down?

A (developing) Theory:

The Chinese are nervous about protecting the value of their US Treasury (UST) investments against inflation. Chinese officials come to the U.S. earlier in the year, meet with our officials, express concern and begin to sell their long-term USTs. The problem is there isn't a buyer large enough to soak up Chinese supply. This is compounded by the fact U.S policy makers are pursuing a low-interest rate plan to stimulate our economy. The Fed knows Chinese selling USTs will drive down UST prices causing interest rates to go up and work contrary to their monetary stimulus plan.

The Fed concludes they are the only real and logical buyer of Chinese UST holdings. They don't have the cash because they have been buying up assets from U.S. banks to preserve our financial

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system. So the Fed cranks up their printing press and makes money fresh to buy Chinese long-term UST holdings.

Chinese use the freshly made dollars to buy gold as an inflation hedge for their remaining UST holdings. This drives gold's price up.

The U.S. dollar drops because now the Chinese sell their dollars collected in trade for other currencies instead of investing them back in the US as they have in the past. This drives down the dollar's exchange value against floating currencies.

Smart hedge funds know all this and are currently betting with the Chinese. Don't worry about the not-so-smart. Those hedge funds will figure it out soon enough. Hedge funds are getting long gold and short the US dollar. Their speculative demand for gold and supply of dollars drives the price of gold up even higher and the exchange value of the dollar down even lower. Their trade in the short term depends on supply and demand, so don't be surprised to see current trends to continue for both gold and the dollar - gold especially. In the long run, it all depends on whether or not Fed can control inflation.

We view the current gold/dollar situation similar with what existed between oil and the dollar from 2006-2008 that eventually drove oil to over \$150 per barrel before correcting

to \$40 earlier this year as the trade unwound. The thinking then was that Chinese and Emerging Market demand for oil would grow to infinity -- this assertion/hope became especially obvious after applying U.S. consumption rates to the Chinese and Emerging Markets. Speculators drove the price of oil very high. Big oil exporters, concerned over U.S. real and financial asset inflation sold their dollars in exchange for other currencies to diversify their investments around the world.

A couple side notes:

- There haven't been too many, if any, pleasant endings to the Fed printing dollars to monetize U.S. debt. Inflation typically follows. The Fed will really have to tighten up to prevent it getting out of control. Ben Bernanke will not be so popular in four years.
- Oil nearly quadrupled in price in the big speculative run up. Don't expect the same for gold. Oil has a real use. We cannot say the same for gold. If all the oil on the planet disappeared overnight, people would certainly notice. A much smaller fraction would care if the same thing happened to gold.
- The Chinese gold bet by hedge funds could be derailed if the Chinese figure out U.S. stocks are a good hedge against inflation. We think our equity market is undervalued and would not count this out. This could be especially obvious once we make it into October and the year over year equity market returns turn positive and then very positive as we make it into March of 2010.

Please call with questions or comments.

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