

In order to ascertain whether gold is still a good buy, one should ask the following questions:

1. Are people overplaying the inflation-hedge aspect of gold?
2. Are people overplaying the economic collapse-hedge (safety) component of gold?

These two questions signify the two most common reasons that investors give for the decline in the price of gold this year.

The idea that the economy is moderately improving minimizes the safety component of gold.

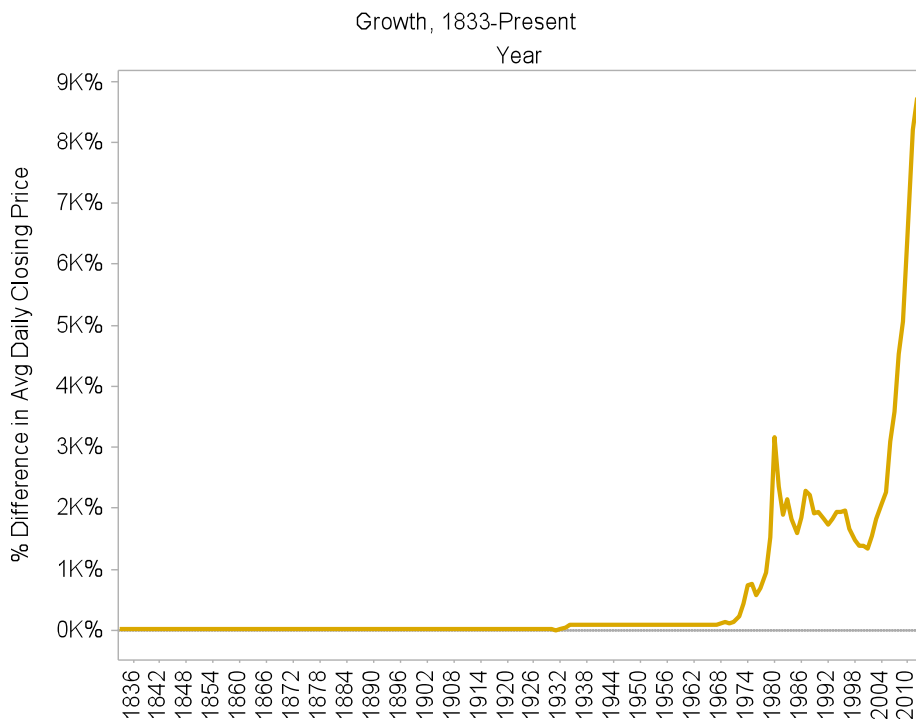
The second factor, that inflation is not increasing and is not expected to, also minimizes the need for the inflation-hedge component of gold.

Are people overplaying these reasons? Put another way, is it possible that the price of gold could appreciate even if expected inflation went to zero? Could the price of gold appreciate even when the economies of the world were expected to perform relatively well over the coming few years?

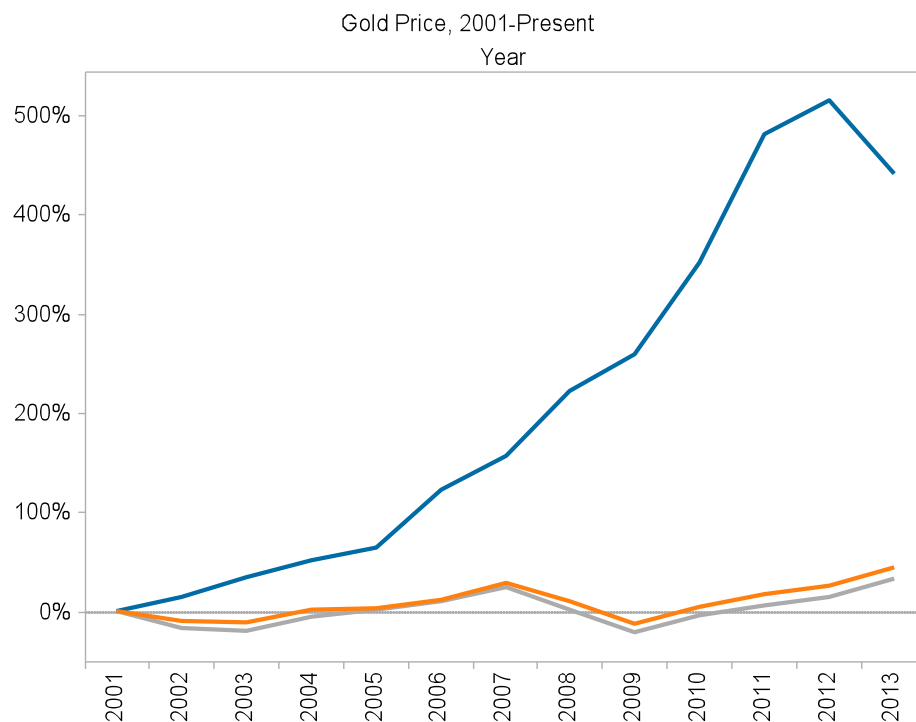
What do you think?

