

Why The Gold Price Will Go Above \$11,000

James Turk



James Turk is often asked what his basis is for predicting a gold price of over \$11,000 per ounce. The following article is his answer to that question. James wrote this piece in October 2011.

Essays are published by the GoldMoney Foundation to promote a better understanding of monetary and economic matters. Views expressed in these essays are those of the authors and not necessarily those of the GoldMoney Foundation or GoldMoney.

About James Turk

James Turk is the founder and chairman of GoldMoney (www.goldmoney.com), which provides a convenient and economical way to buy and sell gold, silver, platinum and palladium online, with payments accepted in nine major currencies. After graduating in 1969 from George Washington University with a BA degree in International Economics, Mr Turk specialised in international banking, finance, and investments and held positions at Chase Manhattan Bank (now JPMorgan Chase) and the Abu Dhabi Investment Authority. From 1987 to 2009, he wrote *The Freemarket Gold & Money Report* and now blogs at www.fgmr.com. Mr Turk's latest book is *The Collapse of the Dollar and How to Profit from It* (2004), www.dollarcollapse.com.

The GoldMoney Foundation

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The Gold Money Index

In one important respect, gold is like any other asset. You want to buy it when it is undervalued, and sell it when the opposite is true – when it becomes overvalued. Thus, knowing how to accurately value gold is essential for sound portfolio management.

Because gold is money, its value cannot be measured with the standard techniques used to evaluate investments. Gold is not an investment because it does not produce any cash-flow. It is a sterile asset. Consequently, gold does not create wealth, nor for that matter, does any national currency create wealth. Currency in all its forms — whether fiat or gold — is wealth, held in the form of deferred purchasing power. This store of value function is one of any currency's most important tasks.

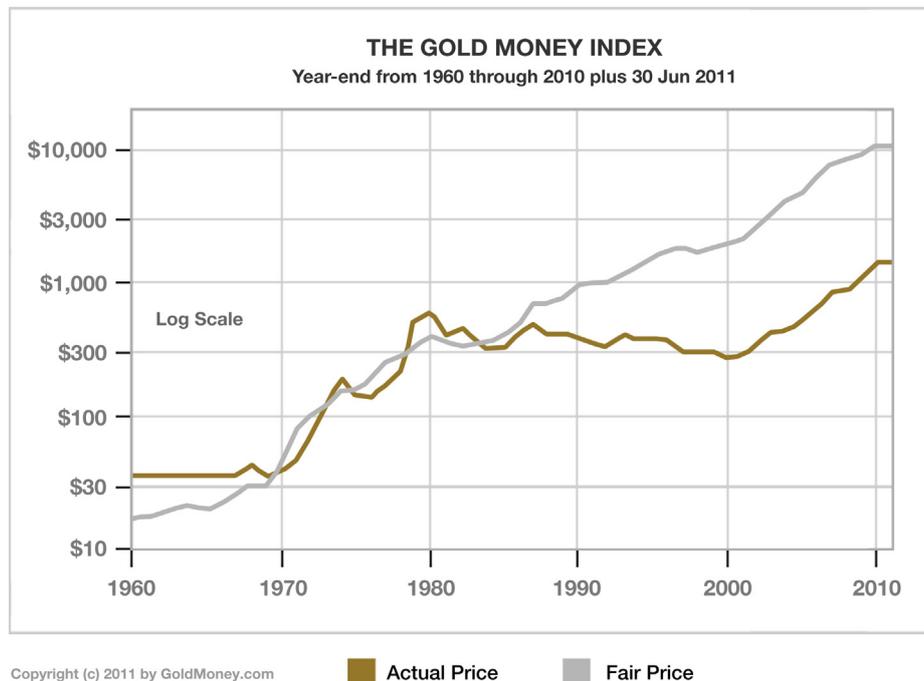
So when the price of gold rises, wealth is just being transferred to people who own gold away from those people holding the national currency being used to report the rising gold price. Wealth is simply being re-shuffled — as I like to say — to its rightful owners, namely, those who choose wisely among the different currencies available in which to hold their liquidity needs. Their wise choice is simply a matter of recognising which currencies are overvalued and which are undervalued, so they own the latter and avoid the former.

One of the most trusted models that I use to value gold is my Fear Index, about which I have written extensively. Another trustworthy model is my Gold Money Index, which values gold based on its historical role as international money and global numéraire. Here is the formula.

