MarketWatch

Opinion: Here’s the ideal amount of gold to keep in your investment portfolio

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Gold has a place — a small one — in a diverse financial plan

Andreas Solaro/AFP/Getty Images

Gold should have performed a lot better over the past two years — and especially the past two months. That’s because both periods were characterized by the factors that, according to conventional wisdom, should cause gold to perform well: higher inflation and stock-market turmoil.

Because gold GCJ8, -0.11% did not do well suggests that we should take a critical look at what makes gold a good investment.

Consider first gold’s performance since February 2016, just over two years ago. That month marked the low of recent years for what investors collectively expected inflation to be over the subsequent 10 years — at just 1.18% annualized. The current expectation is 2.11%. (These levels are based on the 10-year breakeven inflation rate, which is the difference between the yields on the 10-year Treasury and the 10-year TIPS.)

Though expected inflation is still low, a near-doubling is significant when compounded over 10 years. Nevertheless, gold has only barely held its own over this 2+ year period; the annualized gain of the SPDR Gold Trust GLD, -0.45% since February 2016 is 2.7%, for example. Over that same period, the SPDR S&P 500 Trust SPY, +0.17% has produced a 23.8% annualized gain.

Equally disappointing was bullion’s performance during the market’s turmoil last month. In February, for example, the SPDR Gold Trust lost nearly as much as the SPDR S&P 500 Trust — minus 2.1% versus minus 3.9%.

These recent experiences should not have come as a surprise. Consider a study circulated several years ago by the National Bureau of Economic Research, authored by Duke University professor Campbell Harvey and Claude Erb, a former fixed-income and commodities manager at mutual-fund firm TCW Group.

Gold is a decent inflation hedge only over extremely long periods

One of their main findings is that gold is a decent inflation hedge only over extremely long periods — measured in many decades, if not centuries. Over the shorter investment horizons that almost all of us focus on, gold’s relationship to inflation is anything but constant.

Consider the ratio of gold’s price to the Consumer Price Index. According to Erb and Harvey, this ratio since the 1970s has varied from a high of nearly 9-to-1 to a low of less than 2-to-1. Little wonder, therefore, that gold has not responded to the near-doubling of inflation over the past two years. In fact, it would not be out of line with the historical record for the Consumer Price Index to quadruple while the price of gold stays steady or even declines.

Erb and Harvey also found that it is not unusual for gold to fall even when the stock market does too. Upon analyzing all calendar months since 1975 in which the S&P 500 SPX, +0.15% fell, they found that gold bullion also fell in nearly half the cases (45.9% of the time, to be exact).

I reached a similar conclusion about gold’s hedging ability when analyzing an Economic Policy Uncertainty Index that was created several years ago by academic researchers. Gold presumably hedges against such uncertainty, but I came up empty when I compared monthly changes in this index with those of gold bullion since 1985. The r-squared — the extent to which the first series explains or predicts the second — is less than 1%. In other words, gold leaves a lot to be desired as a hedge against equity market turmoil.

None of Erb’s and Harvey’s findings means that gold doesn’t undergo significant bull- and bear markets. It most certainly does. The investment implication instead is that shifts in gold’s trend cannot be reliably forecast on the basis of expected inflation, stock bear markets, or economic uncertainty.

Is there some other way of profiting from shorter-term shifts in gold’s trend? Perhaps, but it’s hard to know what it would be. My Hulbert Financial Digest performance monitoring service has data on the timing-only performance of several dozen gold timers — in some cases dating as far back as the mid-1980s. Their track records do not provide much reason for hope that a successful gold-timing strategy can be readily found.

% of monitored gold-timers who beat a buy-and-hold strategy

Trailing 10 years

0%

Trailing 20 years

0%

Trailing 30 years

0%

One approach to deciding how much of a diversified portfolio should be allocated to gold is to measure the percentage of worldwide financial assets that bullion represents. According to the World Gold Council, the total value of all the gold that has ever been mined is around $7.5 trillion. That’s about 4% of the combined value of the global stock, bond and gold markets.

That 4% is a good place to start in determining your portfolio’s default allocation to gold. You would deviate from that allocation only if you believe you have reason to believe that investors worldwide, collectively, are wrong about gold’s value relative to the stock and bond markets.

The data presented here suggest you face a strong burden of proof when concluding that you have such a reason.

For more information, including descriptions of the Hulbert Sentiment Indices, go to The Hulbert Financial Digest or email mark@hulbertratings.com .

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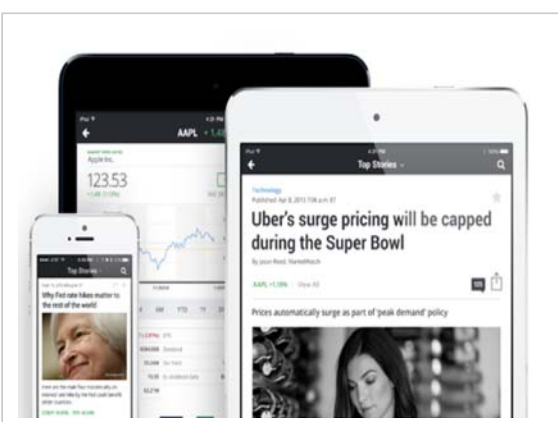

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