

# Fools' gold: A false safe haven

By Art Ernst

As of this writing, the Standard & Poor's 500 is down more than 45 percent from its peak 15 months ago, bond prices of esteemed corporate issuers indicate distress, and there is fear the entire financial system is in peril. We have weathered recessions, liquidity crises and periods of deflation and inflation before, but the economy clearly is in uncharted waters. Extreme uncertainty has led many to a search for safe havens.

Among these places of refuge are some stalwart vehicles that provide safety and earnings such as treasury bills and bonds, bank CDs below FDIC maximum limits, and well-run money market funds. In a hurried flight from stocks and longer-term bonds, a number of nervous investors also seek refuge in non-financial alternatives. One of the most sought and advertised is gold.

Aside from filling teeth, accessorizing outfits, and certain industrial uses, gold has maintained a special aura in finance. Perhaps due to its central importance during the Mercantile Era or its fixed-peg status until the 1970s, gold has been treated as if it is better than money. Indeed, cash used to be simply a substitute for gold, theoretically exchangeable at a set rate. In God we trusted, but gold was the real thing.

Since gold now is merely another commodity, it's intriguing to see it so eagerly sought in tough times. One can do well if he or she can predict chaos and buy before the bad news. Unfortunately, most do not even consider buying gold until after a calamity has wrought panic.

Recent history is telling. In the late 1970s, spiraling inflation and its ancillary effects caused gold to soar, peaking in 1980 at about \$850 an ounce. It was not until 27 years later in December 2007 that those safety-seeking investors finally broke even. Of course, during this same span, the funds spent and merely recovered in gold could have instead more than quadrupled in very safe money markets. Though riskier, those same funds would have gone up 11-fold in bonds

and 15-fold in stocks. Longer time spans demonstrate even starker comparative returns.

When we think of a safe haven, insurance comes to mind. We obtain life insurance to fulfill the needs of dependents in case of an unexpected death of a provider. We get flood insurance to limit the financial impact of a deluge or broken pipe. Gold now is similarly regarded as a means to weather an economic storm. The question is, when should we pay for this protection?

In the case of a life policy, when is it most advantageous to secure a contract — when we are healthy, or when we have been diagnosed with a life-threatening disease? In the case of flood insurance, will we get better



prices for coverage after a dry spell or during a hurricane?

Gold is no different. As many purveyors and 'believers' attest, gold has at times presented wonderful returns. Specifically, gold did very well from 1977 through 1979, from mid-1985 through 1987, from 1993 into 1994, and for a good part of the current decade.

So, what do the years 1977, 1985, 1993, and 2003-05 have in common? Times were relatively calm, the markets behaved normally and the economy was growing. In the same way one can get great rates on insurance when one is healthy, one can buy gold cheaply when all is calm.

## Rates of return during crises

			Gold	Stocks	Bonds	Cash
Oil Crisis Watergate	Into Crisis	1973-1974	199.39%	-37.25%	3.71%	15.44%
	Out of crisis	1975-1976	-25.67%	69.91%	15.75%	11.06%
Hyper-Inflation	Into Crisis	1979-1980	161.82%	56.84%	6.05%	22.58%
	Out of crisis	1981-1982	-24.44%	15.45%	39.89%	26.13%
Crash	Into Crisis	1986-1987	47.63%	24.67%	14.52%	12.10%
	Out of crisis	1988-1989	-17.12%	53.56%	20.46%	16.52%

Taking this one step further, after the bad news, how did gold fare as a preserver of wealth? If one bought gold during the turmoil after Nixon's resignation, during the inflation spike of the late 1970s, or amid the market crash of 1987, substantial sums were lost over the next two years.

Critically, gold pays no income and gold has no employees working to grow anything. Other than its use in specialized industries, it is no different than wheat, oil or pork bellies in terms of its status as a commodity. When you own it, those committed funds are not earning income. If you are not buying it for ultimate use, you are speculating. Does speculation decrease or increase risk?

Aside from sacrificed income, if stability of value is your desired trait, gold is again anything but safe. It rises rapidly at the onset of a crisis and falls often just as dramatically thereafter. Its average return is less than bonds and 5 percent less than stocks. Gold is meanwhile twice as volatile as stocks and eight times more volatile than bonds.

So, what does this mean? Lower returns, lower principal and greater uncertainty — just the opposite of what a safe haven should be.

### True safety

True safety comes with knowledge, knowledge of the investment properties of safe havens, awareness of what drives stock prices, cognizance of the number of securities now backed by the government, and portfolio management that limits exposure to calamity and avoids rash decisions.

If safety means absolute avoidance of loss, then federally insured CDs, agencies and money market funds

might make sense. If safety means real after-inflation value in the long term, it may be time to again look at stocks and bonds. History bears out that functioning companies with motivated people provide better returns and lower volatility than any hunk of metal. Most combinations of stocks and bonds outpace gold, as well as inflation, most times — especially so in times from crisis to calm.

It's often hard to see the light at the end of the tunnel when the news is so dark. Yet people will eat, drive, paint, buy shoes and see movies. Although we know there will be waste and corruption, on the whole the government will put in place mechanisms to help the economy recover. Now is not the time to panic and put funds into non-earning assets.

This is not to say there's never a time for gold. Indeed, when the economy is humming, inflation is under control and when all seems right with the world — that is precisely when to consider gold. After all, no matter how good things get, you know somebody is going to muck it up.



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