

Falling Gold Prices Indicate Rise in Optimism

Gold prices have been falling this spring, from a record high of \$1,887.70 in the summer of 2011, as the U.S. stock market has climbed to record highs. Now that investors worldwide feel more optimistic about stocks and bonds, the price of gold could fall even further this summer – unless a crisis in the Middle East or elsewhere shakes their confidence.

However, the falling price of gold could also be considered as a buying opportunity for some investors. If you are building a diversified portfolio with many different types of assets, you might want to include a small percentage of gold.

Like stocks, bonds, real estate or other assets, gold has both positive and negative aspects as an investment. In that regard, gold can play a protective role in your portfolio. Since gold prices historically have tended to rise during periods of high inflation, owning gold can help guard against the risk of a serious loss of purchasing power in the future.

In fact, the falling price of gold indicates that investors have less fears about inflation than was the case a year ago, when the Federal Reserve and European central banks were using tools like "quantitative easing," which increases the monetary base, as well as other tactics to stimulate their slow-growth economies.

For investors who recognize the importance of diversifying their portfolios, one of gold's major advantages is that prices in the past have shown very low correlations with returns from other assets like stocks and bonds. That's the case today with gold prices dropping while stock prices rise. However, should those trends reverse in the future, gold could potentially increase in value, helping to counterbalance a loss from equities. On the other hand, gold also has significant limitations as an investment. Since gold generates no income, the only opportunity for a positive return is to wait until the price goes up and then sell your holdings.

If you own gold bars, coins or jewelry, you need to store your assets in a safe location, such as a bank vault, and purchase insurance. Because of those drawbacks, many investors use other ways to get into the gold market, such as purchasing exchange-traded funds (ETFs), gold futures, gold options and shares of gold mining companies. But it's important to study these types of gold investments carefully, because they can be more volatile than gold itself.

Mining for gold has become increasingly difficult and expensive in all regions of the world. Several mining ventures in remote areas of Latin America, for instance, have been delayed or canceled due to concerns about the environment and the impact on indigenous peoples. Like silver, copper and other precious metals, there is only a limited supply that can be extracted from the earth.

At the same time, demand for gold will undoubtedly continue to rise, thanks to the rise of the middle classes in India, China, Latin America and other emerging markets. Gold is also in demand by industrial and technology companies for a wide range of products.

So, if you're looking for a long-term investment that could grow in value and add diversification to a portfolio, but will not produce income, now may be the time to consider adding gold to your portfolio. But if you're hoping for quick returns, or need a steady income stream to support your lifestyle, it may be better to focus on other assets.

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