Our Thoughts on Gold - Transcript

Tom Mullooly: Welcome to the Mullooly Asset Management Podcast. This is episode number 275. One of your co-host here smiling today, Tom Mullooly. Joining me today is my other co-host, Brendan Mullooly.

Brendan M.: So what's the hot topic of the day?

Tom Mullooly: How about gold? Gold Jerry. That's gold. Back in the '80s I had a client who was a professional athlete. You would know the name, but he got an allowance every year from his agent. It seemed like the same conversation happened every year. "What about gold? I want to put the whole account into gold. Because it's really going places." Stocks are risky. Stocks are risky, but gold's not?

Brendan M.: So what's the saying? I'm drawing a total blank on who has it. Their pin to tweet on Twitter, market analyst. Nothing like price to change sentiment.

Tom Mullooly: Helene Meisler.

Brendan M.: Right. Sorry Helene for forgetting. And she always refers people to this pin tweet whenever stocks are going up. But this pertains to every asset class out there.

Tom Mullooly: Every single one.

Brendan M.: And so every once in a while when gold rears its head and starts going up in price, we inevitably get a handful of phone calls, usually well meaning from clients who are like, "Hey, I heard gold's going up. Like what's up with that? Is that something we should own?" And we just kind of figured we would use an opportunity. We saw an article in Forbes about gold making the case for why you should own it now.

Tom Mullooly: I'm holding up a chart so everybody listening to the podcast cannot see this.

Brendan M.: Yeah.

Tom Mullooly: But the chart talks about how US inflation is finally starting to heat up. Brendan, you can see this chart. You're the only one who can see it. Is that look like something that's heating up? I mean, does this look like a Bitcoin rally?

Brendan M.: No, not in particular. But one of the cases in there was inflation being a reason to own gold or ... A lot of it ends up being doomsday stuff from people who don't like whatever is happening in the world these days, regardless of their political ideology. It's usually driven by that too.

Tom Mullooly: And I'll pick up on that. It's much easier to write a doomsday scenario headline and to capture eyeballs and attention than it is to basically give the all clear signal.

Brendan M.: Yeah. So Morgan Housel, one of my favorite writers has shared, I'm paraphrasing so it's close to this, but he said that like, "Doomsday predictions or being bearish always sounds smart. Whereas saying that things will most likely be better in the future than they are today just sounds naive. It sounds dumb." Although, if you look over the course of history, that's been true every single time. No matter what scenario or event we're talking about, human progress is not something that I want to bet against. And I think that's kind of what you're signing up for when you put your money into something like gold, or you buy some of these newsletters out there that predict the end of the United States or the dollar is going to like become worthless or something.

Tom Mullooly: Here's how to play the end of the world scenario in your portfolio.

Brendan M.: Right. But these things get eyeballs, like you said, because it sounds intelligent because you often have to come up with this elaborate scenario to explain in detail why now is the time to own gold.

And before we move on from anything in this Forbes article which was drivel, you raised a pretty good point, in this case at least, if you scroll to the bottom of the article, the thing was written by somebody who manages gold mutual funds ...

Tom Mullooly: Yeah.

Brendan M.: Something like that. So obviously he's making the bull case for gold because ...

Tom Mullooly: Not just a portfolio manager. He's been named the mining fund manager of the year by Mining Journal magazine.

Brendan M.: So you obviously don't get to that kind of role in the world without being a gold bug. And so not to say that he's making a case for a pretty short-term, short-term call on the direction of gold, which is not something I would ever do, but he's going to be bullish on it because he'd like your dollars.

Tom Mullooly: It's in his best interest-

Brendan M.: For what he's doing. That's-

Tom Mullooly: ... to be bullish.

Brendan M.: Of course.

Tom Mullooly: Did you renew the office subscription to Mining Journal magazine?

Brendan M.: You know what? I forgot. I'll take care of it right after the podcast.

Tom Mullooly: Okay.

Brendan M.: But thanks. Thanks for the heads up. We'll be missing next month's issue unfortunately.

