Why You Should Buy Gold

May 26, 2016 1:24 PM ET 23 comments
by: Bram de Haas

Summary

- Soliciting investment related questions from readers I received many great ones.
- This one being about taxes and goldbugs.
- Is it good or bad to hold gold?

I am a big believer in tax efficient savings. But, how do you prepare for regular RMD coming out of your account. It seems that, once you hit 70.5, your RMD size is going to be greater than cash accumulated from dividend yield or REIT distribution. So, you are forced into selling the portfolio down. Is there a way to change the RMD calculation by either lengthening the calculated years or clever year end manipulation of the portfolio? Also, I hear that you can call the RMD earned income so the after tax portion can go into a roth. Is that true?

The second is the emotional discussion of people who are so angry or scared of the market that they pulled out and put it all in gold (or diversified into gold and silver...) These folks are not logical. I hate when they enter the room smug in the knowledge that they are prepared for the next Armageddon when in fact they are making a huge mistake.

Even if Armageddon was coming, the grocery store does not take gold and you must convert it to dollars or watch it lay uselessly in your back yard. Better to buy a gun and a peppers station under your house.

The first question by this reader, I'll keep his name confidential as it involves a tax question, is a little bit too tough for me. I understand this is about a required minimum distribution, but I'm not a U.S. citizen and lack any knowledge of this subject.

The second question is about goldbugs. They sure can be annoying and the way they are now is nothing compared to when the next crisis hits.
I'm not sure they aren't thinking logical. Certainly, they are operating under a different paradigm where their actions do make sense.

To an extent, I understand it if someone tries to live a decent life on his or her income and put all savings into gold; with the expectation of keeping up with inflation in even the worst case scenario and making bank in a few worst case scenario's like a zombie apocalypse or raging inflation. Actually, I prefer that strategy to putting all your savings into a savings account, a popular investment plan in the Netherlands, non-existent interest rates notwithstanding.

Any strategy where anyone puts nearly 100% of their assets into one type of asset doesn't make a lot of sense to me. It must be the result of laziness, overconfidence or lack of imagination.

A friend of mine recently spent some time working as a gardener for a small business. The small business owner turned out to be one of those gold bugs. What surprises me most is how open these guys are about their preference. Telling everyone how much you love physical gold as an investment, kind of defeats its purpose.

Even if you don't get robbed, it doesn't necessarily work so well as a safe haven as it isn't entirely clear you will be able to access your stash when the Black Swan event manifests itself. A famous example of a gold stash not providing the desired protection is the Hoxne hoard as the owners clearly were never able to retrieve it.

So there is something to be said for, as this reader suggests, investing in a gun instead. People have, mostly tongue in cheek, given the appropriate preparations for catastrophic events a lot of thought. Even the CDC has a list of stuff that's useful in the event of the zombie apocalypse.
It doesn’t include a gun but there are much more elaborate survivalist lists of useful gear and suggested supplies. The risk that it will be useful at all in your lifetime is small (depending quite a bit on where you live). However, the value of these items at the moment you need them is nearly infinite. I’d never suggest starting an investment career by stocking up on survivalist items, but if the total cost or disaster preparation is negligible and the payoff at the time you need it is nearly infinite, it should be a reasonable investment at least.

Source: CDC disaster kits
By the time I reach a one-in-a billion chance of hyperinflation, the expected value of gold is $72,970. So, I conclude that even a small probability of hyperinflation has a big impact on the price of gold.

Goldbugs could even be right and the expected value of holding a portfolio of gold far exceeded the expected value of a portfolio of stocks. For example, if the odds of hyperinflation are far greater than one in a billion. At the same time, it's very possible the far most common outcome will be for them to underperform badly. Truth is, they could be right but there is no way to know for sure.

Ultimately, Campbell R. Harvey recommends holding some gold, in his paper, but as part of a broader basket of commodities. That's a solution that's fairly elegant. In the scenario where gold value goes up 100x, even a small allocation will achieve preservation of your ability to buy stuff but in the vast majority of futures where gold goes down or does nothing, you are hardly held back by it.

Holding commodity ETFs is a great way to see your money evaporate as you are facing roll costs of the underlying future contracts. Unless the Black Swan hurries, your hedge is gone before it ever hits. It probably works better to hold physical commodities. I don't really like anything that goes bad (like agricultural commodities) because you want to have it in set and forget mode.

Some of the precious metals are fairly easy to stash but if you diversify into more common metals, your spouse isn't going to like it. Or, alternatively, you are faced with a lot of warehousing expenses. There are quite a few commodity-backed ETFs though. Meaning they are holding the physical commodity at scale which is more efficient as compared to you stashing it in your basement. According to ETFDB.com, the following ETFs are all physically backed options: SPDR Gold Shares ETF (NYSEARCA:GLD), Physical Silver Shares ETF (NYSEARCA:SIVR) and the Physical Platinum Shares ETF (NYSEARCA:PALL) and Physical White Metal Basket Shares ETF (NYSEARCA:WITE).

