

# Voltaire and the colour of safety



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Today it's hard to believe that such a brilliant writer and philosopher as Voltaire could have written these words:

*Women are like weathervanes: they only remain still when they are rusty."*

The Professionals' Financial and Mr. Farley do not endorse this comment, which is only used by way of illustration in the article.

Although Voltaire was unquestionably a genius, his relationship with women, and many other aspects of his life, remain doubtful. The anti-establishment deist and provocative writer led a tumultuous life, suggesting that perhaps he was the weathervane.

Nowadays, Voltaire's emulators seem to be those who advocate gold as an indispensable investment. Let's first examine the following questions: Why is gold trading at such a high price? What are the risks of holding this asset? What place should gold have in your investment portfolio?

## Safe haven or hackneyed cliché

Gold bugs argue that the precious metal is a hedge against inflation and a safe haven in times of crisis. Unfortunately, these are just clichés.

Until the early 1970s, purchasing power relative to gold had been constant for close to 400 years. Created in 1934, the Bretton Woods system sought to tie the price of gold—then \$35 an ounce—to the value of the U.S. dollar. The system was abolished in 1971. In 1973, the price of gold soared to \$200 an ounce, then fell back to \$110, and ended the decade at \$970\*. At the time, some analysts predicted that gold could go as high as \$2,500. Today, some expect gold to reach \$3,500, even \$10,000!

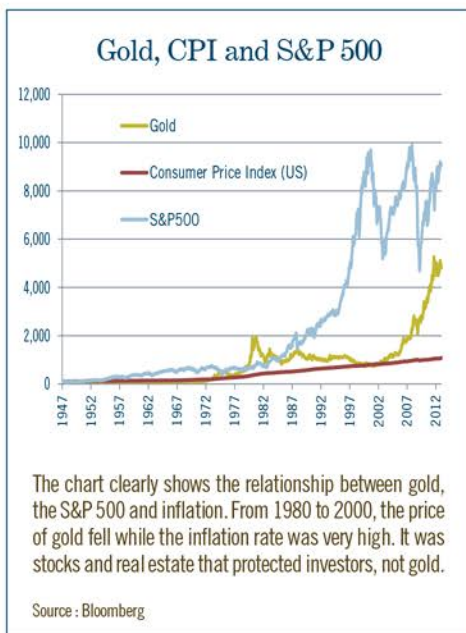
## Inverse relationship between gold and the U.S. dollar

In the late 1980s, gold was trading at \$450; a decade later, its price fell to \$300. In fact, since the beginning of the 20th century, the price of the precious metal has increased 15-fold, which is similar to the rise in the consumer price index for the same period.

Although gold and inflation were highly volatile in the period from 1970 to 1990, it is interesting to note that the U.S. dollar lost more than half of its value versus the German mark and the yen in that timeframe. The increase in the price of gold can be correlated with the decline of the U.S. dollar, a correlation that seems to have been confirmed since 2009. The quantitative easing of the past three years has resulted in a devaluation of the greenback, while gold has almost doubled in value.

## Protection against inflation or comforting illusion?

It is also interesting to note that during these past three years (2009-2012), the S&P 500 Index rose from 665 in March 2009 to 1,474 in September 2012 (excluding dividends). So gold's advantage over stocks does not seem to have any basis.



Since the crisis of 2008, central banks around the world have printed about \$11 trillion, an amount that far exceeds the value of all the gold ever produced. This massive expansion of the money supply is feared by monetarists. The cliché of gold as a safe haven could reappear, but historical data show that the appreciation of gold is, rather, directly linked to the depreciation of the U.S. dollar. Low real interest rates also reduce the opportunity cost of holding gold. A rise in rates would increase this cost and could weaken gold prices.

As for the safe haven notion, why did the price of gold fall 30% in 2008 when the markets collapsed? The greenback rose during that same period, which once again illustrates the inverse relationship between the price of gold and the U.S. dollar.

## The place of gold in your investment portfolio

On this question, our position is clear: gold provides no apparent protection against inflation. It generates no interest income or dividends, costs money to store, and seems to offer no protection against financial shocks. Holding this precious metal can add an element of diversification, but we recommend that it be given a moderate weighting because of the risks involved.

It is always possible to find periods (e.g. 1979-1981) when gold outperforms the stock indices or other asset classes, but considering its benefits relative to its risks, gold is not the best investment solution. It takes sound management to protect your capital and your purchasing power, not volatile investments.

No investment is ideal in all situations. The real colour of safety is green, not gold. Perhaps one day Voltaire's emulators will realize this.

\* KINDLEBERGER, Charles, *Manias, Panics and Crashes*, 1995 and data taken from *The Economist*.