

# INVESTING IN GOLD: PRECIOUS STABILITY



BY PATRICK MARR

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**Savvy investors recognize three significant factors affecting global markets today: the rise of the economic might of China and India; high national debt levels among Western economies, including the U.S.; and the sharp rise in commodity prices, particularly oil and crops. What many investors may not know is that gold is an exceptional investment to capitalize on in each of these trends.**

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“The combination of limited supply and strong demand for physical gold, weakness in the dollar and expectations for higher inflation all are positives for gold investors,” says Thomas K. Anderson, global head of the ETF Strategy and Research Group at State Street Global Advisors.

Indeed, it is those three factors that have powered gold over the past decade, a period when the asset has returned 414%, compared to 15% for

the NYSE Composite. That move, from \$273 an ounce at the start of 2001 to \$1,405 at the end of 2010—and more recently to over \$1,500—has some investors, weary of stock market bubbles, feeling they have already missed their opportunity. That’s not the case when you understand the fundamentals behind gold’s continuing ascent, says Randall Oliphant, Executive Chairman of New Gold, an intermediate-sized

gold mining company. For one, consumers in China and India have a ravenous appetite for keeping their personal wealth in gold. “Having consumers that get richer and richer is good for us. Last year, India was 32% of global gold consumption, and this year China is expected to overtake India,” Oliphant explains.

Add to the bullishness the fact that central banks need to grow their reserves along with their economies.

## A GROWING NUMBER OF INVESTORS ARE RECOGNIZING

that over the long term gold fulfills a strategic role within an investment portfolio. In November 2004, State Street and World Gold Trust Services launched SPDR Gold Shares [NYSE Arca: GLD], the first U.S. commodities-based exchange-traded security that has resulted in broader investor access and understanding of the gold market.

GLD offers investors an innovative, cost-efficient and secure means of participating in the gold bullion market without the necessity of taking physical delivery. This is achieved by allowing investors to hold an interest in gold just like a stock. The introduction of GLD has lowered many of the barriers that had previously prevented some investors from investing in gold, such as access, custody and transaction costs. In 2010 SPDR Gold Shares surpassed \$50 billion, making it the second-largest ETF in the world, by assets.

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Both India and China are heavily invested in U.S. dollars and euros and are hesitant to add more of either currency, given the rising government debt loads of each. Alternative currencies, such as Canadian dollars, Australian dollars and Swiss francs, simply aren't large enough to be significant holdings, so central bankers turn to gold.

Recall too that a decade ago, when gold was mired near its lowest price

That is just one reason gold professionals project the metal has room to grow further. "We believe gold is going to get to at least the \$2,300 level before it takes a breather. That is based on the \$850 peak it hit in 1980, which adjusted into today's dollars is over \$2,300," explains David Beahm, Vice President of Blanchard Gold, one of the largest physical gold brokers in the U.S. "There is still a good



## Investors worldwide are returning to gold as the historic hedge against inflation.

ever, central banks were heavy net sellers of gold. That reversed itself in 2010, according to the World Gold Council, which noted "a paradigm shift in the official sector, where central banks became net purchasers of gold for the first time in 21 years," in its Q4 2010 demand report. That shift appears to be accelerating, most recently with Mexico, Russia and Thailand buying up \$6 billion of gold as it broke over \$1,500 an ounce. The potential for central bank-buying to continue is strong. Central banks let gold slip to just 10% of their assets of late, down from 80% in 1980.

opportunity for new investors to get into the market."

Investors worldwide are returning to gold as the historic hedge against inflation, in addition to the expanding demand from emerging economies and central banks. Part of this is in anticipation of inflation, given the 92% debt-to-GDP ratio in the U.S. and the also-high 80% debt-to-GDP ratio of the euro zone economies. Unlike currencies, the supply of gold isn't easily expanded: All of the gold mined in history—177,000 tons—would fit inside four Olympic-sized swimming pools. The current inflation

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\*Source: Over the 10-year period ending October 2010, gold's correlation with the S&P 500 has been -0.06, with 0 being uncorrelated and 1 being perfectly correlated (StyleADVISOR, December 2010).

Important Information Relating to SPDR Gold Trust:

The SPDR Gold Trust ("GLD") has filed a registration statement (including

and GLD expenses will reduce returns.



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## A gold ETF gives investors a liquid way to buy and sell the metal.

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in the cost of commodities is drawing interest in gold as a hedge as well: Most energy and food commodities such as oil and corn are nearing record-high price levels.

However, keep in mind that gold is more than just an investment vehicle. It is also a commodity with its own inherent demand. In fact, gold investors provide just 35% of total global demand; jewelry accounts for the majority—54% in 2010—and technology, such as electronics and dental applications, contribute 11%.

