HULBERT ON MARKETS

Is Bitcoin Stealing Gold's Thunder?

The future looks tarnished for the venerable safe-haven investment. Blame weak inflation—and cryptocurrencies.

By MARK HULBERT
Oct. 4, 2017 5:45 a.m. ET

Getty Images

The skyrocketing popularity of Bitcoin and other cryptocurrencies has introduced a whole new level of uncertainty to gold's price movements.

In early September, gold approached the $1,350 level, nearly $200 above where it stood last December. Judging by the several dozen gold-market timers I monitor on a daily basis, many started to believe that the metal might finally be ready to mount a major advance toward its all-time high of $1,917.90 an ounce, which it reached in August 2011. But suddenly it hit an air pocket, quickly shedding more than $50 in just two weeks. Since then, gold has dipped below the psychologically important $1,300 level.

Bitcoin, in contrast to gold's year-to-date gain of nearly 10%, has soared more than 340%. Not surprisingly, that huge gain has attracted a lot of investor attention. The total market value of all cryptocurrencies now stands at over $140 billion, according to CoinMarketCap.com—double the combined market value of all gold and gold-mining

Most Popular
1. AMD Insiders Sell $31.4 Million in Stock
2. Applied Opto Plunges: More Pain to Come? Finisar at Risk?
3. AT&T: Darned If They Do, Darned If They Don't
4. AT&T: This Is the Real Storm Crushing the Stock
5. Analyst on AT&T: 'The Wheels Are Falling Off of Satellite TV'
SEE FULL LIST

Latest Market Videos
1 Roku Lowers the Price on 4K. So What?

exchange-traded funds.

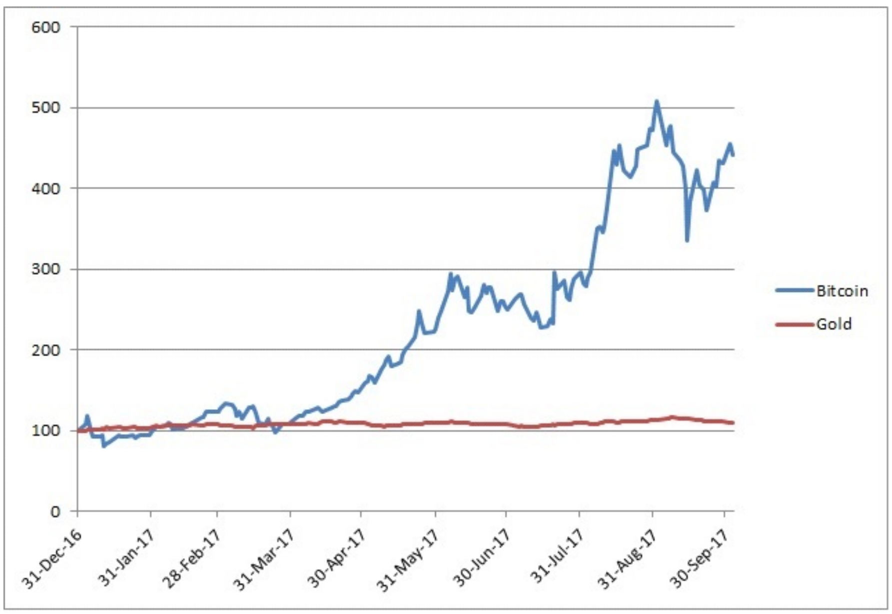
Would gold be performing better if cryptocurrencies weren’t as popular? That certainly seems plausible. Those currencies are at least in part an alternative to gold, since “they provide a new safe haven, albeit a volatile one,” Campbell Harvey, a Duke University finance professor, tells *Barron’s*. “You don’t see the Chinese talking much about buying gold anymore—but a lot of Chinese are interested in cryptocurrencies.”

Does this mean that gold is destined to catch up to Bitcoin’s year-to-date advance soon? Not necessarily. Harvey points out that you could just as easily conclude that Bitcoin is overextended and due for a big pullback as conclude that gold is bound to play catch-up.

The World Gold Council calculates that the total value of all above-ground gold in the world exceeds $7.5 trillion—compared to which cryptocurrencies’ market value is less than 2%. That’s a very small tail to wag gold’s very big dog.

