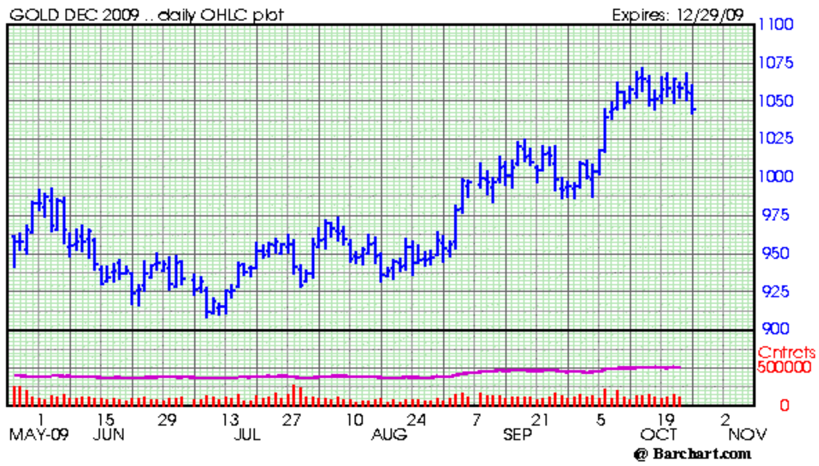
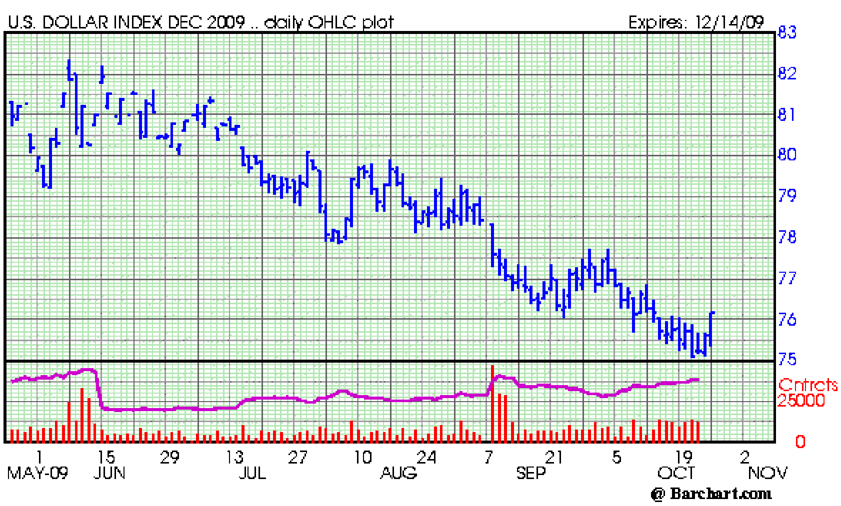
Is Gold Heading for... $1500/oz.?

Gold prices have increased more than 15% since August 2009. As you can see in the chart below, the price of Gold has rallied over $140/oz. in just a few short months.

The Federal Reserve continues to artificially implement a quantitative easing policy that has kept the Fed-Funds rate between 0%-.25%. The apparent goal of the Federal Reserve is to re-liquefy the economy. This should help the stock market and other asset classes recover from their recent sharp declines.



Many investors buy Gold as a hedge against the falling U.S. Dollar. As a result, Gold prices have surged while the U.S. Dollar has moved dramatically lower against most foreign currencies. The chart below shows the U.S. dollar's value since May 2009. The Federal Reserve's complacent attitude toward the U.S. Dollar along with historically low borrowing costs, have led to hedge fund managers and many individual investors to add



Gold to their portfolios through the use of Gold Futures and Options on Gold. When comparing these two charts, it's not difficult to see the anti-correlated relationship that Gold and the Dollar share. The question is, how long will this relationship hold-up as we navigate 2010 and beyond.

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If the U.S. Dollar were to lose an additional 25% in value over the next 12-24 months, it is possible that we may see Gold prices skyrocket to $1500/oz. or more. During the past 12 months, the U.S. economy has suffered the worst economic downturn since the 1930's. In fact, if you were to take the price of Gold during the Great Depression era and adjust it for inflation, the equivalent price of Gold today would be valued at more than $3,000/oz.

For several months, you may have noticed a strong correlation between the price of Gold and the broad stock market indexes. Keep in mind that this can change very rapidly. Gold and the equity markets can become anti-correlated overnight. At some point in the future, investor concern for rising inflation will eventually cause the de-coupling of this relationship. In fact, as the U.S. Dollar continues to fall in value, Gold prices will continue to be underpinned. If the stock markets 50% rally off the March 2009 lows begins to deteriorate, money will most likely come out of equities and be re-invested into other asset classes. Some investors including hedge fund managers will be looking at Gold as a potential hedge trade against a falling dollar and the dark-side of a bear market rally in stocks. Aside from being an important part of someone's portfolio or simply the day-to-day physical demand around the world, Gold historically has been viewed as a flight to quality during global exogenous events.

Trade recommendations

Gold Futures:

Long December Gold at 1027.50 o/b with a GTC sell-stop at 971.

Gold Options:

Buy GCJ10 (April '10 Gold) 1300 calls (exp. 3/25/10) at 7.80 o/b.

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