

## Asset Class Returns

September 30, 2012 (YTD)

	YTD 2012	Last 10 yrs.*	2011	2010	2009
<b>Bonds (%)</b>					
One-Year	0.8	2.6	0.6	1.2	1.9
Five-Year	4.4	4.5	4.5	5.3	4.2
Intermediate	3.7	6.4	9.4	6.9	-0.7
Long-Term	4.6	8.7	29.3	8.9	-12.1
<b>U.S. stocks (%)</b>					
Large Market	16.3	2.8	2.1	14.9	26.5
Large Value	17.9	4.6	-3.1	20.2	30.2
Small Market	14.8	6.7	-3.2	30.7	36.3
Small Micro	15.2	7.1	-3.3	31.3	28.1
Small Value	16.2	8.1	-7.6	30.9	33.6
Real Estate	14.6	10.1	9.0	28.7	28.2
<b>International stocks (%)</b>					
Large Market	10.2	4.9	-12.3	9.3	30.6
Large Value	8.1	7.6	-16.9	10.6	39.5
Small Market	11.6	11.0	-15.4	23.9	42.0
Small Value	12.5	11.9	-17.5	18.1	39.5
Emerg. Mkts.	11.8	14.2	-17.4	21.8	71.8

### Descriptions of Indexes

One-Year bonds	DFA One-Year Fixed Income fund
Five-Year bonds	DFA Five-Year Global Fixed
Intermediate bonds	DFA Intermed. Gov't Bond fund
Long-Term bonds	Vanguard Long-term U.S.Treas.
U.S. Large Market	DFA U.S. Large Co. fund
U.S. Large Value	DFA Large Cap Value fund
U.S. Small Market	DFA U.S. Small Cap fund
U.S. Small Micro	DFA U.S. Micro Cap fund
U.S. Small Value	DFA U.S. Small Value fund
Real Estate	DFA Real Estate Securities fund
Int'l Large Market	DFA Large Cap Int'l fund
Int'l Large Value	DFA Int'l Value fund
Int'l Small Market	DFA Int'l Small Company fund
Int'l Small Value	DFA Int'l Small Cap Value fund
Emerging Markets	DFA Emerging Markets fund

\*"Last 10 yrs." returns are ended 12/31/11.

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**Past performance is not a guarantee of future results.**

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## Is Gold Worth Its Weight in a Portfolio?

Jeff Troutner, Equius Partners

During a weak global economy and uncertain financial markets, many investment advisors tout the benefits of holding gold, often recommending a significant weighting in most investors' portfolios. Gold's often-cited portfolio benefits include a strong long-term return, a hedge against inflation, and safe haven during turbulent times. But does the evidence build a case for holding gold as a separate asset class? Let's look at historical returns for the answers.

### Gold's Long-Term Performance

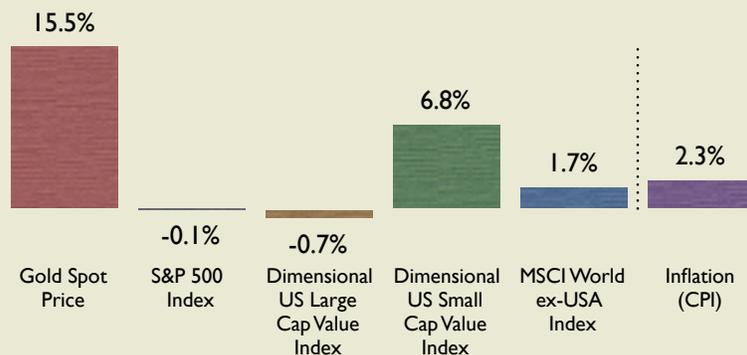
Investors who think of gold as having strong long-term returns base their belief on two strong performance periods in the past four decades—the most recent decade and the 1970s. *These periods account for most of gold's price appreciation.*

**Chart 1** documents gold's strong performance since mid-2001. After hitting a twenty-year low in 1999, gold began a steady climb in the wake of the dotcom bust, the stock market downturn in 2001, and the 9/11 attacks. As the decade wore on, there were Wall Street scandals, natural disasters around the world, and record oil prices. Gold's strongest performance period has come since 2008—and investors can still recall the emotional and financial stress that came with the mortgage meltdown, volatile financial markets, and worldwide recession.

