



A MATTER OF OPINION

Gold no longer offers much of a financial benefit to individual investors other than price speculation, the same as any other commodity.

Just Another Commodity: Reasons for Including Gold in a Portfolio Fade

By James B. Cloonan

After the worldwide disturbance in the markets that began in the Far East, I thought it appropriate to discuss gold again. The last time I discussed gold was five years ago, and events since then have served to reinforce my previous views. This article is really an update of my previous position.

The last time gold was really a hot investment item was in the early '80s. This was just before the beginning of the greatest bull market in stocks; Business Week ran an issue entitled "The Death of Equities," and the Dow Jones industrial average was at about 888. At that time, gold buyers—or more likely, gold brokers—were calling attention to the fact that gold had almost attained the level of the Dow Jones average and soon would be "double the Dow." But even though inflation remained high, gold collapsed quickly to the 400 level. It has remained at that level, more or less, ever since—close to 20 years.

There are still gold believers out there. Nonetheless, I think that it's time to stop thinking of gold as a financial asset.

All the reasons for viewing gold any

differently than any other commodity, such as copper, steel, or aluminum, have disappeared. One of the markets for gold is as a commodity with industrial applications, including jewelry and decoration. While demand has been fairly steady over the years, I believe supply will continue to increase because new methods of recovery in old mines are reducing the production price significantly, and new deposits continually show up. In addition, stock-piled gold is increasing because people holding it for financial reasons are selling. With constant demand and growing supply, I see a gradual move toward an industrial-based price.

At the same time, the financial arguments for holding gold are disappearing. For many years, gold had been thought of as a hard-asset hedge against inflation. But over the long haul, and particularly in recent years, it has not kept up with inflation. If it stabilizes as a commodity, its price will go up every year slightly less than the rate of inflation because of storage charges.

Gold also has been thought of as hard currency in a world thrown into

disorder by war, pestilence, or economic collapse. However, in true times of devastation, soap, chocolate, guns, ammunition, and food are the real currencies of power.

Some believe that gold will swell in value if the U.S. and/or other developed countries switch to a hard-asset economy. But I see almost no possibility of such a change. Even if the world decided to go back to a hard currency, it might not be gold. Every country would like to tie currency value to the commodity it has—oil, wheat, uranium, diamonds, etc. While compactness and portability were important once, they won't be in the future because we wouldn't carry the commodity itself, but rather a script based on it.

Lastly, some financial advisers believe that gold prices move independently of other investment assets, and it therefore can reduce portfolio volatility. In fact, the last time I discussed gold, I received a large amount of mail from professionals who said I misunderstood the need for gold. They said it wasn't supposed to have a long-term yield. Instead, it reduces portfolio risk since it tends to go up when the market goes down.

However, short-term volatility doesn't bother me much, and it shouldn't bother a long-term investor. So, why waste 5% to 10% of one's assets for short-term risk reduction on a non-yielding investment when T-bills will do exactly the same thing—reduce portfolio volatility—and provide some yield?

In addition, in the recent Far East crisis, gold collapsed right along with stocks. Some gold was sold to meet margin calls, but more, I believe, was sold to buy stock that many perceived as bargains after the market pulled back.

All of this confirms my belief that gold is just another commodity. While the mystique and mystery of gold, and the image of it being the currency of choice in hard times, are interesting, the world has changed. You can speculate over the short-term on its price as you can with any other commodity. But other than speculation, I can't think of a valid reason to consider gold as an investment. 

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