Tom Mullooly: Hey, I will add that I was a very, very, very, very, very long-term subscriber to Forbes magazine. The issues that I would get in my mailbox just got thinner and thinner and thinner. I became a subscriber in the late '80s to that magazine, and even 10 years ago it was really kind of wasting away. I don't know. I don't think that they are printing anymore. I think they're strictly online. But they've changed their approach and pretty much you can submit articles now to Forbes and the editors will pick and choose which ones they want to post. So there's not a high barrier to entry to say I was published in Forbes.

Brendan M.: Using that as a springboard, gold is not something that we feel has a place in investment portfolios. We don't use it here, and I don't see that changing. Do you want to share any feelings on why we feel that gold, golden commodities in general don't ... they're not necessary in a portfolio for just about anybody out there?

Tom Mullooly: When I was a retail broker, I'll share this story. I was told. So it wasn't forced upon me, but I was, it was encouraged that every client as part of their portfolio mix should have at least 5% of their assets in gold or in some kind of commodity ...

Brendan M.: Alternatives.

Tom Mullooly: Alternative investment to act as a hedge against inflation.

Brendan M.: Can I pause because this is a great time to share a couple of stats-

Tom Mullooly: Yes.

Brendan M.: That I have here. Okay. So that's one of the cases people will often share to have a portion of your portfolio in something like this. Since 1975, this just looks at gold, which depending on how you're getting exposure to commodities, gold and oil end up being like two of the biggest ones you're getting if you're getting a basket of them. Or you might own one or the other individually. But since '75, which is when it became legal again for individuals to own gold, the real returns, meaning after inflation has been lopped off of the returns for gold are 0.8% per year. Meaning that it did give you something above and beyond inflation. But I'm going to share with you two far simpler things that we use as the building blocks of our portfolio here that have given you way better real returns, meaning a better hedge against inflation. Bonds, 5% a year real returns since 1975. Stocks, 8.3% real returns per year since 1975. Cash, like meaning T-bills.

Tom Mullooly: Yeah.

Brendan M.: 1.1% per year since 1975. So yes, gold has provided a hedge against inflation, but so have a litany of other things that I think are way simpler for people to own that they can actually understand.

Tom Mullooly: I think part of the mix in being a financial advisor is to ... I'm trying to find a sexy term to say complicate or make it sound complicated like-

Brendan M.: Appear sophisticated.

Tom Mullooly: Right.

Brendan M.: Elaborate. Why did they tell you to have a 5% gold sleeve in your portfolio though? Because I interrupted before you could get to that point, which I think has a different ending than what we just discussed, meaning this doesn't make sense from a numbers perspective. So why would they tell you to do it?

Tom Mullooly: Well, remember, I was a retail broker in the mid '80s. And so inflation was still something that people were pretty up to speed on and they could see it in their grocery bills. So they knew that inflation was a real thing. So it was kind of an easy sale. But the nefarious side of this was that the only way that you could get gold or some type of commodity investment into a client's retail account with a retail broker, and you guys know all the names if you watch golf on TV because they advertise on them, you had to buy a managed futures investment, some kind of limited partnership or alternatively structured product. Usually the commissions on them were starting at 8% and you would get like a 1% or 2% or 3% trail ... trailing commission every year for the dollars that you kept in it. So it was an annuity for the brokers because they continued to get paid pretty well.

Brendan M.: So I want to use a point that you made there to kind of delve further into this topic. In the '80s you're saying, obviously after a decade like the '70s where gold did do really well and inflation was very high, this was fresh in people's mind. And so seemingly wasn't just a good story. It seemed sensible based on the last 10, 20 years of what you had seen, what everybody had seen.

Tom Mullooly: That's right.

Brendan M.: I think that raises a good point though because then I basically just gave the forward returns after this period of high inflation in what gold did. I think that gets to an important point about gold, which is that it's completely unpredictable, like even more so than stocks and bonds. It doesn't do any ... Like to say that gold is supposed to do X because of Y is insane because it's based upon nothing.

Tom Mullooly: Right.

Brendan M.: It's a rock.

Tom Mullooly: I was going to try and tee that one up for you, but you beat me to it.