Here is some history on the price of gold over the past 180 years. Overall, the price of gold peaked at +8,700% since 1833; as of now, gold is up about +7,600%. The price of gold, as with many other financial instruments, was generally stable until about the early 1970s, after which volatility and price appreciation became the norm.

What makes people nervous is the price run-up since 2001. Since 2001, gold is



Sources: Moody's, Kitco.com, World Gold Council



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**Measure Names**

- Dow Jones Industrial Average
- Gold
- S&P 500

up about 440%, compared to the S&P 500 at 32% and the Dow Jones Industrial Average at about 44%.

Individuals with this “buy-low/sell-high” view should look at the following figure. The figure shows the price of gold, the value of the S&P 500, and the value of the Dow Jones Industrial Average since 1833.

Which asset looks undervalued? Hint: it is not gold.

Moving back to the two questions at hand, is it possible for gold to appreciate under low, stable prices and moderately growing economies?

Let us look at the inflation aspect first.

The bottom right chart shows the price of gold against the estimated worldwide money supply.

Why consider money supply? Because money supply is the one variable that is almost always associated with high inflation rates.

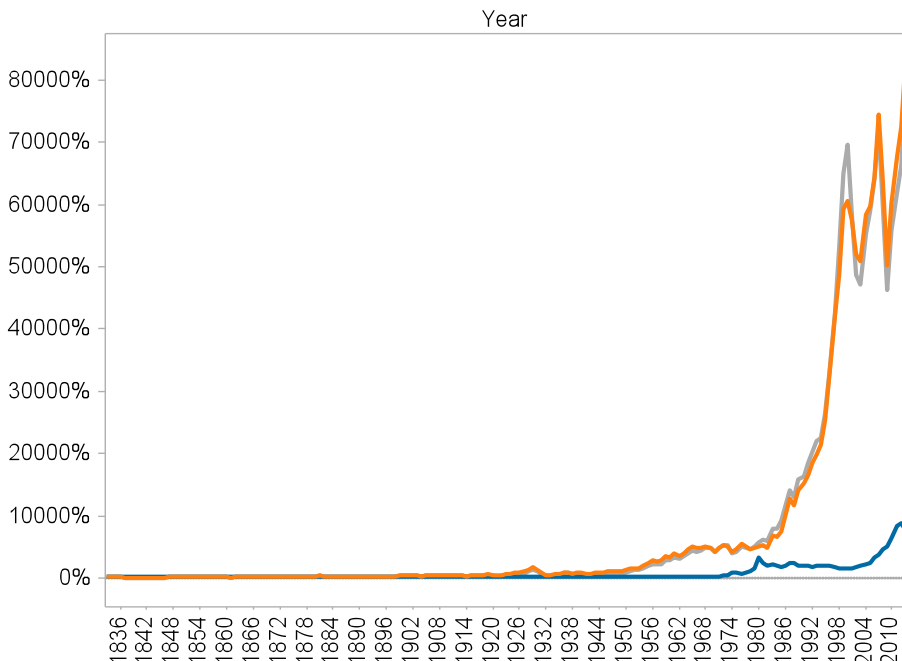
Do the two – gold and money supply – look correlated?

