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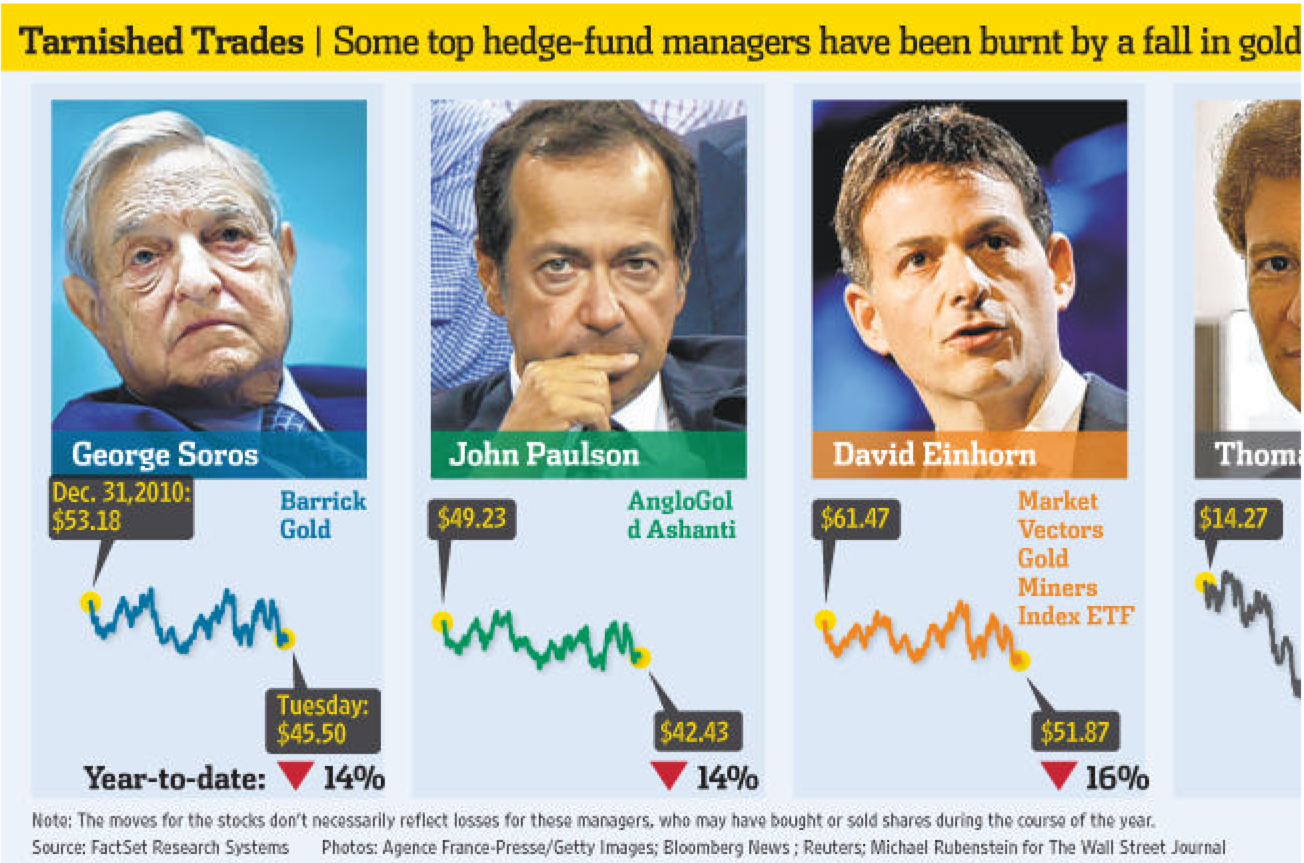
Gold Left Some Investors in the Dust

By GREGORY ZUCKERMAN And LIAM PLEVEN

Gold has been among the best investments in 2011.

Shares of gold miners? Among the worst.

Gold is up 12% this year but shares of gold miners have fallen almost 16%. Smaller gold miners are down almost 40%, based on the returns of leading exchange-traded funds tracking those stocks.



The surprising gulf has caused pain for some of the biggest names on Wall Street—including John Paulson, George Soros, David Einhorn, Seth Klarman and Thomas Kaplan—many of whom piled into gold shares over the past year, sometimes by shifting away from gold itself.

Bulls figured that gold miners had more upside than gold, partly because mining stocks outperformed during past bull markets for the metal.

But this year, gold miners have been hit by concerns that haven't tarnished gold prices. Investors have worried that mining costs are rising, and that governments around the world are becoming more aggressive in taxing resources companies.

They're also concerned that gold miners might squander any windfall with ill-conceived acquisitions or other moves.

