INVESTMENT NOTE

January 2012

All that glistens is not gold

The collapse in the price of gold has been as dramatic as the rise. Why is that happening when bonds made new highs in December?

Anyone watching the gloomy New Year messages from leading politicians would no doubt have gathered the impression that the investment world must still be in panic mode following the entirely predictable failure of the European summit in early December when the Euro weakened. One would be forgiven however for having expected gold, as well as other 'safe haven' investments to have rallied strongly. Oddly though, gold has in fact fallen 20% from its high while gilts have captured new highs. What is happening to this most tangible of safe haven assets?

The TAM International investment team fielded many questions during the second half of last year about our unwillingness to take a speculative position in gold as a "hedge". We suspected that the rather curious arrival of gold ATMs in West London shopping centres, at the height of the gold price rally, was the nail in the coffin. Our unwillingness was compounded by the difficulty one faces in acquiring exposure to the asset, with ETF's one of the few available options (we cannot buy physical gold and related shares fail to reflect the price). It also owes much to our optimistic view on the US dollar, the currency in which gold is priced, which itself has risen 7% against Sterling from the low. The price of gold has also been extremely volatile. **Anyone buying into gold at the beginning of the tax year has had a round trip of exactly zero even before the 7% hit on the currency.** The returns of the last nine months were wiped out in December 2011.

We must also consider the conventional wisdom of owning gold as a hedge against inflation. There is simply no prospect of excess inflation in spite of low interest rates and falling bond yields. Huge bond buying programs by central banks in US, UK and Europe is a battle against deflation rather than inflation which could be readily reversed on the raising of interest rates. The Bank of England has been conspicuously unwilling to raise rates despite inflation hitting 5.2% in October.

The point, as it pertains to inflation, is that so long as a feeble economic recovery persists, amid an almost inevitable recession in 2012, gold is an unnecessary hedge against an unlikely threat and priced in a currency which has historically been deemed a greater safe haven than the metal itself.

Gold remains a purely speculative and volatile asset and in the "new world" is trading on sentiment and the prospect of a debasement of paper currencies. **Its volatility is underestimated**. It may form part of more adventurous portfolios but **should in no way be seen as a hedge against volatility**. The latest reversal in gold has drawn out technical buyers starting to call the short term bottom in both gold and the Euro in a very tense trading environment. It is not a speculation for the faint hearted. **We stand by our conviction that we are right to be cautious of exposure to gold for UK investors but remain aware of the fact that panic buying will provide trading opportunities in 2012.**

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