**Chart 1: July 2001 to December 2011**

When Gold Glittered, Part II

Annualized Returns After Inflation



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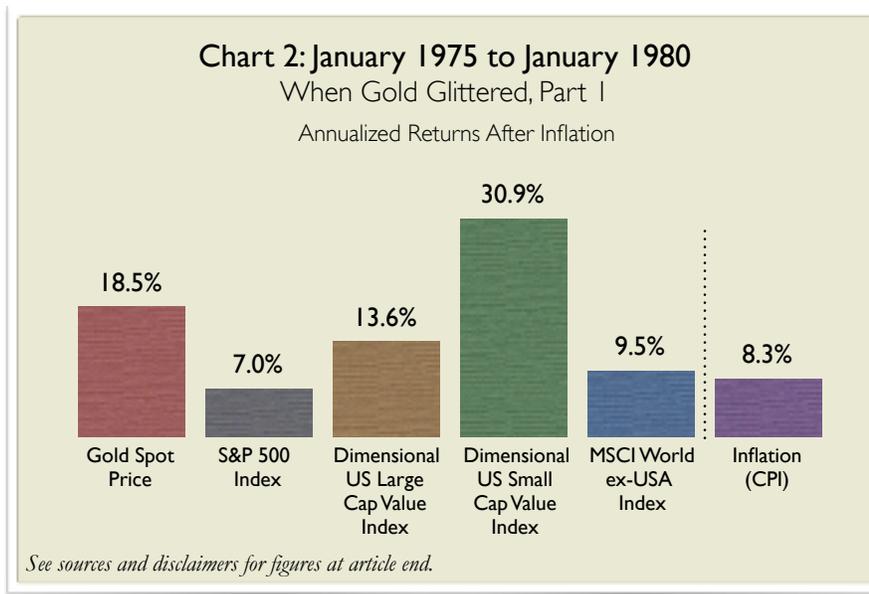
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Now let's step back in time to the other strong decade for gold—the 1970s. From the beginning of 1971 to January 1980, when gold hit its peak of \$850 an ounce, the metal appreciated by more than 27% per year *after inflation*! However, much of this rapid appreciation occurred under special circumstances in which U.S. investors could not benefit directly.

two worldwide oil shocks (1973 and 1979), stagflation, Middle East conflict, and Cold War tensions. In some ways, the 1970s resembled the first decade of this century.

Viewed in isolation, the periods suggest that gold offers a reliable source of returns during economic and market distress. But the details show that rising demand for gold in the U.S. was due not only to economic uncertainty but also to changing monetary policy and federal legislation regarding individual ownership of bullion.

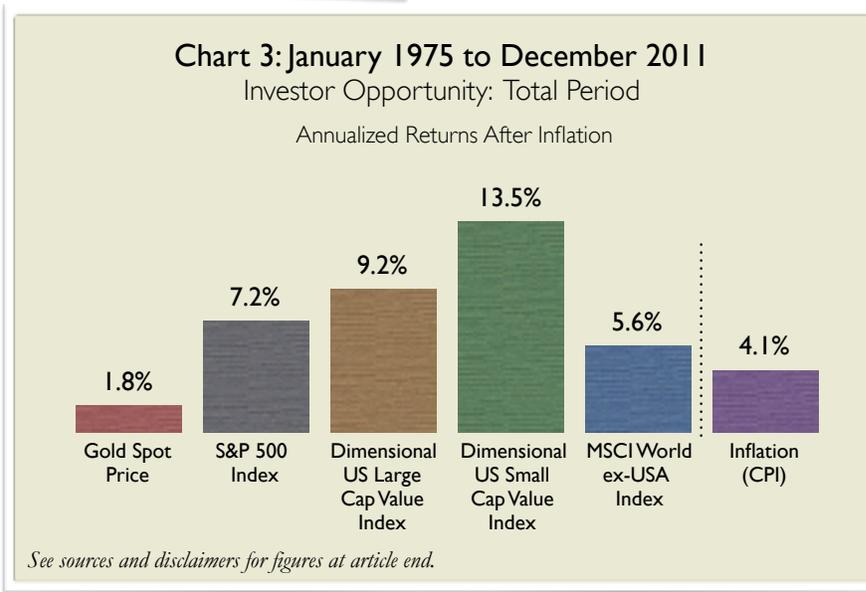
Fortunately, times eventually improved—and from a broader historical perspective gold has not delivered the performance that some investors imagine, especially during more stable economic periods. From 1975 through the end of 2011, gold produced a real annualized return of only 1.82%—substantially less than other core asset classes (**Chart 3**).



