Manager Perspective

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TANDEM
WEALTH ADVISORS

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Should I buy gold now?

Gold has been in the news for much of the past two years as prices have moved almost continuously higher and more and more people fear gold is a bubble. While nobody can ascertain the "true" price of gold, we note that gold prices have been on the rise for most of the past decade due to a number of underlying factors.

One of the key drivers of commodity prices (including 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 even gone negative for a period. Low real rates mean the "opportunity cost" of owning gold is very low.

First, high gold prices aren't solely due 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 five years – not just in the US, but in most developed countries. We can partly explain the gold rally by longer-term inflation fears tied to deficit spending that has increased the money supply. When deficits are high and perennial, investors grow concerned the government will deal with large deficits by creating a surge in the money supply. This is a current concern for US investors after three consecutive years of deficits exceeding $1 trillion, even without any signs of near-term inflationary pressures.

Investors historically have bought gold as a hedge against economic, political, or currency crises (including investment market declines, burgeoning national debt, currency failure, inflation, war and social unrest). The gold market is subject to speculation as are other markets, especially through the use of futures and derivatives. Due to gold's low correlation with other commodity prices, gold behaves more like a global currency than a commodity.

The biggest catalyst for driving gold prices higher over the past five years has been 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 shows no sign of giving up its place, especially with the concerns regarding many currencies including the Euro and the US Dollar. Additionally, gold has become much easier to invest in for individuals due to gold mutual funds and gold ETFs – this has increased the demand for gold as an investible asset manyfold in the past decade. Based on these and other exogenous factors, we do not try to set a price target for gold. Rather, we view it as one of many investable asset classes for our clients.

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