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Gold Notches Twelfth Straight Yearly Gain

By Brendan Conway

Gold's twelfth straight annual rise is clinched. The metal has notched a 2012 rise of just under seven percent, driven higher by … by what, precisely?

Some excellent food for thought comes by way of a recent paper on gold by **Claude B. Erb** and **Duke University's Campbell R. Harvey**, who take an extensive look at gold's price behavior over history. It's common enough to argue that the last few years' aggressive quantitative easing by the **Federal Reserve** and other central banks' moves toward currency debasement are the reason gold is marching higher. But the key distinction may be that investors' *perceptions* of this debasement, as much or more than the reality, may be the real factor, so tough to measure, that you should watch.

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The price of gold is "very sensitive to even a remote possibility of another **Weimar Republic**-like inflation episode," Erb and Harvey find in a study that reaches all the way back to Roman army pay scales. Their other conclusion that may not be very comforting to gold bulls: History suggests gold is not very useful as a hedge against unexpected inflation. Read the paper for the supporting data.

How about gold as a useful place to be in turbulent markets? Not in most cases. "[G]old may not be a reliable safe haven asset during periods of financial market stress." What about a haven from hyperinflation? It didn't work in Zimbabwe, the most recent place to see the phenomenon (the dollar, ironically, did work there). What about the role of low yields increasing gold's attraction? "[T]he argument that gold is attractive when real returns on other assets are low is spurious. Low real yields, say on TIPS, do not cause the real price of gold to be high."

So what really drives gold's price? Erb and Harvey have a candidate: Fear. Fear of inflation, that is. Which isn't the same as arguing that central banks' aggressive quantitative easing is driving gold higher. Rather, it suggests investors should look to how many other investors are concerned about debasement for the true measure of where gold is headed.

The factor I called gold's stealth catalyst recently also comes in for a mention: emerging market central banks. A new buying binge could certainly pressure gold higher, they find. The other factor worth noting: There may be just 20 years' worth of accessible gold supply left in the ground. Unless new sources are found, a sharp dropoff in supply also bears watching.

On the year, the **SPDR Gold Trust** (GLD) and **iShares Gold Trust** (IAU) notched gains of nearly 7%. The **Sprott Physical Gold Trust** (PHYS) lagged, rising 3%.

For comparison, the **iShares Silver Trust** (SLV) enjoyed a yearly gain of 9%. Most mining stocks, meanwhile, racked up another poor year. The **Market Vectors Gold Miners** (GDX) was down by 10%, though the **Global X Silver Miners** (SIL) finished up by more than 7%. The **Market Vectors Junior Gold Miners** (GDXJ) slumped 20%. All figures given on a price basis.

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