Stocks: Investing: The New Gold Rush

INVESTING

The New Gold Rush

By Aleksandra Todorova | Aleksandra Todorova Archive | Published: January 26, 2006

HAVE YOU CAUGHT GOLD fever? With prices soaring, many investors are wondering whether investing in gold may be a golden opportunity for their portfolio.

The price of an ounce of gold rose 30%, from $427.35 to $558.20, during the 12-month period ending Jan. 24, 2006, according to World Gold Council figures. Over the same time period, the two gold exchange-traded funds (ETFs) traded on the U.S. markets — the **streetTRACKS Gold Shares** (GLD) and the **iShares COMEX Gold Trust** (IAU) — returned 30% and 26%, respectively. And gold-oriented mutual funds — which can invest in gold bullion as well as the companies involved in the gold- and precious-metals industries — fared even better, offering average returns of 49%, according to mutual-fund tracker Lipper.

During the same period, the S&P 500 was up 10.9% and the Dow Jones Industrial Average has been almost flat at 2%.

"We've been on a tear lately," says John Hathaway, manager of the **Tocqueville Gold Fund** (TGLDX), up 49.11% over the past 12 months. "The whole sector's been on fire."

Golden Years?

Typically, the demand for gold — and therefore its price — is driven by inflation fears, weakness in the U.S. dollar and high oil prices. It's a witch's brew that some would use to describe weaknesses in the current U.S. economy, but it was most clearly seen back in 1980. Back then, when inflation was 14%, interest rates hovered above 20% and the United States had imposed economic sanctions against Iran, gold prices reached a whopping $850 an ounce as investors sought refuge in an asset that can be converted into any currency.

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And while in today's economy interest rates and inflation are low on a historical basis, some investors are once again turning to this commodity. "You have people concerned about inflation picking up, you have higher oil prices, and you have the talk of sanctions against Iran," says Jeffrey Christian, managing director of CPM Group, a precious-metals research and consulting company. "All of these factors may keep investors relatively more interested in gold than they otherwise would be." Even if gold prices didn't continue to rise on their current pace, he says, chances are they won't fall sharply, either.

Investment Strategies

The one thing you absolutely *don't* want to do is chase returns. Paula de Vos, a Certified Financial Planner (CFP) and president of Synergist Wealth Advisors in Carmel, Calif., compares the gold sector right now with technology stocks in 1999. "Jumping on whatever happens to be the hottest-performing asset class in any quarter or in any year is generally a loser's game," she says "Much like putting all your eggs in a growth-stock basket after four years of outperformance in 1999, you need to proceed with caution."

So, while adding some gold to your portfolio may not be such a bad idea, you may want to wait a while. "Do I expect further gains? Yeah," says Ceasar Bryan, manager of the **Gamco Gold fund** (GOLDX), which was until recently known as Gabelli Gold. "I believe in the medium-term we'll go up. But today, we're overboard. We're up 12% this month alone and there can be a correction at any time."

That's not to say that gold has no place in a portfolio. One of its most common roles is as a hedge. It can offer your portfolio some inflation protection, as gold typically increases in value when inflation occurs, explains Matt McGrath, a fee-only Certified Financial Planner (CFP) and senior vice president of Coral Gables, Fla.-based Evensky & Katz. It can also offer protection against a weakening dollar, and because gold tends to move independently of the broader stock market, it can also offer some diversification when the stock or bond markets turn sour.

Investors looking for this type of "insurance" may consider putting a small portion of their cash into gold, limiting their exposure to no more than 5% of their portfolio. (That said, investors looking to hedge their portfolios against inflation should also consider alternative, less-volatile investments, such as Treasury Inflation-Protected Securities.)

The key to investing in gold is to think of it as a long-term investment rather than an opportunity to play the market and make a quick buck. "I haven't seen anybody who successfully trades us," Hathaway says.

Still bitten by the gold bug? Below is an overview of two popular ways of investing in gold: gold-oriented mutual funds and ETFs.

ETFs

Buying shares of gold ETFs is as close as individual investors can get to owning gold without having to buy actual bullion. That's because the two gold ETFs currently traded in the U.S. invest directly in gold bullion, with each share representing roughly one-tenth of an ounce of gold. Consequently, the ETF shares very closely track the price of gold itself. For example, on Jan. 24, 2006, gold prices closed at $558.20 per ounce; the iShares COMEX Gold Trust closed at $55.77 per share and streetTRACKS Gold Shares closed at $55.73.

Although gold ETFs are a relatively recent addition to the ETF universe — the streetTracks Gold Shares fund opened for trading in November 2004 and iShares followed in January 2005 — investors are clearly enamored. During 2005, $3.4 billion poured into the two ETFs, according to investment-research firm TrimTabs. For the first 20 days of 2006 alone, another $561 million flowed in, double the pace of average monthly inflows for 2005.

But gold ETFs come with several drawbacks investors should seriously consider before jumping in. One is the tax bite: Since they buy gold bullion, the IRS treats these ETFs as though they hold precious-metal "collectibles," explains CFP Michael Kitces, director of financial planning at the Pinnacle Advisory Group in Columbia, Md. Under the current tax law, the long-term capital gains rate on collectibles is 28%, rather than the 15% for traditional long-term capital gains. (For more on this, click here.)

