

# 5 Huge Myths About Gold

Max Nisen | Jun. 11, 2012, 12:16 PM | 20,127 | 28

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Is gold really a good gauge of inflation?

No, says Claude Erb of the Trust Company of the West and Campbell Harvey of Duke University.

In a new working paper titled "The Golden Dilemma", the pair take up the key drivers of gold and put them to the test.

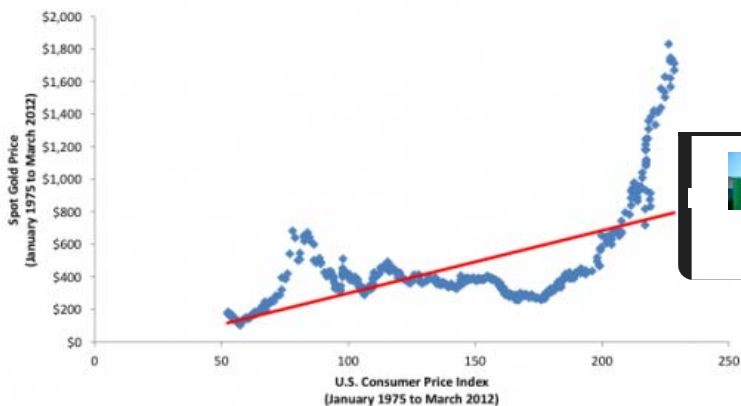
According to the authors of the paper, some of the most common claims about the influencers of gold's value are not true.



Kevork Djanszian/Getty Images

## MYTH #1: Gold is a good hedge against inflation.

Exhibit 1. Gold as an Inflation Hedge



Inflation is a common reason cited to own gold. First, a very literal look. This graph shows spot gold prices against the U.S. consumer price index, a common measure of inflation. The red line is a regression that projects the implied price of gold were it determined by the CPI. It shows a mild positive relationship, but also that gold is volatile, does a bad job of tracking the CPI, and is wildly expensive compared to its utility as a hedge. The current price implied by the CPI is \$780.

Source: The Golden Dilemma, p. 4

## MYTH #1: Gold is a good hedge against inflation.

Exhibit 2. The Real Price of Gold since the Advent of U.S. Futures Trading



Here's gold over the consumer price index. If gold were a good inflation hedge, that blue line would go straight across.

Erb, Harvey (2012)

Source: [The Golden Dilemma](#), p. 5

**MYTH #1: Gold is a good hedge against inflation.**

Exhibit 4. Long-term Inflation Hedging and Gold



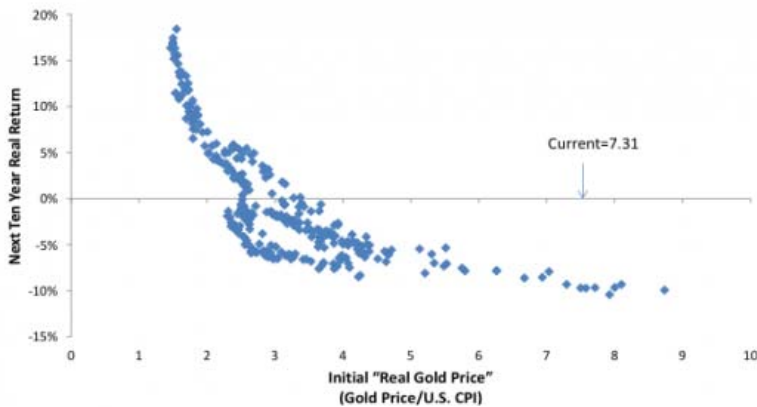
Gold isn't much better as a long term inflation hedge.

Erb, Harvey (2012)

Source: [The Golden Dilemma](#), p. 6

**MYTH #1: Gold is a good hedge against inflation.**

Exhibit 5. Mean Reversion of the Real Price of Gold



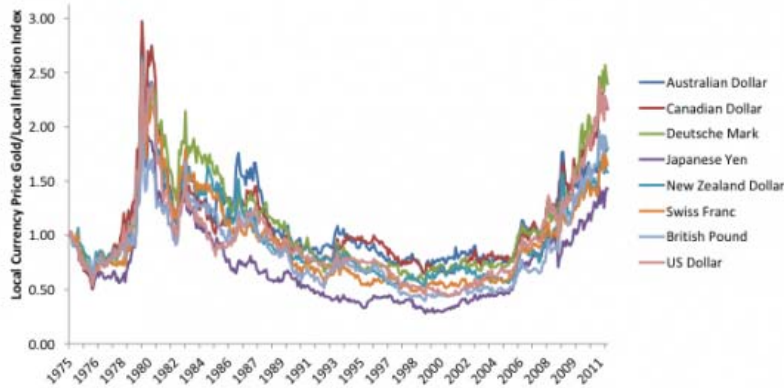
Real prices tend to revert to the mean. Don't look for long term returns if you buy now.

