

Financial Foresight

Dempsey Investment Management • Winter 2009 Edition

Should Gold be in Your Portfolio?

Do precious metals belong in your portfolio? With the incredible swings in the stock market in 2008, and the financial bailouts going on in Washington, many are looking for another asset class or investment they can trust. Let's review how this asset class has performed, the risks and rewards and the various ways to invest.

Since 2000, when it averaged \$279.11 for the year¹, gold has risen at an annual rate of about 15.32%. Considering the average price in 1980 of \$612.56² up to the current price of \$871.20, the average annual return drops to only 1.27%. If you had poor timing and purchased at the highest price of \$870 in 1980 and sold in 2001 for the average selling price of \$271.04³ you would have earned an annual return of -3.81% for 21 years. Because of the volatility of the price of gold bullion, I feel it is a better trading and hedging play than a true long-term investment. An interesting historical note is from 1833 to 1930 there was only one year where the price fluctuated more than .5% from its annual average of \$20.65. That occurred in 1923 when it spiked 3.19%.⁴ Almost all the volatility in the price of gold we have seen in our nation's history has taken place since 1973. This occurred when all currencies started floating freely, without regard to the price of gold.

There are multiple ways to invest in gold depending on your risk tolerance and goals. Exchange traded funds and directly purchasing the physical bullion and coins are two ways to invest. Stock in publicly traded mining companies and mutual funds are other options. Each of these investments have their benefits and drawbacks.

In November of 2004 and January of 2005 the two exchange traded funds were introduced, offering investors a way to invest in gold in

1/10 oz. increments. As of 12/26/08, GLD and IAU held over 26 million ounces for investors.⁵ The key benefits here are liquidity, safety and no need for insurance and shipping. The main disadvantage is the annual fee of .4%. Another issue is the inability to physically acquire the gold. As stated on www.spdrgoldshares.com, "The Gold Shares represent fractional, undivided interests in the Trust, the primary asset of which is allocated (or secured) gold".

"In all of history, only 161,000 tons of gold have been mined, barely enough to fill two Olympic-size swimming pools."⁸

Another way to invest is to directly purchase gold bullion and gold coins. First of all we are not talking about rare coins that are priced on their numismatic value but rather recently minted bullion and 1 ounce coins such as the Gold American Buffalo & Eagle, the Canadian Maple Leaf or the South African Gold Krugerrand. You will always pay a larger premium for the coins, compared to bullion, as they do offer some numismatic value and are more popular. Premiums for the coins are often 8-12% above the spot price of gold. Gold bullion can often be purchased for only 2-4% above spot price. Of course when selling bullion you will likely be 2-4% below spot as well. While you could go to a local coin dealer or www.usmint.com to buy or sell coins and bullion, I would generally direct an interested investor to some of the large bullion dealers like www.kitco.com, www.nwtmint.com or www.monex.com. Be advised that some products especially coins are very difficult to acquire and you may not receive shipment for 3-6 months.

An additional option is to invest in the gold mining sector with stocks, exchange traded funds, or mutual funds. Earnings

from individual companies are often quite volatile so you generally want to find a company with staying power that can ride out the cycles. A safer way to invest is a mutual fund or exchange traded fund so you can diversify. With bullion your investment value is strictly based on the spot price of gold. It's unlikely your investment would ever be worthless, however you may not reap as many rewards as with stock. One mutual fund with a 20+ year record is the Fidelity Select Gold fund. This fund began trading in December of 1985. Since that time through 11/30/08, your average annual return would have been 6.74%.⁶ Had you purchased gold bullion for its average price in 1985, your average return over those same 24 years would have been approximately 3.82% before any storage, insurance or transaction fees.⁷

Before deciding which of these investments may fit your strategy, carefully consider your risk tolerance and goals. If you do decide to invest in a precious metal, remember that it should only be a small fraction of your portfolio as this asset class can be quite volatile. Diversification is your best bet to reduce market volatility.

¹"Historical Charts: Gold," n.d., <<http://www.kitco.com/charts/historicalgold.html>>(12/28/08)

² Ibid.

³ Ibid.

⁴ Ibid.

⁵"U. S. Financial Information," (12/26/08) <<http://www.spdrgoldshares.com/sites/us/value/>> (12/26/08), "COMEX Gold Trust (IAU)," (12/26/08) <http://us.ishares.com/product_info/fund/overview/IAU.htm?qt=IAU> (12/26/08)

⁶ "Fidelity Select Gold (FSAGX): Performance," n.d., <<https://investing.schwab.com/trading/center?PwdMsg=Msg1>> (12/28/08)

⁷"Historical Charts: Gold," n.d., <<http://www.kitco.com/charts/historicalgold.html>> (28 December 2008)

⁸ Brook Larmer, "The Price of Gold," *National Geographic*, January 2009, 43.

