# Gold for your Golden Years?

***By Ron Kelemen, CFP®***


Gold has been the news lately, following its spectacular one-day drop in value on April 10. As of late April, it's now back to its March 2011 levels, a decline of 17%. Meanwhile, stocks, bonds, residential real estate, and other investments have generally gone up in value. So, what's going on? How do you invest it? Is gold a good investment? Is it a good hedge against inflation and disaster? Does it belong in your portfolio?

**Owning Gold**

You can invest in gold several ways, all of which have advantages and disadvantages, as well as direct and indirect costs. If you want physical possession, you can buy jewelry, bullion bars, and coins. If you are buying coins for disaster/survival purposes, you would probably want very small denomination coins. (Maybe cans of tuna, gasoline, bottled water, batteries, toilet paper, shotgun shells, and rolls of silver dollars might be more utilitarian.) However, be mindful of the commissions, markups, shipping and storage costs, and insurance which will add to the cost of owning it.

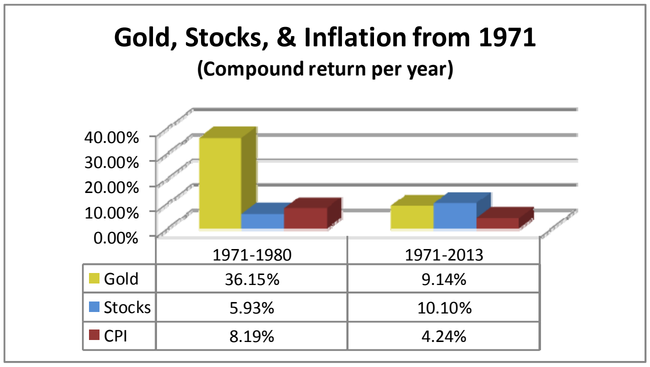
If you want something more liquid, consider shares of gold mining companies (or mutual funds that invest in them). But the most popular way these days is through exchange-traded funds (ETFs) or index funds that track them. ETFs represent shares of gold bullion in a bank vault. You can trade them like a stock, but any capital gains are taxed at the 28% capital gain rate for collectibles. They do have expenses, which are paid by redeeming some of the gold in the vault, so over time, the intrinsic value of the ETF declines. Unlike gold bullion, you can purchase ETFs within an IRA or 401k. Space constraints don't allow me to go into detail about other options, such as exchange-traded notes and commodity funds.

**So, is gold a good investment?**

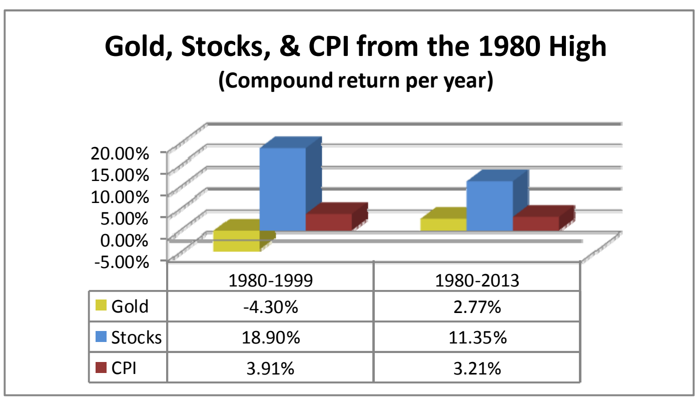
Prior to August 1970 the US dollar was pegged to gold at $35 per ounce. The US money supply was constrained by the amount of gold owned by the US Treasury. For a variety of reasons the US and other countries left the gold standard, and during the inflationary 1970's the price of gold soared from $37 to $835 per ounce by June 1980. However, as the stock market took off in the 1980s and the economy grew in the late 1990s, gold had fallen to $237 per ounce. It didn't hit the $835 mark again until the financial crisis in 2008, a long wait of 18 years.

