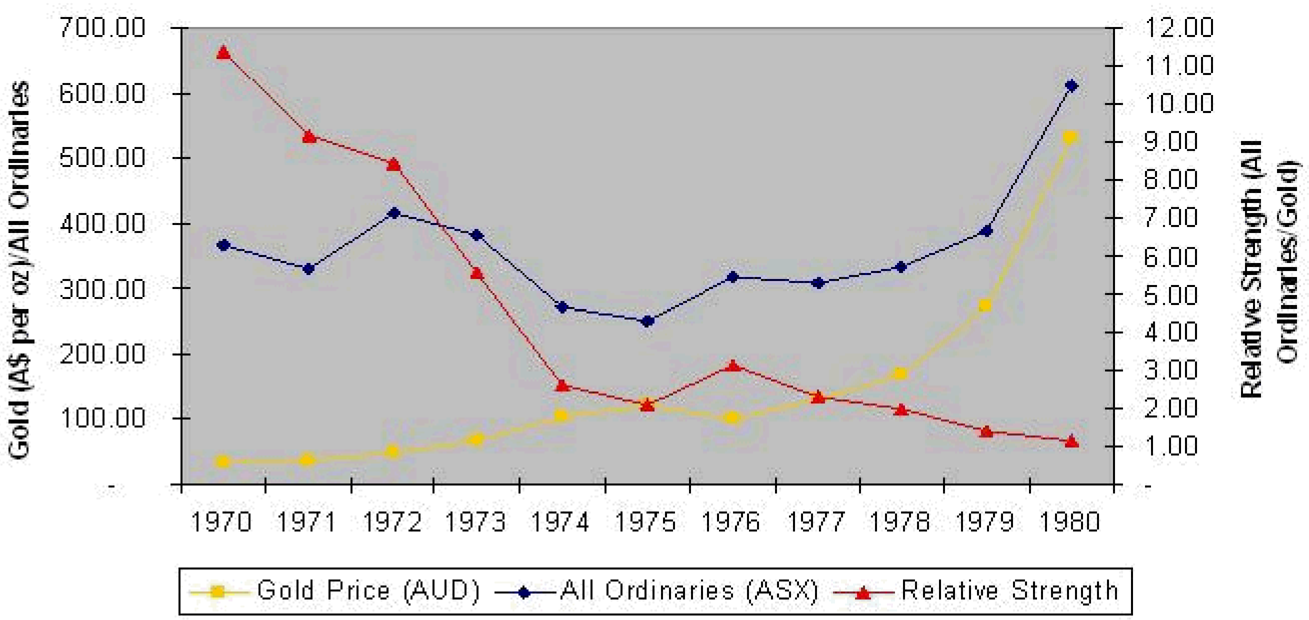
Stagflation adds to gold's shine
By Troy Schwensen

PORTFOLIO POINT: Sharemarket volatility makes buying gold an increasingly prudent investment strategy.

The growing prospect of stagflation – inflationary recession, or recession coupled with higher prices – raises the question: where can investors turn in under these unique and adverse business conditions? A clue to the answer lies in the last period of stagflation, the 1970s when oil price shocks and geo-political instability produced a similar landscape to what we are experiencing today. Inflation was stubbornly high and rising interest rates did nothing more than push economies around the world into recession.