Plus, in a turbulent year, gold shares have suffered along with most other stocks as many investors fled to the safety of U.S. government bonds.

Many investors expect gold to protect their portfolio from economic uncertainty, but gold's recent sharp rise is being fueled by speculation that could end badly for buyers, says Kurt Brouwer, editor of MarketWatch's FundMastery blog.

"When you sell your portfolio, you say, well, what's cyclical, and that includes mining stocks," says HSBC analyst Patrick Chidley, who called gold-mining stocks a "buying opportunity" in a June research report and still thinks they will pay off.

Investors who once turned to gold miners to gain exposure to bullion now can purchase exchange-traded funds that are backed by gold.

"People who want to buy gold stocks for gold are disappointed," says Mr. Chidley. "That drives more and more of them to just buy the gold."

Mr. Kaplan, a longtime gold investor, runs family funds that held nearly 52 million shares of Novagold Resources Inc., a miner focused on Alaska and British Columbia, whose stock is down about 40% this year. He also owns more than 61 million shares of Gabriel Resources Ltd., which owns a huge gold project in Romania, and is down more than 20% this year.

The declines have cost Mr. Kaplan about $430 million this year, based on the change in value of his holdings, noted in regulatory filings. The figure is about $600 million if Mr. Kaplan's warrants, or rights to buy shares at stipulated prices, are included. Still, Mr. Kaplan bought in at prices much lower than today and is sitting on huge paper profits.

"Our focus is on adding to our holdings, especially mines and equities in safe" jurisdictions, says Mr. Kaplan, who believes gold shares are due for a rebound.

Seth Klarman's Baupost Group, a value-oriented firm, owned nearly 13% of Gabriel at the end of the third quarter. He added to his position through much of this year, according to regulatory filings. Mr. Klarman also bought five million shares of Novagold in the third quarter.

In the third quarter, David Einhorn's Greenlight Capital more than doubled its holdings of the Market Vectors Gold Miners Index ETF, making it the hedge fund's third-largest holding, or more than 7% of his firm's portfolio, according to FactSet Research.

Other well-known hedge funds, including Blue Ridge Capital Holdings, Moore Capital Management and Lansdowne Partners, also were major holders of this ETF, as of the end of the third quarter.land

Mr. Einhorn is among investors who say they're holding on to gold mining stocks. "It has reached the point where gold mining stocks should do well even in a stable gold market," Mr. Einhorn wrote in his most recent letter to investors. "We expect the price of gold to appreciate further, so gold miners should do even better."

Mr. Paulson's Paulson & Co. was the largest holder of Johannesburg-based miner AngloGold Ashanti Ltd., with 9.6% of the company's outstanding shares at the end of the third quarter.

AngloGold is down about 14% so far this year. Mr. Paulson holds nearly 3.4% of shares outstanding of Gold Fields Ltd., which is down about 14% in 2011, and more than 8% of NovaGold. That helps explain why Mr. Paulson's fund dedicated to gold investments is down nearly 6.6% in 2011, after losing more than 7% in December, through Dec. 13, according to investors.

Billionaire George Soros sold almost all his bullion holdings in the first quarter, according to SEC filings, while upping bets on shares in a number of gold miners this year. Since then, gold has risen about 11%, while one of the investor's stock holdings, Barrick Gold, has fallen about 14%.

Spokesmen for Paulson, Soros, Blue Ridge and Moore declined to comment. Mr. Einhorn and Mr. Klarman also declined to comment. A representative of Lansdowne didn't respond to requests for comment.

Though all the investors were major holders of gold shares at the end of the third quarter, based on filings, it isn't clear what their holdings are today, or how they traded them throughout the year.

Investors have also been frustrated that gold itself has been falling recently, even though turmoil in Europe continues. That's a possible sign the metal may be losing some of its status as a safe haven.

"It's a little perverse that gold loses value when there's a currency crisis occurring in Europe" that should spark interest in gold, says Darren Pollock., who helps run Cheviot Value Management, LLC in Los Angeles and has been a fan of gold shares.

He notes that Chinese entities have purchased two gold mining companies in recent months, something that should help focus attention on the sector. "But nobody seems to care, yet," Mr. Pollock laments.

Other bulls note that gold-mining companies are seeing improving revenues, and that shares are more attractive relative to gold prices, making them bargains that investors eventually will recognize.

Not everyone is convinced a rally is imminent, however. After gold prices fell, and didn't show signs of a speedy rebound despite a turbulent environment, HSBC's Wealth Opportunities funds, which invest $2.2 billion for wealthy individuals and don't work with Mr. Chidley, the analyst at the bank, first sold silver companies, and then dumped gold mining shares. The funds continue to steer clear of these shares, the firm recently wrote to its clients.