

SARA-BAY FINANCIAL CORP.

November 16, 2005

*“I wanted the gold and I sought it, I scabbled and mucked like a slave
Was it famine or scurvy I fought it, I hurled my youth into a grave.
I wanted the gold and I got it, Came out with a fortune last fall,
Yet somehow life’s not what I thought it, And somehow the gold isn’t all.”*

The Spell of the Yukon - Robert Service

The purpose of this note is to discuss inflation, currency, and gold, as well as their relationships to each other. Virtually all our managed accounts hold at least one, but more likely two stocks whose business involves the mining and refining of gold. We have held some of these stocks for over three years, and have continued to buy them recently in new accounts.

People can get very emotional when it comes to the subject of investing in gold. There are those who will never understand why anyone would buy gold bullion since it costs money to store, and doesn't earn any interest. Others, who hold the exact opposite view, emphatically believe that it is the only basis for a sound currency. Since I am of the opinion that neither side is entirely correct, I thought it a good time to address the issue.

I will not soon forget a client I had in late 1970's, whom I shall call Edward. Edward lived on Bird Key in Sarasota, and had retired from a large bank in the Boston area, where he had been an economist. There was no question he was a bright man, but he was also a staunch supporter of the gold standard and was willing to give little latitude where that subject was concerned. He went so far as to help organize a small group of men who would meet once a week to discuss the impending demise of our country's currency, as well as the decline in its moral standards. Edward knew I had more than a passing interest in the nonferrous yellow metal so he invited me to have lunch with him at the Yacht Club. This in itself put me out of my element, since I am accustomed to dining in establishments where one must stand in line at a counter to order. As he began to extol the virtues of owning gold, he became more insistent and assertive. When he was leading me two martinis to zero (I still had to go back to work that day), his strong opinions began to take the form of a tirade. As we sat there I began to visualize Edward sitting in his living room with all his assets piled in the center, holding a shotgun across his knees. I finally said, "But Edward, what if our country works out of this, the economy begins to get better, and we don't have starvation, chaos and anarchy? What if you're wrong?" His face got redder than it already was, and he blurted out, "Don't be such a pessimist!"

Gold is not necessarily required to be the standard for money. Any other commodity, which is in demand and does not rapidly deteriorate, could be used as currency. The commodity must be valued and accepted by the majority. In the past, tobacco, chocolate, and whiskey have all been used as money. The date gold was first recognized as a valuable commodity remains nebulous, but beautiful and artistic gold vessels found in the Middle East were crafted around 3500 B.C. The first coins were minted in Lydia (western Turkey) circa 640 B.C.

2201 CANTU COURT ♦ SUITE 217 ♦ SARASOTA, Florida 34232-6255
941-371-8027 ♦ 800-373-2917 ♦ FAX 941-371-8314 ♦ www.sara-bay.com

SECURITIES OFFERED THROUGH: NORTHEAST SECURITIES, INC. MEMBER FINRA/SIPC

The Roman Empire minted the Aureus in 70 A.D. It was a high quality coin, weighing slightly less than ¼ ounce. It served well in trade, but was too large a denomination for daily commerce (worth around \$106 today). A Roman soldier was paid a wage of 1 Aureus per month. This bought 28 liters of cheap wine (roughly \$4 a bottle) or 200 pounds of flour (about 53 cents per pound). Today, an inexpensive bottle of wine can be bought for \$4 to \$5, and the supermarket sells flour for approximately 45 cents a pound. Prices 2000 years ago are remarkably close to what we pay now. The value of gold has not really changed that much in all that time!

For centuries, men have been willing to accept gold in trade for other possessions or for the production of their labor. The recipient of gold has absolute confidence that he may exchange it at a time of his choosing, and its value will remain permanent. With such a long and consistent history the universal acceptance of gold is not likely to change during our lifetime. It has sometimes been referred to as “the currency of last resort.”

Inflation

The cause of inflation is simple: the creation of too much money. It is an increase in the amount of money in circulation without a commensurate increase in goods or services. The result is that prices begin to increase for those goods and services. When governments create excess money it is never equally or fairly distributed among the population. A little inflation is probably good and can even be stimulative and beneficial to the economy. The destructive part comes in the excess. Inflation results in transference of wealth, and while there are a few people who benefit; it invariably harms the great majority.

There are signs that I believe could be telling us of impending inflation.

1. Commodity prices have been on the increase. The CRB (Commodity Research Bureau) Index, currently about 329, is the highest level in many years. In the last two years alone, it has risen close to 37%.
2. The war in Iraq is expected to cost around \$200 billion per year, a big chunk of this year's deficit. It will almost certainly continue for the foreseeable future.

We are a very large, very powerful, and very productive nation. That fact is not going to change quickly. We must, however, be always cautious and observant when our country spends billions more than we receive in revenues. To cover this shortfall we will be forced to raise taxes, borrow more money, or simply print it. Raising taxes could slow the economy and move us toward deflation and recession. This has never been popular, as it makes re-election of the incumbents difficult if not impossible. Therefore, borrowing or creating (printing) money is far more politically palatable.

The CPI released Tuesday shows the official rate of inflation is annualized at 4.9% (significantly higher than the 3.3% for 2004). In computing this figure, the Government does not include the price of oil, or the increase in real estate prices (only increases in rents).

In many respects gold is no different than other asset classes. It can become overvalued as economic fears accelerate, then can become undervalued when those concerns subside. But, whether we like it or not, it is still probably the most effective gauge by which we demonstrate our confidence or lack thereof in our currency. Gold is the barometer for measuring inflation or the expectation of it.

If we are correct on the inflation scenario developing in this country, gold will continue to rise until it will eventually become overpriced. It is a good history lesson to study the late

2201 CANTU COURT ♦ SUITE 217 ♦ SARASOTA, Florida 34232-6255
941-371-8027 ♦ 800-373-2917 ♦ FAX 941-371-8314 ♦ WWW.SARA-BAY.COM

SECURITIES OFFERED THROUGH: NORTHEAST SECURITIES, INC. MEMBER FINRA/SIPC

1970's through the early 1980's. We had high inflation, 14% money market rates, and a gold price that moved from around \$200 to over \$800 per ounce. Hindsight, always deadly accurate, tells us that was the time to sell. Over the ensuing couple of decades, as our inflation abated, gold dropped back to below \$300 and money market rates eventually fell to about 1%. There will be a time to sell our gold stocks, but in my opinion – not yet.

***“There’s gold and it’s haunting and haunting, It’s luring me on as of old,
Yet it isn’t the gold that I’m wanting, so much as just finding the gold.”***

Robert Service

May the upcoming holiday seasons bring you and your family good health, joy, and peace.

Sincerely,



J. Michael Hard

2201 CANTU COURT ♦ SUITE 217 ♦ SARASOTA, Florida 34232-6255
941-371-8027 ♦ 800-373-2917 ♦ FAX 941-371-8314 ♦ WWW.SARA-BAY.COM

SECURITIES OFFERED THROUGH: NORTHEAST SECURITIES, INC. MEMBER FINRA/SIPC