Seven Things You Should Know About Gold Before Investing

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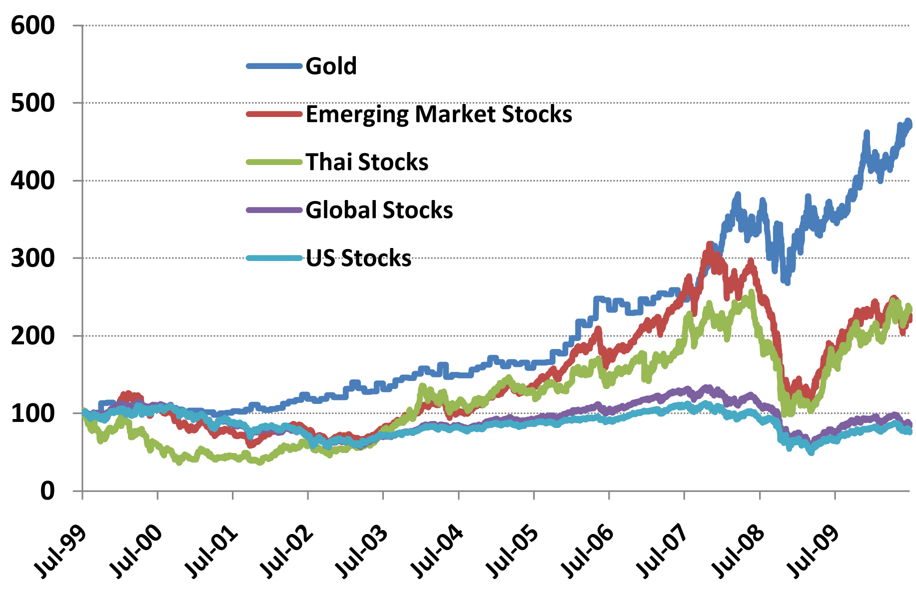
The past two years have been challenging times for expatriate investors. And the uncertainty hardly seems over: currencies such as the GBP and Euro have fallen sharply against the USD, and governments around the world continue to finance their spending by issuing debt and printing money. Property prices in many markets have fallen and banks in most countries are paying next to nothing on deposits. Meanwhile, investing in stock markets can feel like an out-of-control roller coaster ride, and putting cash under a mattress was never a good idea. So where do you put your hard-earned savings during times like these? Many are drawn to gold as an alternative. But before you buy gold as an investment, here are seven things you should know:

1. **The price of gold has already quadrupled.** Near the end of June 2010, the price of gold had reached a high of USD1,252 per troy ounce, having come a long way from its low of USD252.80 back in July 1999. Over the course of the past 11 years the gold price has risen nearly 400%, or roughly 15.5% per year. This phenomenal rise in price during a period when many investments have done relatively poorly has both attracted new buyers to gold as well as dampened demand from some traditional gold buyers.

The rise in the price of gold over has outpaced the performance of stock markets

Gold Price Vs. Various Stock Market Indices, Jul 1999–Jun 2010



Source: Morningstar data, indexed to 100 on 1 July 1999. Gold = Spot price US$per troy ounce, Global stocks = MSCI World Free USD, Emerging Market Stocks = MSCI Emerging Markets USD, Thai Stocks = MSCI Thailand USD, US Stocks = S&P 500 USD

2. **Aggressive marketing of new gold ETFs has been a driving force behind the increasing price.** One of the biggest drivers of the gold price is the introduction and aggressive marketing of new ways to easily invest in gold. Since 2003 new products called exchange traded gold instruments

have become available, with the most common being Gold Exchange Traded Funds (GETFs) and Gold Exchange Traded Notes (GETNs). Both GETFs and GETNs are investments that trade on a stock market and track the price of gold. GETFs may invest in physical gold to back each share sold, while GETNs generally use derivative products to replicate gold price changes. Both types of products have advantages over owning physical gold in that they are easy to buy and have no transportation or storage costs.

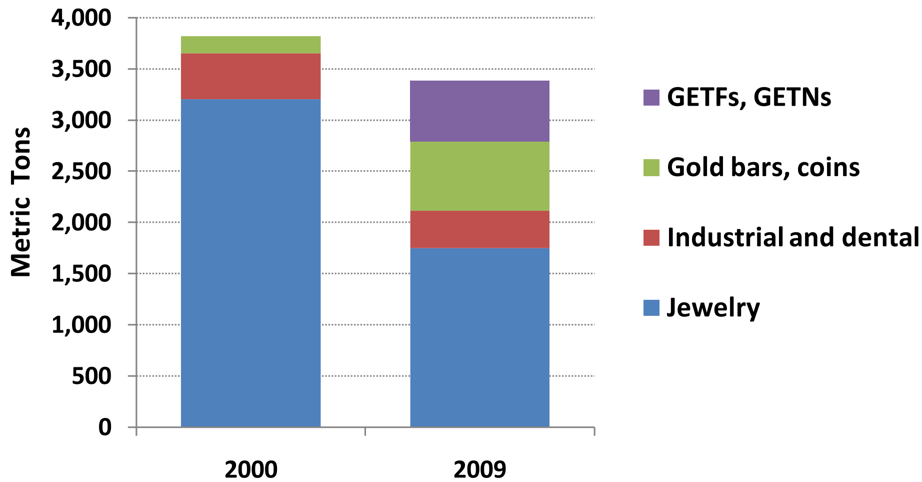
The growth of gold investment products has been nothing short of dramatic. From being nonexistent just seven years ago, Morningstar now lists over 100 trading on exchanges around the world, and last year they comprised nearly 18% of the total annual demand for gold. It's the combination of aggressive marketing of these GETFs and GETNs and a rising gold price that have resulted in a circle of upwards spiraling demand and prices.

