

IS GOLD AN ATTRACTIVE INVESTMENT?


Since it is highly unlikely that gold will soon disappear from the world monetary stage, the question naturally arises is gold an attractive investment? Is Buying gold a wise way to get rich or a dumb way to go broke? Because gold earns no interest or dividends, it immediately suffers in comparison with such alternatives as savings accounts, fixed income securities, shares and rental property, although in this Respect is similar to diamonds, stamps, rare coins, art objects and non-income producing real estate Because it yields no current in- come, the wisdom of buying gold depends entirely on the prospect of future price appreciation.



If gold can be expected to rise in price by more than about 12 to 20 percent annually, which is roughly what one can earn in a savings account, in fixed income securities, or sometimes in shares, then it is worth considering gold as an investment. But if it is not likely to match that rate of price appreciation, one can do better- and with greater safety-in one of the more traditional forms of investment. By this criterion, the historical record indicates that there have been only two worthwhile periods.

In the past hundred years when an investment in gold would have paid off. One was the period just prior to 1934, and the other was the period from the end of 1967 to the end of 1974.

In January 1934, the US government increased the price of gold by 69 percent, from US\$20.67 to US\$35 an ounce. Thus, anyone who had the foresight to buy gold at US\$20.67 from February of 1929 through February of 1933, and who sold it at US\$35 in February of 1934, would have been rewarded with a compound rate of return, anywhere between 11 and 70 percent per annum, the exact figure depending on when it was bought. Thirty years ago, gold buyers have done even better; the free market price of gold rose from US\$35 an ounce in 1967 (unchanged since 1934), to a peak of almost US\$200 in December of 1974, a compound annual rate of price increase close to 30 percent for the entire seven-year period. Indeed, between late 1972, and late 1974 the price of gold more than tripled! The price of gold has doubled since 1974.

 In 1996, the price of gold went up to US\$400 an ounce, as nations feared Boris Yeltsin's ill-health may lead to social unrest in Russia, the effects of which could have spread throughout Europe. The price of gold now fluctuates between US\$350 and US\$380 an ounce. Those who bought gold prior to it peaking and sold it off would have made good profits, while those who bought gold at the top-end of the market and are still holding on to their stockpiles are certainly feeling the punch these days! But careful, because these figures greatly exaggerate the likely profits obtainable from gold in recent years. The free-market price did not rise without interruption from 1967 through 1996. During

Much of 1971, for example, the price was below 1969 levels, and similarly from June through November of 1973 the price of gold fell by 30 percent. How do you think all those people in the US would have felt who bought gold at US\$195 an ounce in January of 1975, as soon as ownership of gold by private citizens of the US became legal, and watched it fall to US\$105 by July of 1976? That's a 45 percent drop in value in just a year and a half. True enough, the price of gold has had a chequered history.

Supply and demand factors make the price of gold highly volatile. With respect to supply, new production adds to the existing stockpile at the rate of only about 2 percent a year. This means that the overwhelming element on the supply side is not the amount of current ore production but uncertainty as to how much holders of the existing stockpile might try to unload.

For instance, the US Treasury deliberately (and successfully) cracked the price spiral in January 1975 by selling 750,000 ounces from its gold hoard and then auctioned off another 500,000 ounces in June 1975. Similarly at the January 1976 IMF meetings in Kingston, Jamaica, the IMF decided to sell 25 million ounces of its gold in the open market and used the proceeds to aid developing countries. In other words, sales by large holders, including Russia and China, are always a threat to break the price.



On the demand side, again, a significant portion of the demand for gold is not for current industrial or artistic use but rather is motivated by psychological considerations, in particular, by fear regarding an uncertain social and economic future. Gold has traditionally been thought of as a hedge against inflation, when prices threaten to rise rapidly the demand for gold expands, but when inflation subsides the demand for gold often vanishes overnight. This sort of demand typically fluctuates widely on short notice. In other words, small changes in supply or demand can produce substantial price fluctuations. Thus, gold is a highly speculative investment in which the warning “caveat emptor”-let the buyer beware is particularly appropriate. Large gains can occasionally be made, but large losses are just as likely on the basis of historical record over the past hundred Years.

It is appropriate to end this article with a story. A man on a sinking ship ran to fetch his gold hoard before jumping overboard. When he landed in the water, the weight of the gold made floating impossible, so down he went. The crucial question is: did he have the gold or did the gold have him?



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