Newsletter: Spring 2011

STUART + CARLYON

Financial advisers for your lifetime goals

Gold myrhh and frankincense

Shopping around for the perfect Christmas gift? The three wise men had the same dilemma 2011 years ago and their choice: gold, and two precious ingredients for incense: myrhh and frankincense. A modern-day equivalent of myrhh and frankincense might be expensive perfume – but the gift that got investors so excited this year was the gold.

Gold has played a valuable economic role for thousands of years across a wide number of civilisations. In times of war or economic crisis, a remarkable number of people trade in their paper currencies in exchange for the ingots of gold. Indeed, with so many world economies in dire straits this year – from Greece to the USA – we've seen demand for gold soar, and the per ounce price go through the roof. Gold dealers have been talking it up as the one truly 'solid gold' investment.

Sure gold has its place within our spectrum of investments, but do your homework before you buy.

Buying gold bullion – ingots of the stuff – is the safest way to hold gold however it is a clumsy way to hold an investment. You would need to house it securely, in a bank vault and that incurs storage costs.

A more convenient medium for buying gold is through ETFs – or Exchange Traded Funds which track the gold price. You buy and sell them easily on the stock exchange so they are more liquid. But with the presence of ETFs, gold prices are now more volatile than they used to be.

So how risky is gold? In the short term gold will remain attractive for a number of reasons. First – there is true demand for gold not just from sentimental or risk averse investors – but from industry as well. Gold is necessary in jewellery.

Second – if gold acts as a safe haven for investors in the face of a stormy global economy, well, don't expect those storms to suddenly disappear. There will be plenty of safety-seekers for quite some time yet, and they will ensure continued demand for gold.

Third, Edward George of The Economist Intelligence Unit points out that the cost of extracting gold in the world's mines remains expensive, and that if prices plummeted toward the $US800 per ounce mark, then mining companies would slow down production, a shortage would ensue and prices would go up again. Nobody is going to continue mining gold if they can't recover their costs.

All this looks good for gold doesn't it? Well from an investment point of view there are some real downsides.

The reward for investing in gold is its value going up. However, it does not deliver an income stream so this makes gold inappropriate for anybody who relies on their investments to help meet their ongoing living costs.

The other problem with gold is that it has a history of spectacular price hikes such as the one we've just seen (or the one in 1980) followed by long – really long – periods of a plateau price. Just because it jumped in price last year is no guarantee that it will jump again next year. History tells a different story. If you had bought gold at its peak in 1980, the inflation-adjusted price 30 years later is around US$2,000 an ounce in today's money. With gold now at US$1,767, it's too bad if you were hoping for an inflation hedge.

"As sensible advisers, we see gold as only a small component of a diversified portfolio. We'd rather invest in companies that make profit and provide income as well as capital growth."

As sensible advisers, we see gold as only a small component of a diversified portfolio. We'd rather invest in companies that make profit and provide income as well as capital growth. For us personally, don't give us bullion to look at. The wise men in our lives would be better to bring gold in the form of jewellery.

Wall Street

By Susanna Stuart

The Rugby World Cup event has spin-offs. An offer from friends to stay with them in a New York apartment was too good to refuse. The free accommodation came courtesy of rugby lovers in New York doing a house swap with our friends' home in Auckland.

I was in New York purely for a vacation, but with the Wall St protests gaining momentum, I couldn't resist a visit to the fabled street to see what was going on.

The root of the protest is economic, with many Americans impatient for an economic recovery. Unemployment is noticeably high in the USA and, conspicuously, the gap between rich and poor is getting more pronounced – to the point where the main middle-class is itself feeling disenfranchised. The single most common refrain of the protest is "I'm the 99%" which refers to the fact that those in the USA who earn more than $1.1 million per annum (the top 1%) pay less tax per dollar than everyone else due to lower tax on capital gains and dividends. A statistic like that provides a focal point for the protests by showing how the rich are getting richer.

But it would be a mistake to say the protest is focused. I saw a wide variety of placards ranging from the polemic "Hire Me and I'll Get Off Your Street" through to slogans highlighting specific issues that have scant direct relationship with the financial protest or even with the economy.

This lack of coherent message is clearly causing problems for the media, who have a parade of TV news broadcast vans parked adjacent to the gathering protestors. For the news crews it is difficult to boil anything down to a single message, or to find a lead spokesperson or even – if balance is what they want – to find somebody to argue the case. Instead the camera crews wait in the hope of sound bites.

Perhaps the fuzziness of the protest reflects the intangible nature of the economic failure; mixed up as it is with a sense of injustice that Wall St bankers are still awarding themselves hefty bonuses, and with the feeling that the USA is pounding Afghanistan with billions of dollars rather than spending these dollars at home. And meanwhile there is the sense that stalwart pillars in society - such as teachers - are the ones who are feeling the pinch. A favourite placard. "The Middle Class. Too big to fail".

People from all stripes are represented here; from young students through to conservatives. There's a shared and palpable sense that the system has somehow failed, and that even the hope that came with Obama's election three years ago has evaporated. This is a crisis of hope.

If you want a good read on the Global Financial Crisis, the Justin Cartwright novel "Other People's Money" presents a sharply observant profile of a venerable British banking family embroiled in the heart of the financial industry and caught between the old-school approach versus the glittering allure of easy money via hot new hedge funds. Cartwright is an entertaining writer and he applies his scalpel to the human condition.

Meanwhile the streets of New York are not at all mean. Compared to 20 years ago, when TV advertisements exhorted pushy New Yorkers to "ease up," the city now has a more pedestrian, friendlier face. People stop and talk, and Manhattan now enjoys a string of new parks, including the High Line (an old railway viaduct converted into a garden walkway,) which make the city more enjoyable. Located downtown near Greenwich Village, I found the standard of food to be exquisite, foodmarkets feature organic everything and of course there is a vast cultural choice. Typical scene: three Orthodox Jews sitting at a park enjoying sushi.

It was good to reflect on Wall St and even to witness the direct hurt caused by the misguided financial fad of repackaging debts and flicking these upward into ever more sophisticated, unstable and unprotected instruments. Thanks to the protests, those in the financial industry in NYC cannot help but reflect on their impact on others.

Our financial philosophy at Stuart +Carlyon remains much more grounded, and we stick to straight bonds and shares. The returns may never be so dazzling as those promised by juiced up funds, but there are no placards protesting the idea of protecting one's capital.

Christmas holiday office hours

This year our office we will be finishing on Friday 23 December 2011 and returning on Monday 16 January 2012. If you are a client, please contact us if you require cash withdrawals before Christmas. You are also welcome to phone us during the holiday break if you need to.

We wish you and your family a wonderful holiday season and New Year!

155 Parnell Road, PO Box 137-154, Parnell, Auckland 1151, New Zealand Phone: 64 9 307 2331 Fax: 64 9 307 2330 www.stuartcarlyon.co.nz