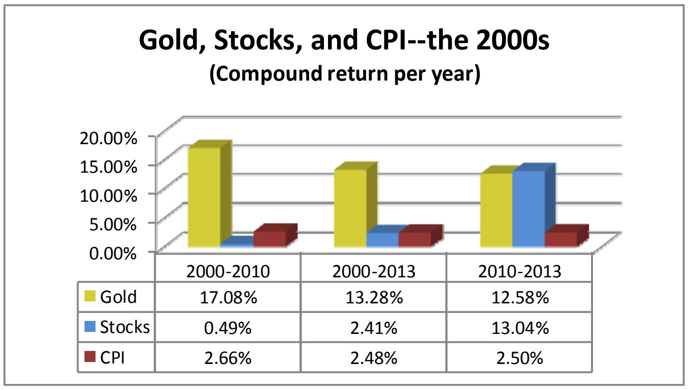
So to evaluate gold as an investment, I thought it would be appropriate to start in 1971 and look at some other peaks and valleys of gold and stocks. We took the price of gold and indexed it at 100, starting in August, 1971 when our currency was taken off the gold standard. We took the month-end closing price of the troy ounce in US dollars from the London afternoon fix, as recorded by the World Gold Council. For stocks, we used the Morningstar 500 Total Return Index, which takes into account both price appreciation and dividends (something gold bugs often omit in their comparisons). For inflation we used the CPI reported by the US Bureau of Labor Statistics.

Take a look at the bar charts. Over the very long run (41 ½ years), both gold and stocks have been good investments.




***But like every other asset, it all depends upon when you bought and sold it. Gold was golden from 1971 to June 1980 and in the 2000s. Stocks were nearly the reverse—good in the 80s and 90's, not good in the first decade of the 2000s, especially if you bought at the peak in early 2000. Both did and didn't keep up with inflation at different time periods.***






**Does it belong in your portfolio?**
I am leery of any investment that is touted in infomercials and full page newspaper ads, with a good dose of fear and urgency in the mix. In years past gold was more negatively correlated with other asset classes. In other words, it tended to move in opposite directions from stocks and bonds. So the portfolio stability benefits are less than before.

According to the World Gold Council, 44% of the demand for gold in 2012 was for jewelry. Only 8% was used for dentistry, electronics, and other industrial uses. The rest was for investment purposes by individuals and central banks. ***Proponents of gold insist that it is a good inflation hedge, but as you can see by the charts, that isn't always so. Gold can be more of an emotional investment, and sometimes an ideological one.*** Some economists have been predicting since 2008 that we are on the verge of hyperinflation with all the government borrowing and Federal Reserve actions to increase the money supply. That has yet to happen, in fact, inflation has been moderating. It sometimes does better in times of fear, but not always. Because of the speed of global finance, often safest haven is the US dollar at the first sign of global turmoil, as we learned from the first Greece default crisis in 2010.

***From a "golden years" perspective, you are going to need assets that produce an income. Gold doesn't do that, as Warren Buffet so eloquently explained in his 2011 Berkshire Hathaway Annual Report:***

"Today the world's gold stock is about 170,000 metric tons. If all of this gold were melded together, it would form a cube of about 68 feet per side. (Picture it fitting comfortably within a baseball infield.) At $1,750 per ounce – gold's price as I write this – its value would be $9.6 trillion. Call this cube pile A.

"Let's now create a pile B costing an equal amount. For that, we could buy all U.S. cropland (400 million acres with output of about $200 billion annually), plus 16 Exxon Mobil's (the world's most profitable company, one earning more than $40 billion annually). After these purchases, we would have about $1 trillion left over for walking-around money (no sense feeling strapped after this buying binge).

"…today's annual production of gold is about $160 billion. Buyers – whether jewelry and industrial users, frightened individuals, or speculators – must continually absorb this additional supply to merely maintain an equilibrium at present prices.

“Can you imagine an investor with $9.6 trillion selecting pile A over pile B?  A century from now the 400 million acres of farmland will have produced staggering amounts of corn, wheat, cotton, and other crops – and will continue to produce that valuable bounty, whatever the currency may be. Exxon Mobil will probably have delivered trillions of dollars in dividends to its owners and will also hold assets worth many more trillions (and, remember, you get 16 Exxon’s). The 170,000 tons of gold will be unchanged in size and still incapable of producing anything. You can fondle the cube, but it will not respond.

“Admittedly, when people a century from now are fearful, it’s likely many will still rush to gold. I’m confident, however, that the $9.6 trillion current valuation of pile A will compound over the century at a rate far inferior to that achieved by pile B.”

***Warren’s time horizon is probably longer than yours, but he makes the point.  So does gold belong in your portfolio?  Is it a good investment?  You decide.***