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JOURNAL REPORTS: FUNDS/ETFs

Gold as an Inflation Hedge: What the Past 50 Years Teaches Us

On the anniversary of the metal's unleashing by Nixon, gold's believers may be disappointed by the record



Investors often think that gold is the answer to inflation. It's not that simple, as the past 50 years have shown.

PHOTO: SHANNON STAPLETON/REUTERS

By Mark Hulbert

Aug. 8, 2021 9:00 am ET

On a Sunday evening 50 years ago—on Aug. 15, 1971, to be exact—then-President Nixon interrupted “Bonanza,” one of the most popular TV shows of that era, to announce that he was ending the convertibility of the U.S. dollar into gold. Many consider it to be one of the most consequential decisions he made.

Up until this “closing of the gold window,” foreign central banks had been able to convert U.S. dollars into gold bullion at the fixed price of \$35 an ounce. In theory, this had imposed a strict monetary discipline on the Federal Reserve, since inflating the money supply could have caused a run on Fort Knox, where the U.S. stored its supply of gold. And inflation did indeed jump in the years following Nixon’s decision to remove that restraint. So did the price of gold, which today is 50 times as high as it was that day.

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What role does gold play in your investment portfolio? Tell us below.

This apparent correlation between gold and inflation has led many to believe that gold is a good inflation hedge. This belief isn't supported by the data, however. If gold were a good and consistent hedge, the ratio of its price to the consumer-price index would have been relatively steady over the years. But that hasn't been the case, as you can see from the accompanying chart: Over the past 50 years, the ratio has fluctuated from a low of 1.0 to a high of 8.4.

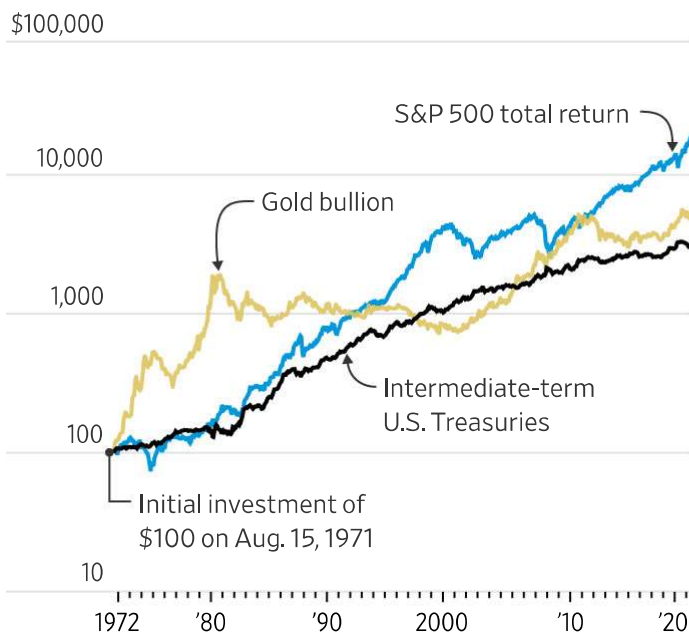
Gold is only a good inflation hedge over time frames far longer than any of our investment horizons, according to [research](#) conducted by Duke University professor Campbell Harvey and Claude Erb, a former commodities portfolio manager at TCW Group. They found that it's only when measured over very long periods—a century or more—that gold has done a relatively good job maintaining its purchasing power. Over shorter periods its real, or inflation-adjusted, price fluctuates no less than that of any other asset.

Gold Has Struggled

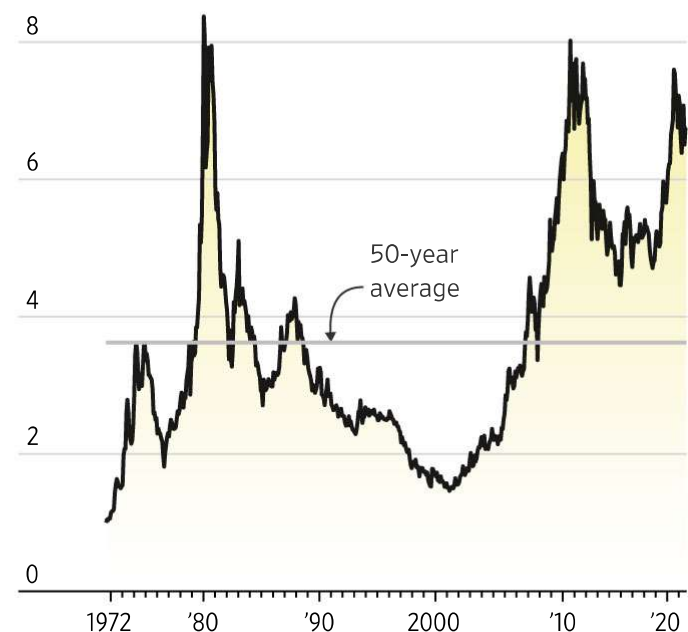
Bullion's performance over the past 50 years relative to stocks, bonds and inflation

Investment performance

Logarithmic scale



The ratio of gold's price to the consumer-price index



Sources: Robert Shiller; St. Louis Federal Reserve; S&P; Hulbert Ratings (performance); Hulbert Ratings (ratio)

Gold's weakness as an inflation hedge may be even more pronounced today, Prof. Harvey says, because "gold is currently very expensive compared to its history." The current gold-to-CPI ratio stands at 6.5, for example, nearly double its 50-year average of 3.6.

