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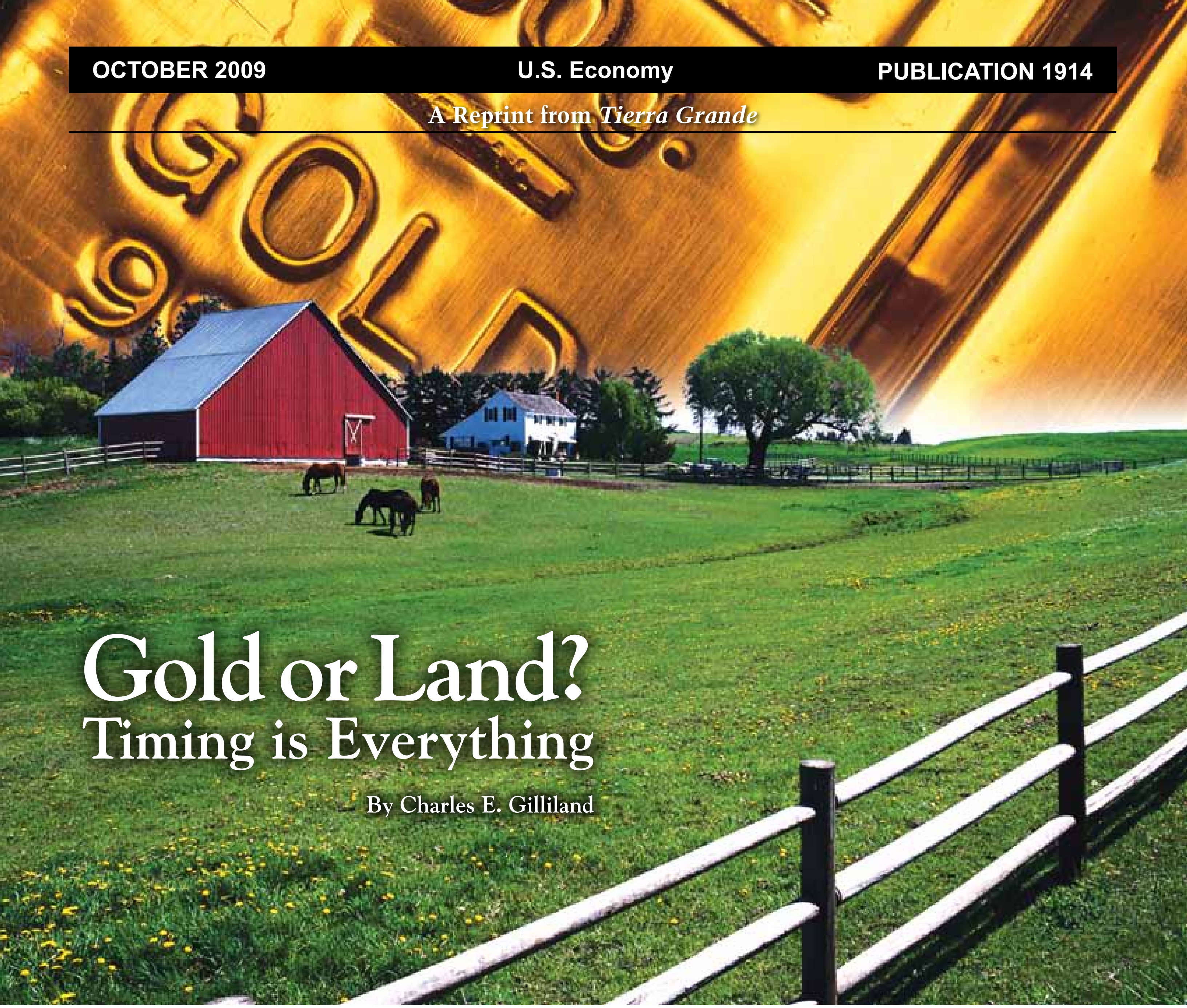


Gold or Land?

Timing is Everything

By Charles E. Gilliland

When I find myself in times of trouble, glittering gold can comfort me. Gold can be the answer — wait and see.

(with apologies to The Beatles)

Hyperinflation can kill. It erodes investment returns and rewards debtors by allowing them to pay off loans with cheaper currency. It destroys the value of savings and lowers living standards of individuals surviving on fixed incomes.

Deflation destroys, too. Debtors pay back loans with more expensive dollars than they borrowed.

Economic activity wanes as society comes to expect all assets to drop in value. As values ebb in a deflationary cycle, gold offers the security of owning an asset that "has never been worth nothing," as one advertiser asserts.