Also, the ETFs pay their annual expenses — a reasonable 0.40% compared with the much pricier precious-metals mutual funds — by selling some of the gold they hold. Because of that, both ETFs have warned potential investors that the amount of physical gold represented in each share will decline over time.

For more on ETF investing, visit our ETF section.

Gold ETFs

Name (Ticker)	1-Year Return	Investment Strategy	Expense Ratio
streetTRACKS Gold Shares (GLD)	29.88%	Purchases gold bullion. Each share represents one-tenth of an ounce of gold.	0.40%
iShares COMEX Gold Trust (IAU)	25.93%	Purchases gold bullion. Each share represents one-tenth of an ounce of gold.	0.40%

Source: Lipper. All returns as of January 24, 2006.

Mutual Funds

As volatile as the price of gold can be, mutual funds that invest in gold-oriented companies are even riskier. "You're overlaying gold exposure with exposure to the stock market," says McGrath. "Anything that involves that next corporate level of an underlying company is going to have some additional risk." The average standard deviation for the gold funds category is 7.67, according to Lipper, compared with 2.61 for the S&P 500.

In other words, when gold is in favor, gold-oriented mutual funds do better than gold itself. The trend reverses when gold prices start to fall. Take, for example, the **Fidelity Select Gold fund** (FSAGX), one of the best performers in our table. In 2005, when an ounce of gold increased 20% in price, the fund returned 40.68%. Back in 1997, when the price of gold went down 20% for the year, the fund lost 39.39%.

Investors looking for less volatile gold funds should look for funds that diversify into other precious metals. The **Vanguard Precious Metals and Mining fund** (VGPMX), for example, also invests in base metals such as lead, aluminum and nickel and coal production companies, so it doesn't move in lockstep with other funds in the category that are more pure plays on gold, says Karen Wallace, mutual-fund analyst with investment-research firm Morningstar.

The universe of gold-oriented mutual funds is relatively small. Our fund screener identifies only 49 funds and of those a mere 11 of them are no-load and open to new investors. Still, there is a variety of investment styles covered in this group. The **ProFunds Precious Metals Ultra fund** (PMPIX), for example, is a leveraged index fund tracking the performance of the Dow Jones Precious Metals index. The **US Global Investors World Precious Minerals fund** (UNWPX), meanwhile, includes a significant weighting of small mining companies. (For details, see table below.)

One thing to pay attention to when looking at gold- and precious-metals funds is the expense ratio, which can run as high as 2.58%. In addition to that, most funds impose an early-redemption fee, which typically ranges from 0.5% to 1% when shares are redeemed within six months to a year.

Gold Mutual Funds

Name (Ticker)	1-Year Return	Investment Strategy	Expense Ratio	Minimum Initial Investment
ProFunds Precious Metals Ultra (PMPIX)	71.84%	Leveraged index fund. Seeks daily results that correspond to 150% of the daily performance of the DJ Precious Metals index.	1.46%	$15,000
Vanguard Precious Metals and Mining (VGPMX)	59.73%	Actively managed, invests in gold, as well as energy stocks, coal and other precious metals.	0.48%	$10,000
Midas Fund (MIDSX)	60.78%	Invests in securities of companies involved in the gold, silver or platinum industries.	2.58%	$1,000
Fidelity Select Gold (FSAGX)	58.90%	Invests at least 80% in companies engaged in gold-related activities; to a lesser degree, companies engaged in silver, platinum, diamonds, or other precious metals.	0.98%	$2,500
U.S. Global Investors Gold Shares (USERX)	57.76%	Invests in mid- to large-cap gold-mining companies.	1.97%	$5,000

U.S. Global Investors World Precious Mineral (UNWPX)	55.42%	Invests in companies involved in the mining of gold, silver, platinum, diamonds and other precious minerals, including small- and micro-cap companies.	1.48%	$5,000
USAA Precious Metals (USAGX)	55.13%	Invests roughly 80% of the portfolio in gold-mining firms; the rest in companies that produce platinum and base metals.	1.26%	$3,000
GAMCO Gold Fund* (GOLDX)	54.66%	Invests at least 80% of its assets in gold-related equities and bullion (including up to 30% in bullion).	1.54%	$1,000
American Century Global Gold (BGEIX)	48.70%	Invests at least 80% of its assets in gold-related equities. Combines fundamental and computer-driven analysis to hold roughly index-like weights of the world's largest gold producers.	0.68%	$2,500
Tocqueville Gold (TGLDX)	49.11%	Invests at least 85% to 90% of its total assets in gold and securities of companies engaged in mining or processing gold (including no more than 20% in gold bullion). The rest in other precious metals.	1.58%	$1,000
Rydex Precious Metals (RYPMX)	37.52%	Invests in U.S. and foreign companies involved in the precious-metals sector, including exploration, mining, production and development.	1.23%	$25,000

Classification average: 49.12%

S&P 500: 10.2%

* Previously known as Gabelli Gold fund.
Sources: Lipper, Morningstar, mutual fund prospectuses. All returns as of Jan. 24, 2006.

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