Here's why: In August 1971, President Nixon took the U.S. off the gold standard, and the price was reset to \$38 an ounce. In 1973, the U.S. government decoupled the dollar's value from gold, and the price was allowed to float freely. In 1974, the price of gold quickly shot up to \$120 per ounce in the free market. Beginning in 1975, the government removed ownership restrictions and U.S. citizens were free to directly own gold for the first time since 1933.

So, U.S. investors *did not participate* in gold's price appreciation during the first half of the 1970s. If you disregard those early years, gold loses much of its glitter. From 1975 through 1980, it returned 18.5% per year after inflation—considerably less than the 27% return for the period starting in 1971. In contrast, U.S. small value stocks had a real return of 30.9% per year. (**Chart 2**).

Some investors who are old enough to remember the 1970s associate the higher demand for gold with turbulent times. The decade was marked by political unrest, war, the 1973–74 bear market,



Now let's consider the twenty years between gold's two high-performance periods in the 1970s and 2000s. **Chart 4** shows returns for the same asset groups from February 1980 through July 2001, during gold's period of extreme underperformance. Those decades are generally known for global economic expansion and positive stock market returns. A dollar invested in gold dropped to 18 cents in real terms, while the other assets grew substantially.

*Continued on page 3*

**Chart 4: February 1980 to July 2001**

Gold Melts Down

Annualized Returns After Inflation



See sources and disclaimers for figures at article end.

So, from a long-term perspective, gold has not experienced a reliable or sustained rise in value. In fact, its price appreciation has been limited to unpredictable, isolated episodes of high demand. Investors who attempted to time these episodes exposed their wealth to potentially higher risk and to the opportunity cost of missing out on stock market growth.

**Gold as an Inflation Hedge**

Some investors perceive gold as a good hedge against inflation and point to its recent record prices as evidence. **Chart 5** shows gold’s performance from its price peak in 1980 through 2011 compared with the other assets. Gold’s price

has climbed substantially in nominal terms. But when adjusted for inflation, a dollar invested in gold in 1980 fell to 82 cents by the end of 2011.

Of course, gold’s performance relative to inflation has varied according to the time frame measured. In some periods, gold has outperformed inflation, while in other periods gold has failed to match it. For example, from 1970 through 2005, consumer prices more than doubled, while gold lost 20% of its value.<sup>1</sup> Gold’s unreliable performance relative to inflation also comes with much higher volatility. Since 1970, its standard deviation has been almost 25%, compared with 3% for the Consumer Price Index

(CPI).<sup>2</sup> By this measure, gold is over *eight times* more volatile than inflation.

**Gold as a Portfolio Diversifier**

Proponents also claim that gold offers a portfolio diversification benefit on account of its low historical correlation with stocks. (Correlation measures how closely two securities or asset groups perform relative to each other over a given time period.) But correlation is not the only factor to consider in diversification. Expected return and volatility of returns also matter.

