Is It A Golden Opportunity?

Jun. 1, 2020 3:59 PM EST 9 comments | 13 Likes
by: Larry Swedroe

Summary

- Fueled by concerns created by the COVID-19, and massive fiscal and monetary responses to it, we are hearing about investors flocking to gold as a safe haven and/or inflation hedge.

- Gold has also produced no real return for two centuries.

- There are very long periods of gold producing large negative real returns.

- While gold has a good record as a safe haven in bear markets, it has failed about 17 percent of the time.

Is it a Golden Opportunity?

Perhaps fueled by concerns created by the COVID-19 pandemic and the massive fiscal and monetary responses to it, once again we are hearing and reading stories about investors flocking to gold as a safe haven and/or inflation hedge. Exchange-traded funds (ETFs) tracking the precious metal attracted $14.5 billion in less than five months, topping the $11.7 billion that flowed into the funds in all of 2009. With that in mind, I thought it would be a good idea to return to my trusty videotape. I dug into my files to find the following forecasts as well as the academic evidence on gold as an investment vehicle.

In mid-July 2012, with gold trading at about $1,577, Merrill Lynch added its voice to the many that were predicting gold would reach $2,000 an ounce by the end of that year. Francisco Blanch, the head of global commodities research at the investment bank, said: “We think that $2,000 an ounce is sort of the right number.” At about the same time, in an interview with ETF.com, money manager Peter Schiff (who has attracted much media attention with his doomsday forecasts) offered up this prediction: “I’m looking for another leg up. … It’s going a lot higher. It’s hard to tell where the next move is going to take it. But it’s going thousands of dollars higher than it is now.” When asked how high, he responded: “I think a minimum of $5,000. But it could go a lot higher than that.”
How did gold perform? As I wrote this, gold was trading at around $1,695, a total return of about 7 percent over the almost eight-year period. By contrast, from July 2012 through April 2020, the S&P 500 provided a total return of 151 percent, five-year Treasuries returned 25 percent, and one-month Treasury bills returned 6 percent. Over this period, gold’s return about matched its historical real return over thousands of years of about zero!

I would add that today gold is trading about 15 percent below its inflation-adjusted peak price of more than 40 years ago (about $2,200 in February 1980). On the other hand, it provided a total nominal return of about 350 percent since April 2001. In other words, investors who were unlucky enough to purchase gold 40 years ago not only lost real purchasing power but missed out on the about 11 percent per year return provided by stocks, producing a real return of about 8 percent a year, outperforming inflation by a total of more than 7,000 percentage points. On the other hand, gold’s return of 350 percent (about 300 percent in real terms) since April 2001 was about 100 percentage points more than that of the S&P 500 Index.

The question I’ll try to address today is: Do individuals choose to invest in gold for the right reasons? One reason for investor interest in gold is the belief that it is a great hedge against inflation. Another is that it provides a hedge against currency risk. And a third is that gold can act as a haven of safety in bad times. Are these valid reasons?

The Evidence

In their June 2012 study “The Golden Dilemma,” Claude Erb and Campbell Harvey examined these issues. In terms of being a currency hedge, they found that the change in the real price of gold seems to be largely independent of the change in currency values. In other words, gold is not a good hedge of currency risk.

As for gold serving as a safe haven, meaning that it is stable during bear markets in stocks, Erb and Harvey found gold wasn’t quite the excellent hedge some might think. It turns out that 17 percent of monthly stock returns fall into the category where gold is dropping at the same time stocks post negative returns. If gold acts as a true safe haven, we would expect very few, if any, such observations. Still, 83 percent of the time on the right side isn’t a bad record.

In terms of gold’s value as an inflation hedge, the following example provides the answer. On January 21, 1980, the price of gold reached a then-record high of $850. On March 19, 2002, gold was trading at $293, well below where it was 20 years earlier. The inflation rate
for the period 1980 through 2001 was 3.9 percent. Thus, gold’s loss in real purchasing power was about 85 percent. How can gold be an inflation hedge when over the course of 22 years it lost 85 percent in real terms?