They are. The price of gold and the growth in worldwide money supply show a direct correlation with the exception of 2013.

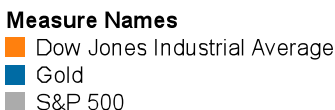
For one to argue that the price of gold will continue to depreciate while the world’s money supply continues to increase at an exponential rate is foolish, unless, one believes that governments will curtail money supply growth.

Now, to answer the question, can the price of gold depreciate when inflation is low? This is actually what has happened over the past 10 years.

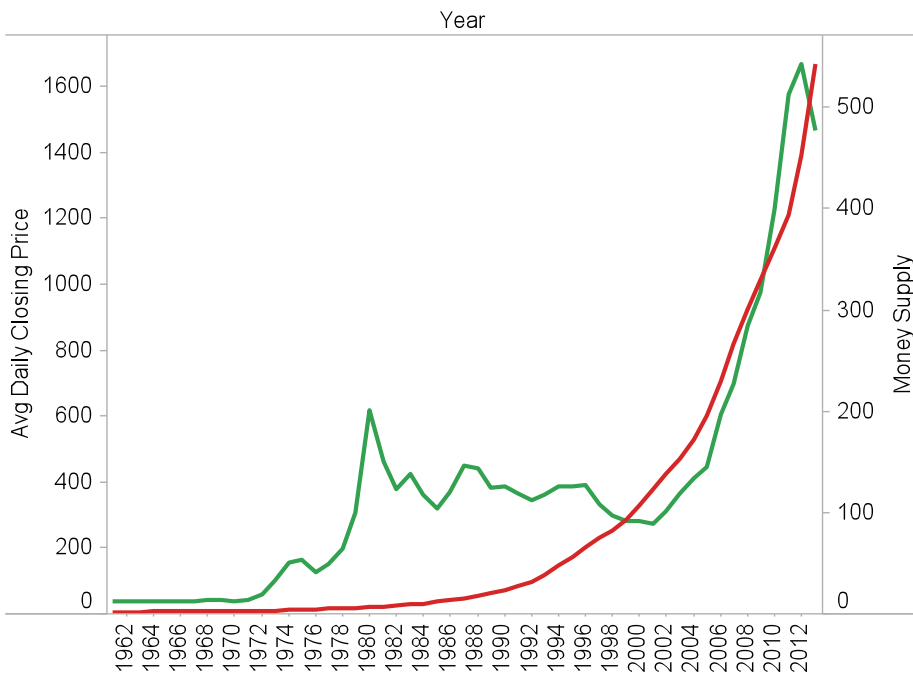
Gold, S&P, and DJIA since 1833



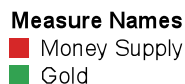
Sources: Moody's, Kitco.com, World Gold Council



Gold and Money Supply, 1961-Present



Sources: Moody's, Kitco.com, World Gold Council



What about expected inflation, can gold depreciate when expected inflation is low? Simple answer: as long as governments continue to control the money supply, expected inflation is unlikely to remain low for a long time.

Moving on to the second question: can moderate economic growth coincide with gold price appreciation?

Well, the easy answer is no, at least not in the short-run.

The question gold bears must answer though, is this: How long can economic growth remain “moderate”?

Generally, moderate growth is not the norm when it comes to economic growth. Economic growth is like an old time railroad, full of thrilling bursts of speed and quick stoppages. Essentially, the business cycle is full of acceleration and deceleration, not constant acceleration. Constant acceleration can only last a little while, and gold generally does well in the other two environments.

Overall, investors are probably overplaying the inflation-hedge and economic-collapse aspects of gold. Gold is likely to continue on a strong long-run path of price appreciation as long as governments continue to control the money supply and/or the business cycle continues to be a real aspect of an economy.