Benefactor's Blog

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The Theory Behind Gold

Throughout history gold has been used as a means of settling trade and debts. Today, many investors use gold as an asset class to hedge against the effects of inflation or debasement of currency caused by, among other things, governmental monetary policy.

Given the global efforts to repair economies since the 2008 financial crisis, gold has increased in popularity. Along with that broader acceptance of the metal as an inflation-hedging tool, there has been an impressive bull run in the price of gold (from roughly $730 per ounce in November of 2008 to a high of $1,900 per ounce in September of 2011 - currently trading at approximately $1,300 per ounce).
When a specific asset class experiences prolonged positive price momentum, there often is an increase in television and radio ads promoting that asset, and various ways for speculators to purchase it. Unfortunately, such promotions happen late, when the asset has reached a high market price, rather than at a time in which buying would be an opportunity.

The recent indication from the Fed that, at some point, it will taper its $85 billion-per-month bond-buying habit, has caused long-term interest rates to increase – and thus sparked a rally in the price of the dollar relative to other currencies and some hard assets, like gold.

Furthermore, according to government statistics, and despite expansionary monetary policies, the risk of substantial short-term inflation seems unlikely – at least for now. The combination of higher interest rates and lower inflation taken in tandem produced a bearish signal the gold market – recently encouraging gold speculators and investors to sell some of their holdings in gold. Specifically, gold began the year trading near $1,700 per ounce – about 20% higher than its current price.

While commodity-oriented equities and ETFs do not typically produce income; in large, highly diversified, risk-tolerant portfolios, some exposure to inflation-hedging investments may prove to be useful when attempting to preserve an institution's long-term purchasing power. Ultimately, as with any asset class, the decision to have exposure to an investment such as gold through gold-related equities or ETFs should be determined by a portfolio's trustees and financial advisors in the context of adhering to the portfolio's goals, objectives, risk tolerance, and diversification criteria.

So, in summary, whenever there is a market correction, it is healthy to revisit one's ownership of an asset and the theory behind holding it in the first place. Gold is no exception. What a gold investor now needs to ask himself or herself is if the developments causing the correction are short-terms events – or long term trends impacting the original inflation-hedging investment thesis. This assessment matters since endowments, such as cemetery trusts, typically have multiple missions: to produce income, and to grow corpus to keep pace with inflation.

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