What's New on the Tax Front

By Christopher Horton, CPA

2008 saw many sweeping changes in tax legislation and that makes 2008 and 2009 interesting years for taxpayers. The changes encompass a wide variety of topics of interest to the individual taxpayer including capital gains and "kiddie taxes", first time homebuyers credits and a change in the home sale exclusion rules, a property tax deduction for people who do not itemize, and other opportunities and challenges.

An opportunity comes in the form of zero tax on some long-term capital gain and dividend income. Beginning this year and continuing through 2010, a zero tax rate applies to most long-term capital gain and dividend income. This low rate has an impact not only on lower-bracket individuals but also, surprisingly, on some whose top dollars are taxed well in excess of 15%. The amount of income taxed at 0% depends on the interplay between an individual's filing status, taxable income, and how much of that taxable income consists of long-term capital gain and qualifying dividend income. The 15% maximum tax rate on qualified dividends and net capital gain has not changed.

Unfortunately, with the good comes the bad. The so-called "kiddie tax" rules increased the age of a child whose investment income may be taxed at the parent's tax rate. These rules apply to a child who is age 18 at the end of the year, as well as a student who is under age 24 at the end of the year unless, in each circumstance, the students provide over half their support from their earned income. The amount of taxable investment income these children can have without it being subject to tax at the parent's rate has increased to \$1,800 for 2008.

There is a new benefit for those who take the standard deduction instead of itemizing deductions on Schedule A. Those taxpayers who pay real estate taxes can add to the standard deduction an amount equal to the amount of real estate taxes paid up to \$500 for

single filers or up to \$1,000 for joint filers.

After 2008, some homeowners who do not use their properties as principal residences for their entire ownership period may wind up paying more of a tax bill than they would under current rules. For sales after 2008, the gain potentially eligible for the home sale exclusion will be reduced proportionately for the period a home was not used as a principal residence. There are, however, a number of exceptions. The new rule is quite complex and will cause big headaches for some home sellers unless they are careful and get an expert's advice.

There is good news for first time homebuyers - they are eligible for a new tax credit on primary home purchases between April 9, 2008, and June 30, 2009. The credit is 10 percent of the purchase price of the home, with a maximum available credit of \$7,500 for either a single taxpayer or a married couple filing jointly. First-time homebuyers are those who have not owned a home in the three years prior to a purchase and there are some income limitations. This "credit" is really just an interest-free loan from the government and you will be charged \$500 each year until you repay the \$7,500 or you sell the house and repay the balance then.

Speaking of payments, taxpayers who did not qualify for or did not receive the maximum amount for the 2008 economic stimulus payment may be entitled to a recovery rebate credit when they file their 2008 tax return if their filing status or income changed.

In this economic climate, many taxpayers' incomes have changed due to job loss. Many job-hunting expenses may be deductible for those looking for employment in the same trade or business in which they are employed. Unfortunately, job-hunting costs are not deductible for those looking for a job in a new trade or business nor are expenses for first time job seekers or for those who have been out of the job market for several years.

Looking ahead to 2009, there is some good

news. A recent tax law change promises to give older Americans much needed financial flexibility as they struggle to manage their finances during this difficult economic time. The tax laws generally require individuals with retirement accounts to make required withdrawals based on the size of their account and their age every year after age 70 1/2. This rule is intended to prevent wealthy individuals from using retirement accounts as a tax shelter. The new law suspends the required minimum distribution from retirement accounts in 2009. This waiver, which is available to everyone regardless of their total retirement account balances, applies to all defined-contribution plans, including 401(k), 403(b), 457(b), and IRA accounts. This allows retirees to keep the money in their account if they choose, and possibly recover some of their losses.

Speaking of IRAs, this may be a good year to convert traditional IRAs to Roth IRAs. The decision making process can be complex and taxpayers need to review their taxable income, cash flow availability to pay associated taxes and the like. We recommend you consult your investment or tax advisor before making this decision.

One way to increase your cash flow may be to decrease your energy costs. Homeowners who install certain energy efficient property on their principal residences may be eligible for a credit. The credits, which originally expired in 2007, have been re-instated for 2009 and cover such items as qualified windows, skylights, hot water boilers and solar water heating systems.

The tax laws seem to get more complex with each year and with a new administration beginning in January 2009 taxpayers may see even more changes. Some of these changes may be of benefit to certain taxpayers but, like many pieces of tax legislation, can be fraught with unexpected pitfalls. We suggest you seek expert advice before making any changes.

Christopher Horton, CPA, Hettena, Wright & Horton, 5399 Williston Rd., Ste. 205, Williston, VT 05495, chris@bwhcpas.com, or (802)865-2777.