

Thank God It's Friday! February 9, 2007

Wars have been fought over it, entire populations enslaved in its quest, myths and legends the world over the retain it at their core: Gold. No other asset carries the mystique or universal desirability. What is it that makes Element 79, Au so precious? Gold is rare, at least it was anciently, and it is indeed beautiful. Gold performs critical functions in computers, spacecraft, and a host of other products. We use gold in medicine and dentistry and its value in jewelry, medals, and awards is famous.

Historically gold was used to back currency; in an economic system known as the gold standard, a certain weight of gold was given the name of a unit of currency. For a long period, the United States government set the value of the US dollar so that one troy ounce was equal to \$35, and actually held in giant vaults enough bullion to back the dollars in circulation. By 1975 the pegged-to-gold value of the dollar was abandoned and since then, your buck is worth only Uncle Sam's promise to pay. Gold has been left to find its free-market level. Central banks still hold historical gold reserves as a store of value although the level has been declining. The largest gold depository in the world is in the U.S. Federal Reserve Bank in New York, which holds about 3% of the gold ever mined, as does the similarly-laden Fort Knox (sorry, neither offers tours).

Since currencies are no longer pegged to gold, and demand for industrial/jewelry use of gold is significantly less than current supply (105 tons less in 2006), the explanation for gold's increasing value is only its mystique and unquestioned history as an elite luxury. Investors feel comfortable owning gold when their own currency is depreciating, when they view inflation as a threat, and when the price of other commodities is soaring. Indeed, the price of gold is the direct result of supply and demand, and highly influenced by investor psychology. Its value is subjective and not necessarily a direct function of its actual usefulness.

The value of many other investments is also highly dependent on investor psychology, such as artwork (up dramatically since 2002) and the goodwill of international brands such as Levi's and Coca Cola: there is no tangible product or book value underlying the rise in price. The increase is solely due to the fact that investors, for various reasons, want to own it.

There may indeed come a day when investors decide that gold is just not that valuable. We don't see that day coming in the near future: the price of gold is only 1/4 in real terms what it was in the early 1980's. Gold's use as a store of value will continue for many years to come, and we will be using careful assessments of all the relevant forces: supply, demand from industry and investor psychology, to determine the best time and vehicle to capture that value in your portfolios.

	February 9, 2007	December 30, 2006	Percentage of Change
DOW JONES	12,580	12,463	+0.9%
S&P 500	1438	1,418	+1.41%
NASDAQ	2,460	2,415	+1.86%
10-year Bond YIELD	4.78%	4.71%	+0.15%*

*When yield goes up, prices go down