As additional evidence of gold’s inflation-hedging abilities, Goldman Sachs’ “2013 Outlook” contained the following finding: During the post-World War II era, in 60 percent of episodes when inflation surprised to the upside, gold underperformed inflation. That said, gold has been a good hedge of inflation over the very long run (such as a century). Unfortunately, that’s a much longer investment horizon than that of most investors.

Thus, in two of the three cases (the exception being the safe-haven hypothesis), there is not sufficient evidence to support investing in gold.

In May 2019, Erb and Harvey updated their study. They began by examining the argument that gold is an inflation hedge, or what they call a “golden constant.” The authors explained: “One way to think about the golden constant perspective is as a collection of statements that assert that: 1) over a very long period of time the purchasing power of gold remains largely the same; 2) in the long run, inflation is a fundamental driver of the price of gold; 3) deviations in the price of gold relative to inflation will be corrected; and 4) in the long run, the real return from owning gold is zero.”

Their study covered the period January 1975 to June 2016. The authors found that over the period the average real price of gold was 3.46 times the U.S. Consumer Price Index (CPI). I updated the data through March 2020. Doing so put the CPI level at 256.9. Multiplying gold’s average real price by the current CPI (3.46 x 256.9) delivers a price of approximately $889. This represents what the nominal price of gold should be today—if we assume the real price of gold is constant.

Of course, over time prices have strayed far from the golden constant. And as Erb and Harvey noted, the golden constant isn’t a fact, just a hypothesis. But if your reason for buying gold is that it is an inflation hedge, your expectation should be that gold will revert to its golden constant over time. Despite having fallen from a peak of almost $1,900 in September 2011, with the price of gold at about $1,695 as I write this, it’s still about 103 percent above the golden constant of $836.

Returning to the 2019 update of Erb and Harvey’s original paper, they asked: “If the golden constant provides a guide to the value of gold, what typically happens when the price of gold is above or below its golden constant value?” They found that the high real price of gold has been about 8.73 and the low real price about 1.47. Thus, while there is a tendency to revert to the golden constant, the price of gold can vary greatly from the
golden constant and stay well above or below it for a long time. And as the authors observe, there is no way of knowing if the “future high and low real prices of gold may be more or less extreme than in the past.” As of May 2020, those are still the highest and lowest values. In addition, the current real price of gold is about 6.6 (1,695 / 256.9), about 90 percent above its historical average of 3.46.

Erb and Harvey added the following: “The high and low real prices of gold highlight that even if there is on average a golden constant the real price of gold has strayed, and probably will stray, far from this possible central tendency. It is also possible that the future will be unlike the past.” They warn that “when the real price of gold falls, the golden constant level is not a floor—a protective line in the sand that the real price of gold will not cross.” With this caveat, they went on to examine the outlook for gold returns where the price is relative to the golden constant.

**Expected Returns to Gold**

In their 2019 update, Erb and Harvey examined what happened to the return on gold when prices were above or below the golden constant. As you might expect to see, the authors found that “below average real gold prices have been followed by above average 10-year real gold returns” and “above average real gold prices have been followed by below average 10-year real gold returns.” The real price of gold is currently well above its historical average, suggesting that over the next 10 years real gold returns will more likely be below their average.

Using Erb and Harvey’s data, we can also look at the downside risk of owning gold. To do so we can use the lowest ratio of 1.47. That produces a lowest valuation of about $378 (1.47 x 256.9). Of course, this does not mean that the price of gold would immediately decline to $378 an ounce. Rather, it’s simply a suggestion that given the volatile history of real gold prices, the real price of gold once fell to 1.47 and could fall to that level again.

We can also examine what would happen if gold went back to its highest real price. To do so, we can use the highest ratio of 8.73. That produces a valuation of about $2,243.