Brendan M.: Jason Zweig has called it a pet rock and he's kind of poking fun at the gold bugs out there. But I think the guy has a point. There are no earnings. There's no cash flow. There's no dividends. You don't have a set interest rate or a interest payment schedule like when you buy a bond. You get none of that. So it's trading purely on sentiment, meaning just emotions, and it certainly does seem to spike whenever we see bad stuff going on in the world, but it's almost always short-lived. Not something that I think you want to have a piece of long-term because, sure, it marches to the beat of its own drum, but is that necessarily good? Like it's uncorrelated, which is something like you talk about in the context of a portfolio.

It's going to do different things than your stocks and your bonds are going to do, which has value. But it also, since we look at portfolios piece by piece, even when we probably shouldn't, it can be infuriating because it's like, "All right. Market was down recently. My bonds did good. My stocks didn't." Vice versa. "Oh great. You're in the stock market.

Bonds didn't really do much. Maybe they lost a little bit of ground." But like you can dream up any scenario and say gold did something during that time period and it might be true. I don't know. There's no precedent.

Tom Mullooly: You have to kind of clip the chart and say, "From this window, from here to there, gold worked great."

Brendan M.: Yeah.

Tom Mullooly: So it's easy to spot looking back and saying, "Hey, we have hindsight and we can tell when these things moved in the past, but I can't really predict."

Brendan M.: Like gold, gold was the best way to hedge inflation during the '70s, and we knew this during the '80s.

Tom Mullooly: Right.

Brendan M.: But the best way to hedge inflation from the '80s through today was not gold. It was stocks.

Tom Mullooly: Right.

Brendan M.: And then bonds.

Tom Mullooly: Yeah. It's amazing that even investments like bonds and T-bills cash have out pulled that train. It's pretty interesting to note. I think, like you said, you're going to hear it when everyone's in a panic, but I hate to make it super simple, but when I get on the phone with someone and they start talking about gold, I ask them. I'm like, "Wait a minute. Wait a minute. So you're going to trade all of your assets for a hunk of gold."

Brendan M.: Mm-hmm. You're not going to own it by the way.

Tom Mullooly: Yeah, well.

Brendan M.: We're not even up to that yet. We'll get there.

Tom Mullooly: But if you were to trade all of your assets for a big hunk of gold, I don't know where you're going to keep it because it has to be somewhere.

Brendan M.: You literally need like a safe and probably like a guard if you're going to have a substantial amount of gold.

Tom Mullooly: The guard knows the combination.

Brendan M.: Right.

Tom Mullooly: So the second thing is when you go to buy bread and milk, how are you going to pay for that if the world's gone down the drain? Are you going to like hack off a slice of the gold? How does that work?

Brendan M.: Yeah. I'm not really sure. And you're definitely banking on like zombie apocalypse type scenarios if you want to have all of your money in gold to address like the 5% gold sleeve, because we see people come in with portfolios from usually other advisors. So it's usually one of two ways. If they have like a 5% gold sleeve, it's from another advisor. If they have like half of their portfolio in gold, they did that themselves because that's insane.

Tom Mullooly: Yeah.

Brendan M.: But it's always one or the other. And so the 50% person probably has canned goods at home too and a bunker because they think the world is going to end. But the person with 5% in gold, like let's say it is a zombie apocalypse and you happen to keep 5% of your portfolio in gold and the other 95% is in the tank, and let's say you've tripled your money on your 5% gold sleeve. Does that matter? Like is that enough to matter?

Tom Mullooly: I don't think it's really going to move the needle.

Brendan M.: Like if you keep a couple of percent in gold, I think advisors do it just to have, as you said, something in there to say like, "Oh, well we're extra diversified. Not only do we have stocks and bonds of different varieties, but we have 2% of your account in gold."

Tom Mullooly: "And we're perfectly hedged for inflation."

Brendan M.: Right. I just ... I don't see a need for it. I just, I would rather keep it simpler than that. And 2% in anything, let's just say that as a blanket, 2% in any asset class is nonsense. Like why bother?

Tom Mullooly: It's not going to move.

Brendan M.: It needs to be enough to make a difference.

Tom Mullooly: Right.

