
# Gold: Inflation Hedge or Just Another Commodity?

## That depends on whether safe assets are offering negative real returns

Given the recent volatility in gold, it's a good time to raise the question: What is gold good for?

Why? Because most have often wondered about the answer.  The answer may not be absolutely nothing, as in the Edwin Starr song, but it is a lot less than you might think.

The yellow metal has reacted meaningfully during only two incidents in the 44 years since Nixon closed the gold window on August 15, 1971: the 1970s inflation/oil crisis and the 2000s rise of China/financial crisis/debt deflation.

### Gold as a Tactical Strategy

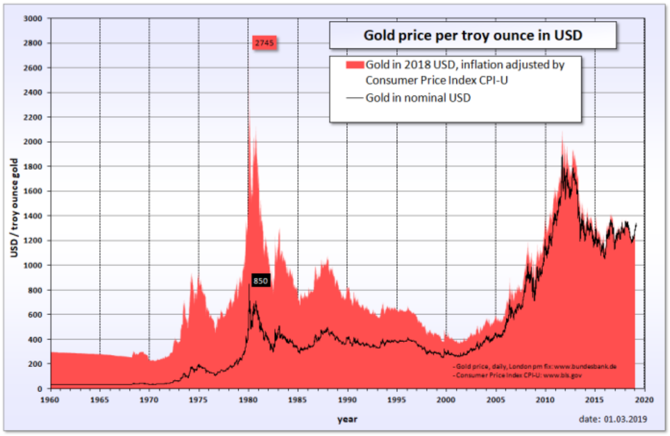
At best, gold is a useful tactical asset in situations where returns on safe assets turn negative.  Those incidents have been relatively rare. Gold should not be a perennial in your portfolio if you live in a place with developed financial markets and the rule of law. It earns no income and serves little purpose.

Gold is touted as many things, particularly as a hedge for inflation and as a safe asset in fraught times. It is neither.

Gold has an inconsistent relationship with inflation. The two episodes in which gold has correlated well with changes in the CPI are stark opposites. It probably gained its reputation as an inflation hedge because it correlated highly with the inflation of the 1970s. Since the financial crisis, it has also correlated well with inflation, which has been very low.  Not anyone's idea of an inflation hedge. Between the malaise of the 1970s and the global financial crisis, gold's correlation with inflation was volatile and largely negative.

## A History of Gold Prices

As for gold's crisis hedging quality, take a look at its chart from 1960 to today.




There are really just two spikes in the gold price. The first occurred at the end of the 1970s. It followed the great inflation and two oil shocks and dissipated in the wake of Volcker's tightening of monetary policy.

Spike two came with the rise of China and the run up of commodity prices in its wake. It continued into the financial crisis. So, gold could have provided a counterbalance to your portfolio during two ugly incidents in financial markets. What about the myriad other crises we have been through over the past four decades?

What did gold do during the savings and loan crisis in the late 80s, the ERM crisis of the early 90s, the Tequila crisis of the mid-90s, the Asia crisis of the late 90s, the tech wreck of the early 2000s? The answer is precisely nothing.

## Safe Assets and Negative Real Returns

Gold has done well when safe assets, like US treasuries, offer negative real returns. It is only at such times that an asset which earns nothing and may cost you (or the ETF provider) something to store is worth holding.

We are beyond the Fed starting to move away from its zero interest rate policy – that started a while ago. Remember, the all-time low was 0.25 percent, which is effectively zero. The Fed lowered it to this level on December 17, 2008, which was the 10th rate cut in about a year. And they didn't raise rates again until December 2015.

Real rates are likely to be higher across the curve over the next few years. That has turned gold into just another commodity; it will remain that way for many years. Someday, when the imbalances have added up and policy makers misjudge events, gold will once again have a moment in the sun.