Complimentary Chapter

from

"The INVESTING OASIS: Contrarian Treasures in the Capital Markets Desert"

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Is Gold Worth Its Weight?

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"In the desert, water is more valuable than gold."

~ Arab proverb

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Objective:

A 360^0 review of gold.

Why Invest in Gold?

There are as many reasons to own gold as there are owners of gold. This chapter will explore how gold fares as a:

- **Long-term investment.**
- **Hedge against inflation.**
- **Hedge against deflation.**
- **Hedge against market corrections.**
- **Diversifier.**
- **Hedge to the $USD.**

Gold as an Investment

The shiny metal has had a long-standing allure to humankind. As an investment, is it truly warranted? The opinion may vary depending upon when you bought and how long you've owned it. Most recently, some investors may even be confused because the macro factors that normally boost gold prices (e.g. steep inflation, war), just aren't getting any price traction.

Since the abolishment of the Gold Standard in 1971, the 50-year graph in Figure 1 below clearly shows gold's outperformance relative to the price of silver, the Dow Index, and the S&P 500 Index. Notably, most of the greatest gains arose between 2000-2011, with a further resurgence during 2015-2020.

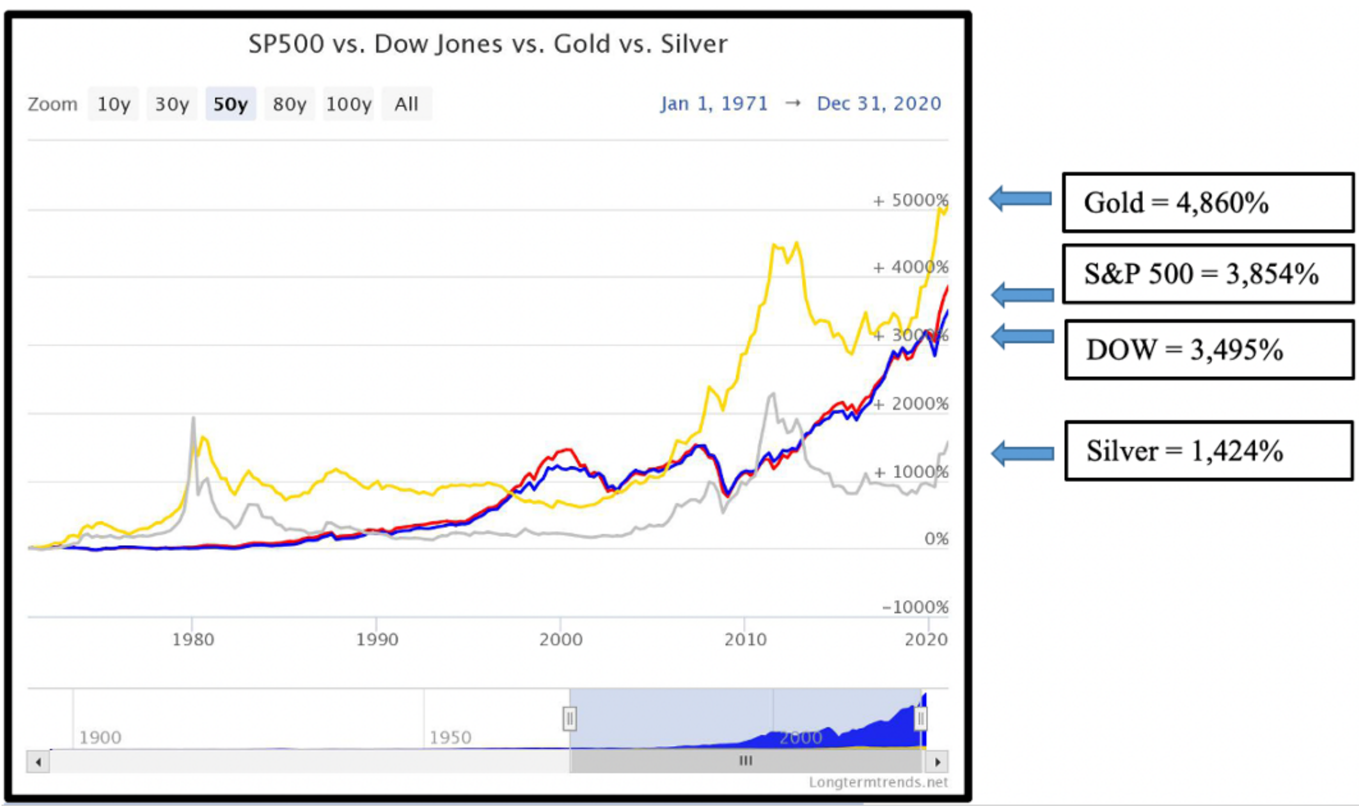

Figure 1. 50-Year Price Chart (1971–2021) Gold vs Silver vs. S&P 500 vs The Dow.

