Is Gold Really an Asset Worth Investing in?

Description

Gold has to be one of the most unpredictable assets available to investors. Since breaking US$1,900 per ounce in late 2011, it has plummeted to US$1,090 in recent months, with many analysts predicting that it will fall even lower. The world's largest gold ETF, the **SPDR Gold Trust**, fell by 16% over the last year. It is almost impossible to predict where gold will go next, with many of the attributes that reputedly make it an attractive investment being unsound or irrelevant.

Now what?

Gold is touted as being one of the most reliable hedges against inflation and economic risk because it is a reliable store of value, but this couldn't be further from the truth. Over the last 10 years its returns have fluctuated wildly, in one year returning as much as 31% and then in another plunging by a massive 28%. Its price has oscillated between extremes, with it moving from as low as US$438 per ounce to a high of US$1,913 and then plunging to US$1,091 per ounce.

When considered with the fact that gold has now generated a negative annual return for the last two years, it illustrates just how volatile and unreliable it can be as an investment. This is certainly not the behaviour I would associate with an investment that is as a store of value and a hedge against economic risk, geopolitical uncertainty, and market volatility.

Strangely, despite the potentially calamitous economic events of recent months that should have acted as tailwinds for gold, such as the Greek crisis, its value has still continued to fall. A resurgent U.S. economy and stronger dollar are part of this, but the reality is that gold is not a hedge against economic risk or uncertainty.

This is because gold, unlike silver, has very few industrial uses and is a non-productive asset, essentially meaning it has no utility. As a result, its value is really determined by how it is perceived or imputed by investors, which makes it almost impossible to measure, unlike the cash flow of a company.

If anything, higher gold prices can be attributed to what economists call “positive price elasticity,” where rising prices attract investors who push the price higher. This increases its attractiveness, thereby perpetuating the cycle.

Clearly, there is little reason for investing in gold, particularly when we consider that many gold investments such as bullion or ETFs like the SPDR Gold Trust don’t pay dividends.

So what?

Now, while I have taken a rather pessimistic view of gold, as an opportunistic contrarian investor, I certainly don’t advocate avoiding it altogether. The imputed value referred to earlier can create opportunities, and with the recent collapse in gold triggering a sharp sell-off of gold mining stocks, some opportunities are starting to emerge.

Some of the best are among the precious metal streaming companies partly because they are not involved in the operation of mines, a risky and costly activity. Instead, they provide miners with funding in exchange for the right to receive a portion of the gold produced at prices that are typically far lower than the market price.

This means they have lower overheads and can remain profitable at prices the miners can’t while still providing levered exposure to gold. Among my favourites are **Royal Gold Inc.** (TSX:RGL)(NYSE:RGLD) and **Silver Wheaton Corp.** (TSX:SLW)(NYSE:SLW). Both have been caught up in the hysteria surrounding weak gold prices, leaving them attractively priced at this time.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

1. NASDAQ:RGLD (Royal Gold, Inc.)
2. TSX:WPM (Wheaton Precious Metals Corp.)

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Author
mattdsmith