Erb and Harvey noted that even though there is little relation between the nominal price of gold and inflation when measured over 10-year periods, the evidence suggests that gold does hold its value over the very long run. For example, in a prior paper, they presented historical evidence that the real wage (in gold) of a Roman centurion was approximately the same as the pay earned by a U.S. Army captain today. They also showed that the price of bread (again, in gold) thousands of years ago was about the same as we would pay today at an upscale bakery.
Erb and Harvey concluded: “Depending upon one’s beliefs, the golden constant framework may or may not be a useful way to think about the ‘fair’ and ‘possible’ values of the price of gold. The golden constant framework suggests that inflation is a fundamental driver of the price of gold in the longer term. It is common for stock and bond investors to point out that stocks and bonds have cash flows that drive their fundamental values. Many fixed rate bonds have fixed cash flows and fixed maturities. Stocks have unknown expected cash flows and no specified maturity. Gold has neither fixed nor expected cash flows and it does not have a maturity. As a result, it is much more difficult to define gold’s fundamental value. Given the challenge of specifying a pricing model, it is not surprising that gold exhibits substantial price volatility even measured over longer-term horizons.”

**Summary**

The conclusion we can draw is that while gold might protect against inflation in the very long run, 10 years or even 20 years is not the long run. Erb and Harvey noted: “In the shorter run, gold is a volatile investment which is capable and likely to overshoot or undershoot any notion of fair value.” In addition, we observe that despite providing virtually no real return over the past eight years, gold is trading well above its “golden constant.”

There’s one more insight we need to consider. While the laws of economics can be defied in the short term, history demonstrates that investors ignore them at their peril. For instance, a basic economic principle is that over the long term prices tend to move toward the marginal cost of production.

In their “2013 Outlook,” Goldman Sachs observed that more than 80 percent of gold production costs less than $1,000 an ounce—or about 20 percent below the then-current price. As another data point, in June 2016 Pavel Grachev, chief executive of Polysus Gold, the largest gold producer in Russia and the world’s lowest-cost gold producer, told CNBC: “Our so-called total cash cost (per ounce) is about $400 per ounce.” As one other data point, in an article on Seeking Alpha, the author estimated the average weighted cost for the top five gold miners was $1,204 an ounce for the first nine months of 2018. Each of these are well below the current price of gold, which should act as a cautionary signal. Another important point to consider is that unlike other commodities, all the gold that’s ever been mined is basically available for sale today. And technological advances can lower costs, as the fracking revolution demonstrated.

Hopefully, the above evidence and analysis will allow you to make an informed decision about whether you want to include an allocation to gold in your portfolio.
Thank you for this excellent article, Mr. Swedroe. As usual, not only do you provide the framework, but also a voice of reason.

Personally, I think my framework for gold maybe different, though. I live in Europe, and if I a look at our history here, except for the last say 70Y, we have lived through many things we now think no longer apply to us but only to other countries... I think of war, revolution... And what does not so often appear in textbooks, the periods where you are not in a war/revolution/whatever else, but you are fearing one. From only a wealth perspective, I would feel very uncertain about how my currency, my bank account, my stocks, my business, etc would fare in such circumstances. I do not know how gold would do either, nor if it would be good for anything actually, but at least I know an ounce of gold would still be an ounce, an ounce that I can store and move more easily than my house or my business, an ounce that is more difficult for the government to freeze, etc etc. The other assets I mentioned have their own advantages even in those circumstances too, so they are complementary - or what is the same, gold gives me diversification. Still, I do not expect it to be of any good most of the time. Even if it loses values in currency terms, I just want it for whatever it might provide in the very bad times.

