
As an Investment, Will Gold Pan Out?

By Editor Test *Mon, Jan 21, 2013*

A new research paper asks whether it makes sense to invest in gold and arrives at surprising conclusions--and some interesting historical trivia.

Gold, the value of gold, and the wisdom of owning large amounts of gold today is the topic of a new research [paper](#) written by Campbell R. Harvey of Duke University and Claude Erb and published by the National Bureau of Economic Research.

In their conclusion, the authors write, "Investors are faced with a golden dilemma. Will history repeat itself and the real price of gold revert to its long-term mean - consistent with a 'golden constant'?

"Alternatively, have we entered a new era, where it is dangerous to extrapolate from history? Those are the uncertain outcomes that gold investors have to grapple with and the passage of time will do little to clarify which path investors should follow."

The paper lists six traditional arguments for owning gold: As an inflation hedge; a currency hedge; an alternative to assets with low real returns; as a safe haven; because the world will return to a gold standard; and because it is "under-owned."

Then the authors assess each of these rationales. Goldbugs may not agree with their findings. They write:

We find little evidence that gold has been an effective hedge against unexpected inflation whether measured in the short term or the long term. The gold-as-a-currency-hedge argument does not seem to be supported by the data.

The fluctuations in the real price of gold are much greater than FX changes. We suggest that the argument that gold is attractive when real returns on other assets are low is problematic.

Low real yields, say on TIPS, do not mechanically cause the real price of gold to be high. While there is possibly some rational or behavioral economic force, perhaps a fear of inflation, influencing variation in both TIPS yields and the real price of gold, the impact may be more statistically apparent than real. We also parse the safe haven argument and come up empty-handed.

History buffs may enjoy the article, which offers such nuggets of knowledge as this:

In the era of Emperor Augustus (reigned from 27 B.C. to 14 A.D.), a Roman legionary was paid about 2.31 oz. of gold a year (225 denarii) and a centurion was paid about 38.58 oz. of gold a year (3,750 denarii). Converted to U.S. dollars, the pay of a Roman legionary was about 20% that of a modern day private in the U.S. Army and the pay of a centurion was about 30% greater than the pay of a captain in the U.S. Army.

And those who relish science or even science fiction may enjoy the following:

The near-Earth asteroid 433 Eros might contain up to 125,000 metric tons of gold... There are currently 15 near-Earth asteroids with expected profit greater than \$1 trillion. Closer to home, perhaps someday in the future someone will figure out how to implement Nobel prize winner Fritz Haber's plan to electrochemically recover some of the estimated 8 million tons of gold in the world's oceans.

My personal fascination with gold and the gold standard stems from a long-ago experience in Europe. In mid-August 1971, while pedaling my pannier-laden Peugeot UO-8 from Fontainebleau to Paris, I stopped at a local bank branch in Melun to change a traveler's check into francs.

The teller was flustered because she didn't know how many francs to trade me for my green \$20 American Express check. President Nixon had just for practical purposes ended the Bretton Woods Agreement and taken the dollar "off gold." That eventually left the exchange rate to float... or, as Nixon's aides might have put it, "to twist slowly in the wind." For some reason, the teller chose to give me the (higher) previous day's rate. I continued on my way, and the rest is history.

Correction: Nixon didn't take the dollar "off gold" in 1971 as suggested above. According to Erb and Harvey, the U.S. did not officially embrace a monetary system of pure fiat money until October 1976. According to "A Brief History of the Gold Standard in the United States, by the Congressional Research Service (June 23, 2011):

"The United States began to halt its redemptions of dollars into gold for international transactions in 1967 and 1968. The actions of 1971 and 1973 were not the adoption of floating exchange rates and fiat money, but the loss of the ability to redeem dollars at a fixed price. Floating occurred by default."

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