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Investment Strategy

A Permanent Investment?

> "Baruch liked gold mines. There is always a market, he pointed out, for their product, and at a satisfactory price. Gold, he insisted, is one of the very few things in the world that approaches the status of a permanent investment. Baruch told the story of a Rothschild who set up a 'permanent trust' consisting of five different currencies. By the time Baruch heard about the trust, it had shrunk to one-fifth its original value. 'But gold doesn't yield any interest,' a friend protested after listening to the story. 'True', replied Baruch, 'but consider the fabulous wealth of some of the Indian princes and rajahs. I had dinner with the Maharajah of Kapurthala on one occasion in Vittel, France. Several of us talked afterward about his wealth, and someone said that among the treasures of these Indian moguls were gold coins brought to the East by Alexander the Great, hundreds of years before Christ."
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> "Their gold and jewels had earned no interest during these more than 2,000 years, but they still had their capital. Suppose they had attempted to provide income from it. They might have been no more far-seeing than the Rothschild I mentioned. If they had tried speculation there have been many times in each century that they might have gone broke. No, save for gold, jewels, works of art, perhaps good agricultural land, and a very few other things, there ain't no such animal as a permanent investment. Even in agricultural land, Baruch pointed out, there is some risk. Lands that made men rich in rice cultivation years ago in Baruch's own state of South Carolina, are not nearly so valuable now that rice is produced more economically in other sections. City real estate is subject to all sorts of hazards, as he learned when he no longer needed his big Fifth Avenue mansion."
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> . . . Bernard Baruch, Park Bench Statesman by Carter Field, 1944

A "permanent investment," what an intriguing concept! When I first entered this business one of my mentors, namely Lucien Hooper (securities analyst extraordinary), often spoke of permanent investments. In fact he once stated, "You should put one quarter of your investment portfolio in stocks, one quarter in bonds, one quarter in precious metals, and one quarter in farmland. His reasoning was that such a non-correlated asset allocation would grow, and preserve, capital through any multi-generational economic cycle. This morning, we focus on precious metals and farmland.

Last week a "tree fell in the forest and nobody heard it." The headline read, "CME To Allow Gold As Collateral For All Exchange Products." The lead paragraph was:

> "U.S.-based clearing house CME Group Inc. (CME/$319.96/Market Perform) will allow physical gold to be used as collateral for margin requirements on all exchange products, a spokesman said Monday. The new global policy is effective Oct. 19 in accordance with a member's notice issued late Friday, said spokesman Jeremy Hughes in London. Clearing member firms will be allowed to post up to a maximum of $200 million worth of gold as collateral to cover performance bond, or margin, requirements, Hughes said."

Then on Friday there was this gold-quip on the Broad Tape:

> "If you've invested in gold, you're about to gain a powerful ally: pension funds. 'I think the largest institutions like our own are realizing that we barely own any [gold],' Shayne McGuire, Director of Global Research of the Teacher Retirement System of Texas said in an interview in Hong Kong very early this morning. 'The same thing applies to most of the pension funds which manage trillions of dollars in world wealth.' TRS oversees $95 billion, and just opened an internally managed gold fund for the 1.3 million public education employees, and suggests other pension funds follow suit. Owning gold is 'financial insurance,' he said, sounding a lot like David Einhorn at the Value Investing Congress earlier this week. 'Consider the tremendous fiscal excess that major governments have made to prevent the world economy from collapsing . . . I don't think the question really is what is gold worth but what are currencies not worth'."

We have been bullish on gold, as well as all "stuff," and "stuff stocks" in general (energy, timber, agriculture, water, base-metals, etc.), since 4Q01. That strategy was driven by China's joining of the World Trade Organization, which we thought

