Investment Insights

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TANDEM INVESTMENT PARTNERS

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Is gold a good investment?

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Gold has been in the news for most of the past five years as prices first climbed to record highs before receding almost steadily for the past two years. While predicting the "true" price of gold is a fool's game, we explain some of the underlying factors that drive gold's price.

One of the key drivers of commodity prices like gold is the level of "real" interest rates, defined as the nominal interest rate minus the expected inflation rate. For most of the past decade, real rates have been at historically low levels; and at times dipped into negative territory for short time periods. Low real rates mean the "opportunity cost" of owning gold is very low.

In the past, higher gold prices have not been due solely to fears of near-term inflation. While gold prices have historically risen when inflation expectations have spiked, inflation expectations have been very low for most of the past decade – both in the US as well as most developed countries. The huge rally in gold that ended in 2012 was due to a combination of very low interest rates, significant deficit spending in the US and abroad, and huge increases in the US money supply brought on by the Federal's Reserve's Quantitative Easing (QE) program. More recently, as signs became more evident that the Fed would wind down the QE program, and deficits began to fall precipitously, gold prices began to decline.

Investors historically have bought gold as a hedge against economic, political, or currency crises (including investment market declines, rapidly increasing national debt, currency panics, inflation, war and social unrest). The gold market is subject to speculation as are other markets, more so today as the use of ETF's has enabled the individual investor to "own gold". As an example, the largest gold ETF, The SPDR Gold ETF (GLD) peaked at $75 billion in assets a few years ago. As of October 31, 2014, it held $28.6 billion in assets, down over 60% in two years.

The biggest catalyst for rising gold prices earlier in the decade was the easy money policies of most central banks around the world. When investors fear inflation, they seek a store of wealth. Gold has long been that store of wealth and investors piled into the commodity without regard to its price level. As stated above, the ease with which investors can purchase gold has significantly increased the demand for the metal. Based on these and other exogenous factors, we at Tandem do not try to set a price target for gold. Instead, we view it as one of several potential investable asset classes for our clients.

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