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ANDRESEN
AND ASSOCIATES

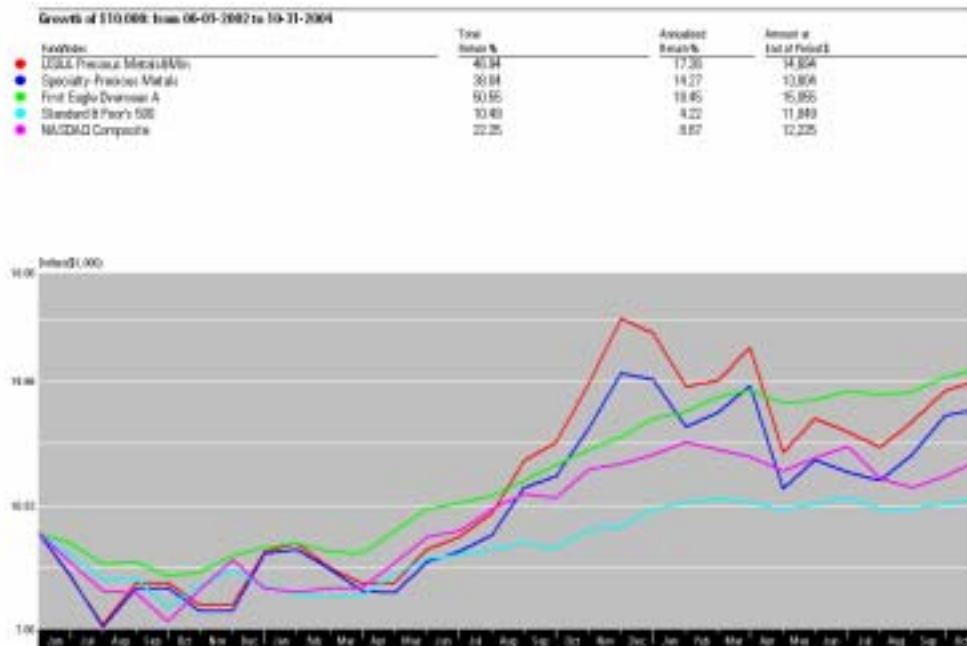
ALL THAT GLITTERS IS NOT GOLD

Long, long ago, in our June 5th, 2002 newsletter, "The Gold Trap", I discussed the emerging precious metals bubble and warned against excessive speculation. As usual, I was very concerned about the risks in the metals markets, and therefore, I recommended a proxy: select international mutual funds such as First Eagle Overseas, which held substantial quantities of precious metals stocks within their own portfolios.

I was seeking to find you an opportunity to participate in the dangerous precious metals markets without facing all those hazards. Two and a half years later, here is my commentary on that choice.

A generic investment in precious metals is represented by the USAA Precious Metals mutual fund. It is up 47% since June 1, 2002. But our alternative, First Eagle Overseas, is up 51%. The average precious metals mutual fund is up 38%. Meanwhile, the S&P 500 Index of the 500 largest stocks in the US is up 10%, and the tech-oriented NASDAQ composite is up 22%.

In other words, our selection of an alternative investment for precious metals worked as well as investing directly in precious metals themselves. My expectations that the precious metals markets would calm down were wrong, but we succeeded anyway, because we invested in diversified proxy investments instead of staying out of precious metals altogether.



We also accomplished these gains without excessive risk. USAA Precious Metals has a standard deviation of 50, versus a standard deviation of 14 for First Eagle Overseas. Basically, USAA Precious Metals is much riskier than First Eagle Overseas. Yet so far we have had gains equal to the precious metals markets without all the risk. But what are the underlying causes of these gains? What is going on? Why were my expectations wrong?

I expected that a fear-based precious metals boom would fizzle. What happened was that rising energy prices and a falling dollar lifted precious metals stocks to new highs. Gold returned to its long lost former role as an international medium of exchange.

So, our alternative investment was successful because larger global economic events caused international investments to succeed as much or more than simple precious metals investments. What moved gold to new highs also moved the Euro and other foreign currencies. That is why our alternative investment succeeded.

It is worthwhile to examine the graph below and see how precious metals have performed over the longer term. The green line graphs the US stock market boom. You can see First Eagle Global, the older sibling of Overseas, grossly under performing during those years. Then you can see the following bust, when almost everything except US stocks went up. And recently you can see the boom in real estate, which I believe is potentially the next bust. And you can see our alternative investment, First Eagle Global, sheepdogging real estate all the way up. Diversification pays.

Administrative note: Pete and Laurie will be in and out of the office during the two holiday weeks. We will be checking messages daily when we are not present in the office. Happy holidays!

