Five reasons gold lost its sparkle for investors

- DON STAMMER

- THE AUSTRALIAN
- AUGUST 04, 2015 12:00AM

The head of research at BullionVault, a British gold trading platform, reminded his readers recently of a comment of NM Rothschild, the famed financier of the early 19th century: “I know of only two men who really understand the value of gold, an obscure clerk in the basement vault of the Banque de France and one of the directors of the Bank of England. Unfortunately, they disagree.”

For many centuries, gold was the means by which people could protect their wealth at times of financial stress, political upheaval, economic turmoil, inflation or war.

During and since the global financial crisis, however, gold has played only a supporting role — and its price has disappointed many “gold bugs”. Sure, the price rose from $US885 an ounce when the crisis erupted in late 2008 to $US1150 12 months later.

But even in the gloomiest days of the crisis, it was the rush into US government bonds (and currency), not gold, that stole headlines.

In 2011, as relative calm returned to the US financial system, gold surged to $US1900. Despite many forecasts the price would soar even higher — $US3000 was a favoured target — it softened. Recently, it plunged to $US1100.

Why hasn’t gold reappeared in its oft-performed role of protecting wealth in troubled and uncertain times?

• **Globalisation and the internet:** Nowadays many investors worried about financial markets or the political outlook have a wide choice of where to park their savings. Buying gold is one choice among many.

• **US dollar**: The gold price usually moves inversely to the value of the greenback. For example, when the US dollar is maintaining (or enhancing) its role as a store of value, people have less need to buy and hold other assets, including gold, for that purpose, which stifles the gold price. In the past 12 months, the US dollar has risen by a fifth against the average of other currencies — thanks to the strengthening US economy and prospects for an increase in the cash rate.

• **Investors’ hunt for yield:** The dominant theme in investment markets in recent years is the “hunt for yield”, triggered, of course, by central banks holding cash rates at record lows. Gold, which doesn’t generate a cash income for its owners, is left out of the game.

• **Gold performs best when rapid inflation is a worry:** At present, investors are little concerned about the risk of even mild inflation. My guess is the cyclic rebound in global inflation, when it comes, will be more of a problem than now expected. But it's a medium-term risk, not an immediate concern. And investors can gain secure and reliable protection against future inflation by holding inflation-linked bonds.

• **'Manipulation' of the gold market**: A noisy minority of gold investors attributed the sharp weakening in gold in 2013 to substantial but unannounced sales by the US central bank. The intention, it was said, was to ensure the Fed's huge purchases of bonds under quantitative easing didn't cause a run on the US dollar. These claims of Fed manipulation remain unsubstantiated.

In 2014 and 2015, some traders and investors believed the Chinese monetary authorities would become a heavy but secretive buyer of gold — in preparation for making the renminbi a global currency. China's holdings of gold now stand at just 1658 tonnes — well short of the 3500 tonnes some market participants had forecast.

The main negative in the gold price outlook would seem to be a further strengthening of the US dollar.

But globalisation and technology — and the range of inflation-linked bonds on offer — are reducing the role gold will play in protecting investors in uncertain or inflationary times.

It's also possible we've recently seen capitulation by investors who've been long-term enthusiasts for gold, driving the price of gold to too low a level.

Gold prices are notoriously hard to predict, so it's not surprising most gold traders and investors are driven by charts and technical analysis, rather than by a detailed look at fundamental influences.

Don Stammer chairs QV Equities, is a director of IPE, and is an adviser to the Third Link Growth Fund and Altius Asset Management. The views expressed are his alone.