

Portfolio Perspectives

Why Are You Buying Gold?



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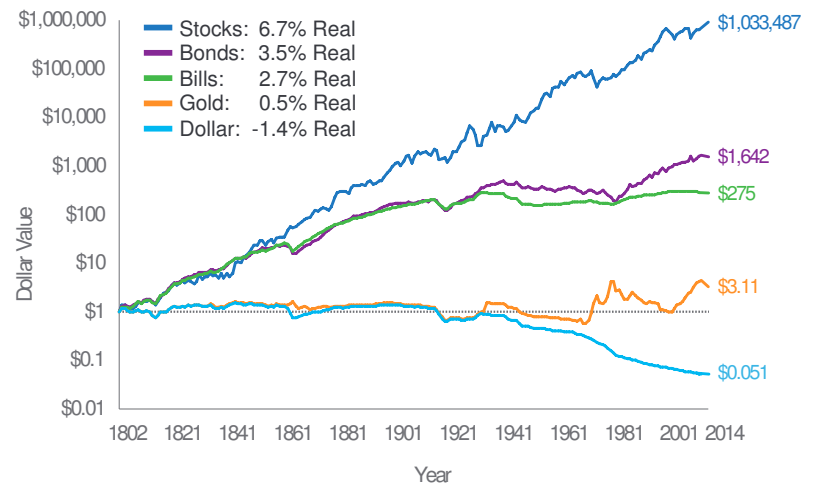
I don't know about you, but lately my newsfeed has been inundated with headlines and stories about gold. It seems many of these articles are written or sponsored by someone trying to get me to buy the shiny metal. Many make the same cliché claims about why gold is a wise investment: it provides safety during financial crises, it hedges against inflation and it creates wealth. Unfortunately, these claims encourage people to buy gold for the wrong reasons.

Apocalyptic Protector?

The idea that gold is the currency of the financial apocalypse is farfetched. Gold hasn't been linked to currency, at least in the U.S., since August 15, 1971, when President Nixon nixed that link established by the Bretton Woods Agreement. Even if the financial world does go to hell in a hand basket, you probably won't be lugging ingots to the supermarket to buy spam and matches. Most investors don't hold gold in any meaningful quantity. Instead they hold financial instruments for gold or gold derivatives. You'll probably never get your hands on gold ingots, even in tranquil times.

Inflation Fighter?

Jeremy Siegel of Wharton calculated the inflation adjusted growth for several financial instruments back to 1802. Gold did outpace inflation but not nearly as well as the alternatives. If inflation protection is what you are seeking, you would have been better off putting your money in any of the alternatives for the long term (see the chart at the right).



Source: Siegel, Jeremy, *Future for Investors* (2005), With Updates to 2014 Data is from Jan. 1, 1802 – December 2014. Hypothetical value of \$1 invested on January 1, 1802 and kept invested through Dec. 2014. Assumes reinvestment of income and no transaction costs or taxes. This is for illustrative purposes only and not indicative of any investment. Indexes are unmanaged baskets of securities that are not available for direct investment by investors. Index performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Stock investing involves risks, including volatility (up and down movement in the value of your assets) and loss of principal. Investors with time horizons of less than five years should consider minimizing or avoiding investing in common stocks. Bonds are subject to market and interest rate risk. Bond values will decline as interest rates rise, issuer's creditworthiness declines, and are subject to availability and changes in price. The price of gold may be affected by global gold supply and demand, currency exchange rates and interest rates. Investors should be aware that there is no assurance that gold will maintain its long-term value in terms of purchasing power in the future. T Bills are backed by the US government and are subject to interest rate and inflation risk. T Bill values will decline as interest rates rise. The value of the U.S. dollar depreciates over time with inflation, so the primary risk is inflation risk.

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Money Maker?

Traditional valuation techniques build upon the concept of discounted future cash flows. In contrast to many other investments available, gold doesn't generate any income, so rationally valuing gold — unlike stocks, bonds, real estate or other assets — is at best arbitrary and at worst impossible. While gold does have intrinsic value for various consumer goods and industrial applications, its only value as an investment is the hope for capital gains from rising gold prices. And, if you factor-in storage costs (e.g., safe deposit box), transport fees or insurance costs, one could argue that gold could be valued as a liability equal to the present value of these 'carrying costs' of owning gold.

Contrast that to some of the great companies of the world that are constantly innovating and providing goods and services for consumers. These companies can potentially generate profits and pay out dividends, which create wealth for investors.

Gold — Just Another Commodity

There is a cultural lag in this country when it comes to gold. Many still view gold as a currency, which hasn't been the case for many years. As Nobel Prize-winning economist Milton Friedman wrote back in 1974, "It [gold] is simply a highly speculative commodity like soybeans."¹ Recall that Winthorpe and Valentine certainly made money in commodities in the movie "Trading Places," but the Duke Brothers, trading against them, lost their fortune and went bankrupt. Think about that the next time you read or hear pundits talk of pending financial doom and gold is held up as the prime candidate to be the savior of your portfolio. Substituting the word "gold" in those stories with any one of your other favorite commodities (eg., soybeans, coffee, wheat, or pork bellies) will make all the difference.

¹ Milton Friedman, "A Dramatic Experiment," Newsweek, April 1974.

All investments involve risk, including the loss of principal and cannot be guaranteed against loss by a bank, custodian, or any other financial institution.

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