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"All That Glitters"
(March 26, 2009)

A few clients have sought our opinion on gold as an investment in the current market environment. Indeed, with the aggressive policies of the Fed and Treasury likely to lead to rising inflation and a decline in the value of the U.S. dollar, hard assets, like gold, become more appealing.

You may be surprised to learn how much gold you already own in your portfolio now. Through our tactical asset allocation process we buy specific sector funds and/or gain exposure to sectors we believe offer opportunity through diversified funds. For instance, **ING Value Choice,** which we have held in IRA and non-retirement accounts since the fourth quarter, has over 22% of the fund invested in gold stocks. In fact, with the allocation to gold among various funds we hold in client portfolios, in some cases our total allocation to gold exceeds 5% of a client's portfolio.

This is not by accident; it's by design. We have been interested in the merits of gold as an inflation hedge, a defensive hedge against a volatile stock market, and for its diversification benefits in our portfolios for several months. Gold has a very low correlation to both stocks and bonds, making it a good portfolio diversifier among these traditional asset classes. And, it has been a very opportunistic position as well. Gold as a sector has performed exceptionally well over the past few months, and in turn has helped propel the returns of ING Value Choice. Since our original purchase of this fund in mid-December, ING Value Choice has gained 10% versus the S&P 500's 6% decline. *That's absolute and relative outperformance we can put in the bank.*

We would, however, caution against an over-investment in gold. While gold has historically done well during times of extremely high inflation, it doesn't have a good track record of keeping up with moderate increases in consumer prices over the long haul. Recently, the metal has been trading between $900 and $1000 per ounce, little more than the price it commanded in 1980. If it had kept pace with inflation, gold would be selling at more than $2000 per ounce today. Moreover, gold prices are very volatile, actually nearly three times as volatile as the stock market over time.

As tactical asset allocators we are not concerned with gold's historic performance as much as what it means for our portfolios over a holding period of just several months. And, with a diversified approach, we can diminish the impact of gold's extremely high level of volatility on our portfolios.

We believe some investors are stockpiling gold now because they fear an ultimate "financial collapse". While we are certainly not looking for anything this catastrophic, there are dynamics in place that bode well for the price of gold. We believe gold is pricing in the "reflation" of the economy. That is, the eventual impact of both monetary and fiscal stimulus. Most other currencies have fallen against the U.S. dollar as money has rushed to the perceived relative safety of the greenback. But gold is also like a currency, so reflation efforts by U.S. policy makers can result, in effect, in the dollar devaluing against gold (also known as currency debasing) – that is, gold prices go up.

As I have stated in recent client communications, we are concerned about inflation and a corresponding decline in the value of the U.S. dollar going forward. But, there are many ways we can invest accordingly, and in a diversified manner for this dynamic. In addition to gold and other natural resources, Treasury Inflation Protected Securities, held in **PIMCO Real Return** (up more than 5% year-to-date) act as an inflation hedge. Additionally, in some of our portfolios we own funds that increase in value significantly as interest rates rise. **Rydex Inverse Government Long Bond**, held in some IRA and non-retirement accounts, actually "shorts" U.S. Treasuries. It is up more than 10% year-to-date. Likewise, **Forward Long/Short Credit Analysis** is "long" high yield bonds (a bond sector we like) and "short" U.S. Treasuries. This fund, held in virtually all of our IRA and non-retirement accounts, is up more than 8% year-to-date.