Fools Gold?

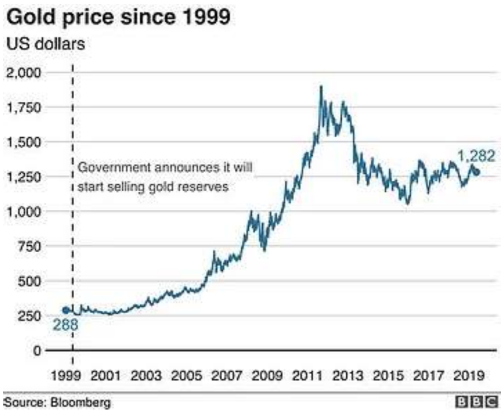
With the price of gold at $1,950 an ounce, is it a good buy?

From King Midas to the Inca civilisation, gold has been revered and worshipped.

Tiny, but shiny flakes of it set off a 19th-century California ‘Gold Rush’, and many Indian and other Asian families use it as a primary store of wealth for their families. Gold has an allure all its own, which seems to never tarnish, a bit like the metal itself.

The question is - Is it really the panacea of investments?

Ups and Downs



British Chancellor Gordon Brown will be forever remembered for selling 41 metric tonnes of gold in May 1999 at the heady price of $250-ish per ounce, on the premise that it would be far more lucrative to hold foreign currencies like the US Dollar and the newly emerging Euro.

What a devastatingly wrong decision, in hindsight! And since the year 2000, gold has seen a 700% rally, a 45% crash and tediously long periods where its price has remained virtually static.

It is easy to understand the concerns many have about equity markets - they are volatile - Many live with a ‘glass half-empty’ attitude and will say things such as “the markets are so volatile-gold is your best bet!”


THE Sun
£50,000 BINGO Lucky numbers are on Page 18
TODAY'S TV IS ON PAGE 14
FREDDIE STARR ATE MY HAMSTER
Comic put a live pet in sandwich, says beauty
SELLERS GIRL IS

At times, I find this mentality very frustrating. The main-stream news media has a lot to answer for.

It feeds sensational headline news, which may be factually accurate on the day, but taken against a backdrop of the much bigger (and longer-term) picture, becomes nonsense which does nothing for investor education and typically scares them into irrational, loss-making decisions.

(Ok, so I admit the headline in the picture isn't about gold, but you get what I mean when I say 'sensational headline news’!)

Well this has to be said - the gold price is subject to mania and passion; and periods of ambivalence and hesitation.

The draw of gold, which jumped from around $500 per ounce in 2005 to more than $1,800 in 2011 and then slumping back to hover around $1,100 to $1,300 for over 6 years, today sits at around $1,950 today, and reminds me of some of the past market bubbles.

Booms and Busts

The dot.com bubble. The late nineties was when everyone piled into those stocks driving the price sky high and most of the speculative stocks crashed badly a few years later.

Soon after that, everybody was jumping into the real estate market and that of course ended pretty badly in 2008.

Most booms and busts have the same pattern. People like to buy things when prices are high.

Maybe they think they’ll miss the chance to make a lot of money if they don’t get in, along with everyone else.

What people forget is prices can fall as fast as they rise. They're investing based on what's happened in the past instead of what's ahead.

Many people were scared that the process of quantitative easing, and the printing of vast amounts of money would simply devalue those currencies, and they see gold as a secure constant that their investments will be safe in. The big problem with this idea is that gold is simply measured in a currency- typically US Dollars.

Tulips

Investing primarily in gold could be likened to the great tulip craze in the 17th century where it has been said that at the peak of the market, a person could trade a single tulip for an entire estate, and, at the bottom, one tulip was the price of an onion.

Many believe that much of this was driven by fear and speculation ,which is abundant at the minute throughout the world.

Investment in gold (or tulip bulbs) is one that technically does not produce anything, but simply relies on the hope that someone else will pay more for your asset in the future. It needs an ever-increasing pool of buyers, all convinced the pool will continually increase and expand further.

Bubbles blown large enough inevitably pop and then Warren Buffet's quote is confirmed once again:

Be fearful when others are greedy and greedy only when others are fearful

There are two major problems with gold investing…

Firstly, it is not heavily used in industry unlike copper, iron or aluminium, meaning demand for gold in industry is so limited that it does not soak up new production.

Secondly, gold itself generates absolutely nothing. An ounce of gold held for a millennium is still only an ounce of gold!

A further point is that, unlike other commodities like crude oil, cotton or coffee, precious metals are not consumed, the amount of gold is more-or-less static.

Would you buy gold or something else?

Warren Buffet gave an analogy some years ago, to explain gold investment in simple terms, that went a bit like this:

Some 197,576 tonnes of **gold** have been mined throughout history, of which around two-thirds has been mined since 1950.

If it were melted-down it would amount to a cube about 21.7133metres per side. Using todays price of $1,950 per ounce that would have a value of $12.3893 trillion and we will call that pile A.

Now, let's create another pile, B, of equal value.

For that, you could buy Apple, Netflix, Amazon, Alphabet (Google), and Facebook. Not just some shares, but the whole companies, and still have $6.99Trillion in change, with which to buy all 400million acres of farmland in the USA ($2.7Trillion), Microsoft, Salesforce Inc, Johnson & Johnson, Walmart, Proctor & Gamble, Visa, Mastercard and Berkshire Hathaway. (Oh, and there is some spare change, too).

So the question is; which pile is the one to go for? Pile A, a commodity is subject to mania and passion; and periods of ambivalence and hesitation; or pile B, including the 400 million acres of wheat, cotton etc, and some 13 of the biggest companies on the planet, each generating combinations of dividend income, and capital growth?

Bear in mind that annual production of gold is in the region of $200billion, and this must be bought by jewellers and industrial users, speculators and the outright frightened individual investors, just to maintain equilibrium, and golds' current price. By comparison, the growth in value of pile B is almost incalculable.

Questions to ask yourself before you buy

If you're looking at gold prices, it's probably a good idea to look at how well the economies of certain countries are doing.

As economic conditions worsen, the gold price will typically rise. Gold is a commodity that isn't really connected to anything else, so in small doses, it makes a good diversifying element for a portfolio.

If you do decide to invest in gold, you must decide whether you will buy physical gold or gold shares. Because you can buy gold in many forms, an important question to answer for yourself is what form of gold is best for you.

Owning gold coins or bullion is one choice. Gold in the form of coins or bullion must be stored in a secured environment, not under the bed, so it probably involves paying a broker or a storage fee, which can eat into any future price gains.

Owning physical gold also has strong emotional appeal, unlike investing in shares, for example.

If you need to cash in your gold coin or bullion in a hurry, you shouldn't have trouble converting gold to cash. However, you will have to take what a dealer will pay, and that will be based on the gold price on the day. Also remember that gold coins and bullion are sold at a premium and bought at a discount, so you may not get market price when you need to sell, though the spread is usually nominal, it should be said.

Investing in gold shares is similar to investing in any other security, except prices may move contrary to the stock market, and more in line with the price of gold. This is not true in every case, particularly if you consider gold mining companies. Then, the price of the stock may reflect the company's financial health and market position more than the price of gold.

Allocation

Most financial experts suggest that you should not have more than 10 percent of your assets in gold, with the rest being made up of a broad mix of assets that look at spreading overall portfolio risk, using a selection of bonds, absolute return products, equities or equity-based assets and cash.

The exact spread will be dependent on your risk profile, age, employment status and other factors.