Source: Longtermtrends.net

However, the matrix in Table 1 compares gold's lacklustre performance (11%) between its peak in August 2011 until its next peak in October 2020, in contrast to the 190% returns generated on the S&P 500. As a commodity that has very little economic value and pays no dividend, timing is crucial.

	August 2011	August 2020	**Total Return**
Gold	$1,768	$1,971	**11%**
S&P 500 Index	$1,174	$3,398	**189%**

Table 1. Peak to Peak Gold Performance vs S&P 500 Index.
Source: Goldprice.org.[1]

With minimal industrial value, the price of gold is driven primarily by supply and demand factors.

On the supply side, about 3,000 oz of gold is mined annually. As a noble metal, gold does not deteriorate, nor can it be destroyed, not even by fire or chemicals. So, all the gold ever mined, now totaling 200,000 tons[2] (= $6.5 billion oz), is still with us. With a population of 7 billion on planet Earth, this equates to approximately one oz of gold per human. This 1oz:1 human rate of production ratio has remained constant for centuries.

On the demand side of the equation, 64% of gold is owned by royal families, governments, and private individuals, while industrial use accounts for only about 12%. The swing factor that most heavily influences gold prices is the 22% traded by financial speculators.

During periods of economic stress (inflation/deflation) and geopolitical tensions the price of gold is ordinarily subjected to boom-and-bust cycles. Yet, if an investor decides to buy into rising prices, history has shown that there could be a very long wait before realizing any substantive gains. Gold investing requires a contrarian mindset.

Gold as a Hedge Against Inflation

Economists have long debated whether gold is useful as a hedge in portfolios. When compared on a year-to-year basis, gold fails to show any meaningful inverse correlation to inflation. Yet when viewed in a long-term context, gold as an inflation hedge does hold merit. Consider the last 100 years ending December 2020. Inflation rose 1,126%.[3] In 1920, an ounce of

[1] https://goldprice.org/gold-price-history.html (Accessed 27 September 2021).
[2] https://www.gold.org/about-gold/gold-supply/gold-mining/how-much-gold (Accessed 27 September 2021).
[3] https://inflationdata.com/Inflation/Inflation Calculators/Cumulative Inflation Calculator.aspx (Accessed 27 September 2021).

gold was priced at $19.95 (USD), while on January 1, 2020, it was valued at $1,894. That is a rise of ~9,500%. Relative to inflation, gold wins 8.4 to 1.

Why compare gold to inflation? For any investment to be worthy, whether a stock, a bond, land, a commodity or cash, it must be able to consistently outpace inflation.

But if an investor sincerely wanted to hedge against inflation back in 1920, an investment into a dynamic group of growth stocks listed on the Dow Jones Industrial[4] over 100 years (1920 to 2020) would have appreciated 41,906%.[5] So, in comparison to gold, the Dow holds an advantage of 440 to 1. Not really a fair fight.

While the price of gold did outpace inflation over the really long term, a basket of quality stocks has proven far more consistently superior relative to inflation, over all time periods.

Gold as a Hedge Against Deflation

Where gold shines, though, is during periods of concerted deflation involving difficult economic times and personal hardships. Despite a mild deflationary period during 2007–2009, the last truly noteworthy period of deflation was in the great depression of 1929–1933. As real assets (stocks, home, cars, land, etc.) were plummeting in value, gold prices rose 44%.

As we find ourselves transitioning from generations of growth and easy money to one of tighter monetary policy and fiscal handcuffs, having racked-up nearly $30 trillion in US National debt and many more trillions in obligations, deflation may not be far off. While not a prediction, it is a possibility. When too many humans are chasing too few goods and the money supply is shrinking, funny things happen. Food for thought.