Research results by Eric J. Levin and Robert E. Wright (*Short-Run and Long-Run Determinants of the Price of Gold*, published by the World Gold Council) bolster belief in gold as an investment. The authors found gold to be a long-term hedge against inflation in the United States. However, potential investors may find the history of relatively recent gold price movements somewhat unsettling when viewed from the perspective of a ten-year investment horizon.

Land, too, is seen as a potential port in the storm during economic dislocations. It is a tangible asset that stores wealth during inflationary times. Even in deflationary eras, land is unlikely to be worth nothing.

How does the capital gain aspect of Texas land ownership compare with gold ownership? Using annual gold prices reported by the World Gold Council from 1973 through 2008, this analysis compares the annual yield for purchasing gold at the average annual price prevailing in a given year with a sale ten years later at the then-current average annual price. Gold returns are reported before accounting for storage costs.

The average annual price of gold as reported by the World Gold Council is shown in the table (page 4), along with the year-to-year percentage change in gold prices and the compound growth rate since 1973. Both real prices and nominal prices are shown, adjusted for inflation using the implicit price deflator for gross domestic product.

When gold was the monetary standard, its price was fixed at $35 per ounce. The world abandoned that standard in the late 1960s, and by 1973 gold was freely traded.

The U.S. embarked on a spiral of inflation driven in part by soaring energy prices. Gold began a sustained upward march from $98 per ounce in 1973 to $615 per ounce in 1980. This remarkable growth rate reflected panic among wealth holders as they saw that government monetizing debt was destroying the value of their investments. They began to flock to gold for protection.

The rapid rise in inflation abated in 1981 as the Paul Volker era at the Federal Reserve began. But choking off inflation inflicted economic pain across the spectrum. Farmers saw their output priced out of world markets as the dollar strengthened. Those using high leverage to play the inflation game, activity rampant in the 1970s, saw leverage cut the other way, increasing their losses as asset values faltered and then dropped. Gold prices peaked on Jan. 21, 1980, at $850 per ounce. But they fell precipitously over the next two years, closing on Dec. 30, 1981, at $397 per ounce.

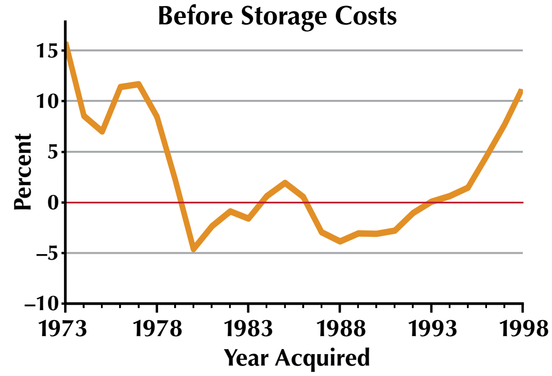
The turmoil of the 1986–87 savings and loan crisis and coincidental collapse of energy prices again sent buyers in search of a safe haven for their wealth. Gold prices modestly recovered lost ground, peaking again in 1987 at $446 per ounce. A sustained ebb in prices characterized the gold markets through the 1990s. Gold fell to a low of $273 per ounce in 2001.

After the 9/11 attacks, gold prices reflected the public's concern over increased uncertainty in international affairs. In 2006, gold prices began a rise reminiscent of the panic-driven upward spiral of the late 1970s. The run-up accelerated in 2007–08, responding to the turmoil in the wake of the subprime mortgage crisis and consequent threat of a meltdown of the financial system. Some extreme pundits now foresee gold selling at $2,000 per ounce if world governments begin to inflate their currencies to deal with economic problems.

From its peak price in the 1980s, gold experienced prolonged periods of falling prices, including some remarkable annual drops. For example, prices slid 25 percent between 1980 and 1981. As recently as 1997–99, gold prices fell a combined 41 percent. Clearly, timing is everything when holding gold as an investment asset.

Figure 1 tracks a ten-year gold investment based on prices listed in the table. When the capital gain equals zero, gold has preserved an investor's capital over a ten-year term before storage cost deductions. Capital gain greater than zero reflects a positive return.