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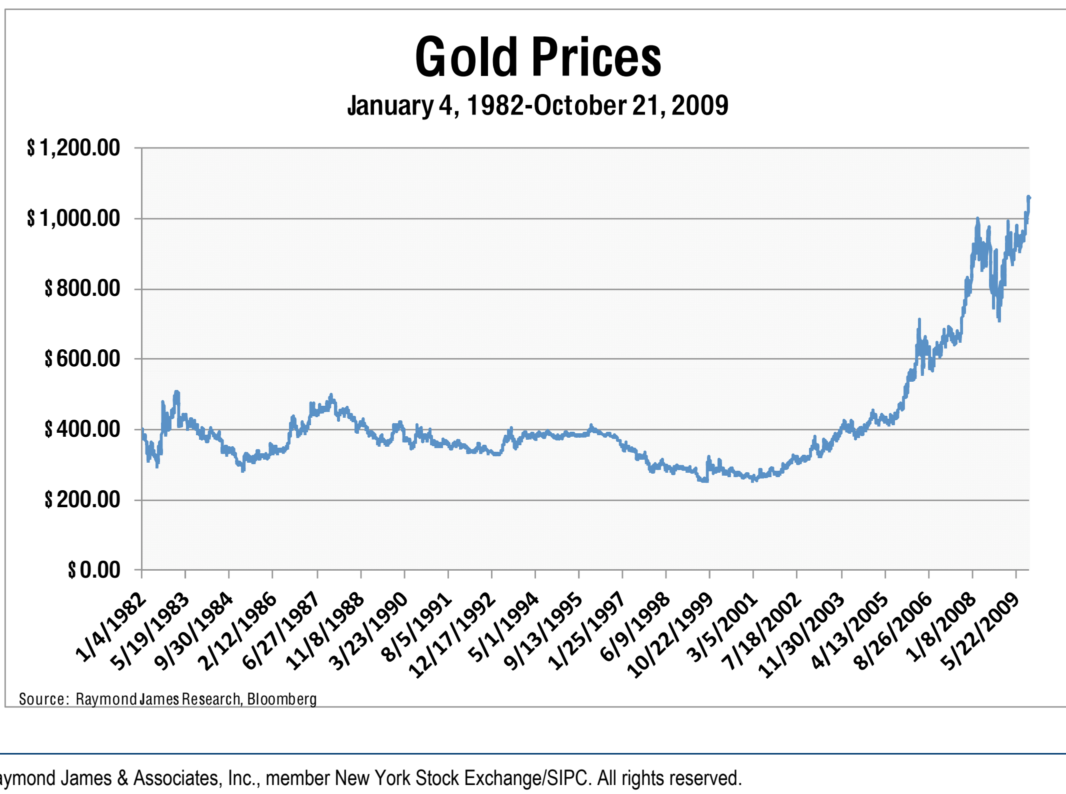
would cause Chinese per capita incomes to rise. Universally, when per capita incomes increase, people consume more "stuff." Ladies and gentlemen, once per capita incomes start rising, they tend not to stop; and this income-rise is occurring not just in China and India, but in Brazil, Indonesia, Vietnam, Malaysia, etc. Consequently, our mantra has been, and continues to be, that the "stuff stock" secular bull market that began in 2001 still has years left to run. While it's true we did recommend re-balancing (read: selling partial positions) ALL "stuff stock" positions in November/December 2007 because they had grown into too large a position in our portfolios, we never gave up on our secular bull market "call" for "stuff" and stuff-stocks. Accordingly, over the past few weeks gold has broken out to new all-time highs (as can been seen in the nearby chart) and we think it continues to travel higher. In addition to Closed-End Funds, and ETFs, there are numerous precious metals funds recommended by our Mutual Fund Department that play to this theme.

Like precious metals, we have been bullish on agriculture since 4Q01. To this point, in last week's *Barron's* Alan Abelson referenced a report by Société Générale's Dylan Grice which stated – (farmland) is the only asset class left behind by the "rally in everything." What piques Mr. Grice's interest is China's voracious need for grain to sate its burgeoning demand for protein. He points out that China has 22% of the world's population, but only 8% of the world's arable land and 7% of it water (water has been another theme of ours). Moreover, China is losing nearly 1,400 square miles to desert each year. Meanwhile, despite record harvests, global grain inventories remain at record lows. Clearly, farmland is an intriguing investment since people have to eat and because investors can collect "rents" from tenant farmers while waiting for farmland values to rise. For example, while British housing prices collapsed last year, British farmland values rose by ~21%. While there are public companies playing to agricultural properties like Argentina's Cresud SA (CRESY/$12.97), a better route might be considering companies that boost agricultural productivity. In past missives we have mentioned many of them, especially the names that have convertible preferreds. Also, for the more adventuresome types, are agricultural companies, and food processing companies, in the Ukraine. The Ukraine has roughly 32 million hectors of arable land; half of that land is termed "black earth," which is considered the world's best soil. For individual names, please contact the liaison desk.

The call for this week: I will be on the West Coast this week, so these will be our only strategy comments. Nevertheless, as stated in last Friday's verbal comments, I have not really liked the tone of the equity markets for the past few weeks, but every time it looks like we are making a short-term top, a mysterious buyer shows up to rescue the day. That happened again last week when Tuesday's, and Wednesday's, downside "two step" was reversed on Thursday. Then came Friday's fade, which stopped us out of our "long" index recommendations. As the prescient Lowry's service wrote, "(While Thursday's) rally looked impressive, our measurement of internal strength suggests that investors should exercise some skepticism. (Thursday's) upswing occurred on a small contraction in volume, and was unable to break above its October 19th rally high. In addition, our Buying Power Index has lost 15 points over the previous 5 trading days, and regained a rather anemic two points today (that would be last Thursday). With some of our short term indexes currently well above oversold levels, near tem caution is warranted." And, we continue to trade, and invest, accordingly.



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