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Economics Group

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Gold Not in Bubble Territory…Yet

Gold has reached a new record high as fears mount about the nation's debt and deficit. We analyze gold from three different perspectives and conclude that gold is not in bubble territory…at least not yet.

Is Gold Primed for a Collapse?

Gold jumped on April 18 after Standard & Poor's downgraded the outlook for U.S. debt to negative. Gold has been on a tear for the last several years, rising from $437/oz. in August 2005 to around $1,500/oz. today. So is gold overbought? Is gold primed for a collapse à la the tech bubble of 2000 and the oil bubble of 2008? We believe this is not the case, at least not yet.

Gold Still Below Record on Inflation-Adjusted Basis

First, in today's dollars, gold has not yet approached the high of about $1,945/oz. seen in January 1980, although it is certainly getting closer. Oil prices kept rising in early 2008, but didn't collapse until after breaching the previous inflation-adjusted record. This is not to say that gold needs to reach a real record before collapsing, but it likely has some room to run yet.

Gold Hasn't Risen as Much or as Fast as NASDAQ or Oil

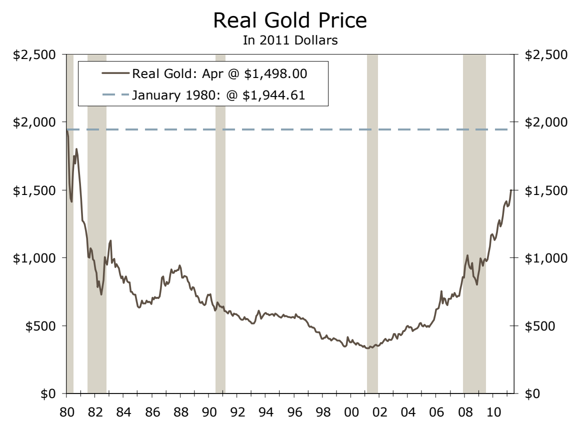
Second, when oil really started shooting higher in early 2007, we noticed it was following a similar pattern to the NASDAQ bubble of 2000. So we indexed both back five years and watched as oil eerily followed the same path to disaster. In the five years prior to their respective peaks, the NASDAQ rose 500 percent and oil rose 340 percent. Over the last five years, gold has not seen nearly the trajectory of increase, rising only about 150 percent. Thus, both the size and speed of the increase suggest gold is not yet exhibiting signs of a bubble ala the NASDAQ in 2000 or oil in 2008.

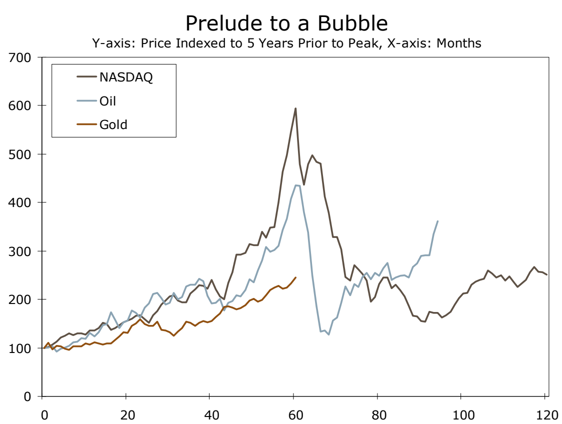
Gold-Oil Price Ratio Slightly Below Historical Average

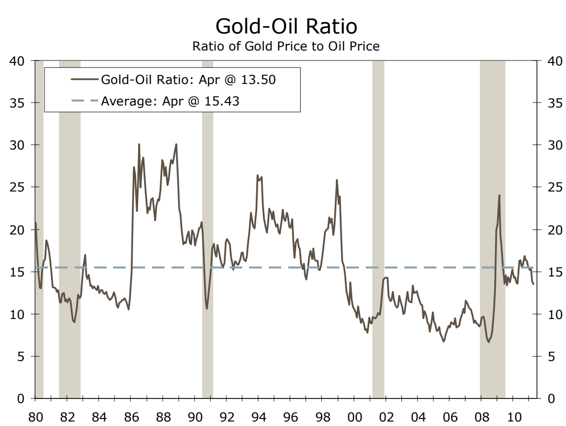
Finally, as they are both inflation hedges, gold and oil are highly correlated. Over the last 30 years, the gold-oil price ratio has averaged about 15.4. From 1986 until 2000, the ratio was above average as oil was extremely cheap. For much of the 2000's, the ratio was below average as oil rose faster than gold. Then, in the summer of 2008 oil prices collapsed and a few months later gold skyrocketed as the U.S financial system teetered on the brink of collapse, pushing the gold-oil ratio above average. Since then, oil prices have rebounded amid economic recovery and, even though gold has continued to rise, the ratio has dipped slightly below average. Thus, gold does not appear to be overpriced relative to oil at this time. Based on these three factors, we do not believe gold is in bubble territory yet.

Fundamentals Support Gold's Ascent

In addition to these three technical barometers, the fundamentals themselves justify the high price of gold. Although the inflation genie isn't totally out of the bottle yet, it has been creeping higher, both overall and core. The bigger issue is the fate of the U.S. dollar in the face of soaring government debt and deficits, and the concerns that finding a solution to the nation's budget woes will be a tremendous challenge and will entail significant sacrifices that many Americans may be loathe to endure.







Source: Bloomberg LP, NASDAQ, St. Louis Fed, U.S. Department of Labor and Wells Fargo Securities, LLC

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