

Money Wise

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The Ups and Downs of All That Glitters

As gold prices rise, Colin Bloodworth explores why the metal is so precious

As a relatively rare, attractive and indestructible metal, gold has been highly prized and coveted since time immemorial. In Greek mythology, King Midas loved it so much he wished that everything he touched would turn to gold. His wish was granted but it backfired somewhat when his food and water and even his beloved daughter turned into gold.

Just days ago an Australian prospecting with a metal detector near the old mining town of Ballarat unearthed a 5.5 kilogram gold nugget worth at least \$300,000.

Earlier this month Germany's Bundesbank announced it planned to repatriate gold reserves held abroad, pulling a chunk from New York and all its bullion from Paris. Germany owns 3,396 tons of gold worth roughly \$184 billion, the world's second largest holding after that of the United States. Most of the reserves were sent abroad for safe keeping during the Cold War. Interestingly Germany, unlike Britain, Switzerland and France, did not sell any of its gold when it was out of fashion. As a result, it now sits on substantial reserves.

There is a lesson for investors here; very often when everyone else is selling, you should be holding or even buying. Successful investors are usually those with the patience and ability to hang in for the long term.

How much have gold prices risen? In 1970 gold stood at \$37 an ounce, in 2000 it was \$273 and today it stands at around \$1,680 an ounce.

Why is gold so valuable?

As with any other asset, the price of gold is driven by the forces of supply and demand. It is also driven by speculation. Gold is considered a safe haven when there is turmoil in financial markets or serious political unrest anywhere in the world. Banks can now treat gold as a currency when calculating their capital reserves. Countries are losing confidence in currency reserves and paper money.

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AFP, Reuters Photos



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The US is striving to revive its economy with stimulus measures such as quantitative easing, a fancy name for printing money. You cannot print gold, on the other hand, so it should automatically rise in value as more money is printed. It therefore acts as protection against the devaluation of money and inflation.

Apart from that it has a number of practical uses in high-tech industries and plays an important part in the huge jewelry market. Add to this the fact that there is a finite amount of gold left in the ground coupled with the high cost of extraction and processing, not to mention the political, environmental and social issues facing the mining industry, and it becomes pretty clear that the future supply of new gold is likely to be limited and costly.

Is there a downside to investing in gold?

Yes, there is, as with any kind of investment.

First of all, while bank deposits, stocks and bonds offer actual or potential income, a bar of gold pays no interest. It's nice to look at but you cannot live off it unless you sell it.

When buying gold you have to cover the cost of manufacturing, marketing, distribution, brokerage, storage and insurance. Even if you buy via funds you will incur these costs. And while the price of gold has undeniably risen over the years there have been times when the price has fallen sharply.



For example, the average price in 1980 was \$615 an ounce although it actually hit a peak of over \$800 during one of history's many Middle East crises. It then fell sharply and remained around half of its peak value for many years. In 1990 it was still only \$383 an ounce. It was even lower at \$279 in 2000. It wasn't until 2007 that the average price exceeded that of 1980, over a quarter of a century later!

Every now and again I have to point this out to clients who, after reading a doomsday newsletter (usually emanating from the US), ask me if they should sell all their investments and switch into gold.

Is there still strong case for gold?

The strongest argument for gold right now is not an Armageddon situation or major political or economic crisis, although the latter could lead to a spike in the price at any time.

The factor most likely to drive up the price is the continuing degradation of currencies and the related impact on global stock and bond markets.

As to how much of one's assets should be allocated and what is the most practical way to invest in gold, this will be addressed in a following article.

In the meantime, I would not recommend trying to emulate King Midas or rushing off with your metal detector to Australia!

Colin Bloodworth, director of PPI Indonesia, has spent over 20 years in Indonesia. If you have any questions on this or a related subject you can contact the writer at indonesia@ppi-advisory.com.