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O'Higgins Makes Dark Case for Gold

'Dow dogs' author makes a big call

By William Hanley

BAL HARBOUR, Fla. - If Michael O'Higgins is right, the crowds at Café Carpaccio here in ritzy Bal Harbour, north of Miami, could be a lot sparser in the coming years. As it is, the competition for a table is just as fierce as it was a year ago when we last had lunch here with O'Higgins, the beautiful people of a gilded age still jostling for a place on the patio.

But if O'Higgins is right -- and the economy is flirting with depression -- luncheon crowds everywhere could be thinner as the wealth effect stoked by the bull market continues to wear off and the mighty U.S. consumer faces a new reality in which the gilded age gives way to a darker time when gold shines.

Reality, as O'Higgins sees it, is that stocks are still grossly overvalued two years into the bear market, bonds are still undervalued but gold is warning against buying bonds, and gold is very undervalued versus stocks. O'Higgins, who runs O'Higgins Asset Management Inc. and made his name as a best-selling author, says the message is simple: Sell equities and buy gold stocks.

"Eleven interest rate cuts later, the market's lower and the economy's lower," he says, sounding an unpalatable note while perusing the menu he knows so well. "Why haven't they revived the economy? Earnings have gone down faster than stock prices. Insider selling is high and sentiment is complacent."

Remarkably fresh after just returning from a three-week round-the-world business/pleasure trip, he outlines the O'Higgins call over a Riviera salad brimming with shrimp while Lunch Money goes for the Pennette Harry's Bar, a dish of small penne with big Mediterranean taste. We recall that O'Higgins, who lives and works nearby, frequents Carpaccio's for the great food and value.

We also recall that at this time last year, he was still insisting that gentlemen -- "rich guys like me" -- prefer bonds. That strategy had helped O'Higgins funds return 71% on a net basis in 2000. He said bonds would be good till mid-2001. In the event, he now reports he finally sold bonds in the fall but his funds' stock-trading let him down and his three funds returned "only" an average 5.5% last year even as the broad market fell for the second straight year.

This year so far, he's up 6.5% with his strategy of putting 20% in gold stocks and 20% into shorting the stock market by writing calls on the S&P 500.

"I'll make money on both sides," O'Higgins says, noting that he has the 60% remainder of his funds in cash. "I think breaking even this year, you'll be a top performer."

O'Higgins was a top performer long before he created a worldwide phenomenon in the early 1990s with his book Beating the Dow, which outlined the "Dogs of the Dow" strategy of investing in the stock market. (Essentially, the Dogs entails building a five-stock portfolio using the highest dividend-yielding and lowest-priced among the 30 issues in the Dow Jones industrial average. But there are many other versions.)

He moved to Miami six years ago from Albany, N.Y., where he began his investment management career in the early 1970s and earned a reputation in Wall Street as a canny money manager with a flair for publicity.

He moved on from the "Dogs" and has been championing bonds over stocks -- a position he outlined in his latest book, Beating the Dow with Bonds: A High-Return, Low-Risk Strategy for Outperforming the Pros Even When Stocks Go South, which was published three years ago.

Now, the big call is gold. "What I try to do is to imagine reasonable scenarios that are not out of the realm of possibility because they've occurred before," he says.

In a scenario that will send chills up and down Wall Street and Main Street, not to mention the sleek crowd dining out this fine day at Carpaccio, O'Higgins declares "it's not inconceivable" that the Dow and the price of gold could meet around the 6,000 mark, stocks falling from around 9700 and gold appreciating from around US$300 an ounce.

The two measures were last even around 850 in 1980, he notes. Since then, the Dow hit a high of 11908 intraday and gold fell as low as US$250, for a stocks-versus-gold outperformance of 50 times. If gold now has the same performance it did from 1968 to 1980 -- rising 24 times to US$850 from US$35 – it would bring it to roughly US$6,000.

Under this "inconceivable" scenario, an ounce of gold prevention would indeed be worth a pound of cure. O'Higgins' ounces of prevention are in five gold stocks: AngloGold Ltd., Gold Fields Ltd., Newmont Mining Corp., Goldcorp Inc. and Placer Dome Inc., which he calls "my dog" among the group.

"Gold was so discredited it was looked upon as a joke -- out of the question. You could buy the whole industry for US $50-billion. How many things can you buy today at a 65% discount to what they sold at 22 years ago? We're talking something real."

Which brings us back to the reality check that O'Higgins believes the consumer is only now beginning to face. The fall in the stock market, where most baby boomers parked the bulk of their pension investments, will ultimately have an effect on consumption, which in turn will slow the economy.

"These people can't retire," he says. "They'll have to save more. How much money are they going to have to save to make up for what they lost in the stock market? Now they can only count on fixed-income returns of 2% to 5%. You've got to save a lot more money to reach your retirement goal. I don't know when it's going to start. But reality is going to set in. The numbers are the numbers."

"If the consumer gets back to reality, he's going to have to cut back. That's the only thing that's been holding up the economy."

So, O'Higgins concludes that a 40% drop in the stock market would represent fair value while demand for gold is skyrocketing -- "especially investment demand."

"Anybody can make money in a bull market," he says, looking around Carpaccio. "Very few people can do it in a bear market."

Of course, that's where Mike O'Higgins believes he comes in. He and the clients who have entrusted him with more than US$100-million to manage are 20% in gold stocks, 20% short the stock market and sitting on a 60% pile of cash. Despite returning "only" 5.5% in 2001, the 71% return in 2000 insured a strong start in this bear market. (More information can be had by visiting www.ohiggins.com.)

Meanwhile, he is working on his next book, about emerging markets, which he says is "well along."

Lunch is well along at Café Carpaccio, too, though the crowd has barely thinned out by 3 p.m. We get the cheque -- reasonable despite the 60% northern peso discount -- and make a mental note to be back next year around the same time to apply a reality check on O'Higgins' big call to see if it is as good as gold.