Make sure to check my previous article in this series where I answer questions from readers called: How I Approach Position Sizing.

**Disclosure:** I/we have no positions in any stocks mentioned, and no plans to initiate any positions within the next 72 hours.

I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

## Comments (23)

**a_zaks**
"Why You Should Buy Gold"

Yet to see a satisfying answer to that question.
It IS pretty though.

26 May 2016, 01:34 PM

**Gary D.**
WITE is defunct since March 2, 2016.
Closed due to lack of investor interest.

26 May 2016, 01:43 PM

**Bram de Haas , Premium Contributor**
Author’s reply »  Thanks Gary, didn't realize that.

27 May 2016, 05:49 AM

**Confusionus**
Interesting article. Thanks Bram!

Gold is a most intriguing topic, and I have researched provable catalysts (as distinct from the many apocryphal catalysts that float around the comments boards).

In the end, all I end up with is: "Financial catastrophe (hyperinflation being one), or the threat of it."

It is most intriguing to have an asset with just one known catalyst, is it not?

I think there are many situations in our present macroeconomy that could perhaps lead to problems (high consumer debt, EU crisis from Brexit, etc); but I don’t see anything on the "we’re f****d!" scale, like we saw in 1929 and 2008.

And the opportunity cost of holding gold bothers me. For me, that's investable capital that is tied up to ensure against a scenario that has cropped up twice in 100 years.

Confusionus Say:

The Wise Man buys gold
When his imagination
Cannot conceive a more dire
Crisis than is beginning to emerge.

27 May 2016, 09:31 PM

Grey Swan
I would only allocate a small portion of my assets to gold. It is kind of like owning homeowners insurance in Florida as you don't need it every year until the CAT 5 hurricane comes along. Gold is a hedge against the continued debasement of our currency and the improbable hyperinflationary scenario.

26 May 2016, 01:42 PM

ROICVSWACC
Mr. T could probably provide a satisfying answer.

Sorry Bram, not sure if you got the A-Team over there, but it's like the foundation for all good American television.

With that said, wouldn't a better investment be gold spray paint in case of zombie apocalypse? It has a pretty deep zombie apocalypse moat due to it's ability to paint anything gold and be sprayed in the eyes of pesky zombies.

Another good idea is gold AK-47s though they might be a little heavy. Its a favorite for cartel leaders and the late Saddam Hussein.

26 May 2016, 01:51 PM

Bram de Haas, Premium Contributor
Author’s reply » B A Barracus! For sure. You can get pretty much anything in gold I guess;
http://tinyurl.com/zs2... 

27 May 2016, 05:57 AM

a_zaks
For the AK-47, you most certainly need rhodium-gold alloy to increase structural strength. Pure gold would probably compromise and would be dangerous of you need to fire a shot. Adding rhodium, although expensive, would improve safety.
The added wait might be of use in close combat. To incur a heavier damage as a blunt force weapon.

In all, an excellent suggestion.

26 May 2016, 02:29 PM

jccnidan1
Financial advisors telling clients to buy gold which has no balance sheet no income statement no nothing but a nice shine. You want a hedge buy a liquor company

26 May 2016, 02:35 PM

Bram de Haas, Premium Contributor
Author’s reply » I like that a lot jccnidan1 working on it :)

27 May 2016, 05:57 AM

Confusionus
Confusionus Say:

The Wise Man invests in sorrow,
For human suffering is a never-ending battle.

27 May 2016, 09:33 PM

EK1949
Why not buy stocks that perform well during recessions?

Gold had greater value relative to everything else when people who owned lots of it lived in castles surrounded by moats, protected by their faithful and well armed retainers.

If another Dark Age should come, will you be the owner of that castle? Will the gold in your basement or fallout shelter be enough to buy that castle? Will your armed protectors be faithful or will they take your gold, your castle and not even pay your Comcast bill?

26 May 2016, 03:16 PM
Buyandhold 2012

"So there is something to be said for, as this reader suggests, investing in a gun instead."

Sorry, Bram, no guns in my house. Something tells me that if I kept a gun in my house for protection that the intruder would shoot me with it.

My father used to keep World War 11 rifles in the house with bayonets. He wanted to be prepared in case we were ever invaded by the Japanese again.

My great uncle Nick used to keep a gun near his bed in case the Bulgarians invaded. He had gone back to Greece to fight in the Balkan War.

My grandmother had a fear of Turks. She was always well armed.

The only gold that I have is a box filled with old gold coins which I inherited from a great aunt in 1975. It has been sitting in the safe deposit box at the bank for 41 years. A lot of good it has done me. I should have sold it and bought Philip Morris.

But I guess having a box filled with old gold coins might help in case we are ever invaded by the Japanese or the Bulgarians or the Turks.

