STANDARD & POOR'S

The New Gold Rush: Factor of Fear or Fundamentals?

Global demand for gold is influenced by a complex set of factors, including concerns about ballooning government deficits and a preference among some investors for hard assets in an uncertain economic environment.

Since the price of gold reached an all-time high of $1,261 an ounce on June 28, observers have debated whether the precious metal presents an example of the most recent asset bubble.[1] Global demand for gold is influenced by a complex set of factors, including concerns about ballooning government deficits and the potential for inflation, as well as a preference among some investors for hard assets in an uncertain economic environment.

Recent Trends

According to the World Gold Council, demand in 2010 has been driven by a growing desire for jewelry in China and India, strong interest from European and U.S. investors in the wake of economic instability, concerns about the potential for sovereign debt defaults, and fear about the potential for a "double dip" recession.[2] In addition, the council believes there is a relationship between the price of gold and relaxed monetary policies that are in place in many corners of the globe. Specifically, the council's research indicates that money supply growth impacts future gold performance with a lag of between six and nine months.[3]

Ways to Buy Gold

Investors in gold may choose from among three ways to include it within an investment portfolio: gold bullion, stocks or bonds issued by companies in gold-related industries, and pooled investments such as mutual funds or exchange-traded funds.

Type of Asset	How It Works	Potential Drawbacks/Considerations
Bullion (jewelry, coins, or bars)	Typically purchased or sold through a gold dealer.	Prices offered by dealers may not be uniform and may not reflect published prices on the London fix. Less liquid than other forms of gold. Need to arrange for storage, insurance, and other safeguards.
Stocks or bonds issued by companies in gold-related industries.	Purchased through a financial advisor or directly through a brokerage firm. Pricing data widely available. Depending on the security, may have high degree of liquidity.	May be influenced by trends in the stock market. Trading fees will apply.
Mutual funds or exchange-traded funds.	Purchased through a financial advisor or directly through a brokerage firm. Pricing data widely available. Usually have high degree of liquidity.	May be influenced by trends in the stock market. Trading fees may apply.

Those who question current valuations point to the period between January 1979 and January 1980, when inflation averaged 14%.[4] During this time, the price of gold more than tripled from $227 to $678 an ounce. As valuations subsequently declined, investors who purchased gold at its January 1980 peak would have had to wait until April 2007 -- more than 27 years -- to break even.[1] This example does not automatically mean that gold is set to take another fall, but it points to the investment risk of purchasing an asset that has experienced a significant surge in value.

Points to Consider

You and your financial advisor may want to review the following issues when deciding whether gold is a suitable investment given your situation; and, if it is, managing gold along with other assets:

- Gold may help to diversify a portfolio that includes financial assets such as domestic stocks, U.S. government bonds, foreign stocks, REITs, or cash. A statistic known as correlation measures the tendency of two assets to move in tandem in response to market or economic developments. Historically, the correlation between these assets and gold has been low, meaning that if these assets decline in value, gold may hold steady or increase, helping to reduce a portfolio's overall volatility. Past performance does not guarantee future results.[5]
- Review your time horizon. Historically, the volatility of gold has been close to that of stocks. An allocation to gold may be most appropriate for investors with a long-term time horizon who are able to ride out short-term bumps in value.
- Limit the percentage of your assets that you allocate to gold. Many financial advisors recommend an allocation of 5% or less of your portfolio given the ups and downs that the gold market has experienced in recent years.

[1]*Source: Standard & Poor's. Gold is represented by the 4 p.m. London fix.*

[2]*Source:* Gold Supply and Demand Q1 2010, *World Gold Council and GFMS Ltd.*

[3]*Source:* Linking Global Money Supply to Gold and to Future Inflation, *World Gold Council, February 2010.*

[4]*Source: Bureau of Labor Statistics. Inflation is represented by the Consumer Price Index.*

[5]*Source: Standard & Poor's. Gold is represented by the 4 p.m. London fix, foreign stocks by the Morgan Stanley Capital International EAFE Index, real estate by the NAREIT Equity REIT Index, cash by a composite of the yields on 3-month Treasury Bills and the Barclays 3-Month Treasury Bill Index, domestic stocks by the S&P 500, domestic bonds by the Barclays U.S. Government Bond Index. For the period beginning January 2, 1973, through June 30, 2010.*

© 2010 Standard & Poor's Financial Communications. All rights reserved. Reproduction in whole or in part is prohibited without the express permission of Standard & Poor's Financial Communications. Visit us online at http://fc.standardandpoors.com or call us at 1.800.326.7697