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The Enigma of Gold

In a thoughtful article entitled *The Enigma of Gold* written in April 2025, the author makes a balanced yet unmistakably critical case for investors' ownership of gold, ultimately concluding that it likely represents a speculative endeavor based on a belief system more so than an investment.

We beg to differ with that notion, and as owners of physical gold for more than a decade, we would like to take this opportunity to briefly substantiate our contrasting viewpoint regarding the suitability of gold as part of an overall asset allocation.

The most logical place to start is to clarify our investment objective: as for many other investors, our overarching objective is to preserve and grow our capital over the long-term. One emphasis that arguably differentiates us from other investors is our focus on striving to achieve that goal in real, rather than nominal terms. In other words, we are principally concerned with preserving and growing the purchasing power of our savings over time.

The difference between nominal and real returns is the rate of monetary inflation, a somewhat abstract notion, which is all the more difficult to quantify. In its narrowest sense, some investors may accept it as an adjusted measure of consumer price inflation, while others may be more inclined to infer the actual rate of monetary inflation by looking at monetary aggregates (i.e. credit creation), debt levels, as well as unfunded future liabilities. In other words, the principal ways in which we debase the fiat currencies we presently call money, and use as a yardstick to measure our wealth.

Making an exact estimation of the rate of monetary inflation is not the central point. We, like the near totality of other investors, measure our portfolio returns in nominal terms. But given our investment objective, it seems clear to us that we ought to focus on real, rather than nominal returns, when considering the manner in which to allocate capital across and within asset classes. While the distinction might sound rather inconsequential, for us it has had a massive impact on how we've positioned ourselves this past decade, essentially substituting what would traditionally be an exposure to fixed-income securities with precious metals instead – which has served us well thus far.

The article starts of by exploring the question of gold's intrinsic worth, and asserts that as a non-productive, non-yielding asset, gold should be seen as a speculation, the success of which depends solely on price appreciation. It goes on to suggest that there is no commonly-accepted methodology to value gold, which further rules it out as a strictly-defined investment, and implies that its ownership must therefore be based on ideology rather than a deliberate asset allocation decision.

Perhaps a more appropriate question to start with is to consider what gold is, rather than what it's worth. Gold is a commodity, one of many natural elements listed on the periodic table. It does, however, share a certain unique characteristic with a number of other 'noble' elements, namely the fact that it is chemically inert. This permanence, along with other factors (i.e. its instinctive appeal, relative abundance/scarcity, divisibility, density, etc.) arguably resulted in gold's gradual establishment as free-market, *de facto* money throughout a millennia-long process of natural selection. The historical evidence to support this viewpoint is quite unequivocal, notwithstanding the acknowledgement that throughout history, people have found it more convenient to use more than one metal as money (i.e. gold and silver).

So money is a commodity. It differs from other commodities by being demanded mainly as a medium of exchange – which is money's most vital function – and as a store of value. Like all commodities, gold's price in terms of other goods is determined by the interaction of its total supply, or stock, and the total demand by people to buy and hold it. And with a global supply growth remarkably aligned with population growth, gold's purchasing power has remained relatively stable over very long time periods (volatility notwithstanding), exhibiting a strong tendency to revert to the mean. Over recent decades, the purchasing power of gold has undeniably strengthened. One might argue that this reflects a certain level of euphoria on the part of gold investors and speculators, while others might emphasize the fast-changing monetary, fiscal, and geopolitical realities of the world we live in.

Let us now get to the crux of the matter: gold as part of an overall asset allocation.

The vast majority of gold investors would indeed refer to it as arguably the most suitable form of long-term liquid reserves and store of value. We've already mentioned gold's ability to preserve its purchasing power over the long-term, but another crucial aspect which needs to be underscored is the risk side of the equation. Unlike bank deposits, money market funds, and government bonds, which are all essentially 'promises to pay', physical gold is something one owns directly and with no counterparty risk. The only 'risk' for long-term owners of gold is volatility, which is very different than the real risk of a permanent capital impairment. Another appeal is its universal liquidity around the world and independence from the financial system, which further supports the notion of gold as free-market money. Lastly, the 'opportunity cost' of owning gold is something that is often talked about, and while we don't consider it particularly useful to value gold, it is indeed a relevant consideration, especially for income-focused investors. But it should not be assessed in isolation, and without considering risks. Moreover, while historically there has been a pretty strong negative correlation between the nominal price of gold and real interest rates, it will not have been lost on anyone that this relationship broke down in spectacular fashion in early 2022, following the decision to freeze another nation's foreign exchange reserves. But leaving geopolitics asides, we would argue that the other side of the coin when talking of 'opportunity cost' is 'option value', which we focus on in the next paragraph.

Most gold investors also make use of the precious metal as a potential hedge against the myriad risks they face as of today. Gold's inherent characteristics, as previously discussed, tend to make its price dynamics counter-cyclical, although not quite as matter-of-factly as many would like, because gold often gets caught in the initial selling frenzy to create liquidity. Nonetheless, gold can serve as a reserve asset that can be exchanged for other assets as opportunities arise, which, if done judiciously, can be a meaningful source of option value. And lastly, gold's role as a permanent stabilizer and counterbalance does indeed tend to enhance the risk/return profile of most portfolio constructs.

To sum up, we view gold as money, the inclusion of which serves a clear purpose in our overall asset allocation: to protect the purchasing power of our savings held as liquid reserves, to provide a hedge against extreme market events, and to be exchanged for other assets as opportunities arise. We don't try to 'value' gold per se, reflecting our view that the gold price says little about gold itself, but rather speaks of the fiat currencies in which it is priced. But in determining just how much of this 'barbarous relic' we should own, we of course scrutinize a number of exchange ratios: gold relative to the quantity of goods and services it can purchase in the real economy, gold relative to monetary aggregates and total debts/liabilities outstanding, and finally gold relative to other real and financial assets. These judgments help guide our allocation to precious metals, which typically ranges from 5% to 30% of total assets. Despite taking profits on numerous occasions over the past year, our current allocation remains at the higher-end of our stated range.

Does that make us gold investors or gold believers? Semantics aside, for us as for the vast majority of serious, long-term owners of gold, if any hint of ideology is to be perceived, it certainly isn't about some sort of obsession about gold, or merely getting caught in a speculative hysteria; it more likely reflects a staunch belief in the central tenets of liberalism and free-market economics, as well as a certain historical understanding and keen awareness of the manner in which governments shape monetary affairs to their benefit, and at the expense of common savers.

Disclosure:

We have a beneficial long position in physical gold and physical silver.

Disclaimer: