The Return of the Goldbugs

It's Apr. 7 and the world is trying to make sense of the latest tumult in Iraq, following the takeover of the town of Fallujah by Shiite insurgents. From Washington to Tokyo, economists worry that the war's growing uncertainty will upset global markets for weeks, if not months, to come.

But from his home in Dallas, Bill Murphy sees it all a little differently. He's writing his daily online pep talk to some 3,600 of his worldwide brethren. "The reasons to own gold are better than ever and still a 10+++," he writes. "With the geopolitical scene heating up, the Gold Cartel is going to have a heckuva time keeping gold from taking out $430 in the weeks to come."

Murphy, a former professional football player and commodities broker, posts the missive on Le Metropole Café, a Web site he runs. Gold is trading at $423 an ounce. Murphy thinks it should sell for hundreds more. His reasons: the monster deficits the U.S. government is running; the turmoil in Iraq; and a secret plot—engineered by some of the most powerful people and groups in world finance—to suppress the price of gold,

BY RUSSELL PEARLMAN  ■  PHOTOGRAPHS BY DANNY TURNER
Goldbugs

a plot that’s rapidly falling apart (more on all that later).

Murphy has invested every penny he has, over $2.5 million, in the shares of gold or silver companies and gold bullion. He is the King of the Goldbugs, investors who are fascinated by the yellow metal and who are convinced that an explosion in the price of gold is just around the corner. “Gold is the ultimate form of money,” Murphy declares. “It should be double the price of what it is today!”

For a generation, goldbugs have been dismissed as crackpots, the lunatic fringe of the investment world, clinging to the anachronistic ideal that gold, above all things, is the only currency with lasting value. That notion, in an era when money can be electronically transferred worldwide in an instant, seems ridiculous. Gold, as doubters say, is only the “currency” of last resort. So gold wasn’t high on the list of investment topics from 1980 until the end of the millennium: Over that period the metal lost nearly 70 percent of its value.

Then came 9/11, and the world suddenly seemed far less safe. Stock markets continued to fall. The U.S. government cut interest rates to nearly zero and began running a huge budget deficit in the hopes of reviving the economy. The price of gold, on a slide for most of the previous 21 years, began to rise. Now throw in more-recent terrorism fears, the declining U.S. dollar and a still-growing deficit, and the price keeps climbing. It’s up almost 12 percent in the past six months, and 54 percent since 9/11, far outpacing the Standard & Poor’s 500. Stocks of gold companies have done even better, with the American Stock Exchange’s Gold Bugs index of mining companies up 250 percent since January 2002.

All of which can mean only one thing: The goldbugs are back. Indeed, they have reemerged to proselytize to a diverse group of embittered tech stock investors, worried baby boomers, even hedge fund and institutional money managers. And as the price of gold continues to rise, the bugs are finding converts.

But history, at least the past 200 years or so, is not on the side of gold lovers. Yes, there’s money to be made in gold, but not for very long. The bull market for gold will not last, and anyone making gold the cornerstone of his or her investment portfolio is making a serious mistake.

Still, at the moment, the goldbugs are getting happier by the day. Murphy’s site alone is attracting some 300 new gold enthusiasts a month, each paying $149, while messages are skyrocketing at the Web site run by Kitco, a major bullion firm. In November, meanwhile, about 1,000 people attended the New Orleans Investment Conference, the traditional gathering of goldbugs, up from 400 just four years ago. In years when the price is down, most bugs just “fade into the woodwork,” says Brien Lundin, the conference’s organizer.

There are the longtime bugs like Ray DeMoss, an Arcadia, La., flower industry consultant who started buying gold stocks in 1976 on the advice of a friend. He says he made 140 times his money on his original investment. In 1998 he thought another gold run was coming, but it didn’t; yet common sense tells him now’s the time to stock up.

“You buy things that are out of favor even when the fundamentals are good,” says DeMoss, 56, who once again is buying South African miners such as Durban Roodepoort Deep. “Whoever buys gold or stock will be able to buy the world on sale.”

Then there’s Todd Luebke, a 40-year-
old network administrator in Maple Grove, Minn., a husband and father of two children who describes himself as “Joe Six-pack.” He started looking at gold around 2000 as a hedge against a possible decline in the dollar. He now has about $45,000 invested in precious-metals mutual funds, gold and silver stocks, coins and bullion. “For now it’s the best thing out there,” he says. “It’s an alliance of strange bedfellows—hedge fund managers, Asian savers and hard-core, money-in-the-mattress goldbugs—laughing at one another all the time,” Lundin says.

There hasn’t been this much enthusiasm for gold since the late 1970s, when double-digit inflation, the Iranian hostage crisis and worries about the Cold War sent the price soaring. In November 1978 the price of gold was $193 an ounce. By January 1980 it hit an all-time high of $850, or $1,933 in 2004 dollars.

Sure enough, it was a bubble. Inflation was curbed. The world didn’t end. By December 1981 gold’s price was down to $395. Except for a couple of brief spikes, it fell, and fell, to $252 an ounce in 1999. With stocks in their generation-long bull run, gold enthusiasts were being ignored as the investing equivalent of sidewalk evangelists, preaching to the uncaring masses.

Today there are plenty of reasons that gold has run up in price and that it shouldn’t return to its low anytime soon. Gold’s price often moves inversely to that of the U.S. dollar. So as the dollar has fallen against other major currencies, gold’s price has shot up. About 70 percent of the increase in the price of gold since the end of 2001 can be attributed exclusively to the dollar’s decline, says Kevin Andrus, an analyst for the Invesco Gold & Precious Met-

als fund. And with the U.S. running a $478 billion deficit with no relief in sight, the odds of the dollar rising fast are slim.

Inflation also plays a part in determining the value of gold. It has always been seen as a hedge against inflation—its price rises, at least in the short run, to keep pace with other goods, while “money” loses buying power. When higher inflation returns, and most economists suspect it will in the next year, demand for gold will rise, which will help support its price.

World turmoil usually helps gold too. Economic panics, wars and terrorism increase the attractiveness of gold to those who view it as the currency of last resort. For example, James DiGeorgia, a Boca Raton, Fla., coin dealer and self-described “Golden Energy Zealot,” thinks gold can hit $1,000 an ounce, admitting that he cites that price because he has a very pessimistic outlook on the world right now.

But there’s another, more nefarious reason, in some bugs’ minds, that gold has been down for so long and that it will continue to rise now. Murphy and his brethren are convinced that for a decade there has been a government-sanctioned plot to suppress gold prices to prop up the value of the dollar. This plan has been carried out by a “Gold Cartel,” composed of the Federal Reserve and giant commercial banks. Murphy contends that the U.S. government has been using derivatives to secretly sell its stash of gold, essentially turning ownership over to other groups while never physically moving the gold. Murphy formed the Gold Anti-Trust Action Committee to publicize this plot, and no conversation with a goldbug lasts for long without mention of the Cartel.

In 2000, Federal Reserve Chairman Alan Greenspan said any accusations that the Fed had intentions of manipulating the gold market were “inappropriate.”

That same year another goldbug, Reginald Howe, sued the Federal Reserve, several banks, Greenspan and then-Treasury Secretary Lawrence Summers, demanding that they stop manipulating gold prices. The suit was dismissed in 2002.

But this alleged cabal’s power is waning, Murphy says, because it is running out of reserves to sell. The World Gold Council, a trade group, says there are about 32,000 tons of gold held by the central
banks. The conspiracy bugs estimate that there are only 16,000 tons that haven’t been sold or traded using derivatives.

The whole theory sounds like an X-Files episode, but even some gold company executives believe there’s a grain of truth in it. “There’s no doubt in all of our minds that they have colluded to manage the price,” says Arthur Johnson, CEO of Centurion Gold Holdings, a small South African mining company. But it’s not as if there’s anything he or anyone else can do about it. “It’s a fact of life.”

The Cartel argument is usually where the bugs lose institutional money managers. “If you talk about that, you have to talk about who shot JFK,” Andrus scoffs. Jean-Marie Eveillard, who co-manages the First Eagle Gold fund, calls the plot an impossible-to-prove conspiracy theory. Even if it were true, he says, “so what, they’re beating the wrong bush.”

Conspiracy or not, the outlook for gold is good in the short term, thanks to the deficit and inflation issues. Gold miners certainly think that gold’s price is going up. Nearly all mining firms have stopped forward-selling gold, a hedging transaction in which the company agrees to sell gold at a set price years before it’s dug out of the ground. If miners feel they can get a much higher price for gold in the future, they won’t lock in a price with a hedging contract, which usually yields only a few dollars above the current gold price. A longtime holdout had been Barrick Gold, a large Canadian miner. But a little more than a year ago, it too said it would stop hedging and even unwind its existing hedges.

Gold-mining stocks are essentially an option on the price of gold. For every 1 percent change in that price, the stocks usually move about 2 to 3 percent, says Invesco’s Andrus. That’s fantastic if gold goes up another 20 percent, but watch out if the metal moves the other way. Large gold-mining companies are trading with an average price/earnings ratio of 85, a high multiple that leaves little room for disappointment.

Even with seemingly good fundamentals in the industry, some investors aren’t convinced. Unlike silver, which is used in film processing and tableware, gold has very few major uses beyond jewelry. Dentistry is one example, and gold’s imperviousness to tarnishing makes it a superrelieable electrical conductor for switches. But in all, only 12 percent of the yellow metal’s annual production finds industrial use.

And despite being known as a hard currency, gold has no real long-term investment value. No one goes to the store to buy milk and pays with gold. A piece of gold bullion doesn’t pay dividends; it just sits in a vault. “I just don’t get it,” shrugs portfolio manager Christopher Davis of Davis Selected Advisors in New York. “It’s not an earning asset. It’s a psychological asset. You can’t quantify it.”

But the most important thing to understand is that gold has a long history of disappointing investors. As the chart on pages 88–89 shows, after adjusting for inflation, the value of gold—that is, its purchasing power—has actually declined over the past 200 years.

On a total return basis, gold doesn’t do much better. Since 1971, when the U.S. abandoned its policy of stabilizing gold prices, the price of an ounce has risen from
RAY DeMOSS  He made a killing on gold stocks in the 1970s; now he’s a goldbug again.
$35 to $420—a 1,100 percent gain. Sounds great. But prices in general are up 463 percent over the same time frame. And the S&P 500 is up about 3,300 percent, including reinvested dividends.

If you want to speculate that prices will go higher, feel free to buy some gold bullion or gold coins like the Canadian Maple Leaf or American Eagle, which cost only a few dollars more than the spot price of gold. Bullion and coins are easy to order through either a coin shop or a bullion dealer such as Kitco. Granted, people have made killings in gold by getting out near the peaks of the periodic gold spikes of the past 30 years. But timing the market is a risky proposition. And the upside is limited. Eveillard, the First Eagle fund manager, says that a gold price much higher than $420 would require the U.S. economy to falter dramatically, a major jump in inflation or even more geopolitical chaos. He doesn’t even treat it as an investment; it’s more like insurance. As a hedge against inflation and the stock market, Merrill Lynch recommends having no more than 4 percent of your assets in gold and gold stocks.

To the goldbugs, talk about gold as mere insurance or just something to trade is silly. Says DiGeorgia, the Golden Energy Zealot: “To have no gold in your portfolio now is pretty much insanity.”