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<th>20,881</th>
<th>-21.50</th>
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<th>NASDAQ</th>
<th>5,876</th>
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6:37 P.M. ET  U.K. lawmakers remove last obstacles to Brexit
6:33 P.M. ET  White House Defends Trump's Truthfulness
6:29 P.M. ET  Yahoo's Marissa Mayer to get $23 million severance package
6:23 P.M. ET  The CBO is Congress's Scorekeeper, Punching Bag

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By Mark Hulbert
Published: Mar 13, 2017 12:31 p.m. ET

3 ways to value it, 3 conclusions
Where is the price of gold headed? Well, consider this: One closely followed statistical model concludes that bullion is 46% overvalued, while another says that gold is 35% undervalued.

Which is closer to the truth? It’s impossible to say.

Gold poses more difficulty than almost any other financial asset when it comes to determining fair value. The reason that there can be such a divergence of forecasts, according to Campbell Harvey, a finance professor at Duke University’s Fuqua School of Business: “Gold is poorly understood. There are many forces driving the price of gold, and the importance of those forces changes through time…. This is very hard to model.”

Harvey says that when it comes to valuing a company, “we can look at the fundamentals, the sales, the margins, new investments, debt and dividends, and build a bottom-up valuation.” Or when looking at a country, he says, “we can do a similar exercise looking at GDP growth, indebtedness, consumer behavior, and get a sense of the value of sovereign debt or stock markets.”

But for gold, Harvey says, “there is not much to work with.”
Analysts often disagree as well on valuations of particular stocks or industries, he adds. “But the range of disagreement is [relatively] small. With gold, reasonable people can have sharply different views of the value.”

To see how sharply those views differ, consider three different ways to value gold: as an inflation hedge, as a hedge against political uncertainty and as a way to get portfolio diversification.

How to invest and do good (1:54)

Wall Street's latest trend promises to make you richer while also making the world a better place. But will ESG (Environmental, Social, Governance) investing catch on?

First, gold’s relationship to inflation has been anything but stable since the early 1970s, when it became legal for U.S. citizens to invest in gold. The ratio of gold’s U.S. dollar price to the consumer-price index has been as low as 1.5 and as high as 8.7, according to Claude Erb, a former commodities manager at mutual-fund firm TCW Group.

Only over the very long term—many decades, if not longer—does gold do a creditable job as an inflation hedge, according to a study of gold over the past 2,000 years by Erb and Harvey. Over any period of relevance to individual investors, relating gold’s price to inflation proves profoundly unhelpful.

If an investor nevertheless should insist on basing gold-trading decisions on inflation, he or she currently should be out of gold, according to Erb. That’s because bullion currently is 46% higher than its inflation-based fair value of $860, according to his and Harvey’s research.

Next, consider geopolitical uncertainty. This also makes at least some intuitive sense. But until recently it couldn’t be confirmed statistically, because no one had come up with a way to quantify uncertainty. Then three economics and finance professors—Scott Baker of Northwestern University, Nick Bloom of Stanford University and Steven Davis of the University of Chicago—created a series of Economic Policy Uncertainty, or EPU, indexes. And sure enough, according to Harvey, gold shows a modest historical correlation with the global version of the EPU.

That modest correlation translates into a bullish forecast for gold currently, since the global EPU index is at an all-time high, while gold is trading 35% below its record high of $1,925 an ounce. But don’t forget that gold’s inflation-based valuation model is painting a very bearish picture.

A different argument for investing in gold comes from financial planners. They argue that owning gold promotes portfolio diversification, on the grounds that it zigs when other assets zag, and vice versa. But Erb cautions against overconfidence on this score as well. He says that, on those occasions over the past three decades in which the financial markets suffered their worst returns, gold was more or less evenly divided between rising and falling.

If you want to invest in gold, exchange-traded funds are probably the least expensive way to do so. To invest in the physical metal itself, the largest ETF is SPDR Gold Trust, GLD, +0.02% with $33.9 billion in assets under management and an expense ratio of 0.40% (or $40 per $10,000 invested). To invest in gold mining companies, the largest ETF is VanEck Vectors Gold Miners ETF, GDX, +1.24% with $11.5 billion in assets and a 0.52% expense ratio.

If you’re looking for the least expensive way to hedge against inflation, however, you might want to look elsewhere altogether. Treasury inflation-protected securities, or TIPS, guarantee a return over inflation. A low-cost ETF that invests in TIPS is Schwab
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GDX  
+0.27  +1.24%

SCHP  
-0.07  -0.13%

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National averages from Bankrate.com
Mark Hulbert has been tracking the advice of more than 160 financial newsletters since 1980.

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8 comments
55 PEOPLE LISTENING

**Craig Bader**

3 hours ago

“To invest in the physical metal itself, the largest ETF is SPDR Gold Trust, GLD"

Speaking of this fund in particular, why is there a clause in the GLD prospectus that states GLD has no right to audit subcustodial gold holdings? Why would the organizations behind GLD forfeit this right and create this massive audit loophole? I haven’t heard of a single good reason for the existence of this loophole so far. In addition to the audit loophole, 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.

I remember CNBC’s Bob Pisani visiting GLD’s vault in a well documented segment. GLD’s administration arranged this visit to disprove everyone claiming that GLD’s gold did not exist. However, Mr. Pisani held up a gold bar with the following serial number - ZJ6752. This serial number did not appear on the most recent bar list during that time period. Cheviot Asset Management’s Ned Naylor-Leyland later found out that this “GLD” bar actually belonged to ETF Securities.

**Craig Bader**

3 hours ago

Note that even on the subject of GLD’s insurance, they are not at all straightforward about it. Their representatives will not confirm nor deny the existence of GLD’s insurance. I recommend anyone curious about this to confirm via calling GLD’s publicly listed number for general inquiries at 866 320 4053 and ask about this clause from the GLD prospectus: “The Custodian maintains insurance with regard to its business on such terms and conditions as it considers appropriate which does not cover the full amount of gold held in custody.” Exactly how much of the fund is insured? They will not give you a straight answer and might even throw in some bizarre excuse which I’ve experienced. Why hide this information from investors? The people behind GLD certainly do not seem like the most honest types.

**Frank Further**

6 hours ago

Physical gold can be looked at simply as insurance for when SHTF, not merely as an investment. We insure homes and vehicles, why not unrest or grid failure or.....?

**Ray Junke**

6 hours ago

I discussed as “money” these are exactly the issues that should come up.