Client's Corner

The Persistent Illusion of Gold

THE AUGUST 7 ONLINE EDITION OF *THE WALL STREET JOURNAL* contained a remarkable article titled "When Markets Get Scary, Mom and Pop Buy Gold." In addition to being a fair sample of everything that's wrong with financial journalism, it's an almost encyclopedic recitation of the perceived benefits of owning gold (per se, and as a preferred alternative to that hissing, writhing bag of poisonous snakes known as "the stock market").

For the record, the subtitle of the *WSJ* piece is *"Swings in stocks and bonds have boosted the metal's popularity with ordinary investors."* This should already be ringing alarm bells in your head, knowing as you certainly must by now that significant upsurges in the popularity of just about anything among "ordinary investors" is as reliable a contrarian indicator of potential value as you're likely to find. (The article somehow neglects to mention this, so I thought perhaps I'd better.)

The statistic at the heart of the article is as follows. "The percentage of Americans who believe gold is the best long-term investment jumped to 26% this year from 15% in 2022, according to a Gallup report from May. In contrast, those preferring stocks dropped to 18% from 24% last year, while those favoring bonds climbed to 7% from 4%." That this happens quite reliably every time there's a bear market in stocks—"ordinary investors" are always recalibrating their preferences in the rear-view mirror—again goes unreported by the *Journal*.

But I digress. My major purpose in this little essay is to parse the pathology which—in the face of the near totality of the evidence—persists in the illusion not just that gold is an efficient inflation hedge but that it is somehow preferable to holding a broadly diversified portfolio of quality common stocks for the long term.

First, let's get our terminology straight: gold is not, in any accepted sense, an investment at all. That is, it does not produce anything. It just sits there. (Indeed, it costs money to store and to insure, but set that aside for the moment.) Beyond the fact that it looks quite lovely on my wife, gold's sole financial function is as an inflation hedge. The question then becomes: how's that working out?

You may remember that from the end of World War II until President Nixon took the U.S. off the gold standard in August 1971, the price of gold was arbitrarily fixed at $35 an ounce. When that system finally collapsed, gold prices spent the stagflationary '70s catching up to a quarter century of real-world inflation. And by January 1980—the last time "ordinary investors" went totally gaga over it—gold had reached $800 an ounce.

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Thus, if you bought an ounce of gold nearly 44 years ago at $800, you now own an ounce of gold worth (at this writing) $1,965. It's up about two and a half times, having produced in the interim neither dividends, nor interest, nor anything else.

It now becomes my painful duty to disclose to you that the Consumer Price Index in January 1980 stood at 78. In July of this year it was 306. It's up just shy of four times. Which means that, ***just to have kept up with inflation,*** your $800 gold ounce would now have to be valued pretty close to $3,200. But it isn't. Not even close.

Wait, it gets worse. The Standard & Poor's 500-Stock Index at the end of January 1980 stood at 115. I just this minute looked, and saw it at 4,490. That's right: while the price of gold was rising two and a half times, the S&P 500 went up 39 times, ***not counting dividends*** which—at the risk of repeating oneself—gold does not pay.

With reinvested dividends, and assuming you paid taxes from another source, $800 invested in the S&P 500 Index in January 1980 and left to compound would currently be worth right around $95,000.

Are we just about done here?

I read somewhere that gold actually is a pretty effective inflation hedge over extremely long periods of perhaps a century and more. And for all I know, that may even be true. (The idea of gold as an inflation hedge must come from ***somewhere.***)

What weight that factoid should carry with mom and pop, the "ordinary investors" who have elected to get upset about today's quote scary unquote stock market, seems to me at the very least debatable.

Sources: S&P 500 prices: Standard & Poor's, NYU Stern School. Gold prices: Investopedia. Consumer Price Index: U.S. Bureau of Labor Statistics, inflationdata.com. S&P 500 compound return: Robert Shiller.