Figure 1. Returns on Ten-Year Gold Investment Before Storage Costs

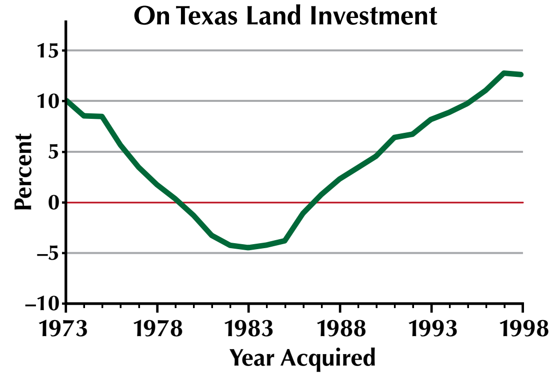


Source: Real Estate Center at Texas A&M University

Buying gold in 1980 for $615 and selling in 1990 for $383 would have netted a negative return. That investment would have eroded at slightly more than a 4.5 percent annual rate. In fact, holding gold for ten years provided a positive return only for purchases made in the 1970s and in the mid- to late 1990s. Gold investments provided negative returns for purchases between 1980 and 1983. Negative results also accrued from purchases made from 1987 through 1992. However, purchases made in the late 1990s have begun to book gains even exceeding returns on ten-year Treasury bond yields.

A similar analysis of capital gains for ten-year holds of Texas rural land is shown in Figure 2. The results show yields only for the capital gain portion of land returns over the ten-year period. The results do not reflect revenues from land use, such

Figure 2. Ten-Year Capital Gain Returns On Texas Land Investment



Source: Real Estate Center at Texas A&M University

Nominal and Real Changes in Annual Average Price of Gold, 1973–2008

	Nominal			Real		
Year	World Gold Council Annual Price per Ounce	Year-to-Year Percentage Change	Annual Compound Pretax Growth Rate From 1973	Deflated Annual Price per Ounce*	Year-to-Year Percentage Change	Annual Compound Pretax Growth Rate From 1973
1973	98	****	****	98	****	****
1974	159	62	62	146	49	49.2
1975	161	1	28	135	–8	17.5
1976	125	–22	8	99	–27	0.4
1977	148	18	11	110	11	3.0
1978	193	31	15	135	23	6.7
1979	305	58	21	196	45	12.3
1980	615	102	30	362	85	20.6
1981	459	–25	21	247	–32	12.3
1982	375	–18	16	191	–23	7.7
1983	424	13	16	207	8	7.8
1984	361	–15	13	170	–18	5.2
1985	317	–12	10	145	–15	3.3
1986	368	16	11	164	13	4.1
1987	446	21	11	194	18	5.0
1988	437	–2	10	184	–5	4.3
1989	381	–13	9	154	–16	2.9
1990	383	1	8	150	–3	2.5
1991	362	–6	8	137	–9	1.9
1992	344	–5	7	127	–7	1.4
1993	360	5	7	130	2	1.4
1994	384	7	7	136	5	1.6
1995	384	0	6	133	–2	1.4
1996	388	1	6	132	–1	1.3
1997	331	–15	5	110	–17	0.5
1998	294	–11	5	97	–12	0.0
1999	279	–5	4	91	–6	–0.3
2000	279	0	4	89	–2	–0.4
2001	273	–2	4	85	–4	–0.5
2002	310	14	4	95	12	–0.1
2003	363	17	4	109	15	0.4
2004	409	13	5	119	9	0.6
2005	444	9	5	125	5	0.8
2006	604	36	6	165	32	1.6
2007	695	15	6	185	12	1.9
2008	850	22	6	221	19	2.4

*In 1973 dollars
Source: World Gold Council

as returns on crop, livestock and recreational activities. It also does not deduct the property taxes.

Land also posted negative results between 1980 and 1986. Historically, farmland has returned a 4 to 6 percent net return for crop activity and as much as 2 to 3 percent for grazing.

The average gross return on ten-year gold investments was a nominal 2.4 percent for purchases made between 1973 and 1998 before storage costs.

Interestingly, the largest negative results occurred for gold purchases made during periods of fear and panic. The early 1980s and 1987–91 posted prices substantially higher than their annual counterparts ten years later, reflecting the frenzied nature of the markets during such times of turmoil.

These purchases are made as a bulwark against uncertainty. As market turmoil recedes to more orderly conditions, demand for gold reverts back to its traditional underpinnings in jewelry and dentistry.

Nevertheless, investors continue to look favorably on gold and other tangible assets as armor to protect them from the ravages of troubled economies. Investors would do well to recall that timing is everything and a long-term hold may yield dismal results.

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THE TAKEAWAY

Gold and land have been historically popular as "safe" investments during tough economic times. But timing is everything when investing in these tangible assets. Investors should consider how ten-year holds on gold and land compare with returns on other investments.

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