INTELLIGENT INVESTING

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Calamity Insurance

JEAN-MARIE EVEILLARD left a golden legacy at First Eagle funds—a slug of the yellow metal in each portfolio to hedge against disaster. By Michael Maiello

FOR 30 YEARS JEAN-MARIE EVEILLARD, 69, the semiretired elder statesman of First Eagle Investment Management, ran its mutual funds with great success. He did it by buying value and sitting on it. No momentum plays. Not much turnover. No fad stocks (he used to rail against banks that had "c" in place of "k" in their names, like Banc America).

He also had as one of the funds' larger positions a chunk of a classic store of value, gold bullion. That rather old-fashioned way to preserve wealth has stood the funds' investors well in the past decade, as stocks have gone down in price while gold has gone up from $300 to $1,100.

But don't mistake Eveillard for one of the swarms of goldbugs who have been attracted by the recent action in the metal's price. Eveillard is not a trader. He is uncomfortable forecasting inflation rates, guessing at GDP growth or pontificating about what the Federal Reserve will do next. He is, rather, a bottom-up stock analyst with a fixation on free cash flow. He defines that as cash flow from operations less capital expenditures or, as he once put it, comparing the cash in the register at the beginning of the day against the cash in it at the end of the day.

Still, Eveillard believes the current level of economic uncertainty is so great, and so much depends on the Fed getting things right, that gold is one store of value that no value investor should ignore. First Eagle has a half-dozen mutual funds (Eveillard is a "senior adviser" to their management company); all of them have between 5% and 10% of their assets in gold, except a pure-gold fund.

For individuals "a stake below 5% is irrelevant and anything more than 12% becomes more than insurance," the Parisian native says in a noticeable accent.

Insurance against precisely what, Eveillard doesn't claim to know. He believes the Fed's actions are critical to how things play out but has had exactly one dealing with a Fed chairman during his decades in finance. That was in 2003, when the Bank for International Settlements proposed buying out its public shareholders, including some of Eveillard's funds, at what he considered a lousy price. The bank at the time was a curious blend of regulatory institution and store of value, the latter taking the form of bullion kept in Switzerland. Eveillard's funds sued the BIS and its directors, who included Alan Greenspan. The result was a higher price for the investors who'd been squeezed out.

Gold has recently proved its ability to stabilize a portfolio. In 2008 the First Eagle Global Fund was down 22% and the First Eagle U.S. Value Fund was down 23%, as the Morgan Stanley Capital International EAFE index (in dollars) was down 43%. In 2009 the funds were up between 22% and 24%, closely approximating the market even though growth stocks far outpaced value. Among the holdings, besides the heavy metal, in one or both funds: Berkshire Hathaway, Home Depot, Apache and Sanofi-Aventis.

Before 1971, when President Nixon eliminated the international convertibility of dollars into gold, it wasn't so important for a U.S. dollar investor to hedge against his home currency. Now, says Eveillard, you need the metal as "insurance against an extreme outcome," given that the system of fiat money is "fraying at the edges."

But don't go into this with quick trading profits in mind, warns Eveillard. The risk that gold's price could sink by a few hundred dollars is especially prevalent at a time like this—when fear remains in the air, prices of gold and other commodities have been bubble-like and late-night TV pitchmen are offering to buy gold jewelry sight unseen. The metal's price is also highly sensitive to the dollar and, thus, the U.S. economy. Its price could take a hit if growth picks up and rising interest rates make U.S. Treasurys more appealing.

"If authorities engineer a recovery that is not inflationary it would be a considerable negative for gold," he says. "All of a sudden tax revenues would increase and the credit of governments would look better."

But you can't count on any such happy outcome. The credit quality of Eveillard's adoptive country has been going downhill for a long while. Two decades ago he expressed horror in the pages of FORBES that the public was living beyond its means, his point of illustration being a grocery store near his upstate-New York weekend home that had started stocking live lobster. Since then federal deficits have gotten rather larger.

Eveillard, who shuttles frequently between the U.S. and France, says the majority of investors he has talked with recently believe a recovery will follow the typical postwar pattern, with the big economies enjoying a multiyear expansion and gold prices falling back to earth.

He remains skeptical. To get to this soft landing, Fed Chairman Ben S. Bernanke will need "exquisite timing" in sopping up the extraordinary amount of liquidity the Fed has pumped into the economy. After the recent quarters of falling consumer and producer prices, the early 2010 inflation numbers are almost sure to look nasty by comparison, Eveillard figures. But even those could understate the risks. Bonds are, in his words, "an accident waiting to happen."

"Inflation is not the CPI. It's not asset prices, real estate or stock prices going up," he says. "Those are symptoms. Inflation is the excessive supply of money and credit." Because Treasury Inflation Protection Securities are linked to the CPI, Eveillard doesn't think they'll do investors much good in an ugly bout of inflation. All this leads him back to his favorite mainstay: gold.

True paranoids believe the only reliable way to own the metal is bullion vaulted and under guard somewhere safe. (The First Eagle U.S. Value fund is sitting on 55,000 troy ounces, stored with HSBC.) Eveillard figures a cheap, liquid exchange-traded fund, like SPDR Gold Shares, will do most investors just fine. He also likes the stocks of gold miners but cautions that most leverage their balance sheets, adding another layer of risk that investors should assume only knowingly.

The table below lists funds that invest primarily in gold or gold miners. All carry relatively modest fees and, when combined with other investments, can provide worrywarts the sort of cushion Eveillard recommends. **F**

GOING FOR THE GOLD

Value maven Jean-Marie Eveillard is no trendy goldbug, but he suggests individuals put 5% to 10% of their assets into the metal. Here are four smart ways to play.

FUND	TOTAL RETURN LATEST 12 MONTHS	TOTAL RETURN 5-YEAR ANNUALIZED	ASSETS 11/30/09 ($MIL)	ANNUAL EXPENSES PER $100
ISHARES COMEX GOLD TRUST	44.1%	NA	$3,105	$0.40
MARKET VECTORS GOLD MINERS ETF	91.5	NA	5,770	0.55
POWERSHARES DB GOLD FUND	41.6	NA	195	0.58
SPDR GOLD SHARES	43.8	20.5%	42,702	0.42

Performance through Nov. 30, 2009. NA: Not available. Source: Lipper.