By the way, I do not expect any war, famine, nor calamity. At all. But looking back at history I wonder if these last 70Y of peace will go on or whether we will revert back to the mean. Who knows? Many Poles who could afford to leave Poland failed to so because they could not believe Germany would invade. (edited)

03 Jun 2020, 03:27 AM

Larry Swedroe
Contributor PREMIUM

Author’s reply » Certainly very reasonable. One problem I note that people seem to forget about gold. As one extreme example, the Jews of Europe thought their assets were safe in gold, as did many in Russia and East Asian countries --but when they come with the machine guns (the extreme environment many are concerned about leading them to buy gold) the gold doesn't help, and if held in another country, have to be able to get to it. So in at least some of those extreme situations does't do any good. Best wishes

03 Jun 2020, 08:54 AM

IndyDoc1
@Larry Swedroe

How would the proposed HOMEX fund be different from residential REITs such as EQR ?

03 Jun 2020, 02:28 AM

Larry Swedroe
Contributor PREMIUM

Author’s reply » The concept is the same, but should be much broader diversification across markets.

03 Jun 2020, 08:50 AM

FalconCowboy

An interesting piece, Mr. Swedroe. I’m curious as to how you would recommend preparing for high inflation (God forbid). From reading some of your previous articles I imagine you would advocate a simple portfolio allocated
appropriately for one's age between stocks, bonds and cash. If so, my next question would be how would such an eloquently simple strategy handle an actual currency crisis compared to a more commodity-centered allocation (such as gold).

02 Jun 2020, 01:58 PM

Larry Swedroe

Contributor PREMIUM

Author's reply » Few thoughts cowboy.

First, real assets tend to do better in high inflation, so stocks and real estate. Also there are alternatives that don't have equity exposure and also don't have TERM risk, which IMO should be included in portfolios. While they don't hedge inflation they are not exposed to the risk of inflation. They would include funds like LENDX, SRRIX, AVRPX and CCLFX which I own as good diversifiers with equity-like expected returns but less volatility. Another good diversifier would be single family homes for rental. Stone Ridge was planning to launch such a fund until the COVID hit, but that should be out next year I would think, called HOMEX. Another diversifier that I invest in are drug royalties, through a fund. I prefer these to commodities because commodities don't have a risk premium while these do. Personally not a fan of gold since it has no expected real return and doesn't hedge inflation for any reasonable horizon. So I prefer other assets that don't have inflation risks but have significant risk premiums. And of course should diversify internationally, avoiding home country bias

Hope that is helpful

Larry

02 Jun 2020, 02:48 PM

FalconCowboy

Thanks for the timely reply. I shall consider all of your thoughtful suggestions.

02 Jun 2020, 03:09 PM

Larry Swedroe

Contributor PREMIUM

Author's reply » My pleasure
to help, think about reinsurance fund. It takes in capital and buys insurance risk from other reinsurers. It holds the cash as collateral to prove it can meet claims. It earns the tbill rate as well as the risk premium (ex-ante of course). Inflation or real rates rise and the collateral return rises. So it had no duration risk at all. Similar a fund that does higher quality private middle market lending like CCLFX, its loans all tied to Libor (or equivalent) and most have floors, so no duration risk, but also a risk premium, which is currently a very healthy one. Those are two examples of what IMO are better diversifiers.

02 Jun 2020, 04:12 PM

vozmozhno

PREMIUM

Interesting piece, but I'm not sure we really have enough data to draw broad conclusions because:
1) It's only been 50 years since the dollar was decoupled from gold, and...
2) During most of that time we had far less debt than we do now.
3) We are largely in uncharted territory with the money supply exploding, so it is questionable how much analyzing even the past 50 years really tells us about what may transpire in the future.
4) Until now central banks have had the ability to manipulate events, but the effectiveness of their tools may be at an end, so...
5) How applicable is past data if a crisis starts to develop and central banks no longer have any tools that work?
6) To hedge against the possibility of a dollar crisis can anyone give me a better alternative than gold?

02 Jun 2020, 05:19 AM

vf02
"6) To hedge against the possibility of a dollar crisis can anyone give me a better alternative than gold?"

