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Buffett vs. the golden bulls

Renowned columnist George Will was there and heavyweight investors such as John Hathaway and Thomas Kaplan were there, but a certain sage from Omaha was missing from the inaugural Precious Metals Summit in Vail, Colo.

Given his view that investors should forget gold and buy equities, Warren Buffett's absence was a surprise to no one, and yet his physical absence didn't mean he lacked presence.

Indeed one of the highlights of the summit — a talk on gold by Kaplan and Hathaway — really comes to life when Buffett's bearish views on the metal are used as a foil.

"If I'm right [about rising gold prices], then the eye of the storm will be mining equities," Kaplan told the crowd. "Mining companies will come to be viewed as great businesses and mints of money. Everyone will want to own them . . . even Warren Buffett."

Kaplan's track record suggests he could well be right. This is a man that built a great part of his fortune on calling a silver bottom back in the 1990s, and who has consistently been out in front of gold's latest run to historic heights.

Buffett, of course, has a pretty decent track record himself. But when it comes to gold the sage has missed the boat, his value investing thesis being so intimately tied to picking companies set to grow revenues that he finds no appeal in inanimate metals.

To illustrate his point Buffett imagines melding all of the world's gold into a giant cube that would be worth US$7 trillion dollars.

"For seven trillion dollars you could have all the farmland in the U.S., you could have about seven Exxon Mobils and you could have a trillion dollars of walking-around money," Buffett told CNBC in March. "And if you offered me the choice of looking at some sixty-seven-foot cube of gold . . . and you know me, touching it and fondling it occasionally . . . call me crazy, but I'll take the farmland and the Exxon Mobils."

Putting aside the stereotypical image that only wing nuts and barbarians stand in awe of a golden cube, why not apply Buffett's own value techniques to companies set to generate great wads of cash from gold production?

Here Kaplan deftly strikes with the thrust of Buffett's own argument.

"You can buy the aggregate of all gold and silver equity for not much more than Apple," he says. "That is an aberration."

What is also an aberration is the small percentage that gold holdings make up in the global investment basket.

A recent study from the International Strategy and Investment Group says gold made up 4.8% of all global financial assets in 1968. It was down to 2.8% in 1980 and just 0.2% during the tech boom of the late 1990s.

We are currently at 0.6%. Even a small move in the direction of the historical mean, say to 1.2%, would require another 26,000 tonnes of gold production — which at current output would account for 10 years worth of production.

And that is to say nothing of renewed demand from central bankers, who had been the big sellers in the 1990s, or of increasing demand for the metal in China and India.

Presumably Buffett's desire to invest in assets that grow is tied to growth in those two emerging economic powerhouses, so why their increased demand for gold wouldn't factor in remains a mystery.

As Kaplan points out, the two countries are already competing over who will be the largest purchaser of the metal, ". . . and whenever China and India are competing over the ownership of an asset, you want to own it," he says.

The question as to why gold equities are so undervalued at a time of such robust gold prices continues to confound many.

Kaplan chalks up the situation to sustained disbelief that gold will maintain its current levels, or go higher.

"People who don't want gold itself especially don't want to own a producer of it," he says.

As an analogue he recalls what happened with oil when it awakened from its US$10-a-barrel days. Oil equities did little at the time and they remained moribund when oil prices went into the US$30 range, and then the US$40 range.

Finally, with prices rising unabated, the peak oil thesis took hold and oil equities shot up.

"Such a level of disbelief and cognitive dissidence can't translate bullishness into earning potential," Kaplan explains. "When belief in gold gains traction, equities will explode to upside."

But for now, the Buffett line of thinking holds sway.

"Gold is a way of going long on fear . . . you really have to hope people become more afraid in a year or two years than they are now," Buffett told CNBC.

There are a few problems with such an analysis. The most obvious one is that some of the world's biggest gold investors aren't afraid at all.

They have simply reasoned that fiat currencies are being printed to a point of worthlessness. They don't see any indication that it will stop, and consequently turn to what has been humankind's longest-serving store of value.

It's an investment based on a rational analysis of the current situation. And all it will take for gold to go higher is for other investors to come to the same conclusion. Mr. Buffett, with no fear in his heart, may yet be one of them.