ORCAM | ALTERNATIVE PERSPECTIVES

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Gold—Is the Bull Still Running?

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Gold is Money

Gold is an interesting and unique asset class for several reasons. At Orcam, we think of gold as a form of money and its own currency. That is, anything that is so widely accepted as a medium of exchange can only be deemed money. This might not seem rational to all people (after all, gold is really nothing more than a shiny rock), but perception is reality. And the broad perception in our world is that gold is a very valuable medium of exchange. You can argue about the merits behind such thinking, but that doesn't change the fact that you can walk into just about any pawn shop in the USA and trade gold on demand for anything in that shop.

"anything that is so widely accepted as a medium of exchange can only be deemed money. "

But gold is not like cash. We view cash (dollar notes) as its own investment class. Cash can protect you from the risk of permanent loss, but it cannot protect you from the risk of purchasing power loss. Gold has the opposite attributes – it can protect you from loss of purchasing power, but it cannot protect you from the risk of permanent loss (for instance, if everyone decided gold was just a shiny rock!). So they play very different roles in an investment portfolio.

Cash is Similar to a Call Option With no Expiry

We view cash like an option with no expiration date. That is, cash is an asset that we accumulate and maintain an allocation of with the readiness to exercise. Cash plays two extremely important roles in a portfolio by not only protecting against the risk of permanent loss (since cash is a risk-free asset), but also because cash offers you the potential to keep a loaded weapon around at all times. Cash gives the ready investor the potential to dollar cost average or average into a position one has built, thereby reducing one's cost basis and improving the long-term potential profitability of any investment.

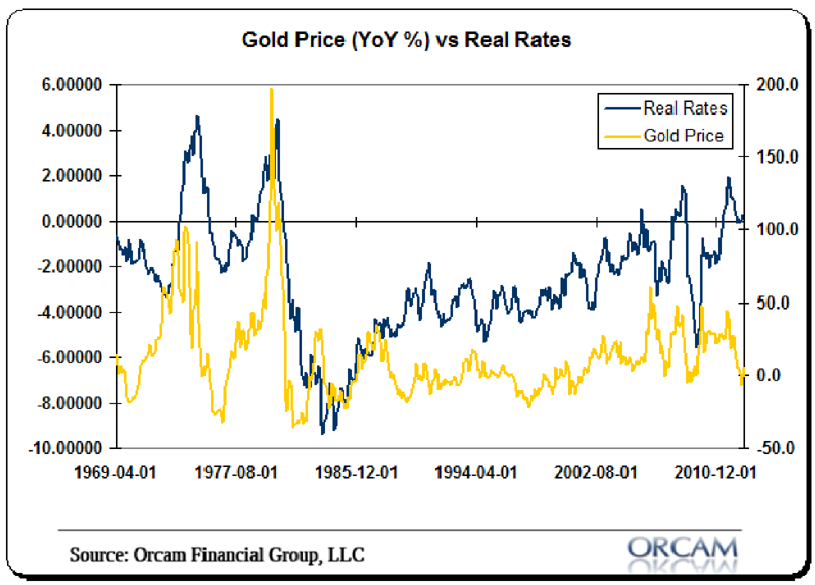
Gold is Similar to a Long Duration Bond

If you're familiar with macro theory and Gibson's paradox then you're familiar with the relationship between real interest rates and gold. This relationship exists because gold, as a form of money, is viewed as having zero default risk. There is no maturity date for a bar of gold. So it's a lot like an infinite maturity T-Bond (which, assuming the US government decides not to default has no default risk) in terms of its moneyness. Negative real interest rates are perceived as being inflationary or consistent with a loss of purchasing power so perception becomes reality when gold prices soar in anticipation of higher potential inflation.

"Gold is a lot like an infinite maturity T-Bond"

The Gold vs Real Rates Relationship

This relationship is put into visual form to the right. We've inverted the real interest rate (in blue) and applied the YoY % change in gold.



There is an incredibly interesting development that has played out over the years as central banks have manipulated the price of various assets classes all over the place. The paradox is one of inflation versus low yields where central banks are manipulating rates in many markets, but failing to create any sustainable inflation. As we've noted previously, this creates the potential for simultaneous bull markets. Bonds are likely to remain in a cyclical bull market as the Fed keeps rate policy accommodative, but inflation fears are likely to linger as a result. This means real rates will remain low and continue to put a floor under the price of gold as perception remains reality. We remain secular gold bulls as a result.

If you have questions or inquiries about Orcam Financial Group's products and services please contact us directly at 858-220-5383 or via email at info@orcamgroup.com.

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