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Market Facts

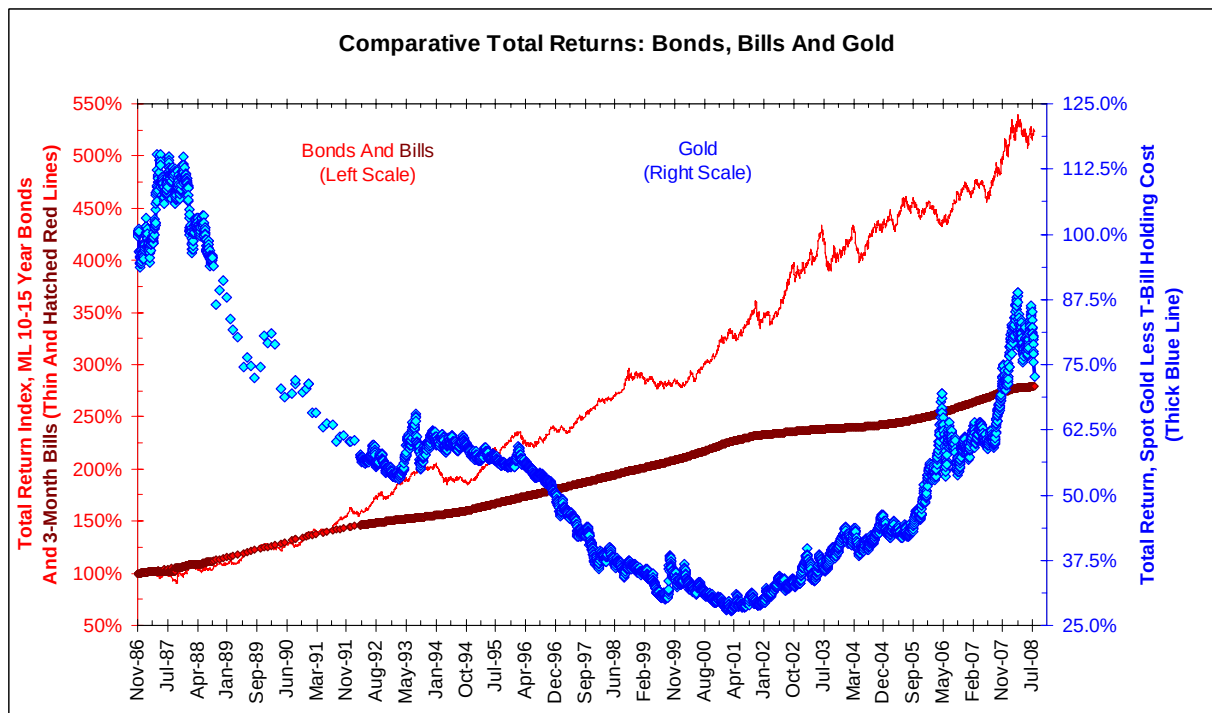
Gold As A Failed Investment

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August 13, 2008

We noted in an October 2007 [Market Facts](#) how the Merrill Lynch 10-15 year indices of Treasury bonds and of three-month Treasury bills (thin and dark red lines, respectively) had outperformed gold adjusted for short-term interest rate holding costs but not physical storage costs (hatched blue line) over a long period of time and therefore were better inflation hedges than the yellow metal.

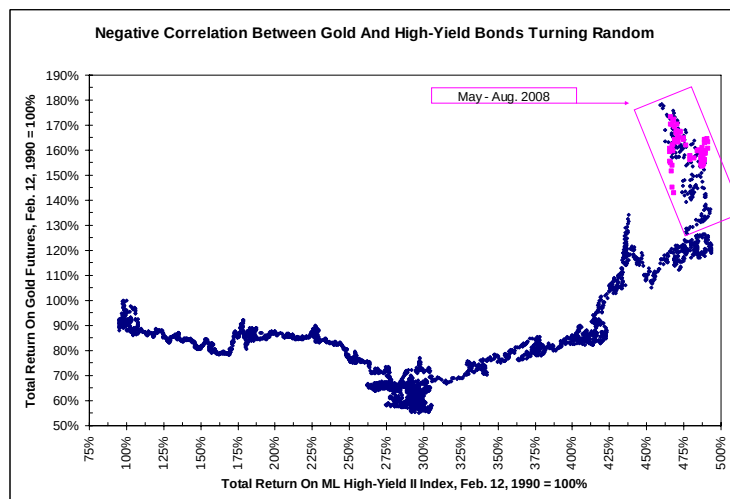
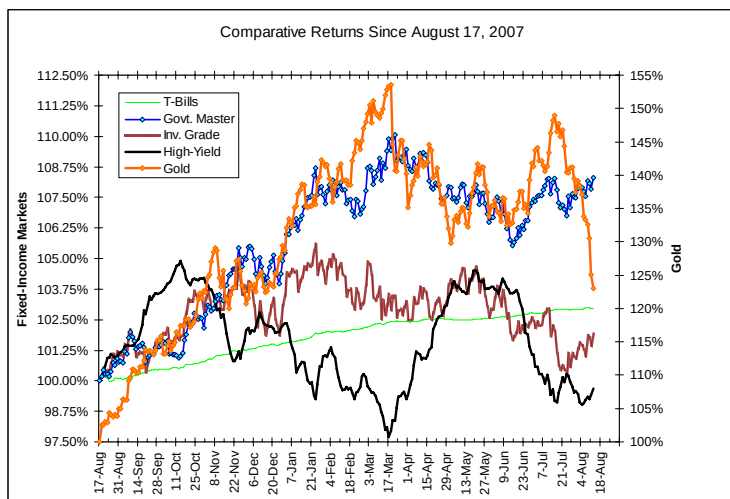
Gold's recent decline has placed this measure of its total return at -2.57% year-to-date; this compares unfavorably with the 2.56% and 1.40% total returns for the bonds and bills. None of these markets protected investors against inflation. No bragging rights will be awarded.



If we return to an analysis from a May [Market Facts](#) and take a sample designed deliberately to favor gold (golden line, left-hand chart, following page) against Treasury bills, the Merrill Government Master and the Merrill Lynch indices for both investment-grade and high-yield corporate bonds (thin green, hatched blue, shaded red and black lines, respectively, left-hand chart), we see gold has in fact outperformed fixed-income instruments during the credit crunch, and by a wide margin even after its recent fall.

Gold remains negatively correlated with high-yield bonds. We opined then this shift to negative correlation was a short-term phenomenon; after all, it had not existed in any data sample since February 1990.

The three-month data sample (magenta markers, right-hand chart) since May is too short to state with certainty the negative correlation between gold and high-yield bonds has disappeared, but it appears to be turning into a random relationship.



Conclusion

We concluded in [May](#):

While we have been positive of gold many times for a short-term trade, the mathematics of compound interest argue against a long-term commitment: Assets earning compound interest over time outperform assets whose holding costs compound over time.

That conclusion remains valid and almost certainly will remain valid for years to come. Just as we noted in [June](#) gold had ceased to be a viable hedge against dollar weakness and in [July](#) how gold was not

responding as expected to either interest rates or to both reported and expected inflation, we now have to conclude gold is threatening to return to its 1980-2001 role as a substandard investment.

That is on an absolute basis. On a relative basis, gold may remain acceptable as an alternative to stocks and non-sovereign bonds, but that is not saying much.

The simple fact of the matter is 2008 has been a difficult year to say the least. If an investment long touted for its constancy is losing it before our eyes and is unable to outperform the short-dated paper of a government risking its own [credit quality](#), then it has failed the proverbial acid test.

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