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Gold Rush

Investors flock to inflation hedge

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Interest in buying and selling gold has exploded in recent months. Numerous commercials on television and the radio are bombarding the airwaves, advising people to buy gold as an investment.

Many other commercials offer folks a chance to sell their gold jewelry.

As a commodity, gold has quadrupled in value over a nine-year period. In 2001, it traded for less than $300 per ounce. Today, an ounce of gold is trading in the $1,200 range.

Investors, large and small, have gotten in on the action. There are several publicly traded gold funds on the New York Stock Exchange that allow investors to play in the gold market without actually owning gold itself.

Interest in gold investing is driven largely by concerns about possible inflation, which could be triggered by the government's moves to rescue the economy by increasing the money supply.

"In this cycle, we took on too much debt as individuals and we're in the process of deleveraging, which is a multi-year event," said Joe Hickey, director of equity strategy at Milwaukee-based Cleary Gull Inc. "That's a scary process for a lot of individuals and for countries themselves. And one of the side effects of trying to prevent a global financial crisis was to flood the system with money."

That global quantitative easing pushed more money into bonds, stocks and commodities, Hickey said – driving up prices in many different markets. The emergence of publicly traded gold funds and the ability of many investors to buy commodities within their individual retirement accounts also helped fuel the gold frenzy, he said.

"We've had a whole new investor class start to come along here," Hickey said. "Now people are concerned that we're going to have a devaluation of currencies. You saw it in the Euro last month."

While gold has risen significantly in value over the past decade, the commodity has not reached the classic example of a bubble. However, the potential for a gold bubble looms as a possibility.

Gold's rise in value looks like a long, steady climb when placed on a chart. There are several falls over the course of time (gold fell from around $960 an ounce to $725 in 2008 and fell again late last year until early this year), but for the most part, it has steadily gained in price.

If gold is to become a bubble like the housing market, tech stocks or other previous investment bubbles, it will need to quickly rise in value over a short period of time, according to Michael Sadoff, investment advisor and principal with Glendale-based Sadoff Investment Management LLC.

"If we would see a bubble for gold, we'd need to see at least one last 30 to 50 percent jump in a short period of time," he said. "The one last thing I would say is missing from the gold bubble is that last moonshot hurrah."

'Moon shot'

Most bubbles have a traded commodity rising in value roughly five times, and gold has roughly quadrupled in value so far. And if gold continues to rise in price at the pace it has over the last several years, it may not become a bubble, Sadoff said.

"It's not about to burst (now)," he said. "If it's in a bubble, then it's got to have one more shot to the moon. If other commodities break down, that can help call it. But gold marches to its own tune, not necessarily to that of other commodities."

Close to peak?

However, Ken Evason, chief executive officer and chief investment officer at Waukesha-based Windermere Wealth Advisors LLC, believes that gold is near the top of its valuation and there is a significant risk of a meaningful fall in its value in the near term.

"I think we're close to the peak. Most of the institutional money has been invested, and the little guy cannot carry the day on this one," he said. "I think there will be a bubble. (But) so many people are worried about getting busted in a bubble that it might get contained."

Evason believes the current demand for gold, which has fueled its price run, is also driving demand for gold production. Mines are stepping up production, and more people are selling gold jewelry, which is being melted down and sold.

"Every piece of gold ever made is somewhere on the planet, parked in someone's hands," he said. "My Canadian friends are in a frenzy to stake out new places to mine. Production will go up. We can clearly see that if the price stays at these levels, there will be an enormous influx (of supply)."

Another possible indicator of a gold bubble is that current economic indicators now point to a deflationary market instead of an inflationary market, which should make commodities such as gold a less viable investment class, Evason said.

"We have very weak economic activity now. Labor wants to discount its services now," he said. "There is no inflation in the system."

A gold bubble could be triggered by another economic crisis such as a rapid deleveraging by large global financial institutions, Hickey said.

"(People) are concerned about the excess money on the books of the banks. If that comes out too quickly before interest rates can go up, then inflation expectations will rise," he said. "And some people will buy gold to protect the purchasing power of their dollar."

The situation could be made worse by publicly traded gold funds and other investment vehicles that allow people to buy and sell commodities.

"Once things start going up, there are all kinds of traders now," Hickey said. "They start to see something that's running and they can just jump on - they become renters."

Both Sadoff and Hickey said many of their firms' clients have asked about gold and other commodities in recent years. While neither firms offer commodity trading, they routinely advise clients to only carve out a small space in their portfolios for commodities.

"What we've said is, 'If you want to, buy it as a diversifier,'" Hickey said. "With a lot of commodities, unless you buy and hold them for a long time, it's a gamble. So we say 'Let's pick a good price, and we'll get in and pull back (at that price).' Commodities are one of those things you can use in times of uncertainty. Once you come out (of uncertainty), you buy other assets."

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