8 Reasons To Own Gold

Gold is respected throughout the world for its value and rich history, which has been interwoven into cultures for thousands of years. Coins containing gold appeared around 800 B.C., and the first pure gold coins were struck during the reign of King Croesus of Lydia about 300 years later. Throughout the centuries, people have continued to hold gold for various reasons. Below are eight reasons to own gold today.

A History of Holding Its Value

Unlike paper currency, coins or other assets, gold has maintained its value throughout the ages. People see gold as a way to pass on and preserve their wealth from one generation to the next.

Weakness of the U.S. Dollar

Although the U.S. dollar is one of the world's most important reserve currencies, when the value of the dollar falls against other currencies as it did between 1998 and 2008, this often prompts people to flock to the security of gold, which raises gold prices . The price of gold nearly tripled between 1998 and 2008, reaching the $1,000-an-ounce milestone in early 2008 and nearly doubling between 2008 and 2012, hitting around the $1800-$1900 mark. The decline in the U.S. dollar occurred for a number of reasons, including the country's large budget and trade deficits and a large increase in the money supply.

Inflation

Gold has historically been an excellent hedge against inflation, because its price tends to rise when the cost of living increases. Over the past 50 years investors have seen gold prices soar and the stock market plunge during high-inflation years.

Deflation

Deflation, a period in which prices decrease, business activity slows and the economy is burdened by excessive debt, has not been seen globally since the Great Depression of the 1930s. During that time, the relative purchasing power of gold soared while other prices dropped sharply.

Geopolitical Uncertainty
Gold retains its value not only in times of financial uncertainty, but in times of geopolitical uncertainty. It is often called the "crisis commodity," because people flee to its relative safety when world tensions rise; during such times, it often outperforms other investments. For example, gold prices experienced some major price movements this year in response to the crisis occurring in the European Union. Its price often raises the most when confidence in governments is low.

Supply Constraints
Much of the supply of gold in the market since the 1990s has come from sales of gold bullion from the vaults of global central banks. This selling by global central banks slowed greatly in 2008. At the same time, production of new gold from mines had been declining since 2000. According to BullionVault.com, annual gold-mining output fell from 2,573 metric tons in 2000 to 2,444 metric tons in 2007 (however, according to Goldsheetlinks.com, gold saw a rebound in production with output hitting nearly 2,700 metric tons in 2011.) It can take from five to 10 years to bring a new mine into production. As a general rule, reduction in the supply of gold increases gold prices.

Increasing Demand
In previous years, increased wealth of emerging market economies boosted demand for gold. In many of these countries, gold is intertwined into the culture. India is one of the largest gold-consuming nations in the world; it has many uses there, including jewellery. As such, the Indian wedding season in October is traditionally the time of the year that sees the highest global demand for gold (though it has taken a tumble in 2012.) In China, where gold bars are a traditional form of saving, the demand for gold has been steadfast.

Demand for gold has also grown among investors. Many are beginning to see commodities, particularly gold, as an investment class into which funds should be allocated. In fact, SPDR Gold Trust became one of the largest ETFs in the U.S., as well as one of the world's largest holders of gold bullion in 2008, only four years after its inception.

Portfolio Diversification
The key to diversification is finding investments that are not closely correlated to one another; gold has historically had a negative correlation to stocks and other financial instruments. Recent history bears this out:

- The 1970s was great for gold, but terrible for stocks.
- The 1980s and 1990s were wonderful for stocks, but horrible for gold.
- 2008 saw stocks drop substantially as consumers migrated to gold.

Properly diversified investors combine gold with stocks and bonds in a portfolio to reduce the overall volatility and risk.

The Bottom Line

Gold should be an important part of a diversified investment portfolio because its price increases in response to events that cause the value of paper investments, such as stocks and bonds, to decline. Although the price of gold can be volatile in the short term, it has always maintained its value over the long term. Through the years, it has served as a hedge against inflation and the erosion of major currencies, and thus is an investment well worth considering.