Gold as a Hedge Against Market Corrections

During the two most significant market corrections of recent memory (the Great Financial Crisis in 2007–2009 and the Global Covid Crisis in 2020–2021) in Table 2, gold responded capably when the financial system was under severe duress.

	Great Financial Crisis (GFC)				**Global Covid Crisis (GCC)**		
	07/10/2007	01/03/2009	**Change**		19/02/2020	23/03/2020	**Change**
Gold[6] (Troy Oz)	$740	$937	**+27%**		$1,609	$1,599	**-1%**
S&P 500 Index[7]	1558	683	**-56%**		3386	2290	**-32%**

Table 2. Gold vs. S&P 500 during crises.

[4] The S&P 500 Index was only created in 1957.
[5] https://www.longtermtrends.net/stocks-vs-gold-comparison/ (Accessed 27 September 2021).
[6] https://www.gold.org/goldhub/data/gold-prices (Accessed 27 September 2021).
[7] https://finance.yahoo.com/quote/%5EGSPC/history/ (Accessed 27 September 2021).

Gold as Diversification

The matrix in Table 3 compares 13 ETFs representing all 11 Economic Sectors plus Gold and the S&P 500 Index. The data (correlation coefficients) was derived from the portfolio visualizer application (see Chapter 9: Brains and the Brawn, and Chapter 11: 3+ Degrees of Diversification).

When two assets respond to the same external stimulus and move relatively in tandem, they are considered highly correlated. As such, their coefficient number would be close to "+1". When two assets are completely uncorrelated (meaning they react exactly opposite to the same stimuli), their coefficient number would be "-1". And then there is gold (highlighted in the vertical column). With correlation coefficients between –.50 and +.30, gold makes its case as the ultimate in diversification. In other words, no matter the type of portfolio an investor might hold, gold prices remain very independent from all other sectors. Now, this doesn't mean that gold is better than investing in other sectors. It just means that gold could be considered a 12th sector in a world defined by 11 economic sectors.

Name	Ticker	GLD	SPY	XME	IXC	TLT	IBB	XLY	XNTK	XLF	EXI	IXJ	RWX	XTL
SPDR Gold Shares	GLD	-	0.08	0.36	0.17	0.22	0.05	0.08	0.09	-0.09	0.10	0.14	0.29	0.07
SPDR S&P 500 ETF Trust	SPY	0.08	-	0.66	0.80	-0.45	0.65	0.94	0.88	0.89	0.93	0.81	0.69	0.84
SPDR S&P Metals and Mining ETF	XME	0.36	0.66	-	0.75	-0.43	0.42	0.60	0.57	0.62	0.71	0.48	0.55	0.65
iShares Global Energy ETF	IXC	0.17	0.80	0.75	-	-0.47	0.38	0.73	0.62	0.73	0.81	0.56	0.70	0.67
iShares 20+ Year Treasury Bond ETF	TLT	0.22	0.45	-0.43	-0.47	-	-0.18	-0.39	-0.41	-0.62	-0.49	-0.23	-0.17	-0.49
iShares Nasdaq Biotechnology ETF	IBB	0.05	0.65	0.42	0.38	-0.18	-	0.63	0.61	0.54	0.61	0.80	0.41	0.61
Consumer Discret Sel Sect SPDR ETF	XLY	0.08	0.94	0.60	0.73	-0.39	0.63	-	0.86	0.81	0.87	0.75	0.67	0.80
SPDR NYSE Technology ETF	XNTK	0.09	0.88	0.57	0.62	-0.41	0.61	0.86	-	0.76	0.83	0.64	0.55	0.84
Financial Select Sector SPDR ETF	XLF	-0.09	0.89	0.62	0.73	-0.62	0.54	0.81	0.76	-	0.86	0.64	0.60	0.76
iShares Global Industrials ETF	EXI	0.10	0.93	0.71	0.81	-0.49	0.61	0.87	0.83	0.86	-	0.73	0.76	0.81
iShares Global Healthcare ETF	IXJ	0.14	0.81	0.48	0.56	-0.23	0.80	0.75	0.64	0.64	0.73	-	0.60	0.65
SPDR Dow Jones International RelEst ETF	RWX	0.29	0.69	0.55	0.70	-0.17	0.41	0.67	0.55	0.60	0.76	0.60	-	0.55
SPDR S&P Telecom ETF	XTL	0.07	0.84	0.65	0.67	-0.49	0.61	0.80	0.84	0.76	0.81	0.65	0.55	-

Table 3. Correlation Coefficients for 13 ETFs.

