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ROI | September 17, 2010

The 10 Biggest Myths About Gold

By BRETT ARENDS

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Gold has been the investment phenomenon of the past decade. It hit a new high of \$1,278 an ounce this week. In the past 10 years, investors in gold have made nearly five times their money. Over the same time, Wall Street has gone sideways.

But few investments seem to attract more myths and hokum than gold and other precious metals. At the risk of inflaming those on both sides of the issue, here are 10:

1. "Gold is overvalued."

As gold reaches historic highs, Brett Arends attempts to dispel some of the myths about the yellow metal.

How can anyone know this? Nobody even knows what gold is worth, so it's impossible to say with any confidence that it's overvalued (or undervalued, for that matter). Some perfectly intelligent people, such as Dylan Grice, a strategist at SG Securities, argue that when compared to the ballooning money supply, gold is still low by historic standards. And even if gold is in a bubble today, it may have a long

way to go. As I've pointed out earlier this year, as our accompanying chart shows, at a comparable stage Nasdaq (1998) and real estate (2003) still had a couple of years to run.

2. "The smart money got out of gold a long time ago."

Really? People have been saying that for at least five years. Yet hedge-fund honcho John Paulson has got nearly \$4 billion of his firm's money in the [SPDR Gold Trust](#) exchange-traded fund. George Soros has \$650 million in the ETF. Every month Bank of America/Merrill Lynch conducts a survey of the world's top fund managers. About six years ago, when gold was around \$400 an ounce, I suggested they started asking the money managers about gold. Initially they got few responses. Few cared enough even to venture an opinion. More recently, while interest has risen, the skepticism has remained. For the last two and a half years, apart from a brief moment in early 2009, money managers have pretty consistently told the interviewers that gold was overvalued, and usually by a wide margin. During that time it's risen from around \$850 an ounce to nearly \$1,300.

3. Gold is a "safe haven."

Remind me never to buy life insurance, or a new set of brakes, from someone who thinks this metal is "safe." From 1980 to 2000, it lost more than four-fifths of its purchasing power. During the 2008 crash, it fell by nearly a third. If that's safe, I'd hate to see volatile. Gold is just an asset, like anything else.

About R.O.I.

Brett Arends writes ROI, or Return on Investment, offering analysis on what the latest news means for you and your money. The column covers investments, spending and broader personal-finance issues. Brett writes from a value-oriented and generally contrarian perspective. He has been writing about finance, in Europe and in the U.S., since the 1990s. Before that he worked as an analyst at McKinsey & Co., the strategy consultancy.

Neither this nor any other column should be taken as the sole basis for investment decisions, and investors should consider their own finances carefully before making any commitments.

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4. "Gold is 'real' money, while money created by government or society is just paper or 'fiat' money."

What nonsense. The only thing that makes anything "money" is that other people—meaning "society"—accept it as such. A fund manager was recently telling me about someone she knew who bribed his way out of a crisis in Africa with bottles of liquor. She pointed out that, if society really fell apart, the best "money" would be the things people need—like food, cigarettes, and liquor. (My tip for Armageddon? Stock up on Charmin Ultra Soft. You'll be amazed how valuable it becomes when we're down to leaves.)

5. "Gold stocks are a more profitable way to invest in gold than the metal."

The most dangerous tense on Wall Street is the perpetual present. The reality: Gold stocks are sometimes more profitable, and sometimes less so. It all depends on the price you pay. For years, many big mining stocks were overvalued. The metal was a better bet. But during the 2008 crash, gold stocks plummeted even further than the metal. That left them an absolute steal. Anyone who bought the big miners at the lows has more than doubled their money in two years, and anyone who bought the small ones has quadrupled it.

6. "Small gold-mining stocks are risky."

Sure, any individual mining stock is very risky. (Even one like [NovaGold Resources](#), which I recommended [earlier this year](#). Proceed with caution.) But a broad basket of small mining stocks—such as that tracked by the [Market Vectors Junior Gold Mine](#) ETF—will be much less so. And indeed, depending on the price you pay, small miners will at times offer a much better bet than bigger companies or the metal. (See point 5, above.) Knowing the way the fund industry works, in a gold boom the small fry will probably be the last ones to get scooped up—suggesting they offer a leveraged play.

7. "Gold is a much better investment than other precious metals."

Really? Why? Once again, it all depends on the price. Over long periods, silver and platinum seem to have marched in the same direction as gold. Over 20 years, silver has beaten gold by 25%, platinum by 5%. But it hasn't been a steady move. At different points one metal has risen much higher, while another has been left behind. You could have made much better money taking advantage of these moves. There are now ETFs that invest in silver ([iShares Silver Trust](#)) and platinum ([Physical Platinum Shares](#)). You aren't always stuck with just gold.

8. "Gold is a great investment because it has kept its purchasing power over thousands of years."

Bah. It's hard to believe serious people repeat this. We can't even get reliable information from 50 years ago, let alone from ancient Rome. Did a toga under Caesar really cost one ounce of gold, the same as a man's suit today? Some claim it did. But what kind of toga? And what kind of suit? I can buy a suit for \$300. There is a widely circulated claim that in the Bible an ounce of gold bought "300 loaves of bread." One hesitates to assert a negative, but I have looked, and I have asked informed sources, and no one has so far been able to produce the relevant Biblical reference. If anyone has it, please forward it to me. Furthermore, even if gold had "kept its purchasing power over 3,000 years," that would merely mean it produced a real, inflation-adjusted return of 0%. Inflation-protected government bonds will give you inflation plus 2%.

9. "Gold mutual funds are pretty much the same."

Not a chance. You need to look under the hood. [Vanguard Precious Metals & Mining](#) isn't even a gold fund anymore; [Morningstar](#) moved it to the "natural resources" category, because it invests in general mining and related activities as well. Most "gold" mutual funds don't even invest in gold itself, just the equities of mining companies—further evidence that gold is scarcely over-owned. Morningstar analyst Janet Yang says that two which invest in both stocks and metal are [First Eagle Gold](#) and [Fidelity Select Gold](#). Other funds also vary in style. [Oppenheimer Gold & Special Minerals](#), for example, tends to own a lot of smaller mining stocks, and to invest in silver and platinum miners as well as gold. [U.S. Global Precious Minerals Fund](#) focuses on smaller mining stocks.

10. "You should always have 7% of your portfolio in gold for security."

This has become a shibboleth. But why 7%? If the other 93% of your portfolio collapses, that 7% isn't going to help much, even if it, say, doubles in price. As usual, these things

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depend on the price you pay. Personally, if I thought the gold boom were going to continue, I'd rather bet by risking a smaller amount in high-octane, out-of-the-money call options on the SPDR Gold ETF or maybe the Market Vectors Junior Gold Mine ETF. Those give you the right to buy into the fund later at a fixed price if it booms. You only have to put a limited amount down. If prices don't move, or fall, you will lose that small stake. But if prices skyrocket, you can make many times your bet. As an illustration: SPDR Gold Trust is at \$125 a share. The \$150 call options, good until January 2012, cost \$6.50 per share. Your downside is limited.

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