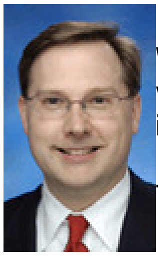
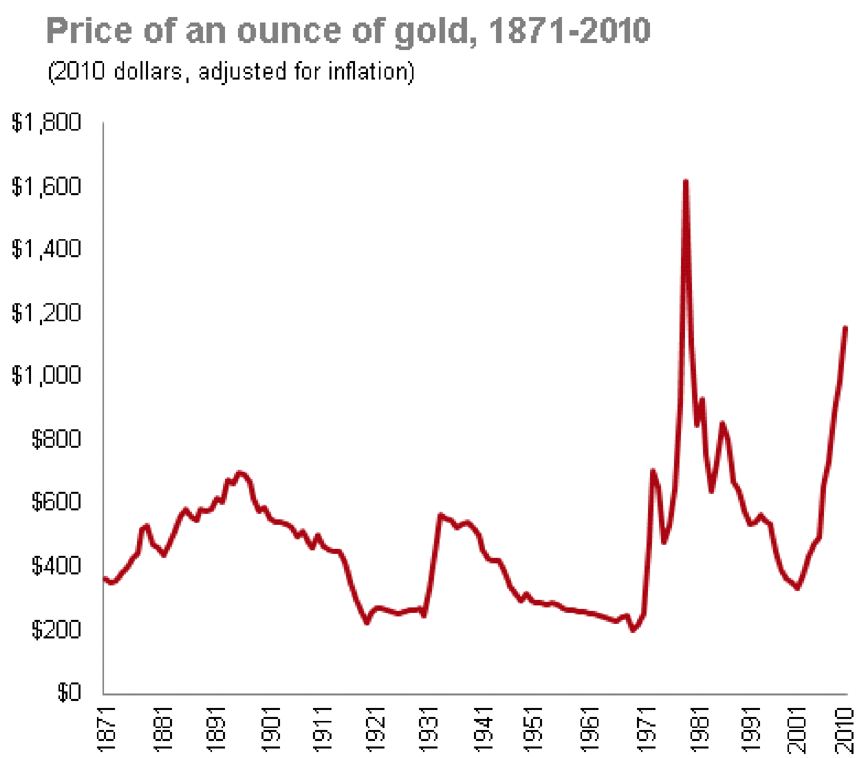
The gold rush of 2010

By John Ameriks on July 26, 2010 10:40 am



We've been hearing a lot about gold over the last few months, related to concerns about inflation, the creditworthiness of various governments, and fallout from the financial crisis—all against the backdrop of what is the most significant increase in inflation-adjusted gold prices since the early 1980s.

The chart below is my way of putting gold prices in perspective.



Over this entire 140-year period, the average price of one ounce of gold was $480 (in 2010 dollars). If the gold price remains stable through the end of this year—not a given by any means—there will have been only one other year in the last 140 (1980) in which the inflation-adjusted average daily price of an ounce of gold was higher than in 2010.

In other words, there was only one year in the last 140 when it would have cost you more in terms of foregone alternative goods and services to become the owner of an ounce of gold.

These data show that during some periods of extreme inflationary or broader economic distress, gold prices have increased sharply, only to recede back to lower levels as things return to normal. For example, from a peak of $563 in 1934 to a low of $201 in 1970, the inflation-adjusted value of gold declined by 64.4%. This is an annualized rate of decline of more than 1%

per year over a period of more than 35 years. The inflation-adjusted price of gold was higher in 1871 than it was 100 years later in 1971.

Bottom line: Any value that gold has as an investment appears, historically, to have accrued to investors who had a position **prior to** certain episodes of economic or financial distress. And to generate truly eye-popping returns from a gold-based strategy, you'd have needed to be selling at the peaks of these past price spikes, not buying.

The basis for making an investment in gold now is a conviction that the worst is yet to come. I'm not saying it can't happen. But looking at how far these prices have come already, and thinking about the kinds of truly disastrous events that are included in this 140-year period, I'm skeptical.

Note: *In the chart above, gold prices are based on the historical "Yearly Average Prices" of the London PM Fix as reported by Kitco. For 2010, the figure used is the year-to-date average of daily data through July 14, 2010. For the period 1871–1912, Consumer Price Index data are the annual average of monthly CPI values reported by Yale economist Robert Shiller. For 1913–2009, the data are annual average numbers from the U.S. Bureau of Labor Statistics. For 2010, the number is the average of monthly values through June 2010. Links to the sites mentioned here will open new browser windows; except where noted, Vanguard accepts no responsibility for content on third-party sites.*