LONSDALE

Belmores Wealth Management

All that glitters...

Snapshot

The world is in the grip of a latter-day gold rush but instead of pitching a tent and staking a claim, modern day gold diggers are making a beeline for their local mint, coin dealer or stock exchange.

It's not hard to see why. The gold price hit a new record in October as it surged above US$1,000 an ounce, a gain of almost 300 per cent since its low of US$255 in April 2001.

Total demand for gold in all its forms, from gold bars and coins to exchange-traded funds, leapt 29 per cent last year - an increase of US$15 billion, according to the World Gold Council, and the trend is continuing. This is because gold is prized as a safe haven when financial markets are unpredictable, currencies are weak and inflation and interest rates are on the rise.

Governments around the world have been pumping money into their economies to ward off recession, giving rise to concerns that inflation and higher interest rates will follow. Australia was the first OECD nation to lift its interest rates but others are expected to follow as global growth picks up.

While the fear of runaway inflation may prove unfounded, the fear is real. Gold has always been an accurate barometer of human emotion, with periods of extreme highs and lows. In other words, even though gold is seen as a safe haven its price can fluctuate wildly. Gold outperformed shares in the Great Depression of the 1930s and the high inflation 1970s but it underperformed shares during the post-war boom years and the bull markets of the 1980s and 1990s.

In Australian dollar terms, the gold price rose 30 per cent last year compared with a fall of 42 per cent in the local share market (as measured by the All Ordinaries Index) and a 20 per cent fall in gold stocks.[1] This year, the situation is reversed as shares recover and the Australian dollar gold price falls. Yes, you read that correctly: the Australian gold price has fallen this year due to the strength of our currency. The Aussie dollar was worth more than US90c last month compared with the low 60s early this year.

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When investing in gold, Australian investors need to take into account not just the headline gold price in US dollars, but the exchange rate. The question then is how to safely invest in gold. Because of its unique history, there is often confusion about where such an ancient symbol of wealth fits into a modern investment portfolio. Gold coins were originally used as a medium of exchange as well as a storehouse of wealth. But this dual role was split with the introduction of paper currencies.

These days, gold is valued not just for its intrinsic value but also because its price moves independently of other assets such as shares, property and bonds. Over the long term, a small amount of gold in your portfolio may help to smooth out your overall investment returns – although asset allocation experts suggest no more than 5 per cent.[2]

Physical gold in the form of bars and coins is the purest gold investment and is available from the Perth Mint, the Australian Bullion Company and the Royal Australian Mint Company. On the downside, you pay a premium above the official gold price and you also pay for storage.

Shares in gold mining companies are probably the most familiar option for Australian investors. While gold shares do reflect the price of gold, they also carry the risk of currency fluctuations, management performance, operational problems and general share market risk.

The simplest and most direct investment in gold is via an exchange-traded fund, or ETF, which can be bought and sold on the stock exchange. Gold ETFs are popular in the US and Europe but Australia has just one, Gold Bullion Securities.

Each Gold Bullion share is backed by around one tenth of an ounce of physical gold held on your behalf. Unlike physical gold, there are no holding or handling costs and units are easily traded. Managed funds are another option. Specialist gold funds invest in everything from bullion to gold futures, shares and exchange-traded funds.

Times may change, but a modicum of gold can still help investors sleep easier at night. The good news is that anyone with money in a diversified superannuation fund, in general probably has exposure to gold through owning diversified Australian shares. Australian mining companies such as BHP Billiton, Rio Tinto and Newcrest are all big gold producers and due to their size and significance, are owned in some form by most superannuation funds.

1. http://seekingalpha.com/article/26775-gold-in-your-portfolio-how-and-how-much
2. http://goldprice.org/gold-news/2008_01_01_archive.html

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