THE GOLD MONEY INDEX

$$\frac{\text{Central Bank Foreign Exchange Reserves}}{\text{Central Bank Gold Reserves}} = \text{Fair Price of Gold}$$

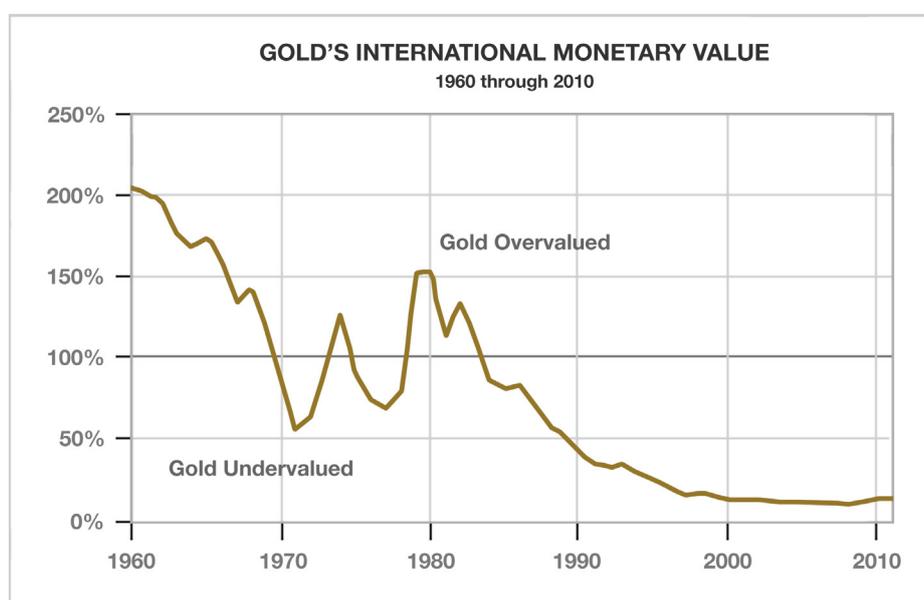
The following chart illustrates the usefulness of this index.



There are two prices for gold in this chart, the actual price and its “fair value” price, which is calculated by the above formula. Back in the early 1960s when the dollar was still thought to be “as good as gold”, gold’s actual price was above its fair value. In other words, central banks had adequate gold reserves on hand relative to the quantity of dollars and other national currencies circulating in international commerce. But that relationship began to change by the late-1960s.

Because the dollar was being debased, gold’s fair price rose above its actual price, meaning that gold was undervalued. In other words, gold was worth more than the \$35 per ounce fixed rate of exchange then prevailing. This \$35 price could no longer be maintained because the dollar had become too debased and was overvalued, with the consequence that the dollar’s formal, fixed link to gold was finally abandoned in August 1971.

Thereafter, the gold price began to rise, but gold's fair price remained above the actual price until 1974. By then gold had become overvalued, with its actual price exceeding its fair value. Gold had reached a point marking the first peak in that decade's bull market in gold. At the January 1980 peak, which is also clearly seen on the above chart, the actual price again rose above gold's fair value. The level of overvaluation reached by gold of course was not sustainable. Its price fell back, but remained above fair value until 1984. Gold has been undervalued ever since, as is clear from the following chart, which uses the data from above to show the degree of relative valuation. In other words, this chart presents, as a percent, gold's actual price divided by its fair value.



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Having filled the role of international money for 5,000 years, gold has been supplanted by fiat currency for the past 40 years because of government force. However, this nascent experiment with fiat currencies is not going well, as evidenced by growing global imbalances, unchecked increases in debt and financial derivatives, ongoing debasement of currency purchasing power and worsening monetary turmoil. Fortunately, the attributes that made gold money in the first place have not disappeared or been lost; they have only been ignored or forgotten, with the consequence that gold's unique usefulness as money remains. This usefulness is being rediscovered, as evidenced by gold's rising price this past decade.

Despite this remarkable rise in the gold price, it is clear from the above chart that gold's undervaluation has barely budged for more than a decade. The reason of course is the growth in the quantity of national currencies held by central banks (the numerator in the Gold Money Index) is rising about the same rate as the weight of gold held by central banks (the denominator in the Gold Money Index). So gold remains tremendously undervalued.

The logic of the Gold Money Index is founded on one underlying principle — gold still is money. Things have value because of their usefulness, and gold's value comes from its usefulness as money. It is money because the free market makes it money. Consequently, governments cannot stop gold from having value, nor even stop gold moving in time from its present undervaluation to a fair valuation, which is presently over \$11,000 per ounce.

We today look back at the Tulip Bubble, Mississippi Bubble and the South Sea Bubble with smug amusement and ask ourselves laughingly how could the people back then have been so foolish. No doubt people generations from now will look back at the present era of government-issued fiat currency and ask themselves the same question.

James Turk

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