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Gold attracting hordes of investors

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In Oklahoma, where oil drilling rigs dot the horizon, commodity investing usually means speculating on black gold. But Edmond, Okla. retiree Carol Clemens' latest gold bet is in the shiny stuff.

Over the summer, the 63-year-old bought into an exchange-traded fund, SPDR Gold Trust, that purchases and stores bullion and then sells ownership stakes that can be traded.

Clemens is tiptoeing in for now -- an investment she sees as an inflation hedge accounts for just 1 percent of the portfolio she shares with her husband, a military retiree.

"We don't have inflation now, but my instinct is it will head in that direction with the government printing so much money to fix the economy. It's nuts," said Clemens, a local investing club member who normally turns her nose up at speculative investments.

Clemens is hardly alone. SPDR Gold Trust has seen nearly $9.7 billion flow in from investors in the year to date through September, according to Morningstar.

The flood of cash has made it the second-biggest ETF, with nearly $37 billion in assets, second only to the $67.6 billion in an ETF that tracks the Standard & Poor's 500 index. All told, through September, nearly $14 billion has flowed into precious metals ETFs and mutual funds that buy stocks of companies mining gold and other metals.

The lure? Gold has cracked the $1,000-an-ounce level for just the second time ever, and it is making its first sustained $1,000-plus run since briefly eclipsing that mark a year and a half ago. A partial recovery this week for the recently deteriorating U.S. dollar has sent gold prices down $30, but it's still around $1,030.

That is less than half the inflation-adjusted value that gold hit in 1980, when it briefly spiked to $850 -- equivalent to $2,200 in today's dollars. But the metal has more than tripled since 2003 and doubled since 2005, after staying mostly within the $300 to $500 range throughout the 1980s and '90s. Gold's recent performance has been spectacular considering the lost decade stocks have seen due to the dot-com bust and last year's broader market meltdown.

Many experts believe the fundamentals are in place to sustain gold's recent rise or at least avoid the sharp decline that often quickly follows a price spike. They expect ballooning federal deficits and the nascent economic recovery will eventually trigger long-term inflation, sending investors fleeing to gold as a refuge. Meanwhile, global production from gold mines has been declining since 2001.

"We're not at the end of the road for gold at all," says Joe Foster, a former gold mine geologist who's managed the $780 million Van Eck International Investors Gold Fund (INIVX) since 1998.

Bear in mind that any investment in gold is highly speculative. Foster and other experts advise keeping no more than 5 percent to 10 percent of an individual portfolio in gold or gold-related assets. Think of it as a buffer to smooth your ride when stocks and bonds tank, and when inflation erodes values of most other assets. One of gold's chief selling points: Price movements typically don't track those of other assets.

You can gain gold exposure from buying the physical asset, such as coins typically sold at a premium to the prices of bullion traded on global exchanges. But then there are fees to pay if you store gold in a safe deposit box. You can save yourself the trouble of storage by investing in a gold ETF like SPDR Gold or iShares COMEX Gold. You can also try mutual funds that buy stocks of companies which mine gold and other metals.

The fund option may seem like a safer bet than buying the metal itself, but beware. The volatility of gold mining stocks is typically twice as high as the already jumpy prices of gold itself. That's because the fortunes of those companies are tied not only to the direction of gold prices, but also the risks involved in developing mines.

If the 37 percent jump in gold prices over the last 12 months seems like a lot, consider that precious metals stock funds soared an average 131 percent over the same time frame. That rocket-like rebound can be explained partly by the unusually severe hit the sector took last year as a credit crunch scared away investors.

Go back five years, and precious metals funds have an average annual return of more than 14 percent -- tops among all Morningstar fund classes except for a trio of hot international fund categories.

Mining companies are also highly exposed to political risk. This week, the socialist government of President Hugo Chavez in Venezuela seized control of one of the gold ventures owned by Spokane, Wash.-based Gold Reserve Inc.

The zigzag nature of mining stocks is also seen in the recent comeback at the Midas Fund (MIDSX), which targets mining stocks with strong growth potential. Last year, the fund plunged more than 60 percent. This year, it's up nearly 53 percent. The $99 million fund's manager, Tom Winmill, acknowledges only those with a stomach for risk should consider his fund, and even then in small doses.

"What does most investors in is the volatility," Winmill says. "They either won't get into the fund because they're afraid of getting in at a market high that might not last, or they bail out when it hits a low."

Clemens, the Oklahoma retiree in a gold ETF, is playing it safe. If she does increase her holdings above 1 percent of her portfolio, it will come only after careful thought about how imminent the long-term inflation threat appears. She's sticking with the physical commodity, rather than the riskier play from a gold fund.

"Even in inflationary times," she says, "mining stocks can face all sorts of problems that I don't want a part of."