



5 Silly Things Investors Say About Gold

Description

There's no other asset class that inspires as much passion as gold. But emotion is not synonymous with good investing. And as a result there're all kinds of myths floating around about the yellow metal.

So whether you are a goldbug skypic, own Maple Leaf coins, or exchange traded funds like the **iShares COMEX Gold ETF** (TSX: CGL, TSX: CGL.C) and the **SPDR Gold Trust** ([NYSEMKT: GLD](#)), it's always good practice to revisit the assumptions in your argument. Here are five silly things investors say about gold that just don't hold up to scrutiny.

1) Gold is a hedge against inflation

This is a logical assumption. The real value of gold is roughly stable over long periods of time. As fiat money is debased, the nominal price of gold should rise protecting investors from inflation.

But this theory hasn't worked out in practice. I'll refer to the work of respected financial professor Aswath Damodaran who [found only a small correlation](#) between the U.S. consumer price index, or CPI, and gold prices since the 1970s. And when the 70's are removed from the data sample, there's almost no statistical relationship.

Of course, goldbugs may be skeptical of the CPI and may refer to money supply growth as a better measure of inflation. But once again, [even a quick look at the data](#) reveals no meaningful relationship.

Perhaps over centuries, gold serves as some kind of hedge from currency debasement. But this is not a time frame that's useful for individual investors.

2) Gold is a hedge against uncertainty

Through the centuries gold has been seen as a safe haven for nervous investors during times of uncertainty. Many see the commodity as a hedge against black swan-like events such as recession, hyperinflation, war, and terrorism.

But a casual glance at any chart shows that this is untrue. In 2008, perhaps the most uncertain period

in financial history, the price of gold fell sharply. The metal didn't provide any refuge for investors.

More empirical studies show that there is no relationship between the price of gold and common barometers of financial uncertainty such as the VIX or [bond spreads](#).

3) Gold should [rise/fall] because of jewelry demand

This was a favourite argument of gold bears during the metal's recent rally. Many analysts would argue that jewelry is the only real use for gold outside of industrial demand. If jewelry demand was falling, it was evidence of a speculative bubble.

But I prefer to think of it this way: gold is just a pretty metal that sits in storage. Whether it's held in a vault or a jewelry case doesn't matter. If investor demand grows, then the opportunity cost of holding gold jewelry will increase and *vice versa*. The only thing that matters is the *total* demand for the metal.

4) Gold should [rise/fall] because of mining supply

Gold mining statistics are often used to make ridiculous predictions about future prices. Bears will suggest that record production could flood the market. Bullion promoters argue the 'peak gold' will send prices skyrocketing. In reality, mining figures are an exceptionally small factor in the marketplace.

Think of it this way. The world's total gold stock could form block about 67 cubic feet in size. Annual gold production adds roughly a half a foot to this cube every year. Even if annual production were to double or be cut in half, it's impact on the size of the whole block is relatively tiny.

That's not to say mining supply or industrial usage will have no impact on the price of gold. But it's relatively small, especially compared to other commodities like oil or wheat, and shouldn't serve as the basis for any bold predictions.

5) Gold is an investment

The goldbugs' central thesis is actually quite sound: over the long run, fiat money will lose most, if not all, of its value. Indeed, history is on their side. Given that this is probably true, investors must seriously consider where to store their wealth.

In the short run, the U.S. dollar reigns supreme. Gold is a terrible medium of exchange. As *Reuters* columnists Felix Salmon showed in this [hilarious video](#), almost no one in New York City would accept gold as payment.

Even in the long run, I would much rather store my wealth in productive assets like stocks or real estate. Over the next several decades, these investments will generate profits and rents. Even if the dollar fails, my assets will continue to produce wealth for decades to come in whatever newfangled currency they come up with next.

Gold, in contrast, will sit in a vault. Like Beanie Babies, Pokemon cards, Picassos, or Bitcoins, someone may offer to pay more for these assets in the future. But that's not something I want to count on as an investor.

Foolish bottom line

What does the future hold for gold? I have no idea. But please, let's eliminate these five phrases from

future discussions.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSEMKT:GLD (SPDR Gold Trust)
2. TSX:CGL (iShares Gold Bullion ETF)

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