Brendan M.: If you're going to own something to diversify, like if you're going to own bonds because you want to diversify risk from your stocks, you need to keep more than 5% in there. It needs to be something that's going to actually offset what happens with the other pieces of your portfolio.

Tom Mullooly: Well said. Let's talk about something else related to this. How do most people invest in gold today?

Brendan M.: Well, it's interesting because of when it launched, one of the biggest ETFs out there is a State Street GLD is the ticker.

Tom Mullooly: Right.

Brendan M.: So basically what you're paying for there is not to say like, I'm going to have a big hunk of gold at my house and keep it in a safe or pay guards with dogs to stay in front of it all day.

Tom Mullooly: Wait a minute. Do guards now have dogs?

Brendan M.: Yeah.

Tom Mullooly: So we need to buy dog food.

Brendan M.: Right. Instead of paying for an advisor, you're going to pay for a team of surveillance dogs. This gold is kept in a vault in Boston, Massachusetts where State Street is headquartered. So in the event of zombie apocalypse, if you have GLD, like no one's going to care when they come to raid your house if the world has ended that you have a super low cost basis in gold and that you got to ... You just got to head up to Boston to get it from the vault.

Tom Mullooly: Well, I guess the-

Brendan M.: Come on-

Tom Mullooly: ... next question is if the stock market's like circling the drain and the only thing left is gold, how are we going to even sell our GLD shares?

Brendan M.: I don't know.

Tom Mullooly: Can you get paid in gold or in dollars?

Brendan M.: And does it matter at that point?

Tom Mullooly: Right.

Brendan M.: Is State Street going to even give it to you?

Tom Mullooly: Yeah.

Brendan M.: They have gold. And right. And what are you exchanging it for? So basically to believe in gold as having value because you think it's a good hedge against inflation or the apocalypse or whatever, you have to give them dollars for them to give you a share in the gold. So they're basically telling you like, "Yeah, we'll gladly accept your dollars," because they believe in them.

Tom Mullooly: Yeah.

Brendan M.: But you don't maybe.

Tom Mullooly: Yeah. But hey, if it makes you feel better, okay.

Brendan M.: Sure. I just, I don't know. It's not something that I think makes a whole lot of sense and the proportions in which people hold it, I don't think are going to make a difference in the long run.

Tom Mullooly: Let's kind of refocus a little bit and talk about inflation.

Brendan M.: Mm-hmm.

Tom Mullooly: Because historically inflation has been higher than it has been in the last 10 years.

Brendan M.: Mm-hmm.

Tom Mullooly: There's been very little inflation in the system. However, if you ...

Brendan M.: If you're looking at CPI, which is the general measure-

Tom Mullooly: Right, Consumer Price Index, and yeah, that's what the Fed uses to measure inflation. That's what we should use. But ...

Brendan M.: It's interesting though, because you look at like maybe, maybe you're still paying the same price for a can of food at the grocery store that you did 10 years ago or the difference is not nominal, it hasn't really moved the needle for you. But things like health care have skyrocketed over the last decade in terms of their cost.

Tom Mullooly: About the cost of attending CW Post.

Brendan M.: Right, college cost too. And so you see this. We're working with an average when we say inflation has averaged X over many numbers of years. That's talking about almost all of the goods in the economy in aggregate. Not meaning that some things obviously cost a lot more than they did 10 years ago and other things might cost less.

Tom Mullooly: Perfect example, in 1969 when the Mets were in the World Series, my father went out and bought a color TV, and it set them back like $700. Now you got a color TV when you open a bank account.

Brendan M.: Yeah.

Tom Mullooly: And I mean it's ...

Brendan M.: For $700 you can get something, you can get like a smart TV that can hook you up to like Netflix from it nowadays. So yeah, like electronics have advanced many times over since they were first invented and they cost the same now for a base ... A basic TV cost that then, and it costs the same now, but it's way better, so.

Tom Mullooly: Way, way better and bigger.

Brendan M.: Right.

Tom Mullooly: There's this meme going around on the internet, you'll see it every now and then, where they show a newspaper ad from Radioshack and they have like a calculator, a tape recorder, a camera, a phone, all these different things that they're selling on sale. And you can get all of that now in a cell phone.

