Over the last decade, newsletters that time the gold market beat a buy-and-hold in bullion, but they failed to keep pace with a riskless investment in cash.

Gold Loses Its Luster for Newsletters That Seek to Time the Market

By Mark Hulbert

Should you allocate part of your portfolio to gold and precious metals?

There are two ways of approaching this question, and thus two ways of being right (or wrong) about it. The first is as a market timer: Is now a good time to invest in gold? The second is as an asset allocator: Does gold deserve a permanent place in your portfolio?

To appreciate how different these two approaches are, consider this: The answer to the market timer's question depends on a completely different set of assumptions than the answer to the asset allocator's question. For example, the answer to the market timer's question is "yes" only insofar as a gold bull market is about to take off. But this is irrelevant to the asset allocator: If gold deserves a place in a balanced portfolio, then it does so regardless of where gold stands in its own market cycle.

Timing the Gold Market

Let's first examine gold market timing. The gold timing newsletters I track in the Hulbert Financial Digest currently are quite bullish, on balance. An even more bullish picture emerges when we examine those that have the best long-term record. The consensus is that we already have entered, or are about to enter, a gold bull market.

How much credence should you give this bullish consensus? To answer this question, take a look at Table 1, which reports the records of the gold timing newsletters tracked by the HFD over the last 10 years and five years. These records were calculated on the assumption that these timers were invested in gold bullion when they were bullish, and in 90-day T-bills when bearish.

Two overall conclusions emerge from this table. First, the majority of the gold timers did better than buying and holding the metal. Over the last decade, for example, all seven of the gold timers tracked by the HFD did better than the 1.4% annual return of gold bullion. And over the last five years, 16 of the 18 timers beat a buy-and-hold in bullion.

The second conclusion that needs to be highlighted from these results: Only a small number of the gold timers did as well as they could have simply by staying invested in cash. Over the last decade only one out of seven did better, while the proportion over the last five years is four out of 18.

This mixed result can be traced to the presence over the last decade of just one of the two preconditions for successful market timing. The first precondition is that there be a bear market. Without a bear market, after all, there is little opportunity for even the best of timers to do better than buy and hold. By being in a bear market, gold surely has satisfied this precondition. Indeed, the only thing a gold timer had to do to beat a buy-and-hold over the last decade was to have a portion of his portfolio allocated to cash.

The second precondition, however, is one that the gold market satisfied only marginally, if at all. This precondition is that the market being timed needs to exhibit a lot of volatility. Without volatility even the best market timers have little opportunity to sell high and buy low. And over the last decade, gold has been 17% less volatile than the U.S. stock market. The last several years have been particularly deadly for gold timers, since gold has been stuck in a very narrow trading range. However difficult it has been to time the U.S. stock market, it has been that much harder to time the gold market.

What does all this mean if you believe, along with many of the gold timers, that now is a good time to invest in gold? It should give you pause before betting your portfolio on their bullish scenario. The HFD's performance data over the last decade do not give us a lot of confidence for thinking that gold timing will do better than investing in a money market fund.

Asset Allocation With Gold

The asset allocator's approach to investing in gold is entirely different. In answering the question, "Does gold deserve a place in your portfolio?," the

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Table 1.
Gold Timers' Performance

*10 Years (3/31/86 to 3/31/96)**

Newsletter (Timing System)	Contact	Annual Return (%)
Ruff Times (Short-Term)	(801) 489-8681	6.0
90-Day T-Bills		**5.6**
Elliott Wave Theorist (Investors)	(800) 336-1618	5.0
Garside Forecast (Gold Bell Ringer)	(714) 259-1670	4.2
Fund Exchange	(800) 423-4893	3.4
Fabian Investment Resource	(800) 950-8765	3.3
Market Logic (Gold Model)	(800) 327-6720	1.8
The Dines Letter (Short Term)	P.O. Box 22, Belvedere, CA 94920	1.6
Gold Bullion		**1.4**

