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"Gold gets dug out of the ground in Africa, or someplace," Warren Buffett once said. "Then we melt it down, dig another hole, bury it again and pay people to stand around to guard it. Anyone watching from Mars would be scratching their head."

The price of physical gold has risen five-fold since 2001 and continues to reach new heights. There is significant interest in gold today as a means of possibly hedging against depreciating global currencies and inflation. The concern now is that for those investors who choose to load up on gold today may be placed in a disadvantageous position if history repeats itself. After gold hit a then-record high in 1980 of US $850 an ounce, it fell and failed to recover for more than 20 years.

## Observations on the state of gold

Real supply is greater than demand. In simplistic terms, prices go up when there is more demand than supply. However, according to the World Gold Council, there has been a surplus in the supply of gold mostly due to advances in mining technology. Since 2002, there have been 29,000 metric tons mined, while the demand from goldsmiths, jewelers, dentists, and other industries has been only 22,500 metric tons.

The supply of gold typically comes from mining production with smaller amounts coming from Central Banks and recycling, ie melting old jewelry. The recent dramatic price increases are due to increased demand from speculators and hoarders, not from typical industrial use.

## More disadvantages than advantages

Gold as an investment has several notable disadvantages. It produces no cash flow. It has no real utility. It is speculative. It is possibly in bubble territory right now and at a premium at current prices. It requires an ongoing cost to carry or store, ie the guards Warren Buffett alluded to.

Also, the only people who make money on gold are those who sell it, and many of them are the loudest supporters of gold to protect you during "scary times." However, these same individuals are accepting cash in the transaction. If they truly believed in these scary scenarios, why would any of them accept cash? The answer of course is that they can make a lot of money by selling the idea of fear.

## The real return above inflation is not compelling

The real return from holding gold over the long run has significantly underperformed stocks. Since 1871, gold has provided a return only slightly above inflation. Anyone who bought gold at the peak in the last gold craze in the late 1970s would need the price to reach around US $2,100 today to break even on an inflation-adjusted basis (current gold price = US $1,200).

Buying shares in a company allows an investor to purchase a portion of that company's earnings, which has the potential to grow. Gold, however, will always remain the same size. In addition, shares and bonds provide cash flows in the form of dividends and interest, while holding a bar of gold amounts to little more than storing metal. Shares and bonds also provide diversification across thousands of companies across different sectors and countries, not just relying on the value of one commodity. Finally, shares and bonds are very liquid, while a physical or "hard asset" such as gold, may be more difficult to liquidate quickly.

While we here at Plan B recommend holding a diversified portfolio for our clients, the element of holdings related to the gold sector would be a proportion or element of the portfolio in gold shares in both the Australian and international portfolio to an appropriate level of diversification to other sectors in the market. There are listed opportunities for gold exposure which, as a diversified investor, we here at Plan B have exposure to. These range from large producers through to small exploration companies.

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