FT REPORT - WEEKEND MONEY: Going for gold begins to look like a bright move

By David Stevenson, Financial Times
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I've never been that much of a gold bug. In my mind, I've always associated gold with things such as RollsRoyces or leather-bound men's wash kits - there's nothing wrong with them as such, it's just that they're a bit proto-modern and not quite with it.

I also remember certain books from the 1980s about inflation, gold and the end of the world as we know it. These convinced me that gold bugs were fundamentally dystopian.

In the intervening years, my gold-phobic tendencies have been reinforced by hard facts.

A few years back, the great American investment writer William Bernstein ran an analysis of long-term returns from equities exposed to gold and silver prices and found that "both did exceptionally well in the high-inflation '70s when other traditional investments suffered, but have performed miserably during other market environments".

Those returns were also at the cost of monumental volatility. In the period 1963-2004, his precious metals equity selection "lost more than 35 per cent five different times and on one occasion nearly 70 per cent". It gets worse: "Between October 1980 and August 1998, it lost a total of 53.8 per cent or 4.2 per cent annualised - a 7.7 per cent annualised loss after inflation."

Bernstein rattles off the causes of that decline - central banks selling their gold stock, the demise of high inflation and the dwindling industrial usefulness of the metal. The killer stat for me, however, is this: compared with its inflationadjusted peak in 1980 ($1,800), gold is now worth less than a third ($576).

But the worm may be turning. The graph below compares returns from the dollar spot price of gold and the FTSE 100 since 2002 - the thick line is the FTSE 100 and that line towering above it is gold.

Clearly, something has changed - and I think it's connected to the popularity of US exchange traded funds (ETFs). The biggest of these is the Street Tracks Gold Trust (see www.nyse.com, ticker code GLD). This $6bn, 15-month-old ETF currently accounts for the ownership of one-tenth of an ounce of all physical gold. To put it another way, the ETF is sitting on 343 metric tons of the stuff - more than the Bank of England, and more than all but 16 of the world's central banks!

This suggests that mainstream financial types have discovered gold in a big way. It also explains why there's been a slew of specialist actively-managed funds launched in the past year, most notably by industry leaders such as RAB and Merrill Lynch.

However, my attention has been caught by a tiny upstart. The Hinde Gold fund is run by two traders who met up at RBS Greenwich Capital - Mark Mahaffey and Ben Davies. It has assets of less than $10m (it's registered in the British Virgin Islands) and it's only really been fully operational since mid-October, registering a return of 3.81 per cent since inception.

That's nothing special compared with the track record of Graham Birch at Merrill Lynch Gold & General. But Hinde is quite a bit different. It's a proper long/short trading fund that will invest in everything from options to bullion itself - with a core holding of reasonably-priced equities exposed to gold. So it aims to use trading expertise, to make money whatever the gold-price direction.

There are two other reasons why I like Hinde. First, its newsletters are hugely entertaining reading, namechecking everyone from Jim Rogers through to Jose Mourinho. Recent gems include the supposed fact that a few decades ago it cost just 170 ounces of gold to buy a five-bedroom house in Chelsea, whereas it now costs 5,000 ounces - a rate of inflation matched by carrots (no pun intended).

Second, the managers make a strong case for gold still being cheap, relative to other asset classes. All those statistics about low returns against rampant asset inflation suggests that gold's day may have come and we may be in for a fairly long bull phase. Gold prices may also be boosted by the rocketing cost of mining production - the average cost of production per ounce is now $400-$450 compared with around $150 a decade or so ago.

That inflationary pressure is driving what Hinde reckons is a global debasement of currencies, otherwise known as a "monetary juncture". Admittedly, this arouses my old suspicions about the dystopian tendencies of gold bugs. Nevertheless, I can see that a long/short strategy married to careful stockpicking could well deliver the goods in the next few years.

I also think that Hinde may well be right in suggesting "fair value" for gold might be closer to $1,500 over the next few years. The only disappointment is that the fund is aimed at "high net worth" clients with $100,000 or more to invest. If your portfolio can't stretch to this, you could consider a long-only fund, such as Merrill Lynch Gold and General or RAB's gold fund.

Another alternative is the listed structured note from SocGen called the Gold Index Accelerator (see http://uk.warrants.com, code SG43). This index will trend in the same direction as gold spot prices - and you get 170 per cent participation in any upside plus some capital protection as long as gold doesn't fall back by more 30 per cent from an opening level of $764. This four-year note could be an interesting long- term bet for the risk-averse.

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