THE WALL STREET JOURNAL.

MONDAY, MARCH 14, 2011

© 2011 Dow Jones & Company, Inc. All Rights Reserved.

THE CASE FOR AND AGAINST GOLD

DON'T BUY: It's a Gift, Not an Investment

By Lewis J. Altfest

It's hard to beat a solid gold piece of jewelry as a gift. And if you want to escape a country in turmoil with closed borders, a gift of a few ounces of gold will work wonders.

However, I don't believe gold holds much appeal as an investment today.

Fundamentally, the problem of gold as a portfolio investment is that it isn't a real investment. Real investments are stocks, bonds, income-producing real estate and private businesses, all of which, except for bonds (which produce interest instead), produce profits. These are paid out as income in the form of dividends or are reinvested and grow.

In contrast, bullion just sits there hoping to look attractive. Since the price of gold is not supported by anything other than the mood of investors, its value can plummet just as quickly as it soared.

The fact that is has soared of late is another negative. To me, gold has more downside than upside potential. The metal has risen from \$600 an ounce to more than \$1,400 in less than five years. After the last great gold move in the 1970s, its price declined sharply and then essentially did nothing for more than 20 years.

It's true that we have a ways to go before we reach the metal's inflation-adjusted all-time high of \$2,000. But that figure is hardly representative; it was set under a period of very high inflation, when gold more than tripled in one year. This was followed by a dramatic drop over an extended period of time.

I know the counter-argument. "Isn't it true that gold is one of

the few investments having a negative correlation with stocks or real estate? If so, shouldn't you have some gold as a diversifier and a hedge against a 'Black Swan' event, and establish it as a core holding in your portfolio?"

Gold does look beguiling when the world is full of fear or concerned about a coming bout of inflation. To some, that may sound like today's difficulties. To me, that is rearview-mirror investing.

Economies are generally improving world-wide, and inflation, while of some difficulty in a few countries, is not currently a problem in the biggest one, the U.S., nor should it become a really serious problem in the future. No need to call in the gold troops here.

In fact, I believe U.S. stocks will do well over the next several years. In my opinion, growth in the economy and corporate profits will exceed expectations, boosted by U.S. inventiveness and effort plus large excess capacity in labor and plant. As a result, doesn't that augur poorly for any investment that moves in the opposite direction of stocks?

True, the recent outbreaks in the Middle East could create economic difficulties if they were to spread to other large oil-producing countries. But I don't think that is likely, and already Saudi Arabia has reportedly made up for Libya's oil shortfall.

Riding the Bandwagon

Another point about having a "core holding" of gold is that it often hides a desire for momentum investing — latching onto a hot investment and hoping it keeps rising.

Gold momentum can reverse as quickly as the core holding

in oil and commodities that was "required" when oil was \$100 to \$140 per barrel. What's more, after a weak performance by gold, too many people forget the benefits of using it for diversification, sell it and like Don Quixote climb aboard the new "heroic investment."

In my opinion, people with a strong urge to have some money in gold can keep up to 5% of their portfolio there as a hedge if they promise to hold it rain or shine.

Zigs and Zags

Since it zigs when other investments zag, it is an insurance policy. But be aware that it will lower, not raise, your overall return in those years when you're holding it — because, as we've seen, it doesn't produce profits or dividends as other investments do.

Some may argue that central banks will boost demand for gold, as they use it to support the value of currencies. But given the explosion in world financial transactions, there probably isn't enough of the metal to do so efficiently.

Some countries may try to weaken their currencies to dilute their debt obligations and use gold to steady their balance sheets. However, I don't believe any major nations will seriously pursue a consistent decline of their currencies over an extended period of time.

The arguments against gold don't end there. Even some methods of buying exposure to gold can present practical problems. True, you can buy a gold-bullion ETF and pay a relatively reasonable fee for the privilege. But what if you want to personally hold a really meaningful sum of pure gold in, say, gold bars? Such an investment can



Lew Altfest

be a cumbersome process with a cost for safekeeping it with a thirdparty vendor.

Buyinggold coins can be more convenient but can involve

paying a markup over the asset value of the gold, with extra liquidation costs at the time of a momentum-based sale.

As for gold-mining stocks or mutual funds owning gold stocks, they tend to see even more volatility than the bars. There are relatively fixed costs to mine and develop the gold. Therefore, a, say, 10% move up or down in the price of gold will have little effect on costs but a much greater impact on profits and on the share price.

Is It the Right Thing?

There's also ethics to consider. There don't seem to be many benefits from gold production. Very little of the production takes place in the U.S. or is owned by U.S. companies, and this doesn't help our unemployment problem.

Finally, for all you jewelry buffs — jewelry being gold's only major industrial use — I have some bad news: In the U.S., yellow gold is considered old fashioned and less popular, and it's becoming too expensive for many buyers in poorer nations.

In sum, if I were a border guard today who received a "gift" of gold, I would cash it in and buy stocks.

Dr. Altfest is chief investment officer of Altfest Personal Wealth Management in New York and an associate professor of finance at Pace University.