Scannell Wealth Report
October 12, 2009

The Markets

The S&P 500 index jumped 4.5% last week as a weakening dollar and a positive earnings report from Alcoa helped keep the bulls in charge.

Early last week, Australia surprised the world and became the first central bank of the Group of 20 Nations to raise its benchmark interest rate during this economic cycle, according to MarketWatch. This helped send the dollar lower as currency investors realized that countries such as Australia may offer better growth prospects – and higher returns on interest-bearing investments – than the United States.

Alcoa, traditionally the first company in the Dow Jones Industrial Average to report quarterly earnings, started the reporting period with a bang as it reported revenues and earnings that exceeded Wall Street expectations, according to CNBC. As an aluminum maker, Alcoa's products are used in manufacturing and the company's results may provide a glimpse on how that sector of our economy is performing. While the quarter was above analyst expectations, the expectations were low. Alcoa's revenue was down 37% from a year ago while its earnings per share were off 89%, according to CNBC.

The economy still has a long way to go before it regains its former glory days, but the financial markets are wasting little time in trying to recoup their bear market losses.

Data as of 10/9/09	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	4.5%	18.6%	19.2%	-7.4%	-1.0%	-2.2%
DJ Global ex US (Foreign Stocks)	4.8	37.4	27.3	-3.3	5.4	1.8
10-year Treasury Note (Yield Only)	3.4	N/A	3.8	4.7	4.1	6.1
Gold (per ounce)	4.8	20.9	19.0	22.3	20.0	12.7
DJ-UBS Commodity Index	4.0	10.2	-14.8	-7.4	-3.9	3.9
DJ Equity All REIT TR Index	5.5	17.3	3.8	-13.0	1.2	9.8

Notes: S&P 500, DJ Global ex US, Gold, DJ-UBS Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.
Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.
Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not applicable or not available.

GOLD PRICES HIT AN ALL-TIME HIGH last week driven by a weak dollar and concerns over potential inflationary pressure, according to CNBC. Many people consider gold to be a good inflation hedge. Is it true? Let's look at some examples.

Way back in January 1980, gold prices peaked at approximately $850 per ounce. Last week, it closed at $1,051 per ounce according to the London Bullion Market Association (LBMA). This represents a gain of about 24%. By comparison, between January 1980 and August 2009, inflation, as measured by the consumer price index, rose approximately 179%, according to the 2009 Ibbotson® SBBI® Classic Yearbook and the Bureau of Labor Statistics. Score one for inflation beating gold.

If gold prices had kept pace with inflation since January 1980, gold would sell for roughly $2,400 an ounce in today's dollars, according to MarketWatch. This is one reason why some investors feel gold could move to $2,000 an ounce without too much trouble.

However, before we get too carried away, let's look at the other side of the story.

Like many statistics, what you pick as your starting point can greatly influence your results. By picking the January 1980 gold price peak as the starting date – after gold had already risen more than 2,000% in the previous 10 years – the returns between 1980 and today look weak.

A more representative analysis of the inflation-fighting benefits of gold would start in June 1973. By June 1973, all currencies were allowed to "float" freely without regard to the price of gold and the U.S. was a couple years past exchanging dollars for gold at a fixed price, according to the National Mining Association. In other words, by June 1973, we had a market-based price for gold that reflected supply and demand and we were just prior to the start of a major inflation binge in the U.S. The price of gold that month was approximately $120 per ounce, according to the LBMA.

Here are a couple numbers to consider.

First, between the June 1973 price of $120 per ounce and the January 1980 price of $850 per ounce, gold had risen 608%. By contrast, inflation rose 76% during that same period, according to the 2009 Ibbotson® SBBI® Classic Yearbook. Clearly, gold was an excellent inflation hedge during the inflationary 1970s. Score one for gold beating inflation.

Second, between the June 1973 price of $120 per ounce and last week's price of $1,051, gold had risen 776%. By contrast, inflation rose approximately 385% during that same period, according to the 2009 Ibbotson® SBBI® Classic Yearbook and data from the Bureau of Labor Statistics. Clearly, gold has been an effective hedge against inflation since 1973, although past performance is no guarantee of future results. Score another one for gold beating inflation.

Here are some conclusions to ponder.

First, gold has historically been a solid inflation hedge *over a long period of time*. However, there is no guarantee this will hold true in the future.

Second, between the 1980 gold price peak and last week, gold has significantly underperformed inflation. However, it is misleading to say "gold is selling well below its inflation-adjusted 1980 price" as a reason why gold should easily move to $2,000 per ounce. It is misleading because gold had already moved up more than 2,000% during the 1970s, as measured from gold's January 1970 price of $35 per ounce.

Third, gold has historically moved in long cycles. In the 1970s, it had a strong up move. In the 1980s through the early 2000s, it was in a down move. Since the early 2000s, it has been in a strong up move.

Presently, gold could be on the rise due to inflation expectations or as a hedge against a declining dollar. Most likely, it is a combination of both.

Because of its long history, gold enjoys a special place in society. It can be an investment. It can be a hedge. It can be worn on your body as jewelry. It can be exchanged for cash. And, because of its special place, we will likely still be talking about gold over the next millennium.

Weekly Focus – Think About It

"Thinking to get at once all the gold the goose could give, he killed it and opened it only to find - nothing."
-- Aesop

Best regards,
Scannell Wealth Management Group

P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you would like us to add them to the list, please reply to this email with their email address and we'll ask for their permission to be added.

* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.
* The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks.
* The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.
* The Dow Jones World (Ex. U.S.) is an unmanaged group of securities considered to be representative of the non-U.S. stock market in general* The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System. * The Dow Jones World (Ex. U.S.) is an unmanaged group of securities considered to be representative of the non-U.S. stock market in general. * Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.*To unsubscribe from the Weekly Market Commentary, please reply to this e-mail with "unsubscribe" in the subject line.