

Precious

When we think of that which is precious, two broad categories arise: that which is valuable and that which is valued. The distinction may be subtle but it is important nonetheless. The whole of a portfolio can be thought of as precious as it has a value, i.e., it has monetary worth. It also is valued for its purpose, e.g., providing retirement income. Investments in precious metals can be found in a portfolio, primarily gold and silver. These metals are considered precious as they are thought to be valuable, rare and durable. But what role do they play in a portfolio. It is not as a source of income as they provide none. Therefore, appreciation must be a primary investment objective along with potential diversification of price movement relative to other sources of appreciation such as stocks. The perspective here provides some thoughts as to the merits of precious metals as an investment.

Q PERSPECTIVE

The price of gold bullion per ounce just reached \$3,600 for the first time. [Chart I](#) shows the price trend over the past 47+ years. The annualized rate of growth over this whole period was +6.1%. The path to \$3,600 was not one of consistent gain. Very little growth occurred from 1979 to 2004. From there, a notable acceleration pushed the price over \$2,000 for the first time in 2011. A material price decline and then several more years with little gain followed. The price returned to \$2,000 for a few years before the steep ascent to current record prices began. Gold plays a major role in jewelry where demand often is tied to levels of discretionary income. At such times, gold likely competes with other investment choices such as stocks.

From ancient times, gold has been used as a currency. Its rarity and durability have been key attributes for this use. Among its roles as a currency, gold has been less utilized for transactions and more as a storehouse of value; i.e., something whose value would keep up with inflation. While gold achieved a +6.1% annualized rate of growth over the past 47+ years, inflation grew at +3.5%. The storehouse record of gold is shown in [Chart II](#). Using rolling one-year rates of return, the return from gold matched or exceeded inflation only 51% of the time. As can be seen, the return record relative to inflation has varied widely with only one notably sustainable period, from late 2001 to early 2012.

Portfolio investments contribute income, appreciation or some of each. Gold is not a source of income, so appreciation has to be its primary contribution. The appreciation element of a portfolio investment can take on added value if it is achieved at a lower relative level of risk. Over the past 47+ years, U.S. stock returns have far surpassed gold returns as shown in [Chart III](#). The annualized return from stocks was +12.2%, twice the +6.1% return from gold. Using rolling one-year rates, the return from U.S. stocks averaged +16.8% versus +7.8% for gold. The superior stock returns came with a lower level of risk. The variability of stock returns was $\pm 16.8\%$ versus ± 23.6 for gold returns. One-year stock returns were positive 81% of the time while positive gold returns occurred 59% of the time.

INVESTMENT IMPLICATIONS

The focus on gold as a portfolio investment reflects many attributes of the metal for which it is called precious. Outcomes over an extended period of time call into question the value that gold may have added to a portfolio. When viewed as one of many commodities to be considered for investment, a more favorable rationale can be developed. But that rationale has less to do with a perception of any special feature of precious metals per se and more with the return and risk patterns of commodities. Therein may lie an asset class that could be precious for the value it adds to the overall portfolio.

CHART I

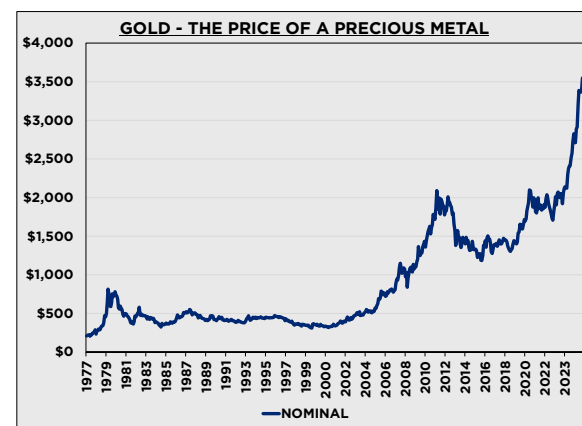


CHART II

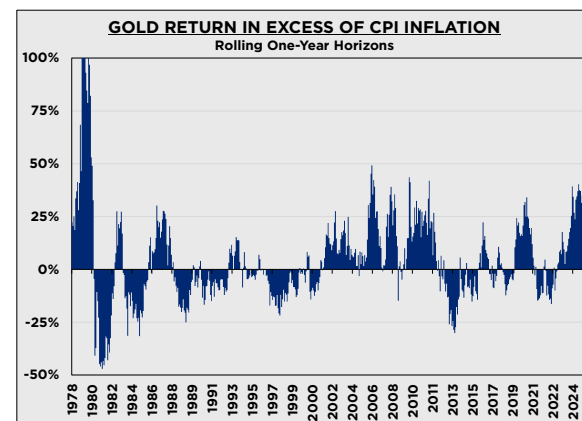


CHART III