Brendan M.: Right. Yeah.

Tom Mullooly: You can buy the whole page now in a phone.

Brendan M.: Yeah.

Tom Mullooly: It's crazy.

Brendan M.: Right.

Tom Mullooly: So inflation works both ways.

Brendan M.: Mm-hmm.

Tom Mullooly: Technology has certainly made things a lot more affordable. We have more power in our cell phones now than they had in the Apollo 11.

Brendan M.: Yeah, I've seen it. Rocket. Pretty wild.

Tom Mullooly: Yeah. That is crazy. But on the other hand, we know things cost more.

Brendan M.: Yeah.

Tom Mullooly: We do. So you have to have-

Brendan M.: It makes sense to plan on that being the case too. Because if you plan on the opposite, you can only be surprised in a negative way. And if you plan on things costing more and you align your decisions around money to account for that and it doesn't end up being true, then you're only better off. And I think that that's okay.

Tom Mullooly: It kind of, when I hear folks on the phone or at the table here in the office talking about, "Well, I'm going to retire and so I want to get a lot more conservative with my investments," I kind of cringe a little bit. I don't know how you feel about it. And I'm like, "Okay, like we have to have this talk." Like I can't believe I'm having this talk for the eighth million at the time. But it's the first time that someone else is hearing this. And we have to explain to them that, "Look, while inflation is practically zero the last few years, it's not going to stay there and things will cost more in the future. So if you don't have a component, at least a piece of your assets that's growing, keeping up with inflation, you're screwed."

Brendan M.: And that's going to end up being a mixture, in our portfolios at least, a mixture of stocks and bonds.

Tom Mullooly: Yeah.

Brendan M.: And I think that that, keeping it simple that way, I think we know more what to expect. These are businesses that are either issuing us stock or they're issuing us bonds, and we have a payment schedule, or this is the government offering bonds out. We know what to expect.

Gold is a wild card and it can be a wild card in a good way and it can be a wild card in a bad way. And I think that seeing something on a statement for most investors that just has no rhyme or reason in terms of what it's done or its performance is a little bit maddening. And I just think that being the top reason for why most people shouldn't and probably can't handle having gold in their portfolio.

Tom Mullooly: So I'll ask a question for the listeners. How many times have you received a statement from your broker or a phone call out of the blue from your firm and the person on the other end of the line will say, "Hey, Mr. Jones, or Mr. Smith, I'm your new advisor. So-and-so left the firm." And you start going through all these different investments. How many times has that happened? Because I know it happened with me.

When I was a broker, guys would leave and we would get these accounts just handed to us. And we, I would have this conversation all the time. So you have X number of dollars in this gold fund or in some ... a couple of gold mining stocks. And I would just ask them. "Why'd you get that? Why did you buy that?" Or, "How's that working out for you?"
Almost every single time that I can remember, people are like, "I don't know why we own that," or, "That thing hasn't done a damn thing," or, "It's gone straight down since we've owned it."

Brendan M.: Right.

Tom Mullooly: So not saying that gold is a terrible investment. There may be a time when we're back in 1975. I can't predict that. Even a broken clock is right twice a day.

Brendan M.: I would just say not to get roped into investments off of infomercials that feature Tom Selleck. And so I think whether it's-

Tom Mullooly: Or the guy from the West Wing.

Brendan M.: Yeah, I just ...

Tom Mullooly: Martin Sheen.

Brendan M.: Yeah.

Tom Mullooly: Yeah.

Brendan M.: I don't think having 5% in gold is going to make a difference. And that's, as I said, what a lot of advisors will do because they think it's sophisticated and it's nice to talk about when gold has then gone up and you had 5% in your money in it. On the reverse side, people who want to put all of their money in gold, I don't think that anybody is ever going to change their minds because it's like a religion all by itself. So if that's their emo, then more power to them. I just don't ... I don't think that it has a place in client portfolios and I don't think that will be changing anytime soon.

Tom Mullooly: That's a wrap on episode 275. Thanks for tuning in and we will catch you next time.