OPINION

Don’t be fooled into buying on gold’s dip

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While gold may be a good short-term investment, it has not historically been a good investment in the long run, writes George Athanassakos.

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Between February 2024 and February 2026, the price of gold rose from US$2,049 an ounce to US$5,248 an ounce, marking one of its strongest performances since the early 2000s. The drivers of the rise are well known by now. Among them: deglobalization, protectionist policies, central banks' efforts to diversify away from U.S. assets, low interest rates and protection against a myriad of "unknown unknowns" – both political and financial around the globe.

An investment in gold over that period was highly profitable. But can such profits endure over the long run?

This is an interesting question considering recent developments where, despite increased geopolitical uncertainty (including tensions involving Iran) and renewed inflation fears, gold prices have fallen by more than 15 per cent in the last couple of weeks.

History shows that while gold may be a good short-term investment, it has not been a good investment in the long run. It won't be this time around either. Commodities, including gold, are cyclical. They go up and down in price, they do not just go up indefinitely.

Gold volatility likely to persist as Iran war spooks investors

A gold bull market also happened between 2001 and 2011, when gold prices rose from US$280 an ounce to US$1,800 an ounce. This bull market was attributed to the bursting of the technology bubble in 2000, weakness in the U.S. dollar and the 9/11 attacks.

However, as equity markets rebounded, real interest rates rose and the U.S. dollar strengthened, gold fell from about US$1,800 an ounce in 2012 to roughly US$1,100 an ounce by 2016. According to Goodreid Investment Counsel Corp., the materials sector's share of S&P/TSX fell from a high of 22 per cent to about 9 per cent and stayed around 10 per cent until 2024.

The materials sector has underperformed the S&P/TSX since 1987, with a compound annual return of about 6.5 per cent compared with 8.2 per cent for the broader index. The underperformance of spot gold relative to the S&P 500 Index is even worse: approximately 6.3 per cent for gold versus 11.5 per cent for the index.

According to the Financial Times, since 1900, the real annual return on gold has been about 1.3 per cent, underperforming both global bonds (1.7 per cent) and stocks (6.7 per cent). But since the U.S. left the gold standard in 1971, gold has delivered an annual return of approximately 4.7 per cent, driven largely by the 2001-2011 bull market and the sharp run-up in 2024-2025.

Moreover, a Merrill Lynch study examining the performance of 10 different asset classes over rolling periods between 1970 and 2007 found that gold was the worst-performing asset. In fact, history shows that longer holding periods tend to reduce gold's relative performance. For commodities, including gold, high prices encourage supply, which eventually leads to lower prices.

Contrary to popular belief, gold has been a poor inflation hedge. Of the 28 years since 1971 in which inflation exceeded 3 per cent, gold returns were negative in 13 of them, according to the Financial Times.

In the 1930s, economist Nicholas Kaldor analyzed commodity price behaviour over the business cycle, developing what's known as the cobweb theorem. It states that producers' expectations about prices are assumed to be based on observations of previous prices. This framework applies to commodity markets, including gold, since there's a time lag between exploration, mining and production decisions.

Put differently, low prices in one period lead to a fall in supply and a subsequent rise in prices. When prices rise significantly, higher production is encouraged. That, normally, will lead to overproduction and subsequent price declines as demand dips. As prices fall, many marginal producers go out of business. In turn, production declines, often so much that when demand starts to increase, prices rise sharply.

The recent increase in demand for commodities, combined with constrained production due to stricter regulation and ESG-related policies, has contributed to higher prices. But rising gold prices are also incentivizing new supply.

First, higher metal prices over the last couple of years have made the opening of marginal mines possible. Second, AI and robotics, along with improving shipwreck gold recovery, are making economic exploration of the ocean floor and gold retrieval possible. Finally, people are lining up to sell their jewellery and household utensils. Together, these factors are likely to increase supply, which – consistent with historical patterns – could place downward pressure on prices in the next phase of the business cycle.

This raises a broader question: why don't governments take steps to smooth commodity price cycles?

This is exactly what Benjamin Graham proposed more than 80 years ago in his books *Storage and Stability* and *World Commodities and World Currency*. In these books, he described a specific plan to produce and store commodities, with the aim of adjusting supply to demand – thus stabilizing prices – an aspect of his work that extends beyond his well-known contributions to value investing.

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