YES!! Much as I, personally, like Gold: better alternatives are select Gold and Silver Exploration and Mining Companies/Stocks

Thank You :-)

03 Jun 2020, 10:57 AM

vozmozhno
PREMIUM
$KL is my largest holding. Do you have an opinion on them?

04 Jun 2020, 01:06 AM

Larry Swedroe
Contributor PREMIUM
Author’s reply » Not believer in investing in individual stocks as IOM that has more to do with speculation than investing because you are taking idiosyncratic diversifiable (and thus uncompensated, meaning market doesn't reward you for taking risks that can be diversified away) risks. And the evidence on actively managed funds failure to show persistence of performance beyond randomly expected shows the wisdom of that. Recommend reading The Incredible Shrinking Alpha.

In other words, if you want that exposure buy a systematically managed fund or ETF that provides the broad exposure, eliminating the idiosyncratic risks

04 Jun 2020, 09:13 AM

pascia
The major flaw in the analysis is that Gold is a hedge against inflation in terms of Austrian School of economics not that in terms of CPI i.e. look at monetary metrics

02 Jun 2020, 04:23 AM

Wiekierc
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.

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Comments (59)

Dale Roberts
Contributor PREMIUM
Absolute debasement of fiat currencies might be factored in, as well.

Dale
04 Jun 2020, 09:09 AM

Larry Swedroe
Contributor PREMIUM
Author’s reply » That certainly is one of the possible outcomes that should be considered in the wide dispersion of possible outcomes. But don't overestimate that risk, nor be overconfident in your own forecasts (-:-)
And I would add this, when that happens they often come with the "machine guns" and take away your gold.
So the hedge didn't hedge

04 Jun 2020, 09:25 AM

NervousNeville
PREMIUM
So what IS a good hedge against inflation. TIPS? The most unexciting investment in the market?

03 Jun 2020, 03:48 PM

Larry Swedroe
Contributor PREMIUM
Author’s reply » The ONLY true hedge is TIPS. Others can eliminate or minimize duration risk and have risk premiums, unlike gold, but they don't have benefit of flight to quality/safety that gold often provides. Among them are funds like SRRIX, XILSX, LENDX, AVRPX and CCLFX, all interval funds.

03 Jun 2020, 05:11 PM

thereal_jrumble
"...the average weighted cost for the top five gold miners was $1,204 an ounce for the first nine months of 2018. Each of these are well below the current price of gold, which should act as a cautionary signal."

Yeah. Caution about using your dry powder on anything BUT mining stocks.

01 Jun 2020, 11:47 PM

Steve in TN
IMO an important driver of gold price advances is the increase in money supply. If that is correct gold investments are currently in their sweet spot. The more money is printed it's value is diluted, therefore gold will go higher. Examine what happened in the last M1 expansion in '09 through the 1st half of '11. The gold miners (GDX) appreciated over 300%. It is my opinion we're in a similar but even greater gold price appreciation situation now. However, I don't expect this current gold move to last more than two or three years.

01 Jun 2020, 10:54 PM

Larry Swedroe
Contributor PREMIUM
Author’s reply  »  Just to point out the while the MS is growing rapidly, unprecedented, the velocity of money has slowed, and FED can reverse the increase. We heard the same cries about money supply growth leading to higher inflation when Fed acted in 2008 and we never got the inflation, partly due to dramatic fall in velocity. As to the future, my crystal ball is cloudy but IMO cannot find a reason to invest in something with no real return for 2000 years and cannot even act as good inflation hedge over any reasonable horizon.

02 Jun 2020, 09:19 AM

dougkitchen
Only a few political economists believe the CPI measures inflation correctly. Everybody else knows inflation is far higher. So, maybe adjusting $836 by a factor of 2 or 3 might reflect reality. Anyway, gold investors are forward looking, anticipating all future inflation in the decades ahead. Current inflation has little or no impact on prices.

