

Taking Stock: Gold is no standard against inflation

by Malcolm_Berko

Dear Mr. Berko: A salesman has been soliciting me to buy gold bullion. Even though I'm familiar with all the negatives of owning the metal, his pitch makes awfully good sense. He insists the United States will go through a period of hyperinflation because of the trillions of dollars being added to the national debt. I don't want to buy gold. So I'm asking you, are there any alternatives to protect us if inflation runs from here to the moon? I'd appreciate your thoughts on this. Also, what do you think of International Paper for a 500-share speculation. It almost yields 10 percent and its revenues seem fairly steady. I know a little about this industry, and IP seems to be the best positioned company with the best dividend record. â€” H.W., Boca Raton, FL

Dear H.W.: No! No! Ten thousand times no! Do not buy gold as a protection against inflation. In my opinion, and in the opinion of many professionals in the business who are much smarter than I am, Treasury Inflation Protected Securities are the safest and probably the best inflation hedge between here and "the moon." The principal of a TIPS increases with inflation and decreases with inflation as measured by the Consumer Price Index.

So, if inflation next year is 10 percent, the principal value of your TIPS increases by 10 percent. However, if you're wrong as Corrigan and the CPI declines by 10 percent, the principal value of your TIPS declines by 10 percent. And when TIPS mature â€” they have maturities out to 30 years â€” you are paid the adjusted principal or the original principal, whichever is greatest.

TIPS pay interest twice a year at a fixed rate. Now this rate is applied to the adjusted principal. So, like the principal, the interest amount (not interest rates) will rise or fall with the principal value of the TIPS. If you have a 3 percent TIP, which was bought at par (\$1,000) five years ago, the principal value would be about \$1,445 today. And the interest payment would be 3 percent of the \$1,445. However, if we have deflation and the TIP is worth \$988, the interest payment would be 3 percent of \$988. Get it? Got it? Good!

So go tell that gold jerk to put a gold ring in his nose. You can buy TIPS from your broker, your bank or directly from the government. However your broker probably thinks TIPS is a hot stock that may move up suddenly. Your banker is even dumber; he thinks a TIPS is a gratuity given to a waiter "to insure prompt service." However, if you ring Charles Schwab I think you will quickly get the straight skinny.

International Paper Co. (IP-\$7.72) pays a dividend of 25 cents, which hasn't changed in 13 years. It is still the largest paper and forest-products company in the world, and the weak world economy has beaten the stock to a pulp from its \$33 high price this year.

Well, there are a number of numbers that make this stock interesting. This company owns 300,000 acres of forestland in the U.S. and 250,000 acres of forestland in Brazil, plus "cutting rights" in Russia that can produce more timber than its Brazil properties. Meanwhile, even in this soft economy, Wall Street's consensus

indicates that IP will earn between \$2.15 and \$2.40 this year on revenues of \$25 billion. That's a profit-to-earnings ratio of less than 5; a book value of nearly \$21 (which makes IP buyout bait) and its \$1 dividend gives a new shareholder close to a 12.5 percent yield.

I don't like IP, and during the past 20 or more years I could never warm to the stock. But whenever a big, healthy company trades so far below its book value, I begin to get interested. And IP is a big, healthy company. If there is a buyout (probably a Scandinavian paper company) I would guess that a price of two times book value would be fair. So I don't have the slightest objection if you decided to purchase 500 shares of IP. I don't think there's any danger to the dividend and I think the current price is scraping the bottom. I suspect revenues, while they may not rise over the next couple of years, will remain at the \$24 billion or more level. IP seems to be a classy speculation.

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