



Napa Wealth Management's The Sensible Investor

June 2010

Next Newsletter: July 2010

Gold Has Been Moving—Why?

By George P. McCuen, CFP®, President



You can't turn on your television, open an investment- or business-oriented magazine, or walk through a shopping mall without seeing or hearing a message about investing in gold or selling your gold jewelry. This isn't new. It has been going on for several years. So what is up (no pun intended) with gold? Let's take a closer

look.

The easy money days for Americans are over. The U.S. economy has been hurt by tighter credit associated with big losses in real estate. In response, the Federal Reserve has cut interest rates effectively to zero in an effort to lift the economy out of recession (Europe is heading down the same path). Interest rate cuts also drive down the value of our currency. As the reserve currency status of the U.S. dollar falls into jeopardy in the minds of investors, they will buy gold as an alternative reserve asset.

From July 2002 – July 2007 the Dow Jones Industrials went from 7,592 to 13,895, an 83% increase. In 2008 stocks and commodity markets were crushed as the global economy slid into recession. With other hard assets such as real estate losing value, gold's "safe haven" appeal has taken root as investors focus on capital preservation.

The recession that began in 2008 created a large, new class of gold investors. Investors are accustomed to rotating (transferring money) into different asset classes when market volatility causes their investments to drop, e.g. investors bought real estate after the tech bubble and 9/11 attack. In 2008 investors were faced with the financial meltdown and recession. A new generation of investors has emerged who are clamoring toward gold. The strong demand exerted by this group, along with traditional gold buyers drained the gold inventory thus driving up the price of gold bullion at a time of shrinking worldwide production.

The world's money supply has been growing. Years of easy monetary policies, (low interest rates and easy credit), and trillions of dollars in economic stimulus to fight the global recession have caused a swelling in the money supply. This immense increase in the supply of money creates an inflationary environment. In other words, excess cash in the marketplace eventually tends to increase prices for goods and services. The prospect of inflation decreases people's confidence in paper money, which drives many to buy gold to preserve wealth. The operative words in the last sentence are "prospect of inflation".

Inflation is simply an increase in the supply of money and deflation is a decrease in the money supply (see our September 2009 newsletter article about deflation and December 2009 article about inflation for more information on these topics. You can view them at www.napawealth.com and click "newsletters" on our home page). We don't see inflation rearing its head currently but the mere prospect of inflation in the future causes investors to invest in gold. The price of gold also appreciates in a deflationary economy because investors turn to gold for its safe-haven nature.

What about China? China is the world's largest producer and consumer of gold. The Chinese love the stuff! China also buys a lot of U.S. Government bonds. As a means of diversifying their reserves, China is increasing its holdings of gold. The Chinese have one of the world's highest savings rate and currently gold is the investment of choice for them.

Decreased supply with increased demand. After climbing as high as \$850/oz. in 1980, gold dropped to \$252/oz. in 1999. The low-priced environment for gold in the '90s discouraged mining companies from spending money to find new supplies of gold. The cause and effect from the lack of production in the low-price years resulted in a lack

Gold Has Been Moving—Why? - Continued on page 2

The Most Popular Question about Social Security

By George P. McCuen, CFP®, President

As you ponder your retirement and the income you will enjoy from Social Security, the question that most frequently comes to mind is, “When should I take my Social Security benefit?” One rule of thumb comes from the bird in the hand axiom which would compel you to take it as soon as possible. Maybe, or maybe not. When designing your retirement plan you should view your Social Security benefit as another one of your retirement assets.

The full retirement age for those born from 1946 to 1954 is age 66. It gradually increases to age 67 for those born from 1954 and 1960. If you choose to start receiving Social Security benefits at age 62, you’ll get your money sooner – bird in the hand – but the monthly benefit will be reduced by 25%. On the other hand, if you wait until age 70 to start receiving benefits, the amount is increased by up to 8% per year, in addition to annual cost-of-living increases.

For example, assume your monthly benefit at the full retirement age of 66 is \$1,000. Taking early retirement benefits at age 62 results in a permanent decrease to \$750 a month. But waiting until age 70 would produce a monthly benefit of \$1,320, a 32% increase.

Waiting to begin benefits is not a one-size-fits-all approach. If you need the income sooner in retirement to enjoy the benefits longer, albeit at a reduced amount, then take the income and don’t look back. Your health and family history also plays a role. If you are planning on working during retirement, that may sway you to defer your benefit since creating income during retirement could cause your Social Security benefit to be taxed.

As usual, planning is the key. We will help you analyze the options so you can make an informed choice. If you have friends or family that are in their mid-50’s and beyond, now is the time to look at these options. Call us and we can help with this important decision.

Keep looking up,

George

Gold Has Been Moving—Why? — Continued from page 1

of supply of new gold as prices increased. Production, and thus supply, has not kept pace with the global demand.

So much of the world’s supply has been mined within the last 50 years that the world’s richest deposits are quickly being depleted in South Africa, Australia and the U.S. New discoveries are becoming rare. The reduced supply with increased demand creates higher gold prices.

Low interest rates have also played a role in gold’s ascent. When interest rates are low, many investors turn away from paper assets with declining values, such as stocks, and turn toward hard assets, such as gold. Stocks of companies that mine gold are valued based on the underlying assets, in this case the metals themselves. This makes gold mining stocks attractive investments in a low interest rate environment.

In October 2009, Nicholas Brooks, head of research and

investment strategy at ETF Securities stated, “The surge in demand for gold does not appear to be short term in nature, since we have been seeing very rapid growth of investor holdings of gold through our Exchange Traded Commodities for over a year now”. At that time gold was trading at a price of \$1,065/oz. As of this writing, gold is \$1,227/oz.

Gold is the only asset class making multi-year highs. The recent market volatility continues to fuel the demand for gold. Our largest investment position in client accounts is in gold. It is a frustrating position to hold since it does not pay a dividend. However, it has served our portfolios well: as the market has moved lower, the price of gold has moved higher. We believe that the price of gold will continue to increase over the long term. Our research suggests that gold could reach \$1,500 and perhaps much higher in the next one to two years. Stay tuned and together we will see if all that glitters is gold!

Keep looking up - George

Congratulations Tim & Janeane! Hugh Alexander Ayles, born June 4th, 6 lbs, 14 oz, 19” long.