## HOW TO MELD GOLD INTO YOUR PORTFOLIO

Considering the benefits of gold and the outlook for the metal, the typical portfolio is underinvested in gold, with the average U.S. investor holding just 0.3% of their assets in gold. That's low, even if you're not concerned

about inflation, since gold offers a safe haven in market upheavals such as 2008, which saw stock and bond investments fall in tandem. Says State Street's Anderson, "Gold has proven to be an excellent diversifier, offering extremely low or even negative correlations to equities and fixed income investments. From a diversification standpoint, a 1% to 4% allocation to gold is fairly typical."

The question then becomes how best to make gold a part of your portfolio. Fortunately for today's investor, there are a number of avenues.

### Exchange-Traded Funds

Just as ETFs transformed stock investing by allowing low-cost sector investing, ETFs have revolutionized investing in gold. The first gold ETFs appeared in 2004 and now hold a total of 2100.3 tonnes of gold worth \$97.6 billion. The largest of these, SPDR Gold Shares (ticker: GLD), holds well over half that amount. A gold ETF gives investors a liquid way to buy and sell the metal like any ETF or stock, while the physical

## WHY GOLD?

Gold shines brightest in challenging economic times. Gold is renowned as a hedge against inflation and a declining dollar. China, India and the Central Banks are driving a sharp uptick in the demand for gold as they strive to insulate themselves from growing problems in America and abroad.

## WHY BLANCHARD?

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gold represented by shares is held on the investor's account in secured storage and periodically audited. Expenses are much lower than a typical mutual fund, at just 0.4% a year in the case of the SPDR.

#### Mutual Funds

In most cases, a mutual fund does not own physical gold, but instead invests heavily in the companies that mine the metal. One advantage of this is investors can view it as buying gold at a discount, since the average gold miner has a cost of production of \$650 an ounce, less than half of the market price. This also provides a beneficial tax rate, since gold-related equities are subject to standard long-term capital gains rules, as low as 15% for qualified U.S. stocks. Gains from owning physical gold or a bullion-holding ETF will get taxed at the collectibles rate, currently 28%.



Many investors opt to own physical  
gold bullion itself, through coins and bars.

Mutual funds aren't perfect, however: They have higher expenses and fees than ETFs, and very often are heavily invested in the largest gold companies, which tend to provide less growth.

#### Individual Stocks

A more direct way to gain exposure to gold stocks is to simply buy them directly. Generally speaking, large gold miners are the most liquid and predictable, since their reserves and cost of production are well known. Yet their shares have lagged behind gold price gains, and company management has been slow to boost dividend payments. On the opposite end, exploratory miners offer huge potential returns, but are highly speculative and often fail to find economically productive deposits.

Intermediate-sized miners—like New Gold—often provide a sweet spot for growth with relatively lower risk, better

reserves certainty, plus the potential for a buyout by one of the major mining companies, which tend to grow their reserves through acquisitions.

Another stock option is companies that focus on buying royalty streams from various gold mines. In such cases the company typically provides an upfront payment, usually used to finance mining operations. In return they receive a percentage of the gold. Essentially, this buys the future potential of the gold mine without having operational responsibility or liability around the mine itself, keeping costs low. "Investors will want to evaluate a royalty company's portfolio in terms of the size and types of royalties, the quality of the producing assets, the skill and experience of the operators and the longevity of the mines," advises Tony Jensen, CEO of Royal Gold (ticker: RLGD), a royalty company based in Denver, CO.



you to margin calls while a modest drop in gold's price could reverberate into big losses. Plus, you'll need to rotate through the most actively traded monthly contract, which raises trading costs and brings liquidity risk. You will want an experienced futures broker to handle the details for you regardless.

However you invest in gold, the poorest decision would be not to, given the market fundamentals and the natural protection against market volatility and inflation gold offers, adds Blanchard Gold's Beahm. "Gold is portfolio protection, a way to protect your wealth, a way to deal with your wealth, and a way to diversify out of paper assets." ■

<sup>1</sup> Margin requirement subject to change at time of press.

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### Physical Gold

Many investors opt to own physical gold bullion itself, through coins and bars. The best route to take is with a reputable broker, who would lock in a price over the phone and then securely deliver the bullion to you, as well as buy gold on an agreed-upon price subject to your delivery of the gold. The advantage of owning physical gold is that it shields you from the risks that come along with stocks and fund investments, including market risk, political risk in countries where mines are located, and the risk of corporate mismanagement. However, bullion offers less liquidity than stocks and brings with it the need for adequate storage and security.

### Gold Futures

Futures contracts for gold can be controlled for relatively little capital down: Today, \$5,001 is enough to control a 100-ounce futures contract (worth over \$150,000) on the Nymex, for instance.<sup>1</sup>

Such leverage holds great appeal because it can mean outsized returns, but there is also a big downside: Changing contract value can subject

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