Gold as a Hedge to the $USD

Since gold and the $USD were decoupled in 1971, the association has been somewhat bipolar. When the US economy nosedives, the $USD weakens. Yet since gold is valued in $USD, this spurs the international demand for gold. Therefore, when the $USD weakens, gold rises. This is an inverse relationship. In other words, gold has merit as a hedge against $USD weakness.

On the other hand, during geopolitical strife, the $USD and gold typically rise in concert as capital seeks safety. Therefore, in circumstances involving strife, gold does not offer value as a hedge (although who would complain if gold prices were to rise during difficult times?!)

So, if an investor is expecting gold to be a clear hedge against the $USD, they may find this two-faced relationship disappointing. And it's about to become a lot more complicated with countless cryptocurrencies (Bitcoin and Ethereum included) competing as stores of value, and the imminent introduction of CBDCs (Central Bank Digital Currencies) by a host of central banks globally. CBDCs will be the digital replacement for the world's major fiat currencies (see Chapter 25: The Nextgen Financial System). China was hoping to get first-mover advantage by unveiling the CBDC digital Yuan during the 2022 Olympics.

Nevertheless, as the world's reserve currency, the $USD and indestructible gold have been, and should continue to be, twin pillars of strength for the global economy.

Buying Gold at a Discount

With gold prices hovering near its all-time high of $2,069.40/oz (August 2020), it can be daunting to buy gold, particularly given its cyclical history. Poor investment timing can leave an investor holding gold for a very long time before realizing any gains.

Yet, if you don't want to wait for gold prices to fall back, here's how you can still participate.

Consider selling long-term, deep out-of-the-money (OTM) Put contracts on the SPDR GLD ETF. This would generate premiums for the seller of the contracts (you) on something you don't yet own but could if the price of gold were to discount down to the contract's strike price. The SPDR GLD ETF is a trust holding gold bars for those that cannot afford or do not want to own gold outright. The trust is expected to reflect the performance of the price of gold bullion, less the Trust's expenses. Table 4 outlines 3 Put selling choices sourced on June 3, 2022, when the SPDR Gold ETF was trading at $174/unit:

Discount Preferred	SPDR GLD Contracts (1 contract = 100 ETF units)				
	Strike Price	**Maturity Date**	**Duration**	**Premium**	**Income Earned per Contract**
15%	$150	Dec 16, 2022	195 days	$1.38/contract	$138
20%	$140	June 16, 2023	377 days	$1.70/contract	$170
25%	$130	Jan 19, 2024	594 days	$2.00/contract	$200

Table 4. Put Selling Examples for the SPDR GLD ETF

So, even if an investor's view on gold is bearish, they can still participate with the value of gold by selling OTM Put contracts. How many contracts to sell depends upon the desired exposure. For example, at a 15% discount ($150 relative to the current SPDR GLD price of $174), to achieve $10,000 of coverage, divide $10,000/$150 = 67 contracts. Each contract is equal to 100 units. The premiums generated would, therefore, be 67 contracts x $1.38/contract x 100 = $9,246. That is a very healthy premium to gain a discounted exposure to gold!

When buying gold at its current price of $1,860 is intimidating, instead of buying $10,000 worth of gold bullion and hoping the price goes up, consider selling deep OTM Put contracts. The investor would only take ownership if the ETF units fell below the Strike Price by the maturity dates. If so, then the investor would probably be thankful that they hadn't bought gold at the current prices. However, if gold prices were to rise, the investor would not participate in any price appreciation. An investor would benefit best if gold prices were to remain relatively stagnant or decline less than the built-in discount. To learn more about how to sell a put contract, see Chapter 19: In Search of Buried Treasures.

At the End of the Rainbow

Table 5 provides a summary of the challenges of gold. It works well as a partial hedge against stock market tumult, yet not as well as a hedge for currency or inflation. As a hedge against the $USD, it's proven to be bipolar. And, unless an investor owns a dividend-paying gold stock or a Covered Call Gold ETF, ownership pays no rent.

For the last 100 years (1920–2020), gold prices have risen 9,500%. While that may sound attractive and certainly better than inflation (1,126%) it pales relative to the 41,906% generated by the Dow Jones Industrial Average.