01 Jun 2020, 07:32 PM

Fiat mirage
PREMIUM
There is one element of the price of gold that is missing in the analysis... real interest rates. Periods of high inflation may be followed by very high real interest rates such like when the FED set 10 year rates to 15% in the start of the 80s to kill the inflation. Once this occurred the price of gold crashed even with still high inflation. Today we are in an environment where savings are repressed by artificially negative real interest rates. As gold is mostly the pure definition of money it get bid up as bonds and fiat cash are trashed. I have no idea when real interest rates will go up but I fear that with all this debt it will may take decades. In the meantime gold will be king. Anyway, keep buying every year and when you retire sell it every year. Gold is for wealth preservation not speculation.

01 Jun 2020, 06:43 PM

language police
The Fed doesn't set 10-year rates.

02 Jun 2020, 07:03 AM

vfk02
Thank You Fiat.

All: My guess is that our Federal Reserve (and Jerome Powell who is incredibly well meaning and will print through the sky as needed and the perception will continue to be printing printing will be needed) will continue to print and buy up Debt to keep interest rates artificially low

Until:
our poor watered down paper money goes into steep decline in purchasing power. We will be between a rock and a hard place. High inflation will become politically unacceptable but the cure - higher interest rates (most any currency is not defended with tanks and guns but rather with higher rates) - will be the higher rates which will drive unemployment up up up.

Not happy times when we must accept either higher unemployment and depression or (much) higher inflation.
Or (most likely) both together.

Thank You

03 Jun 2020, 11:05 AM

Larry Swedroe
Contributor PREMIUM
Author’s reply » I would just add that this is the same talk we heard back in 08-09 and inflation remained quite tame, well below expectations. Clearly increased inflation is a risk, but it's not a certain outcome by any means

03 Jun 2020, 11:44 AM

RandyFloyd
Marketplace
So, regression to the mean essentially? I still think that there are some good fundamental reasons to keep a permanent holding in gold, and i dont see Real rates rising anytime soon

01 Jun 2020, 06:23 PM

Oscar Carrascosa
www.treasury.gov/...

30 YR is already positive

04 Jun 2020, 04:33 AM

Alexis Tocqueville
Oscar Carrascosa

Exactly: Daily Treasury Real Yield Curve Rates

04 Jun 2020, 11:25 AM

Tawm

Gold metal is an (often costly) inflation hedge.

01 Jun 2020, 06:20 PM

Larry Swedroe

Contributor PREMIUM

Author’s reply » That is ONLY true as I pointed out over super long horizons. You cannot call something an inflation hedge that loses almost 90% in real terms over a 23 year period.

02 Jun 2020, 09:22 AM

Larry Swedroe

Contributor PREMIUM

Author’s reply » Like I said, it has ONLY been an inflation hedge if your horizon is way beyond that of most investors, like a century (:-)) You cannot call something a hedge against inflation when it loses almost 90% in real value over a 23 year or so period. That is just plain wrong

04 Jun 2020, 02:43 PM

Tao Jaxx

Contributor

Very informative, as always with LS's articles. One extra motive to hold gold is as insurance since, at least in 83% of cases, it cushions bear markets. The lower the risk free rate, the cheaper the insurance. As such, despite the zero real return issue, some allocation to gold makes sense.

Just don't buy it at 8.73 times the golden constant lol.

Also, stay away from the emotional "fiat money issued by the banksters always goes to to zero blah blah"

01 Jun 2020, 05:24 PM

CashFlow13

Gold is still the most private way to store wealth in the world and has been since the dawn of time.

01 Jun 2020, 05:11 PM

Doofnut

Gold and silver are merely elements on the periodic table. There is an infinite amount of it in the universe. When mankind begins off earth mining and uncovers endless supplies of it, gold and silver will be treated like cardboard and plastic.
Franky R.
Probably true but I don't see that happening any time soon. Not in my life time anyway. (edited)

01 Jun 2020, 08:36 PM

vozmozhno
PREMIUM
Seems unlikely that it would be economically viable to get gold from space unless it went many multiples higher than its current price. In that case, anything you could buy now at current prices would be considered a bargain.

