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Gold, A Brief Update

Gold is used in medical science, dentistry and making jewelry, but the bulk of it is held as a currency reserve, taking up storage space in places like Fort Knox. Its reputation is impeccable, bringing with it notions of high value and great reliability. Our daily language supports this, with such expressions as "good as gold", a "golden opportunity", "golden handshakes", "golden parachutes" and "The Gold Standard."

Gold coins began circulation around A.D. 600 and went on to be the ultimate in liquid wealth until displaced by paper currencies. This triumph of paper started in 1971 when rising inflation made Richard Nixon take the United States off the gold standard (US $35 per troy ounce). Over the next eight or so years the price of gold climbed to over $600, and it looked like paper money was losing the battle. But gold prices then consolidated for the next twenty-five years, with some enticing fluctuations between $300 and $500 during that period, proving that paper money unmoored to gold was not the financial apocalypse it was feared to be.

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Obviously, gold is not an investment. It pays no dividends and has a horoscope-level of price predictability. It is not as useful as a man's suit, the price of which it is thought by some to mimic. On the other hand, the price movements can be huge as well as long-lasting, making it an attractive speculation. At times.

Is now one of those times? Traditionally, gold rises with rising inflation expectations. Yet, we live in a low inflation environment. On the other hand, our low-interest rates mean the economic cost of owning gold is less onerous than if investors could earn six percent on a five-year GIC. The negative side of low interest rates is the mostly negative return on government debt. The interest earned minus taxes and minus inflation produces a negative number. At least gold only has a storage cost.

The recent blip in the price of gold to over $1300 is likely related to currency uncertainties. The Chinese domestic debt situation and the lack of a trade agreement with the United states has weakened the outlook for the yuan. The lack of a clear outcome for Brexit has made the British pound a suspect storehouse of value. The future of the Euro faces uncertainty from the shaky finances of Italy and Greece, as well as a few of the major European banks.

The US dollar, on the other hand, remains strong. Despite President Trump or because of President Trump or because of so much uncertainty elsewhere, the U.S. dollar has maintained its value well. Of course, if the U.S. dollar were to weaken, almost by definition the price of gold would have to rise. This is what happened in the wake of the depression of 2007-09 when the US dollar fell. The price of gold rose to $1800 by 2011, but by 2015 had slid back to under $1100.

But that big move in gold wasn't a real loss of faith in the paper money system. Central banks, the really big potential buyers of gold are still not really piling in. They have increased their holdings slightly over the past 10 years, but it hasn't yet gathered steam. They still hold less in aggregate than they did when the US went off the gold standard more than 45 years ago.

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Canada, for its part, despite being a significant producer of gold, has abandoned gold as part of Canada's currency reserves. In 1965 our central bank had 1,023 tonnes of gold. Now, after having sold all their gold bars more than 15 years ago, they have also disposed of all their gold coins, taking their reserves to zero. By way of contrast, The U.S federal Reserve holds 8,100 tonnes of gold.

Investors can be assured demand for gold is deep and that gold will remain a fixture of the investment scene. If central banks around the world push the panic button again and start printing money *en masse*, gold prices will surely rise. But now it seems the price of gold has become something of a simple barometer of uncertainty, not the stuff true gold bull markets are made of.

So, for now, while I confess to owning small positions in rather speculative gold companies - Eastmain Resources (TSX: ER), a gold exploration company, and Yamana Gold (TSX: YRI), a mid-size Canadian gold producer - my only gold bullion speculation will be to hold onto the gold cufflinks inherited from my grandfather.

Briar Foster is the founder and former CEO/Chairman of Foster & Associates Financial Services Inc (Foster), and remains a Board Member of FAFS Holding Corporation, the parent company of Foster.

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