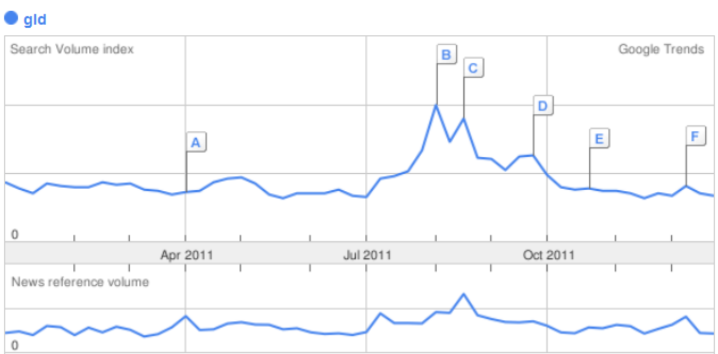
Passive Capital Management

All that Glitters Is Not…Milk?

2011 was an exciting year for gold bugs.

It had been a long wait. After hitting an all-time high of $850 an ounce in 1980, gold failed to return to that spot price for 25 years. Even after the yellow metal finally broke back through the $850 ceiling in 2005 and hit a new high of $1,197 in August 2011, **investors who bought a dollar of gold in 1980 had only 99 cents in inflation-adjusted terms to show for it (Source: DFA).**

Still, with tremendous uncertainty and sluggish performance in global equity markets, gold was a terrific asset for those who were lucky enough to buy in January 2011 and exit in August. **As with most attempts at market-timing, however, many investors jumped in only when the price shot up in June and July.** Almost **three billion dollars** flowed into the largest gold ETF, GLD, in the month of July alone (Source: ETF Trends). Public interest in GLD peaked in August, as did news media interest:



A. SPDR Dow Jones Industrial Average, SPDR Gold Trust: Money Flow Leaders (DIA, GLD)
Wall Street Journal - Apr 8 2011

B. Gold Keeps Shining; Panicked Investors Put $1.3 Billion Into GLD
Barron's - Aug 9 2011

C. SPY's Back At No. 1; GLD Slides Into Second
Barron's - Aug 25 2011

D. The Bursting Gold & Silver Bubble… Both Became The Devil's Metal (GLD, GDX, GDXJ, SLV, TIF)
Fox Business - Sep 26 2011

E. GLD, SLV Soar; BLK: 'Massive' Buying Opportunity In Miners
Barron's - Oct 25 2011

F. Flurry Of Bearish Options Activity In Avon, First Solar And GLD
Forbes - Dec 14 2011

Perfectly in time for the price to drop by 15.5% before the end of the year. In December, the GLD fund experienced net *outflows* of $2.2 billion, meaning that many investors who bought high subsequently **locked in those losses** by selling low. (Source: ETF Trends).

Sadly, this kind of investor behavior is far from unusual. The team at Passive Capital Management frequently refers to the famous Dalbar study, which shows that **investors relentlessly fail to capture market returns**, thanks in large part to failed efforts to time the market.

Still, should we give credit to the handful of pundits who did recommend buying gold at the very beginning of the year? After all, those few investors who were ahead of the game and bought in January saw a return of 11.7% for the year. Not bad in a year when the S&P 500 (net of dividends) returned an underwhelming 0.00% (2.11% with dividends).

Yes and no.

In the first place, we can't be sure whether these January gold bugs were lucky, skillful or both. Secondly, **if picking the best commodity for a tough year in the equity markets was really the goal, they should have recommended milk.**

Yes, milk.

Milk futures rose 35.7% in 2011, meaning that returns to prescient investors were triple those of gold (Source: CNN Money). But how many investors (or pundits) sat down at the beginning of the year and decided to buy futures for powdered and condensed milk for export and for manufacturing of processed dairy goods? Even if you did make this call, **how did you do in 2007 on Zinc, or natural gas in 2001? How will you do next year on wheat futures?**

Periodic Table of Commodity Returns

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
7.01% Pb	86.34%	133.07% Ni	67.57%	82.55%	154.45% Ni	93.02%	5.77% Au	153.14% Cu	96.60% Pd
3.40%	57.26%	75.44% Pb	42.80% Pb	50.79% Zn	126.16% Zn	76.65%	-10.65%	152.37% Pb	83.21% Ag
2.46% Au	25.63% Pt	51.11% Cu	41.30% Cu	40.48%	80.88%	57.22%	-23.01% Ag	129.36% Zn	51.75%
2.44%	24.77% Au	35.61% Pt	33.61%	39.79% Cu	61.36% Pb	42.65% Pb	-24.70%	118.07% Pd	46.68%
0.43% Ag	21.46% Ni	34.55%	25.99% Zn	36.46% Pd	47.68%	34.33% Pt	-24.87%	77.94%	31.47% Ni
-9.82%	12.80%	34.49% Zn	23.52% Al	29.20% Ag	46.40% Ag	30.98% Au	-30.99%	58.95% Ni	31.39%
-14.61% Al	12.46%	29.23%	14.86% Ag	17.92% Au	37.20% Cu	18.80%	-36.06% Al	56.82% Pt	29.96% Cu
-17.61% Ni	5.06% Cu	24.27% Ag	5.90% Pt	16.19% Al	31.24% Pd	16.72%	-38.76% Pt	48.16% Ag	29.52% Au
-19.16% Cu	3.46% Ag	19.37% Au	5.54% Au	12.65% Pt	24.15% Al	14.65% Ag	-49.29% Pd	45.71% Al	20.79% Pt
-22.04% Pt	0.53% Al	17.98% Al	-0.65%	10.33%	23.15% Au	10.40% Pd	-51.07% Zn	24.36% Au	15.17%
-24.83% Zn	-2.35% Zn	16.00%	-3.62% Pd	5.37%	17.05% Pt	6.14% Cu	-53.53%	1.84%	11.29% Al
-25.97%	-12.70%	4.35%	-10.29% Ni	4.17% Pb	0.02%	-16.70% Al	-55.37% Ni	-0.89%	5.16% Pb
-54.14% Pd	-16.37% Pb	4.23%	-16.77%	-7.26%	-25.22%	-23.56% Ni	-56.53% Cu	-11.34%	-5.15% Zn
-73.71%	-45.91% Pd	-18.70% Pd	-18.44%	-10.12% Ni	-43.88%	-47.13% Zn	-62.52% Pb	-13.36%	-21.18%

Key

Al	ALUMINUM
	COAL
Cu	COPPER
	CORN
	CRUDE OIL
Au	GOLD
Pb	LEAD
	NATURALGAS
Ni	NICKEL
Pd	PALLADIUM
Pt	PLATINUM
Ag	SILVER
	WHEAT
Zn	ZINC

Source: Bloomberg/usfunds.com

As the table above demonstrates, the performance of commodities is **as random and unpredictable** as other asset classes. In addition, an efficient marketplace of experts makes it all the more difficult for any one expert to get an edge. Commodities are also **highly susceptible to sudden macro events**, including war, weather and politics.

Clearly, making speculative, predictive bets on individual commodities is a **very risky business**. We only like to take risks for which there is commensurate evidence of reward over time.

The larger lesson is that while gold may have attracted hype, attention, and billions of dollars in 2011, poor market-timing meant that the average gold investor may have ended up underperforming even the flat S&P, in some cases very substantially. We believe it is a far better strategy to stick to less shiny but more historically productive asset classes like stocks, bonds, and real estate, including stocks of companies that mine, process, refine, market, sell and deliver these commodities, in the context of a broadly diversified, low-cost portfolio of index funds and asset class funds.

And save the milk for your cereal.

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