02 Jun 2020, 06:25 AM

language police
Yes, I'm expecting that to begin in the next couple of weeks.

02 Jun 2020, 07:04 AM

vkf02
@CashFlow13
YES! Thank You

03 Jun 2020, 11:06 AM

vkf02
@Doofnut
Cost of ‘Space or Mars, etc. Mining far far more than cost of Gold and Silver. Can't see this changing anytime soon. Space Travel to Asteroids is still impossible. Elon Musk working diligently on Space Travel to Mars. Mars not yet visited and cost of all this is very high (good thing Elon is rich!).

03 Jun 2020, 11:09 AM

vkf02
@Franky R.
Totally Agree

All: buy a Tesla, support Space Travel to Mars! :-)

03 Jun 2020, 11:10 AM

Praveen Chawla
"While gold has a good record as a safe haven in bear markets, it has failed about 17 percent of the time." I think I will take my chances with the 83% of the time the glass was full. I had compared the performance of gold over the last 2
recessions. The results were very impressive. As soon as Covid hit the US, I loaded up on gold.

seekingalpha.com/...

01 Jun 2020, 04:52 PM

Franky R.
Yeah I didn't quite get that... Is the author using that 17% as an argument against gold? Because that would be hilarious.

Also, "no returns in the last 2 centuries"... Gold has increased about 517% in value in JUST 2 decades.. And that will only continue if we keep using fiat (monopoly) money. I'll take that over any dividend. (edited)

01 Jun 2020, 07:26 PM

Larry Swedroe
Author's reply » Weird how people read things. I did NOT use it as argument against gold and cannot even imagine someone reading that into it. I simply pointed out that one should be aware that it has not always worked. A true hedge ALWAYS works—that's the definition of the word. Like buying earthquake insurance is a hedge against an earthquake causing damage—and it ALWAYS works. That's a hedge.
And btw, gold lost 86% of its real value over two prior decades, a period of fiat money
As to the future my crystal ball is as always cloudy.

02 Jun 2020, 09:28 AM

Praveen Chawla
Hedges need to work probabilistically, not always and not always 100%. An insurance company can go out of business too (imagine an extreme event like a comet strike). Just because Gold was in secular decline for 2 decades does not mean it will not work for the next 2 decades. I think that its a good probability it will work fine for the next 2 or 3 years (which is my horizon).

02 Jun 2020, 10:35 AM

Praveen Chawla
Thanks for the article. My criticism hopefully shows that I am engaged and is hopefully constructive. Keep up the good work.

02 Jun 2020, 10:39 AM

Larry Swedroe
Author's reply » Praveen, if it doesn't work all the time it's not a hedge. That is what the word hedge means. Now it's commonly used in the way you are saying it, but that is not correct usage. With that said, your example is also incorrect. The insurance company could hedge it's risk by working with a reinsurer, selling off that risk as they do with hurricane and earthquakes. Now that is a hedge, as is purchasing a put is a hedge.
As to probabilities, your guess is as good, or as bad as mine—and my crystal ball is cloudy, which is why I diversify. But I prefer to diversify across assets that have historical risk premiums and gold does not. But I
also don't have a problem with people using gold as a small allocation for the benefits it can provide in some situations, but I wrote the piece so they could make an informed decision.

Best wishes
Larry

02 Jun 2020, 02:52 PM

Praveen Chawla
It's beyond stupid to put the bulk of your portfolio into gold. I would say about 5 - 10% would be OK. (edited)

02 Jun 2020, 11:51 PM

Tao Jaxx
Contributor
I just did. Feb to April. It made me $58k. I guess you'd call it stupid money lol. As they say, "better lucky than smart" :)

Now doing exactly nothing (VGSH) to make sure I don't spit it back out.