3. **Getting physical–hoarding of gold bullion exacerbates the price rise.** The old fashioned way of investing in gold—buying bullion or gold bars or coins—has grown in popularity in sync with the demand for GETFs. Buying and holding physical gold is not as easy as purchasing a GETF—with physical gold an investor needs to consider transportation, storage, and security costs. Nevertheless, companies that sell physical gold are heavily making the case that owning bars or coins is safer than owning a derivative product. And so annual demand for physical bullion has similarly increased substantially from 166 tons in 2000 to 676 tons in 2009—for a total increase of over 300% during this period.

4. **But all that is gold does not glitter—demand for gold jewelry has actually fallen.** Traditionally the biggest demand for gold comes from its economic uses rather than from the investment world. The largest industry that uses gold for economic purposes is jewelry-making, and it's here where the gold price increase has really taken a negative toll. As the price has risen, global gold demand from jewelry-making has nearly halved from 3,204 tons in 2000 to just 1,747 tons in 2009. Meanwhile demand for gold for other economic purposes such as electronics and dental has also declined. Some might say that the commercial world's fall in demand is actually a more rational response to rising prices than the investment world's increase in demand.

Annual Gold Demand (Metric Tons), 2000 Vs. 2009

Gold's price increase has depressed demand from traditional industries but triggered new demand from the investment community



Source: World Gold Council; Identifiable demand for gold excluding activities of central banks; GETF = Gold Exchange Traded Fund; GETN = Gold Exchange Traded Note

5. **Hedge funds and momentum traders further amplify price movements.** The newer gold investment instruments make it extremely easy to trade gold, and so it's no surprise that short-term investors such as hedge funds and momentum traders have become major players. These types of investors look for rising price trends, and then ride them upwards—in some cases eventually becoming the dominating force driving a particular trend.

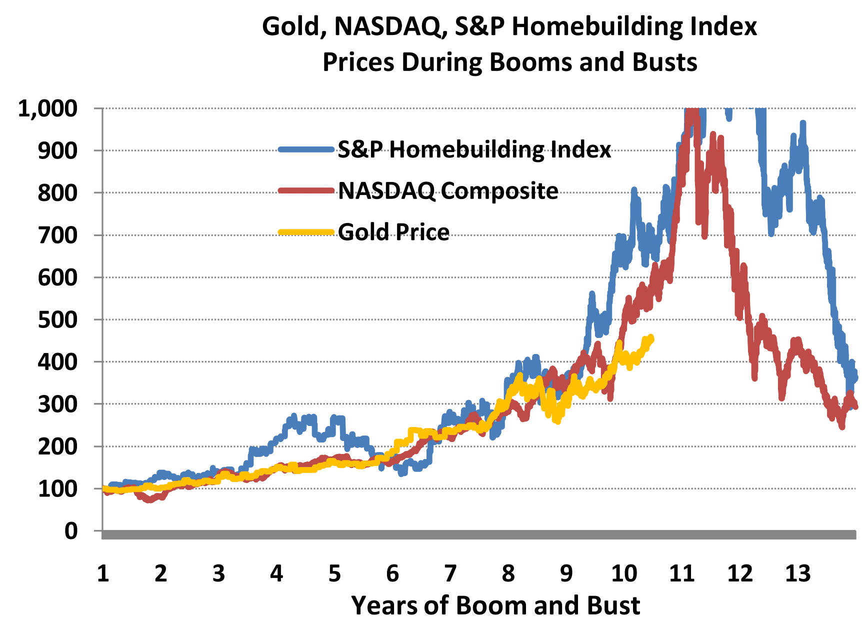
   But hedge funds and momentum traders also look to book short-term profits, and are therefore typically among the first to exit an investment when prices look set to weaken. As an example, short-term trading is thought to have played a large role in the sky-rocketing price of oil two years ago—and its subsequent collapse from a high of $147 per barrel in July 2008 to under $40 by December – a 75% drop in just six months time.

6. **Gold is not a safe haven.** A key feature for a safe-haven investment is price stability—the whole point of making a safe-haven investment is to ensure that value is retained for use when it's needed. Unfortunately gold is one of the more volatile investments—its price can vary significantly from day-to-day and year-to-year. While investors buying gold as a safe haven may be confusing strong price performance with price stability, unfortunately the reality is that the price of any hard asset that can quadruple in a decade can also fall. Given gold's volatility, investors seeking a true safe haven would do better to stick to high-quality, short-term fixed income investments denominated in the currency they may need in an emergency.

7. **When gold loses its luster, the price can plummet.** Just like NASDAQ, dot com stocks, and the prices of property, oil, and tulips—the price of gold can fall as well as rise. Gold prices last peaked during a period of negative real interest rates back in 1980, and then plunged dramatically as central banks such as the US Federal Reserve raised interest rates in a war

against inflation and triggered gold hoarders to rush for the door. The dynamics this time may be slightly different, but one thing is certain: the laws of gravity still exist, and investments that overshoot on the upside will one day fall back to earth.

Safe haven… or just speculation?



Source: "Is Gold the Next Bubble" <u>WSJ</u> 25 May 2010, Morningstar data
Indexed to 100-NASDAQ 1990,S&P Homebuilding 1995, Gold 2001

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