This is not to say that gold cannot be competitive with a portfolio of stocks. Rather, it's just that timing is everything. Buying late in the cycle could require an exasperatingly long time to recoup an investment in gold. So, instead of being exposed to current gold prices, consider selling Put contracts at a price discount and generate a little income, while you wait.

Reasons to Own Gold:	Comments
Investment	• Gold is best deployed as a contrarian investment. Buy low, sell high. • Earn income from gold by buying senior dividend-paying gold stocks and selling Covered Calls to earn some extra income. • Alternatively, buy a gold ETF that deploys Covered Calls. • If gold prices are too high, consider selling deep, long-term OTM Put contracts for the premiums. (Sell high, buy low). • Junior gold-mining stocks are worse than gambling. Casinos offer better odds. • For better long-term investing, buy an S&P 500 ETF.
$USD Hedge	• Short term – gold prices correlate positively with the $USD (in times of fear). • Long term – gold is usually negatively correlated to the trend of the $USD.
Inflation Hedge	• Gold is an unreliable inflation hedge from year to year. In the really long term, it has merit, but then in the longer term, the S&P 500 is a better investment.
Deflation Hedge	• Gold shines during periods of political turmoil and weak economic times.
Portfolio Hedge	• Gold hedges a portfolio well when markets are volatile. But no more than 5%.
Diversification	• Gold is the ultimate diversification choice. It correlates weakly with all assets.
Reserve Currency	• Indestructible gold will outlast all fiat, digital currencies, and eventually humans.
Jewelry	• Who doesn't look good wearing gold?

Table 5. Gold's report card.

Worth its weight?

Despite being relatively useless for industrial purposes, an uncertain hedge against inflation, bipolar against the $USD and an overall temperamental investment, it's true worth only comes alive during times of strife.

If you worry that gold is just too expensive, average your cost by buying a golden ounce every birthday. If you're concerned that gold doesn't generate any income, own senior gold stocks or buy a gold Covered Call ETF, or even get paid to buy gold at a discount by selling an OTM Put contract!

And if you worry about keeping gold bars in your home, consider buying gold ETFs that hold the gold in reserve until home delivery is requested:

- USA – [iShares Gold Trust (US)][8]
- Canada – [MNT from the Royal Canadian Mint][9]

And sometimes gold's greatest value is as an adornment. A shiny but indestructible metal that mesmerizes with its aura.

Gold Fun Facts

- Gold does not naturally occur on our planet. It was created through nuclear fusion when Neutron stars collided and scattered debris across the universe.[10]
- Earth's gold was delivered by meteorites that bombarded our planet 4 billion years ago.[11]
- An Olympic gold medal is composed of 210g of silver, plated with 6g of 24k gold.
- Gold is non-toxic. It can be eaten but has no flavor.
- Gold melts at 1,064° C but it cannot be destroyed. Even an acid, HNO_3 (Aqua Regia) is only capable of dissolving gold but it only disperses it into smaller particles.
- Gold lasts forever. It never tarnishes nor, as a noble metal, can it ever be degraded.
- Every ounce of gold ever mined across history and worn by kings and queens of the day, continues to exist. This totals approximately 184,000 metric tons, or enough to fill 3.5 Olympic-sized swimming pools.
- It is estimated that only 54,000 metric tons of gold remain undiscovered. At the current rate of mining 3,100 metric tons per year, unless new reserves are found, all gold on land will be unearthed within 20 years. Not to worry, though, estimates are that 20 million metric tons of gold are suspended in ocean water, not including the 28 million metric tons buried on the ocean floor. Should I mention the moon and plans for interstellar mining?

"More gold has been mined from the thoughts of men, than has ever been taken from the earth."

~Napolean Hill (1883-1970)
Author of *Think and Grow Rich*

[8] https://www.ishares.com/us/products/239561/ishares-gold-trust-fund (Accessed 27 September 2021).
[9] https://www.reserves.mint.ca/Tsx_Gold/about/ (Accessed 27 September 2021).
[10] https://www.businessinsider.com/how-much-gold-created-in-neutron-star-collision-2017-10 (Accessed 27 September 2021)
[11] https://www.sciencedaily.com/releases/2011/09/110907132044.htm (Accessed 27 September 2021)