GSA-Pro™

The version of Gold Stock Analyst newsletter for Professional Investors
Reports on 60+ Gold miners plus the GSA-Top10 newsletter in mid-month

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Where Are We Now?

Based on 1/30/13's **$1,677** close in NY for Gold, and GSA's proprietary Market Cap/oz data base, **gold stocks trade as if gold was $1,160/oz**; Gold stocks on average are:

-35% Undervalued

Federal Reserve's Balance Sheet

Most subscribers know your Editor was a Professor of Economics for 20 years (Bentley University in Waltham, MA) before leaving to start *Gold Stock Analyst* in 1994. At GSA most of our work and commentary involves analyzing and finding the best Gold and Silver stocks, the GSA Top 10 and the Silver Fave 5.

But email sometimes brings multiple subscriber questions on an economic issue. The Fed's balance sheet crossing $3 trillion last week (see chart at bottom) prompted several to write, especially as Fed's buying $85 billion debt/month adds $1.02 trillion/year, and assures $4.0 trillion total assets by the end of 2013. The Q&A:

1) *The Fed's ultimately reducing its balance sheet will drive interest rates higher, which is bad for Gold.* No. First, the issue is what happens to real, not nominal interest rates. And second, the Fed will not sell the its debt, but let it mature and be repaid. The Fed's $3.0 trillion consists of $1,697 billion Treasuries, mortgage backed securities (MBS) at $983 billion, and $333 billion of other assets. The term structure of the Treasury holdings is 23% of 1-5 year maturity, 52% of 5-10 and 25% at 10+ years. The MBS securities will likely be repaid at a similar rate as people move. So at the end of 10 years, even $4 trillion at end of 2013 will have shrunk to ~$1 trillion, not much above the Fed's $875 bil when QE began late 2008.

2) *Higher interest rates will bankrupt the Fed*. No. While higher rates will make the Fed's holdings worth less, the portfolio is always carried at face value and never marked to market. In any case, as all currency are Federal Reserve Notes, the Fed can print whatever it might need.

3) *Bond vigilantes will force higher long term rates*. No. While they did so in the mid-90's by refusing to buy new Treasury debt issues, the Fed is a now the buyer of last resort and keep interest rates low to spur the economy.

With just-reported 4Q12 GDP down 0.1%, payroll and income tax increases starting with January 1, 2013, and sequestration taking $120 bil in spending from the economy beginning March 1, 2013, GSA expects the Fed to be active in offsetting these fiscal drags. This will be good for Gold.

Source: Federal Reserve; Chart: Motley Fool