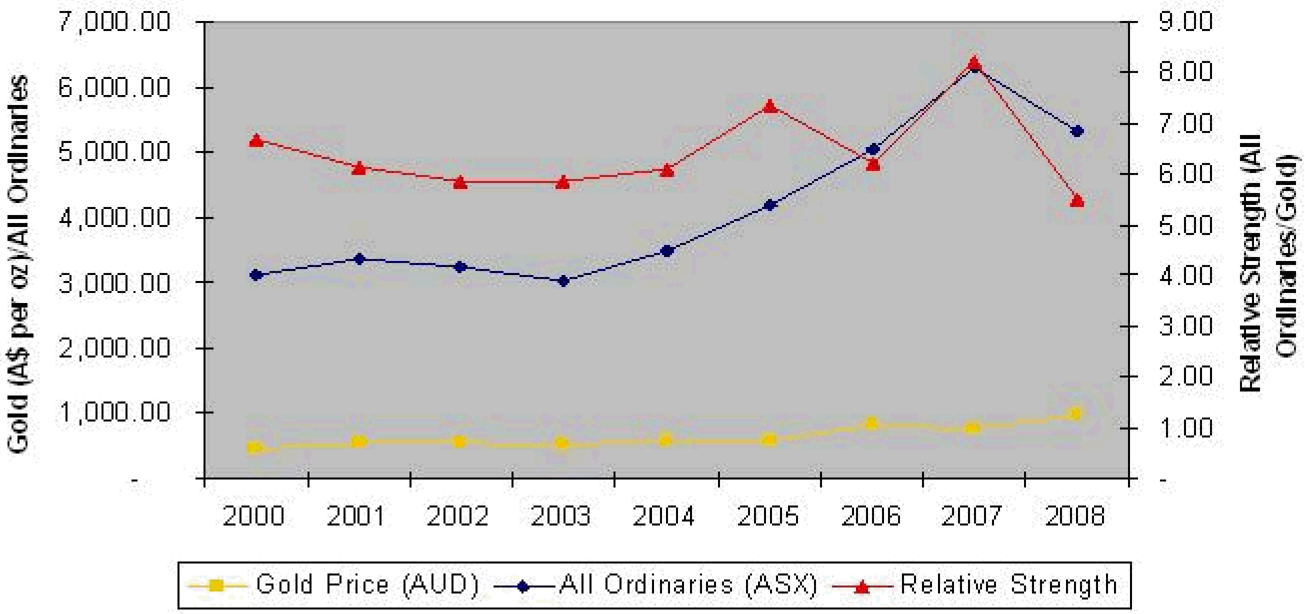
Despite these less-than-ideal investment conditions, one asset stood out: gold, which is starting to gain a grudging recognition from the international investment community. Figure 1 compares the All Ordinaries index with the gold price during the 1970s. The gold price strongly outperformed the All Ords, with the relative strength index (in red) trending continuously lower as gold returned more than 1500% versus a return from the All Ords of just 66%. By the beginning of the 1980s, the gold price and the All Ordinaries index were close to parity.

Figure 1: All Ordinaries index vs gold, 1970–1980



Fast forward to the present, and we see that in recent years the gold price has been rising but most of the gains have largely gone unnoticed on the back of stronger commodity prices across the board and, until recently, a fairly robust investment market. Figure 2 shows the All Ordinaries index just starting to noticeably underperform as business conditions worsen. The present climate is highly conducive to a stronger gold price, with the 1970s providing an excellent guide to what we might expect. With the All Ords more than five times the present gold price in Australian dollars there is still plenty of room to move.

Figure 2: All Ordinaries index vs gold, 2000–2008



Getting exposure to gold

The safest way to get exposure to a rising gold price is to buy gold bullion bars or gold coins and store them yourself. This bullion can be bought from a bullion dealer or directly from the Perth Mint in Western Australia, which will deliver it for a fabrication and transportation fee.

Alternatively, the Perth Mint offers several products to assist investors in purchasing gold. The Perth Mint Certificate Program (PMCT) and the Perth Mint Depository Service (PMDS) enable investors to buy allocated or unallocated gold bullion, which is guaranteed by the West Australian government. Allocated bullion is set aside and stored on your behalf for a fee. Unallocated bullion is a share in the Perth Mint's working inventory of gold. Clients with an unallocated product do not pay a fabrication cost or storage fees.

An easier, more convenient way to gain exposure to rising gold prices is via the ASX listed company Gold Bullion Securities (ASX: GOLD). Each security gives you the beneficial ownership to a tenth of an ounce of gold. The gold is held in allocated form via the custodian, the HSBC bank USA, or a sub-custodian with the gold held in HSBC's London vaults. Storage is covered by HSBC and the gold is insured under the HSBC group's insurance policy. A monthly fee is levied.

With the advent of exchange-traded funds, buying an interest in gold is now as easy as buying shares in Rio Tinto or Woodside Petroleum. There is no longer the inconvenience of having to store and insure the gold. The Perth Mint also offers an alternative for the investor who likes the security of knowing exactly where the gold is being stored with the ability to audit the bars if need be. Given the uncertain economic climate we are presently entering, allocating at least a small portion of a portfolio into gold seems like a fairly prudent strategy. With many product alternatives now available there is something to suit everyone.

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