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Cash out of gold and send kids to college

By Peter Tasker

Just like the non-barking dog in the Sherlock Holmes story, the gold price has become strangely insensitive to the usual stimuli.

The eurozone remains locked in an existential crisis. Growth is fading in the US and China, and policy makers appear conflicted or just plain clueless about how to respond. Meanwhile, losses and scandals at large banks are coming to light weekly.

Unsurprisingly, investors are running scared. The global flight to safety has seen capital flood into "core" sovereign bond markets, driving yields down almost to vanishing point.

Yet, despite this perfect storm of financial instability, the gold price remains becalmed. In fact, over the past year gold bullion has behaved like a "risk on" asset, rising and falling in sync with stock markets.

This makes sense. For most of human history, the yellow metal existed as an alternative to conventional finance, a "store of value" that could be relied on in times of distress and crisis. Gold bugs may hate to admit it, but those days are long gone. Gold has become just another financial asset, as vulnerable to the shifts of investor sentiment as an emerging market. It is symbolic of today's world that the largest exchange traded fund is invested in gold bullion, not equities.

So why has the golden dog suddenly gone silent? One likely reason is that the price has simply become too rich.
All the gold that has ever been mined is still in existence, but it continues to exist because it is sterile – quite literally useless. As such it is hard to value, except by broad rules of thumb.

The current bull market saw the gold price rise from $280 an ounce to $1,900 in 10 years. This is a rate of ascent comparable to some of the great historical bubbles, such as Japanese stocks in the 1980s, Nasdaq in the 1990s and Chinese stocks more recently.

In inflation-adjusted terms, gold remains within spitting distance of the all-time high it reached in 1981. After that it embarked on a 20-year bear market, which delivered a loss of 80 per cent in real terms and a far greater opportunity cost as other financial assets soared in price. Even now the total market value of all the gold in existence – which, remember, generates a return of precisely zero – exceeds the combined capitalisation of the German, Chinese and Japanese stock markets, with all the productive capacity they represent.

According to the website pricedingold.com, gold is at a 120-year high (at least) relative to US house prices. Likewise, it is at a 74-year high relative to US wages, at multi-generation highs relative to wheat, coffee and cocoa and at the same price relative to the cost of a Yale education as in the first decade of the 20th century.

Gold does not rise to these giddy heights by accident. A bull market of this scale requires widespread distrust of other financial assets, of the banking system, of capitalism itself. This was the case in the late 1970s, when Soviet expansionism and the bitter aftermath of the Vietnam war bred a growing pessimism about the future. When gold peaked in 1981, both equities and bonds were cheap by historical standards, having endured long grinding bear markets.

There are similarities in today's political and financial landscape, but also some important differences. Bonds are expensive. If Sidney Homer's *History of Interest Rates* is any guide, long-term interest rates are as low as they have been since Babylonian times. Meanwhile, we are twelve years into a global bear market in equities, but the US market, the world's largest, is not cheap on such long-term measures as the Shiller price/earnings ratio and neither are the most popular of the emerging markets.

So where is the haven that offers protection against the turbulence of markets? Guess what: there isn't one. Everything has become somebody's idea of an asset class, from dodgy modern art to the copper that burglars strip from church roofs. Everything carries some risk of loss.

Even so, some assets offer more value than others. In Europe and Japan, optimism has all but vanished and Shiller p/e ratios are low. For sure, these economies face serious challenges, but, as the example of 1981 shows, that comes with the territory when assets are cheap. Even in a world of no capital gain, a case can be made for solid blue-chip equities purely on the basis of dividend yield, historically the main component of investment returns.

For those who are nervous of financial markets, there exists an obvious alternative. On the pricedingold.com numbers, you should cash out of gold, buy a nice house, hire some workers, send your kids to college and eat big breakfasts.

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