Funds & ETFs

Why would anyone invest in gold?

Gold, gold, who would not like to have some gold? The very word is inextricably tied up with wealth and success. Think gold watches, gold chains and gold bars. We give gold away as dowry. We hoard it in our safety. But is it actually a good investment?

In recent years gold has been love-it-or-hate-it fare — there's very little middle ground. There are those who dismiss it as a low-return asset suitable only for doomsday prophets awaiting the next financial collapse. But I also personally know several sophisticated investors who believe in it. Richard Fisher, president of the Federal Reserve Bank of Dallas, and clearly no fool, was cited by CNN in its 2012 article, “Stock picks from Fed officials”, as having more than US$1 million of his US$2 million portfolio allocated to gold, based on his financial disclosures to the Fed. So, the arguments for gold investment deserve objective consideration to sort the myth from reality. Here is what I found.

Gold offers low investment returns with high volatility

The chart tells us why most investors prefer to avoid gold as an investment. Gold contributed 4.6% to the total capital in the index, but the risk is low. Over the long run, however, gold returns are volatile. Over the past 40 years, the annualized return on gold has been 0.0%, which is to say, negligible. Gold is also significantly negatively correlated to bonds, with a correlation coefficient of -0.09. As such, gold can potentially help to reduce the overall volatility of a portfolio.

However, for this diversification impact to be significant, the allocation to gold would probably need to be quite large. And since gold has relatively low long-run expected returns, there is a substantial cost to pay in terms of lower returns for the reduction in portfolio volatility.

It is not a very reliable safe haven

The “haven” property of gold has been much touted. In terms of economic turmoil, investors are said to rush towards certain...