

The True Value of Gold

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There are over 100 billion galaxies in the visible universe. The Milky Way galaxy, where we live, consists of more than 300 billion stars like our own sun. Some of these stars will have a few planets revolving around them similar to our solar system.

A few of these planets will be the right size, orbit the right type of star (like we do) and be in the 'Goldilocks zone' where conditions are just right for life. Current estimates put that number at about 11 billion planets in the Milky way galaxy alone.

The big question inevitably is, if there are all these likely habitable planets, where are the aliens? There are many suggestions as to why the aliens haven't visited us yet but maybe they think there is nothing to see here. After all, what civilisation worthy of the name digs up gold in one part of the planet only to put it back in the ground in vaults and speculate on its value?

The allure of gold is understandable albeit slightly flawed. Gold is a stable element that won't rust or wither away like other materials. And there is a limited supply. Its industrial applications are also restricted to about 12% of total reserves.

Gold produces no cashflows. Here's a fact for you –1 kilogram of gold in the year 2000 BC is still 1 kilogram of gold today. In the intervening years, its price has increased or decreased largely based on fear or greed. Over the last 200 years gold has barely outpaced inflation, having a 0.5% annualised real return in this period. Much better than cash but woefully worse than other asset classes.

So, what is the true value of gold? Since it produces no cash flows and can't re-invest to create more gold or increase its mass, its value is mainly a function of anticipating what others will pay for it. During financial crises, gold prices tend to go up as other asset classes fall. The role of gold in a portfolio is therefore an insurance against extreme events and more importantly, to act as a proxy for cash.

Baron Rothchild said he only knew two men who could value gold – a clerk in the Banque de Paris and a Director in the Bank of England. Unfortunately, they both disagreed on its value.

This is the difficulty with "investing" in gold. Its true value is opaque but its job in a portfolio is clear. It is cash 2.0 because it correlates negatively to equities during extreme events and keeps its real value much better than paper money ever could. This is why we have some gold in all of our strategies – as insurance against the unknown and more importantly, as a proxy for cash.

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