The Savage Truth: Price volatility hardly diminishes its true value

by Terry_Savage

The allure of gold is nothing new. Throughout the centuries, gold has held a fascination that comes not only from its beauty (hold a gold coin in your hand, and you'll see what I mean), but also from its truly limited supply. That quality has always made gold a "safe haven" in troubled times. And the price of gold has been a barometer of faith in governments and the currencies they issue.

At this writing, the price of gold is around $940 an ounce. But that could change quickly â€” upward or downward â€” because gold is traded around the world on a 24-hour basis. On Sept. 10, 2001, gold was trading at $271 an ounce. In March 2008 â€” and again last month â€” gold traded at more than $1,000 an ounce, just to give you some perspective. As a commodity, the price of gold is easily as volatile as many stocks. But over the longer run, gold has been a reliable store of wealth.

In all of history, only 161,000 tons of gold has been mined, barely enough to fill two Olympic-size swimming pools. More than half of that was extracted in the last 50 years, and there have been few recent discoveries.

Gold can be found, but gold cannot be "created." Over the centuries, alchemists tried to create gold out of base metals, but none succeeded. Thus, the scarcity value of gold â€” especially in an era where politicians create "money" out of thin air!

And that, essentially, is the argument for owning some form of gold in your investment portfolio.

Gold is not meant to be your entire investment strategy. Instead, it is designed to protect against extremes of credit creation (inflation) and also against deflation. When asset values are falling in a deflationary period, gold bullion or coins are easily valued, and exchanged, in a global market.

Despite its history of preserving value, gold is not always priced rationally in global markets. In November 2008, gold traded down to $725 an ounce, as hedge funds and other large investors seeking liquidity sold their gold mining stocks and bullion, taking their profits in the one sector that had not been decimated. So gold prices are also subject to market forces.

Those who think they can preserve their wealth in gold against all economic disasters should realize that in extreme times, few would accept a gold coin in trade for the last loaf of bread. In short, if you invest in gold, you're hoping that this "insurance policy" will never really need to be used!

There is one "doomsday scenario" that encourages investors to buy gold today for future profits. Clearly, the U.S. dollar remains the currency of choice today, in spite of all the debt being created. That's partially because other global currencies are even less reliable! And the global gold market is not large enough to accommodate a rush from all dollar-holders around the world.

But some reason that if the dollar does come under attack, with foreign holders unwilling to lend us money or keep their assets in dollars, the United States could be forced to once again link the dollar to gold. Only this time, at much higher prices than the current $42.22 official price. Some are predicting a conversion price as high as $4,000 an ounce one day.

Only time will tell whether the world will repudiate the U.S dollar if we create too many of them in an attempt to bail out our economic woes. Keep an eye on the gold market for your answer.

And that's The Savage Truth!

Terry Savage is a registered investment adviser and is on the board of the Chicago Mercantile Exchange. She appears weekly on WMAQ-Channel 5's 4:30 p.m. newscast, and her new book, "The Savage Number: How Much Money Do You Make?" has just been published.