03 Jun 2020, 12:04 AM

dalmond
PREMIUM
Earthquake insurance is NOT a hedge against an earthquake. I know because I live in Northern California and did purchase it. It's actually a fund run by the State, and in its literature specifically warns that in a large earthquake with a huge number of claims you may be paid significantly less in order that the Fund not go bankrupt. A hedge is only as good as its solvency in other words. And ANY man made asset can go bankrupt.

And I'm not sure why the author even mentions a "return" on gold. It's self-evident that there is no return on gold. I think the point he's trying to make is that gold is not a productive asset. Of course not. The purpose of an allocation into gold is merely to protect purchasing power for some amount of your holdings.

03 Jun 2020, 12:17 AM

Tao Jaxx
Contributor
@daldmond
And the author shows it does not, except on a 2000 year horizon (Roman Centurion to US Army Captain). Do you plan to live that long lol?
If so, then go ahead and sit on gold.
If not, then invest that money in some income producing asset.

03 Jun 2020, 12:25 AM

Larry Swedroe
Contributor PREMIUM
Author’s reply » Dalmond, that point is a good one to make about when you buy a hedge the other side of the trade must be there or it's not a hedge.
And gold has no EXPECTED real return. And as I noted it CANNOT be viewed as a good hedge against loss of purchasing power unless your horizon is like a century. You cannot say it's a hedge when it has lost almost 90% of its purchasing power in a 23 year period. If that can happen, and it did, that cannot possibly be called a hedge. TIPS are the way you protect against inflation, or through an inflation swap.

03 Jun 2020, 08:59 AM

dalmond
PREMIUM
I took out a paragraph on "cherry-picking" dates, AND a point about gold being a "generational" asset.

If I use the top in 1929 I can point out that equities did not recover, even to nominal price levels, until about 25 years later. It's an absurd way of looking at things and pays no mind to how people actually invest. It really bears repeating: Do NOT cherry pick dates to make a point -- look at averages and be mindful of gold's (or any) assets price levels in terms of technical, interest rates, etc. Timing is important.

As to your 100-year point, yes, that is precisely the point. I look at gold as a generational asset -- it's not how you protect YOUR purchasing power, but more importantly the purchasing power of your kids, their kids, etc. The idea of having some portion of your portfolio be gold is for that reason. People who buy and sell gold over shorter time frames are indeed at risk of market fluctuations.

Please disprove that over long time frames gold is not a good hedge. It's the ultimate hedge. It will be valuable long after the USD is in the dust bin.

03 Jun 2020, 10:02 AM

v kf02
@Larry Swedroe
Appreciate your Work Larry.
"As to the future my crystal ball is as always cloudy." Yes, isn't this the truth though continued watering down of our paper money seems a most excellent bet.

Thank You

03 Jun 2020, 11:14 AM

Larry Swedroe
Contributor PREMIUM
Author’s reply » Daimond, first in real terms US stocks had fully recovered by 1943, not 25 years!
Second, I fully agree gold has been a good inflation hedge over the very long term, but NOT over the horizon of most investors. Now if truly investing for the grandkids, then it has been a good hedge. Otherwise not. But it also has had NO REAL return for centuries,

03 Jun 2020, 11:50 AM

usiah
Many gold buyers do not buy gold for a "return." (edited)
v kf02
I see Gold as Insurance. Like Life Insurance: Insurance against something that is going to happen/continue (Inflation).

Gold has historically protected/preserved buying/purchasing power.

Great way to obtain Gold Returns are Select Gold and Silver Exploration and Mining Companies.

Thank You

03 Jun 2020, 11:18 AM

wanderlustsrt
Really insightful, good article.

01 Jun 2020, 04:38 PM

galicianova
Marketplace
Conclusion: collect golden advices but stay away from the metal gold!

01 Jun 2020, 04:08 PM