

GOLD & OTHER PRECIOUS METALS STOCKS

The earnings, and so the common stock prices, of precious metals producers are generally more functions of the prices than the quantities of the metals they produce. For this reason, the common stocks of such companies tend to trade more like commodities than capital investments.

Not surprisingly, then, the annual total return of the common stocks of the precious metals sector of the market has averaged less than half that of the stock market as a whole over the past ten years.

Gold-related investments have historically tended to be most rewarding in times of geopolitical instability and currency market turmoil. At present, even though there are areas of political instability around the world, they do not appear to pose any threat to major industrialized nations. Similarly, the accelerating tempo of international trade appears to render inflationary trends more transitory than secular.

Other than for speculation, about the only other major source of demand for gold is for jewelry. But gold-content jewelry is very price elastic, with demand dropping precipitously with any but modest increases in the metal's price.

Furthermore, it also appears that the world's central banks sell gold on the open market in quantities sufficient to offset any growth in demand for consumption.

Gold's poor performance as an investment over the greater part of the past two centuries is illustrated in the following table:

AVERAGE ANNUAL TOTAL RETURN ON GOLD AND OTHER ASSETS FROM 1802 TO 1995

<u>Asset</u>	<u>Average Annual Total Return</u>
Common Stocks	8.3%
U. S. Treasury Bonds	4.9%
U. S. Treasury Bills	4.3%
Gold	1.4%

Source: Dow Jones Investor Advisor Magazine, November 1996, Page 118

Over most of this 193-year period, the return on gold has almost exactly tracked the long-term inflation rate. When its price was deregulated in the 1970s, it temporarily spiked ahead of the Consumer Price Index, but it has subsequently returned back to inflation-like returns.¹

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¹ By the late 1960s the U. S. balance of payments had turned negative and gold was streaming out of Fort Knox to foreign central banks at an alarming rate. In a series of developments in 1971 and 1972, to stem the gold outflow, the U. S. ceased redeeming the dollar for gold and stopped using gold for international settlement purposes. The dollar was permitted to "float" in the foreign exchange markets. In addition, after December 31, 1975, Americans were permitted to own gold as an investment. The price went from \$35 an ounce in 1971 to over \$800 an ounce by early 1980, and then plunged to around \$300 an ounce by the middle of the 1980s.