26 May 2016, 04:55 PM

Bram de Haas, Premium Contributor

Author’s reply » Philip Morris stock right ;)

27 May 2016, 06:02 AM

Blake Morgan, Contributor

Reasons not to buy gold: 1. You pay higher taxes, destroying the inflation hedge versus buying stocks, which have a lower tax rate. 2. Gold never pays a dividend or grows. 3. Gold only has value because it has had value in the past, that could change, given that younger generations don't give a damn about precious metals.

26 May 2016, 05:38 PM

Bram de Haas, Premium Contributor

Author’s reply » Thanks Blake, some great points.
Confusionus
I have wondered the same. Many people I know would be more comfortable with being paid in Bitcoin than gold.

27 May 2016, 09:35 PM

Statham
"There are quite a few commodity-backed ETFs though. Meaning they are holding the physical commodity at scale which is more efficient as compared to you stashing it in your basement. According to ETFDB.com, the following ETFs are all physically backed options: SPDR Gold Shares ETF (NYSEARCA:GLD)..."

I don't know about all the other ETFs listed at the end there but GLD would be a prime example of how questionable these "commodity-backed ETFs" can be. Paper gold GLD claims to be fully backed by physical gold bullion but yet it refuses to give retail investors the right to redeem for any of these 'claimed' gold bullion. This fact alone would mean GLD shares are nothing more than paper at the end of the day. Furthermore, GLD's prospectus is chalk full of weasel clauses and legal loopholes that allows the fund to get away without the full physical gold backing. One good example of this is the clause that states GLD has no right to audit subcustodial gold holdings. To this day, I have not heard of a single good reason for the existence of this audit loophole.

CNBC's Bob Pisani also made a highly publicized visit to GLD's gold vault in a segment called Gold Rush: The Mother Lode. GLD's administration organized this visit to show that GLD's gold actually exists. However, the gold bar held up by Mr. Pisani showed a serial number of ZJ6752 which did not show up on the latest bar list during that time. It was later found that this "GLD" bar actually belonged to ETF Securities.

26 May 2016, 05:45 PM

Bram de Haas, Premium Contributor
Author's reply » Thanks Statham, awesome insight into GLD. I specifically looked up a number of physically backed up ETF's because of the roll costs of the other ones, that are only suitable for short term holding period.

27 May 2016, 06:04 AM
Maniad1
What the hell is wrong with everyone thinking gold is for the apocalypse? It's gone up every year since 2001 and you know what it took to bring it down? Trillions in stimulus, zero and negative interest rates and bailed out failed financial institutions. Get some precious metals in your portfolio and stop listening to nonsense

27 May 2016, 10:20 AM

Confusionus
I think I just did.

27 May 2016, 09:37 PM

Bruce Bohannon
An RMD is NOT earned Income in the US. There are many ways to perform tax efficient drawdowns but this depends on 'your' portfolio. Since the US now has a 5 tier 'personal' Federal Income tax bracketed system - you might be wise to get some professional tax advice. Today the cream of the crop tax advisors are commonly looking out across our tax landscape across up to 15 years. Income Taxes are one of the largest drags on portfolio returns. State and Estate taxes vary by state as well.

27 May 2016, 03:16 PM

Peter Palms
Here is why you should own physical gold
Why I'm A Bearish Gold Bug
http://seekingalpha.co...

Physical Gold Flows East As Manipulated Paper Markets Lose Credibility
http://seekingalpha.co...

The Main reason to Buy Gold is it is so underpriced
The total amount of gold exhumed in the history of the world is approximately 183,600 tonnes, or 5.9 billion ounces. If we take that figure and multiply it by the closing price on June 16, $1,181 per ounce, we find that the value of all gold comes within a nugget's throw of $7 trillion. This is an unfathomably large amount, to be sure, yet it pales in comparison to total global debt. The world now sits beneath a mountain of debt
worth an astonishing $200 trillion. That's greater than twice the global GDP, which is currently $75 trillion. More surprising is that if gold backed total global debt 100 percent, it would be valued at $33,900 per ounce. So Gold's price, upon which the settlement of these debts ultimately relies is vastly understated compared to the debt that held against a fiat currency that contains no gold or any other real money. Including derivatives that would increase the price per ounce by another 6 times that amount because the global derivatives market is another $1.2 quadrillion, almost 90% is owned by the U.S. This figure is greater than the entire world's GDP, 20 times the GDP to be exact, and should not be taken lightly. Why? Simply because of the fact that it is highly unregulated, it is so unregulated that the Congress has declared it illegal to regulate it.

http://seekingalpha.co...

Most of exhumed gold isn't ever traded. It is a safeguard against loss through inflation. Most of the naked gold shorts issued are never transacted and just expire on expiration date. This manipulation does enable the price to continue to be fixed.

28 May 2016, 04:05 PM

DO NOT BUY SILVER...
Before You Buy, Learn How to Avoid Costly Rookie Mistakes.
Get our FREE Silver Investment Guide Now! CLICK HERE SBGold.com