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Swedroe: Gold Is A Hedge—If You Have Time

By Larry Swedroe | November 14, 2014

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Gold has long been used as a store of value, as a unit of exchange and to make jewelry. More recently, due to the popular view that it's a safe haven in times of economic trouble, gold has come to be thought of as an investment asset with a potential role in the asset-allocation decision, such as in Harry Browne's Permanent Portfolio.

Don Bredin, Thomas Conlon and Valerio Poti—authors of the 2014 paper, **"Does Gold Glitter in the Long-Run? Gold as a Hedge and Safe Haven Across Time and Investment Horizon"**—examined the period from 1980 through 2013 to determine whether gold consistently acts as a hedge and safe haven.

The study, which incorporated data from the U.S., U.K., German and Japanese stock and bond markets, adds to the literature by looking at gold's hedging properties over short and long horizons. Following is a summary of their findings:

- Consistent with prior research findings, investors turn to gold as a store of value in times of turbulence. Thus, it consistently acts as a short-run—30 days during recessions and 80 days during expansions—hedge for all assets studied.
- Over the longer term, gold may actually increase downside risk for stocks as well as bonds, especially during recessionary periods.
- Gold consistently acts as a safe haven for equities and debt during *financial crises* across *all* horizons.
- Gold is found to consistently have the highest annualized risk levels, followed closely by equities and then bonds.

The bottom line is that the authors found that, in the short term, gold does reduce both variation and downside risk during times of market turmoil. However, in the long term, while gold can serve to reduce volatility during periods of turbulence in the market, it doesn't routinely do so.

During both expansions and recessions, gold can increase downside risk over the long term. Thus, the authors concluded: "An investor seeking to benefit from the short-run safe-haven properties of gold has to accept greater downside risk at longer horizons."

While the authors did examine the use of gold as a hedging vehicle for bonds, they didn't look directly at the issue of whether gold hedges inflation. And that's one of the main reasons cited by investors for owning gold. A quick look at the historical evidence demonstrates that gold isn't a reliable hedge for the time horizon of most investors.

Consider that in January 1980, gold peaked at $850. Before bottoming out in 2002, gold's value in real terms fell about 85 percent. Can something be a hedge against inflation when, over a 22-year period, it loses 85 percent in real terms?

It cannot.

On the other hand, research by Claude Erb and Campbell Harvey showed that, after conversion into gold, the military rate of pay between U.S. Army captains of today and Roman centurions under Emperor Augustus is comparable. If your horizon is that long, it seems like gold would be a good inflation hedge, though it provided no real return over that 2,000 years. So, how long is your horizon?

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