No Contest

Gold and Bitcoin’s year-to-date performance



Source: www.HulbertRatings.com

Given all this, we need to see what we can learn from indicators with a longer history than Bitcoin. Perhaps the most crucial one is inflation, since gold is often used as a hedge against it.

The message on this front is not encouraging. That’s because inflation remains stubbornly low: The personal consumption expenditures price index—the Federal Reserve’s preferred benchmark—rose just 1.4% over the past 12 months, well below the Fed’s stated goal of 2%. Fed Chair Janet Yellen admits to being surprised by how low inflation is, recently calling it a “mystery.”

Gold’s price rise might be reflecting an expectation that inflation will soon heat up. But it will have to do so in a huge way to justify the metal’s current level, according to research conducted by Duke’s Harvey and Claude Erb, a former commodities portfolio manager for Trust Company of the West. They found statistical support for a model that says gold eventually reverts to the mean of its ratio to the consumer price index. When that ratio is below average, it will eventually rise, and vice versa.

The current ratio, 5.2 to 1, is well above gold's historical average of about 3.5 to 1—which is bearish for the metal. To justify gold's current price, the CPI would need to increase by more than half. Absent that, Erb and Harvey's research suggests, gold will be facing stiff headwinds over the next few years.

Might a gold bull market be supported by what appears to be an extraordinary level of geopolitical uncertainty these days? Yes and no. On the one hand, Harvey reports there is a significant correlation between gold and an Economic Policy Uncertainty Index that was created several years ago by academic researchers. On the other hand, this index currently is less than half its apex from one year ago and is not significantly higher than its long-term average. According to that index, at least, any subjective perceptions we might have that economic uncertainty is particularly high are little more than that.

Then there's North Korea. Though gold might be a good hedge in the event of an outbreak of hostilities with that country, its track record as a hedge against geopolitical crises is mixed at best. According to Erb and Harvey, gold has fallen almost as often as it has risen in the wake of past such crises.

What about the current sentiment among gold timers, which has shown some forecasting power for gold's shorter-term direction? Currently, it is no better than neutral. That's because, despite gold's recent pullback, gold timers are not yet running scared—at least as measured by the average recommended gold exposure among the gold-market timers I track. These timers cater to retail investors, who famously tend to shift their opinions on a dime. Over the past four decades, according to my analysis of changes in this average, the most sustainable advances have been built on a foundation of widespread pessimism and despair among the gold timers.

Consider: The gold timers' average recommended exposure level currently is 16.7%. In contrast, the best short-term buying opportunities historically have come when this average falls to at least minus 30%, which indicates that the average short-term gold timer is allocating 30% of his gold-oriented portfolio to going short. That's an aggressive bet that gold will fall, and in true contrarian fashion, my research has shown that gold in the past has tended to rise whenever the gold timers have become that dejected.

But gold timers are a lot more optimistic than that right now. Their relative optimism forms what contrarians like to call a "slope of hope," by which they mean a market environment in which the path of least resistance is down.

Of course, sentiment can change quickly. And if gold continues to fall in coming days as much as it has over the past two months, the gold-timers might become so dejected that they throw in the towel—which, in turn, might prompt contrarian analysts to forecast more than just a couple-day bounce. But for now, at least, sentiment suggests more rough times ahead for the yellow metal.

Follow @MktwHulbert

Comments? E-mail us at editors@barrons.com

Latest in Hulbert on Markets

5. War Is Hell—but Not for The Stock Market

3 comments
7 PEOPLE LISTENING

martin homec user9 days ago

Are any cryptocurrencies used as currency in any transactions? What transactions? If I buy something from any online store, can I use a cryptocurrency if the seller agrees?

FlagShare
Like Reply

Charles Andrews user9 days ago

Gold is tangibles-bit coin can only be a ledger entry. prior to the euro dollar there was the ECU

sanctioned by financial world used for settlement. that worked well transitioning into the Euro.

Bit coin can be used between two parties but with acceptable in international trade can be a disaster deserved by parties using. The Spanish convinced south Pacific Islanders newly invented marbles were worth more than gold. How did that turn out?

FlagShare
Like Reply

CJ TSAI user10 days ago

China has officially banned the bitcoin operations. This bitcoin is just another way to avoid scrutiny of money laundry and tax avoidance. It is also an act to attack the local currency authority. The bottom line is that pig cannot fly.

FlagShare
Like Reply