*5 Years (3/31/91 to 3/31/96)**

Newsletter (Timing System)	Contact	Annual Return (%)
Futures Hotline/Mutual Fund Timer (Fund Model)	(904) 693-0355	7.8
Mutual Fund Strategist	(800) 355-3863	7.4
Market Logic (Gold Model)	(800) 327-6720	7.1
Professional Timing Service	(406) 543-4131	5.6
Addison Report (Gold Mutual Fund Allocation)	(508) 528-8678	4.3
Bob Brinker's Marketimer (Gold Fund Allocation)	(914) 591-2655	4.3
90-Day T-Bills		**4.3**
Fund Exchange	(800) 423-4893	4.1
Professional Tape Reader (ST Signals)	(800) 868-7857	4.0
Timer Digest (Consensus of Top Timers)	(800) 356-2527	3.7
Elliott Wave Theorist (Investors)	(800) 336-1618	3.1
Garside Forecast (Gold Bell Ringer)	(714) 259-1670	3.0
Professional Tape Reader (LT Signals)	(800) 868-7857	3.0
Fabian Investment Resource	(800) 950-8765	2.9
Ruff Times (Short-Term)	(801) 489-8681	2.6
No-Load Mutual Fund Selections & Timing	(800) 800-6563	2.5
Switch Fund Timing (Gold Switching Portfolio)	(716) 385-3122	2.4
Gold Bullion		**2.2**
The Dines Letter (Short Term)	P.O. Box 22, Belvedere, CA 94920	1.4
P. Q. Wall Forecast	(504) 895-4891	(0.9)

**Returns assume manager is invested in gold bullion when bullish, and in 90-day T-bills when bearish.*

asset allocator will focus on two preconditions for a well-diversified portfolio, neither having to do with whether gold is in a bull or bear market. First, the asset should have a respectable long-term return; second, the asset must not be highly correlated with any other asset class. The first precondition seems obvious enough, but why the second? An asset with a great long-term return won't help to diversify a portfolio if it is highly correlated with other asset classes already represented in that portfolio.

Consider first whether gold satisfies the first precondition. Gold's long-term return, while not as good as that of stocks, nevertheless has been respectable. To be sure, estimates of gold's long-term performance vary considerably, depending on the starting point of the measurement. Since 1980, for example, gold bullion has produced an annualized loss of 3.0%. Since 1971, however, bullion has produced an annualized gain of 10.2%.

This 3.0% annualized loss since 1980 is measured from the peak of the 1970s' gold bull market, and thus makes gold look like a poorer bet than it really is. By the same token, the 10.2% gain since 1971 is artificially large because prior to 1971, gold's price had been set by central bank fiat. But it's nevertheless fair to assume that gold's long-term return is in the 7% to 8% range.

Gold more strongly satisfies the asset allocators' second precondition. It turns out that gold bullion actually is negatively correlated with both bonds and stocks. Gold stocks, while more correlated with the S&P 500 than they are with bullion, still are not closely correlated with the stock market as a whole. That means that gold can do a good job of balancing a portfolio: It will often zig when stocks and bonds zag, and vice versa.

To what extent should your portfolio be allocated to gold? A lot depends on what other asset classes are already in your portfolio, and there is no one right answer. But a consensus allocation is between 5% and 10%. Even Peter Lynch, better known for his advice to be fully invested in stocks for the long haul, recently wrote that the case for owning a "little gold" is "compelling."

Conclusion

Don't forget, however, that the asset allocator's approach to owning gold is at odds with the market timer's approach. To the asset allocator, it is crucial that you don't deviate from your allocation to gold: You should stick with it through thick and thin. After all, if you are a market timer jumping into and out of the gold market, you can't benefit from the effect gold has of ameliorating and softening the volatility exhibited by the other assets in your portfolio.

So it's an either/or choice: Either a market timer in gold or an asset allocator in gold. Given the HFD's performance data for investment newsletters, the answer is easy: You have greater odds of achieving your goals when approaching gold as an asset allocator than as a market timer.