Light metal

Even though the price of gold is 50 times as high as in 1971, stocks have performed even better. The S&P 500 has produced an annualized return of 11.2% since August 1971, assuming dividends were reinvested along the way. That compares with 8.2% annualized for gold.

Altering the Course

Nixon Devalues Dollar, Sets a 90-Day Freeze On Wages and Prices

He Calls for Restoration
Of Investment Tax Credit,
End of Auto Excise Tax

10% Imports Levy Imposed

By RICHARD F. JANSSEN

Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON — President Nixon ordered an immediate 90-day wage, price and rent freeze and cut the dollar loose from the historic \$35-an-ounce gold price.

The most stunning and sweeping actions announced by the President in a suddenly scheduled television broadcast culminating a weekend of meetings with his top economic advisers were the long "unthinkable" ones of domestic controls and devaluation of the dollar by letting it "float" in exchange markets. But in espousing almost every economic action that his critics have been urging, Mr. Nixon also:

- Imposed a 10% surcharge on imports.
- Asked Congress to restore the old 7% investment-tax credit at a temporary 10% rate.
- Asked Congress to repeal the 7% excise tax on autos.
- Asked Congress to advance to next Jan. 1 the income-tax cuts scheduled for Jan. 1, 1973.
- Acted to lop \$4.7 billion off the budget for the fiscal year that started July 1 by reducing federal jobs 5%, deferring for six months the federal pay boost slated for next Jan. 1, and postponing the proposed start of general revenue sharing for three months and the start of welfare reform for one year.

[For the initial reaction of businessmen and economists to the President's announcement, see story on page 3.]

A "Flexible" Economic System

"The range of actions I have taken and pro-

posed tonight on the job front, on the inflation front, on the monetary front," the President told the TV audience, "is the most comprehensive new economic policy to be undertaken in this nation in four decades." He said that the strong U.S. economic system is "flexible enough to change its ways dramatically when circumstances call for change."

Despite the sweeping nature of his program, though, Mr. Nixon tried to end his TV talk on an upbeat note. Calling on the nation to meet the challenge of foreign peacetime competition, the President said that "every action I have taken tonight is designed to nurture and stimulate that competitive spirit, to help us snap out of the self-doubt, the self-disparagement that saps our energy and erodes our confidence in ourselves . . . our best days lie ahead."

The Wall Street Journal, Aug. 16, 1971

Furthermore, the only reason gold came even this close to matching stocks over the past 50 years was its huge return during the first decade following Nixon's announcement. Take away that decade, and gold has lagged behind even intermediate-term Treasury notes. Over the past 40 years, gold has risen at a 3.6% annualized rate, compared with 12.2% for the S&P 500 and 8.2% for the Treasuries.

This doesn't mean gold has no role to play in a diversified portfolio, however, even assuming the future will be like the past. Because the correlation of its returns with those of either equities or bonds has often been low or even negative, its presence in a portfolio can reduce volatility. Over the past 50 years, a stock-and-bond portfolio could have improved its risk-adjusted performance by adding a small allocation to gold—around 5% or so.

Still, even gold's volatility-reducing potential isn't guaranteed, since gold's correlation with stocks has varied widely over the years. In fact, there have been occasions in which gold's correlation to the stock market has been positive, which is just the opposite of what it should be to reduce a portfolio's risk. One such recent occasion came during the stock market's waterfall decline in February and March last year: Stocks of gold-mining shares dropped 39%, as measured by [VanEck Vectors Gold Miners](#) [GDX](#) **0.96%** ▲ ETF (GDX)—even more than the 34% drop in the S&P 500. "What kind of safe haven is that?" Prof. Harvey asks.

The next 50 years

Gold's inconsistent correlation with both stocks and inflation makes it difficult to project how it will perform over the next 50 years. An additional wild card, according to Prof. Harvey, is that gold now faces "competition it's never had before" because of the advent of cryptocurrencies.

It is always possible that gold will be a more consistent inflation hedge in coming years. It's just that you will have to look elsewhere than history to find support for such a possibility. Mr. Erb is cynical whether this will pose much of an obstacle to gold's true believers, however: "The past can always be brushed aside when dreaming about how gold and inflation might move in tandem in the future."

Mr. Hulbert is a columnist whose Hulbert Ratings tracks investment newsletters that pay a flat fee to be audited. He can be reached at reports@wsj.com.

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Appeared in the August 9, 2021, print edition as 'Gold and Inflation: What 50 Years Tells Us.'

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