Erb, Harvey (2012)

Source: [The Golden Dilemma](#), p. 7

**MYTH #2: Gold is a good currency hedge.**

Exhibit 12. The Real Local Price of Gold, 1975-2012



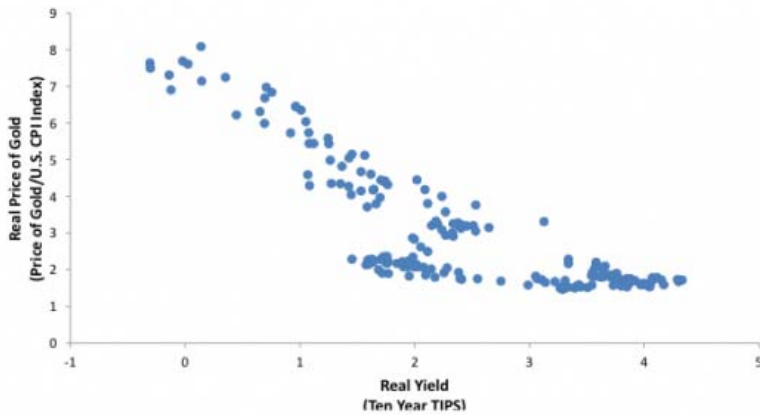
Gold prices in these 8 currencies have moved nearly in tandem.

*Erb, Harvey (2012)*

Source: [The Golden Dilemma](#), p.15

**MYTH #3: Gold is an alternative to low real returns.**

Exhibit 13. The Real Price of Gold and the Real Interest Rate, 1997-2012



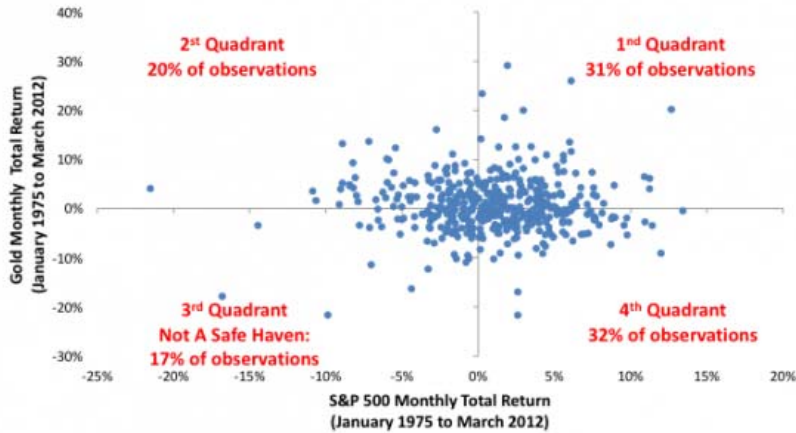
Claude Erb and Campbell Harvey argue that this is a *classic case of spurious correlation*. One could argue that low yields cause high gold prices and vice versa. It is additionally possible that low yields and high gold prices are both driven by the some common external force, like fears of hyperinflation.

*Erb, Harvey (2012)*

Source: [The Golden Dilemma](#), p. 16

**MYTH #4: Gold is a reliable safe haven in times of financial stress.**

Exhibit 14. Gold and the S&P 500, 1975-2012



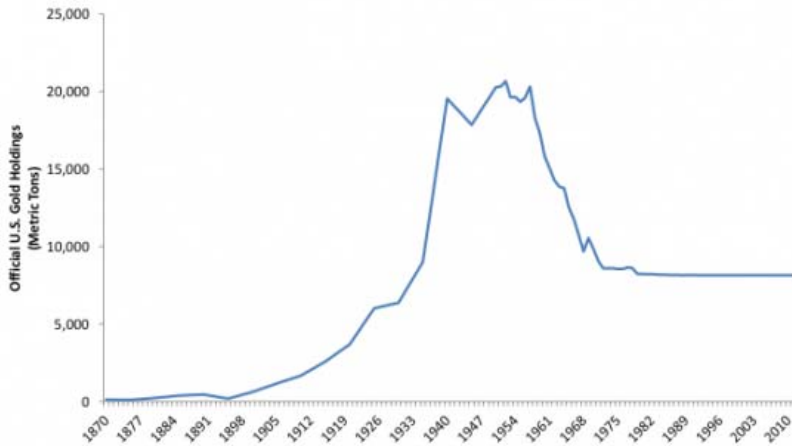
If gold were a reliable haven, quadrant three would be nearly empty, rather than containing 17% of observations.

*Erb, Harvey (2012)*

Source: [The Golden Dilemma](#), p. 18

**MYTH #5: There is already a de-facto gold standard**

Exhibit 17. Official U.S. Gold Holdings (Metric Tons)



Gold prices have little to do with either the U.S. monetary base, or its official holdings of gold. Official government holdings of gold have remained nearly constant in spite of the expansion of the Federal Reserve's balance sheet.

*Erb, Harvey (2012)*

Source: [The Golden Dilemma](#), p. 23

**For much more on the subject**

Don't miss: [The Truth About Gold](#)