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The Five Reasons Gold Will Hit $5,000

By Peter Krauth, Contributing Editor, Money Morning

Let me get right to the point. Gold's going to $5,000 an ounce.

I know that sounds preposterous to most people. In fact, some of you probably think I'm crazy.

But for a whole host of reasons, $5,000 may well end up being a *conservative* estimate.

So before you start posting comments that I've gone bonkers, hear me out...

In 2001, gold traded as low as $255 an ounce. Within eight years, its price had *quadrupled* to more than $1,100 an ounce. How many investors thought that was possible, or even likely? Probably not very many.

Yet, it happened.

What's more, since hitting its secular bottom back in 2001, gold has posted *a positive return in every calendar year*. So far, the current bull market has been pretty orderly.

During the past 10 years, gold has indeed become the trade of the decade, beating out commodities, oil, high-grade U.S. corporate bonds, U.S. Treasuries, and yes, U.S. stocks.

A crisp $100 bill invested 10 years ago would today be worth more than $400 in gold, $357 in commodities (as measured by the S&P GSCI Enhanced Total Return Index), $268 in oil, $190 in corporate bonds or U.S. Treasuries, and only $90 in U.S. stocks.

That's right: We're talking about a $10 loss in U.S. stocks over 10 years. Ouch.

Meanwhile, gold has embarked upon a secular upward trend that is far from over. If the 1970's are any indication, gold's going much, much higher from here.

When U.S. President Richard M. Nixon opted to close the gold window in August 1971, the yellow metal had already risen from its fixed price of $35 an ounce to $42 an ounce. By the time gold peaked in 1980, it had risen to $850, rewarding early investors with a 2,400% return. My guess is that any such forecast in 1970 would probably have been met with the same kind of ridicule I expect that my current projection could attract.

Granted, there's no guarantee that we're about to duplicate the 1970s. (I could certainly do without the disco, bell bottoms and leisure suits). But a s Mark Twain once noted: "History does not repeat itself, but it often rhymes."

And that could mean even sweeter returns for gold investors this time around.

In fact, let's crunch a few numbers - just for fun.

Why $5,000 an Ounce Gold Isn't Out of Bounds

To start with, let's take the 1980 peak price of gold - $850 - and adjust it for inflation. That would take the price of gold to $2,400 in present-day terms.

Better still, let's take the 2,400% gain that gold experienced during the 1970s and translate it into present-day terms. From the 2001 low of $255 an ounce, a 2,400% gain would take the yellow metal all the way up to $6,120 an ounce, making my $5,000 price projection seem a lot more reasonable.

But these are just superficial price comparisons. If we look at what the fundamentals are telling us, it's clear that gold at $1,100 is a long way from its eventual peak, meaning it still appears cheap.

So let's take a closer look.

Five Fundamental Reasons Gold Will Soar

Gold Fundamental No. 1: You Can't Ignore Inflation: The 2008 stock market panic sent stock and commodity prices - including the price of oil - into a tailspin. And that launched the big debate about whether inflation or deflation would ultimately carry the day. Keep in mind that since 2001 - under benign price inflation of roughly 2.5% - gold has managed to rise about 400%. Meanwhile, the U.S. Federal Reserve is widely expected to keep short-term rates near zero through this year, leaving the door open for rampant inflation.

Meanwhile, quantitative easing to shorten the recession has caused America's monetary base to explode. Starting in October 2008, during a very short span of only four months, the central bank *doubled* the U.S. money supply, going way beyond anything ever attempted in the nation's history.

Worldwide, central banks have rolled out an unprecedented $12 trillion worth of stimulus programs, with most of the money still to be spent.

Make no mistake, inflation will win out over deflation.

Gold Fundamental No. 2: Investment Demand is Exploding: Large institutional investors - hedge funds and pension funds - are making large allocations to gold, as are individual investors.

The proliferation of gold-focused exchange-traded funds (ETFs) bears this out. The SPDR Gold Trust (NYSE: GLD), the world's largest physically backed ETF with 1,100 tons of the lustrous metal, is the sixth-largest holder of gold bullion. Individual investors have never had an easier avenue for owning gold.

This isn't just merely a U.S. manifestation. According to the World Gold Council, demand advanced 15% from the second quarter to the third last year.