Since 1975, when gold could be purchased as an investment, the S&P 500 Index has offered four

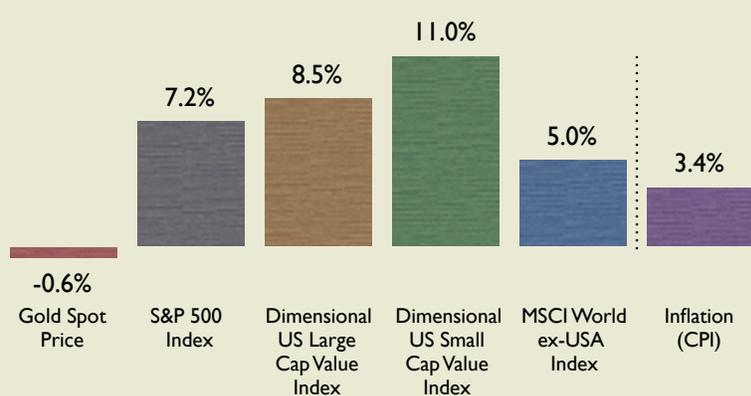
times the annual real return of the precious metal with substantially less volatility. In addition, U.S. small value stocks have produced almost eight times the annual return of gold, with about the same volatility.

Also, according to modern financial principles, the components of a portfolio should have an expected return. As a material input, however, gold does not offer the potential for generating income or earnings. Its only source of return is price appreciation caused by shifting supply and demand. As shown in historical performance, price appreciation is not a certainty.

**Chart 5: February 1980 to December 2011**

It’s Only Good for Bling

Annualized Returns After Inflation



See sources and disclaimers for figures at article end.

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These characteristics make gold a speculative asset, like currency or collectibles. If you put gold in a vault and wait a few decades, it will not produce anything, and its value will reflect the current spot market price. In fact, holding physical bullion may incur negative cash flows due to storage, insurance, and other costs. In contrast, a stock reflects ownership in a business enterprise that seeks to generate profits and produce more wealth. Investors who put their capital to work in the economy expect a potential return from cash flows and appreciation.

## Summary

The evidence raises doubt about gold as an essential component in a portfolio. Over time, gold has not delivered significant growth relative to equities. While in real terms gold has preserved its value, it may not closely track inflation over shorter time periods. Moreover, gold's early and recent performance should not obscure the two decades in which it depreciated considerably. Finally, gold is more volatile than other asset groups and does not generate positive cash flows, reducing its potential benefit as a portfolio stabilizer.

Famed investor Warren Buffett aptly summarized gold's speculative nature, nonproductive quality, and high opportunity cost in a *Fortune* article in February:

*Today, the world's gold stock is about 170,000 metric tons. If it were all melded together, it would*

*form a cube of about 68 feet per side (fitting within a baseball infield). At \$1,750 per ounce, it would be worth \$9.6 trillion.*

*With the same amount of money, you could buy all U.S. cropland (400 million acres with output of \$200 billion annually) plus 16 Exxon Mobils (the world's most profitable company, one earning more than \$40 billion annually), and still have about \$1 trillion in cash.<sup>3</sup>*

Some investors may prefer to hold a modest measure of gold in their portfolio, if only to feel better about uncertain times. But they should think hard before concentrating a large part of their wealth in it.

<sup>1</sup>Francesco Guerrera, "A Golden Age for Gold Loses Some of Its Luster," *Wall Street Journal*, October 4, 2011.

<sup>2</sup>Standard deviation is the statistical measure of the degree to which an individual value in a probability distribution tends to vary from the mean of the distribution.

<sup>3</sup>Warren Buffett, "Why Stocks Beat Gold and Bonds," *Fortune*, February 9, 2012.

Sources for all figures: S&P data are provided by Standard & Poor's Index Services Group; MSCI World ex-USA Index is net dividends, copyright 2012, all rights reserved; Dimensional index data provided by Dimensional Fund Advisors.

**For illustrative purposes only. Past performance is no guarantee of future results, and there is always the risk that an investor may lose money. Indices are not available for direct investment. Performance does not reflect the expenses associated with the management of an actual portfolio.**

