

# Why to Steer Clear of the New Gold Rush

The story of how the yellow metal offers investors the ultimate safe haven is spun from pretty thin straw



▶ **The point of diversification is to** provide shelter from market storms, but suddenly all of the bunkers seem to have been blown away at once. In January, U.S. stocks lost 6%, foreign markets fell 10%, and emerging markets dropped a shocking 13%. Meanwhile, every industrial sector in the U.S. stock market (including energy) lost money; small and large stocks alike got trashed. And the Federal Reserve punished savers by slashing interest rates twice, reducing the income generated by many bond funds by nearly 10% in a matter of days.

So where can you turn for safety? In the desperate search for something—anything—that will go up when U.S. stocks go down, investors have been stampeding into gold and other “hard assets.” In mid-January, when the price of gold jumped past \$900 an ounce, the StreetTracks Gold Trust, an exchange-traded fund that seeks to capture the returns of gold bullion, raked in an average of \$25 million *per hour*. And my e-mail inbox is suddenly bursting with hype about the wonders of investing in timber, rhodium, carbon-emissions credits, private equity funds and a Canadian ETF that seeks to double the return of wheat, corn and soybeans. All of them, the argument goes, will make a portfolio safer because they do well when U.S. stocks do poorly.

## SEPARATE FROM THE HERD

If you are tempted to join this stampede, don't. As usual, the herd has it wrong.

First, diversification works over time, not all the time. “On any given day when the market tanks,” says William Bernstein of Efficient Frontier Advisors, “there's no shelter to be had. But the longer your horizon, the better the shelter you get from diversifying.” Over the past decade, small

stocks, foreign stocks, emerging markets, real estate investment trusts and Treasury bonds have all outperformed Standard & Poor's 500 while not moving in lockstep in the long run. And it's that difference, or low correlation, over years that matters, not the similarity over days.

Second, low correlation is no cure-all. Your results at the casino have a low correlation to the stock market too. That doesn't mean playing the slots with 10% of your assets is a good idea.

And gambling is just what you're doing by betting on commodities. “The beauty of stocks and bonds,” says John Bogle, founder of the Vanguard funds, “is that they have an underlying intrinsic value.” Their fortunes are inextricably linked to a business. But commodities generate

no cash and pay no interest or dividends. They're worth only what someone else will pay for them, and history shows that over time the price is more likely to go down than up. Gold soared in the 1979-80 bear market. Had you bought then, you'd have only recently gotten back to even. Adjusted for inflation, of course, you'd be in the red.

Finally, there's a dirty little secret to the low-correlation argument. The people telling you to buy gold pretend they love it because it's an uncorrelated asset. In reality they're using its recent high returns to wow you. They didn't tell you to buy in 1999, when gold was just as uncorrelated but much cheaper at barely \$250 an ounce.

Should you do something different to find shelter in this latest storm? I doubt it. Falling prices for U.S. stocks make them a better deal, not a worse one; you should be holding firm or adding more. Bonds and foreign stocks remain good diversifiers, so you should be adding them gradually.

Yes, commodities provide diversification. But at today's prices they don't provide much protection. If you really want to make your portfolio safer, invest in assets with a low correlation to blue-chip U.S. stocks *and* low recent returns. That will force you to ignore price and focus on value. Today real estate investment trusts are among the few investments with low correlation and low price. Tiptoe into REITs by investing a little each month (for more, see page 61). You'll pick up protection on the cheap—and avoid the cliff that the herd is rumbling toward. **\$**



## THE TRUE COLOR OF GOLD

The metal is hot now and stocks are cold. But if you had bought the last time gold was this high, you'd be sorry.

VALUE OF \$10,000  
INVESTED IN GOLD IN JANUARY 1980

**\$10,600**

VALUE OF \$10,000  
INVESTED IN THE S&P 500 IN JANUARY 1980

**\$279,000**

SOURCES: World Gold Council; Morningstar.

Jason Zweig is the author of *Your Money and Your Brain*. You can e-mail him at [investor@money.com](mailto:investor@money.com).