Asia, with a population that exceeds 2.5 billion inhabitants and a long-standing cultural affinity for gold, is stoking global demand in a big way. China is overtly encouraging its citizens to buy gold and silver, while offering them gold-linked checking accounts. China is primed to overtake India as the world's largest consumer of gold. A quickly developing middle class whose members are experiencing rapid escalations in disposable income are a major bullish driver for the price of gold.

Gold Fundamental No. 3: Central Banks are Becoming Net Buyers: India's recent purchase of 200 tons of International Monetary Fund (IMF) gold was the likely impetus that pushed gold up over the $1,200 level in December. But more important is the sea change that has seen central banks morph from net sellers into *net buyers* of gold. BlackRock Inc. (NYSE: BLK), one of the world's largest investment managers, said that 2009 was that turning point. If that was the case, it will have been the first time in 20 years, as central banks have been net sellers of gold since 1988.

Gold Fundamental No. 4: A Currency Crisis is Looming: The "PIGS" - Portugal, Italy, Greece and Spain (or "PIIGS," if you want to include Ireland) - aren't in very good fiscal shape. And they aren't alone. Iceland has already gone over the edge. The United States, the United Kingdom, and countless other economies are struggling. And that reality has ignited a crisis of confidence about fiat currencies in the minds of many investors. Money is nothing more than paper and ink, backed by the full faith and credit of the issuer. When investors find that their faith in the issuer is shaken, the value of that currency erodes. Additional sovereign-debt downgrades from ratings agencies are but one potential trigger of a currency crisis. Under such conditions, gold - the ultimate store of value, and the oldest existing form of money on earth - will soar as investors seek to protect their purchasing power.

Gold Fundamental No. 5: We've Yet to Reach the Mania Stage: As we've outlined before, the gold bubble that takes prices to all-time-record levels will inflate in three distinct stages. This process will start with currency devaluations in Stage One, will be fueled by growing investment demand in Stage Two and will experience its stratospheric ascent in Stage Three, the mania phase of this evolution.

Make no mistake, the $5,000 price point will most likely be reached in this third and final phase. The price of gold will behave like it is strapped to a jet pack. And today's market prices will be dwarfed by the levels gold prices will ultimately achieve.

Keep in mind, the entire gold industry has an aggregate market capitalization (value) below that of Wal-Mart Stores Inc. (NYSE: WMT) alone (currently about $210 billion). So as the crowd piles in, the "big money" to be made will lie with gold explorers and producers, where 1,000% returns will not be uncommon, even from today's prices.

All these fundamentals underscore that gold prices have plenty of room to run from here.

And since I expect gold will eventually reach the $5,000 range, that leaves plenty of room for investors to profit by entering at current levels.

It's Time to Make Your Move

Everyone needs some exposure to gold in their portfolios, no matter their age or risk tolerance. Owning some physical coins or bars makes sense, but it's complicated to do inside most retirement accounts.

That's why the explorers and producers of the gold sector promise the biggest payoffs. Although production costs will rise, as gold prices rise, profit margins are sure to expand even faster. Once cocktail-party conversations turn to gold, for any one of the reasons I've outlined, gold stocks will erupt and then streak for record highs.

When will this happen? I think it will take a few years. But with bubbles, or speculative frenzies, one never knows. Just this week, in fact, Robert R. McEwen, the chairman and chief executive officer of U.S Gold Corp. (AMEX: UXG), predicted that gold could more than quadruple to hit the $5,000 level by 2012. Some experts have labeled this expected move as a looming "superspike."

When this happens, gold is likely to create a whole new generation of millionaires, and even a few new billionaires. Despite the mania stage being several years away, the wise investor recognizes both the importance and the potential of investing in gold.

I have no doubt that today's $1,100 gold price level will eventually, in hindsight, look like an outrageous bargain.

My advice: If you own gold and gold shares, hang onto them and buy more on dips. If you don't, what on earth are you waiting for?

[**Editor's Note** : **Peter Krauth is a contributing editor to *Money Morning* and is also the editor of the *Global Resource Alert* advisory service. A highly regarded market analyst and expert in metals and mining equities, Krauth specializes in energy- and resource-related investments.**

A one-time portfolio advisor, Krauth is now headquartered in resource-rich Canada, where he focuses exclusively on his research. He last wrote about gold's potential to be "The Greatest Trade Ever," and detailed how super-investor John A. Paulson could use his gold holdings to vault himself to the top of the Forbes billionaire's list