Gold: Relic or Rocket?

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The two terms above- RELIC and ROCKET- have both been used in recent quotes by experts in predicting the future direction of gold and precious metals.One term implies essential worthlessness; the other implies that gold has yet to make its real move.

Who's right? How can there be such vastly different views about one thing? Is there a middle ground?

The 'relic' term was used by a Citigroup analyst. Many other experts share that view. They seem to be saying that gold is always overvalued because it carries no inherent value, only perceived value. The 'rocket' term was used recently by Peter Schiff of Euro Pacific Capital. He represents a group (albeit a diminishing group) of experts who view gold as a currency, an alternative to the limitless paper printing of fiat currencies around the world. When that printing press comes home to roost, they say, gold will soar. Gold can be mined, but it can't be printed; therefore, it cannot be debased.

For twenty years prior to 2001, gold behaved like a relic. The U.S. went off the Gold standard in the Nixon administration, and after a period of inflation in the 1970s, gold suffered through a 20-year bear market that no investor could reasonably endure. That part of gold's history is too long to describe here.

Many factors contributed to gold's impressive, if not meteoric, rise between 2002 and 2011. The yellow hard stuff went from about $250/oz up to $1900. Since 2011, we have seen a 40%-plus decline in gold. It has been worse for silver and for gold and silver miners. If you want to know what the market is discounting heavily, look no further. Then again, you can get all the ice you want at the North Pole in January. It begs the question: is there a buying opportunity, or are the majority of miners going out of business?

As a portfolio manager, I have maintained a hedge-type position in gold throughout. This means a 5-7% weighting in portfolio devoted to gold, gold miners, and the like. That number has been adjusted up or down based on market conditions. For the last few years, this piece of the portfolio puzzle has had a negative impact on returns. Do I wish I took off that hedge three years ago? Yes. Do I think it should be done now? Absolutely not. Here's why:

The main reason I believe gold has suffered in recent months and years relates to the strong dollar. Gold has actually held up rather well vs. other currencies around the world. In retrospect, a big part of gold's rise was the market's knowledge of, and anticipation of, an easing global monetary policy. The U.S. led that effort, beginning with TARP in 2008. It took a while for U.S. policy to translate into a strong dollar, but when it did, gold suffered. Now other nations, particularly those in the European Union, are discovering their role in easing monetary policy. This has a short-term effect of boosting the dollar, but in the long run, the dollar should revert back, as a mirror image of its rise. When that happens, gold might resume its uptrend. Silver might be poised to perform even better than gold. As stated above, the money printing has yet to come home to roost.

Meanwhile, money is being forced into the markets by virtue of puny interest rates. Much of that money is chasing momentum. Whatever is doing well does even better (utilities are an example). By contrast, whatever is going down drops further. Oil and oil stocks are great examples. Then momentum reverses and sharp moves occur in the opposite direction. Hedge funds appear to be in control of price movement. If the precious metals bandwagon gets rolling, as I suspect it might soon, things could work out quite well. This can be especially important when the overall market struggles.

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