Stay The Hell Away From Gold

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Investing
I write about incisive investing advice.

The oft-quoted line from the Merchant of Venice is apt: “All that glisters is not gold.” But gold lately has been doing a lot of glittering. As the price per ounce soars to its all-time high, the question is whether this is a good thing to buy now. The answer: no.

Not at these prices, because the yellow metal is notoriously volatile. Unless you are a deft in-and-out commodities trader, which not many people are, or a long-term investor, which you should be, then gold is a problematical holding. Certainly in any large amount.
Gold finished last week at $1,897 an ounce, marking an all-time record, beating out the previous apex, reached in 2011. Significantly, the record hit nine years ago was during another fraught time—in the aftermath of the financial crisis and the Great Recession. Then, the new threat of the European sovereign debt mess seemed poised to push the world economy back into the mire.

Physical gold, and the exchange-traded funds and mutual funds that track it, are likely to keep on ascending for a while. As Mohamed El-Erian, chief economic adviser at Allianz, explained the phenomenon in a tweet last Friday, “The surge in gold continues this morning as more investors see it as one of the least unattractive risk mitigator—adding exposure to both tactical and strategic portfolios.”

Amid economic downturns, political turmoil and inflation, gold tends to thrive. Today, we sure have those first two malign forces battering us.

Alas, that damn volatility means that, once the bad times are past, gold will drop like the heavy rock it is. After the sovereign debt crisis petered out in the last decade, gold lost more than 40% of its value, and sank to a low point of $1,060 in late 2015.

Well, then came the U.S.-China trade war and gold took off again. The pandemic has fueled the rise further. Want to bet that the gold price will stay this high and go higher over a long period? The smart money doesn’t think so. Institutions, whose guiding principle is long-term investing, usually spurn gold or just keep a tiny amount for diversification purposes.
The $157 billion Teacher Retirement System of Texas has less than 1% in gold.

And what about gold as an inflation hedge? While inflation is barely existent now, some fear that all the government stimulus pumped into economies worldwide will eventually produce spiraling consumer prices. Isn’t gold worth keeping for that?

Unfortunately, gold’s volatility also renders it less useful as an inflation offset over time. Dating back to the 1970s, an era of genuinely bad inflation, gold’s price as a ratio to the Consumer Price Index oscillated from a low of 1.47 to a high of 8.68, a study by Duke Professor Campbell Harvey and former TCW portfolio manager Claude Erb found. Upshot: Inflation adjusted, gold would need to be more than 50% higher than the present level to equal what it was back then.

You want a better inflation hedge? Try stocks, whose earnings typically rise as inflation heats up. That’s the conclusion of a study by North Carolina State Professor Richard Warr. Calculated by decade since 1871, inflation-adjusted earnings growth rates were 21% less volatile than on a nominal basis. Thus, Warr concluded, equity outdoes gold over time. In fairness, he did concede that over short-term periods of inflation, gold can outperform.

In the fullness of time, investing in this precious metal is buying fool’s gold.

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