Why Gold Is a Poor Long-Term Investment

Description

Every time stock markets tank and the storm clouds of yet another financial crisis gather on the horizon, the usual pundits emerge, claiming that gold is the ultimate safe-haven investment. This is happening again with gold spiking by almost 14% over the last two months as rising market volatility and concerns about the outlook for the global economy weigh heavily on financial markets and investor sentiment.

However, despite this recent spike, gold has abjectly failed investors as a long-term investment.

Now what?

Firstly, despite surging to an all-time high of US$1,917.90 in September 2011 at the height of concerns about another global economic meltdown, gold has been one of the worst-performing asset classes of the last two decades.

You see, over the last 20 years it has generated an average annual return of 4%, which is well below the returns of other assets such as a real estate or stocks. For the same period the **TSX Composite Index** has returned on average 6% annually, while the **S&P 500** has delivered 7% for investors.

When we take a closer look at the returns generated by some of Canada's top stocks over that period, a similar picture emerges. Canada's second-largest bank, **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), has averaged an annual return of 38%, while electric utility **Fortis Inc.** (TSX:FTS) has returned 20% annually.

It is also worth considering that both have steadily growing dividends; Toronto-Dominion Bank has hiked its dividend for the last five straight years and Fortis has hiked its dividend for an impressive 42 consecutive years.

Secondly, gold has been one of the most volatile asset classes over the long term.

A key measure of investment volatility is the standard deviation of its annual returns. The higher the standard deviation, the greater the degree of volatility.

If we take a look at gold we can see that since 1961 its returns have had a standard deviation of 20%, which compares to 16% for both the TSX Composite and S&P 500.

Much of this volatility arises because gold has no utility–investor demand is the key determinant of its value. This makes it extremely difficult to judge how gold's value will move and whether it is undervalued or overvalued.

When considering stocks such as Toronto-Dominion Bank, it is far easier to determine the value by merely considering the fundamentals of their business, their financial reports, and the economic climate.

Finally, gold is a zero-yield asset.

This means that unlike some stocks, bonds, and real estate, it doesn't pay investors any income.

As a result, when interest rates rise, the opportunity cost associated with holding gold increases. This is because bonds and dividend-paying stocks typically pay higher yields when rates rise, whereas gold pays no income at all.

When the Fed raised rates in December of last year, the price of gold fell to just over a six-year low of US$1,051 per ounce as investors fled to higher-yielding investments.

So what?

It is difficult to understand why investors choose to invest in gold. Not only has it performed poorly over the long term and is extremely volatile, but it is difficult to predict its value. Then there is the opportunity cost that comes with investing in an asset class that pays no income.

Clearly, quality blue-chip, dividend-paying stocks such as Toronto-Dominion Bank and Fortis are far superior investments, offering not only the prospects of capital gains, but a regularly growing income stream.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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1. Editor's Choice

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1. NYSE:TD (The Toronto-Dominion Bank)
2. TSX:FTS (Fortis Inc.)
3. TSX:TD (The Toronto-Dominion Bank)

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Author
mattdsmith