

# WHAT IS VALUABLE?

## THE MONEY MARATHON JULY 2012

---

Recently, I read an article written by Eric Whinnie from the Wall Street Cheat Sheet in which he discussed the views of Warren Buffett concerning the value of gold and a Mr. Einhorn, the Founder of Green Capital, concerning the value of money. They have interesting views and it made me think about my own philosophy regarding value. First, here are the opposing views concerning gold and money.

Warren Buffett believes that gold has little or no utility. If aliens from outer space were watching us from above, they would see us dig all this metal (gold) out of the ground only to dig another hole in the ground to store it, which the aliens might think is pretty silly. Buffet says that all the gold in the world would fit in a cube with sides of 68 feet, about the size of a baseball field. At \$1,750 per ounce, this cube would be worth about \$9.6 trillion dollars. Since gold has no utility (produces no income itself and is not used for much other than jewelry), he thinks this is a really high figure. He points to the fact that \$9.6 trillion could purchase all the cropland in the United States (400 million acres), which produces real output of \$200 billion annually, plus 16 Exxon-Mobil Oil Corporations (each of which earns \$40 billion annually) and still have \$1 trillion left of spending money. Buffett would much rather own all the farmland in the US and 16 Exxons than all the gold in the world (and I agree) because of the income farmland and oil companies produce.

Einhorn makes a counter argument about the value of the dollar. He says all the \$100 bills in circulation would fit into a cube with 74 foot sides and would be worth \$1 trillion. In 100 years if all this bills were stacked in this 74 foot cube, they would have produced nothing (like gold) and in 1000 years would be virtually worthless (due to inflation). His other point is that if a person owned all the \$100 bills in circulation, the Federal Reserve could just print so many more that the value of his bills could turn out to be of little value. Gold, on the other hand cannot be printed. It has a limited supply and therefore has served as a store of value for centuries.

I actually agree somewhat with both positions. However, although I believe the second position is accurate regarding the value of currency, I think it misses the point that Buffett is trying to make about utility and consequently what is value. Money or currency itself may turn out to be worth less over time but what money can buy, which has utility and produces income, can increase in value. Farmland and Exxon both have massive utility and produce more and more income each year. If the dollar becomes worth less, the income produced by these assets will increase in dollar terms to reflect the decrease in the value of money. As an example, if an acre of farmland can produce \$250 dollars of income and the dollar drops in value by half, the farmland would produce \$500 of income which would be the equivalent of what was \$250 of income. Likewise, if a barrel of oil is worth \$80 today and the dollar drops in half in value, a barrel of oil should be worth \$160 per barrel. Gold on the other hand may be

worth twice as much if the dollar drops in half but only if the demand for it continues. Most likely the demand will not drop however there are examples of demand for items without utility dropping in value dramatically. In the 1600's, the Dutch thought tulips were very valuable and they had a huge value until people decided tulips weren't that valued and the tulip market crashed. Collectibles, like football cards can be valuable until people decide they are not as interested. I don't actually know the value of an OJ Simpson rookie football card, but my guess is that the value went down following suspected murders and his armed robbery conviction. (I could be wrong here in that as wacky as things are in this country at times this could have made the card more valuable.) The point is that items that have value only from demand are more vulnerable to a loss in value than an asset that produces ongoing income or wealth. If an acre of land drops in value but a person still has the income from the farm every year, he owns something of value regardless of demand. If Exxon stock drops in price from \$80 per share but it still earns \$8 per share and maintains its dividend of nearly 3% of the price or \$2.28 per share, a person still has something of value regardless of the demand. It should be noted that if a person wanted to spend \$10 per year from \$100 of cash he could do it for 10 years. If the person owned an asset worth \$100 producing \$10 of income per year, he could spend the \$10 forever and never run out of money-quite a difference.

In summary, to me gold that produces no income and cash that is in a mattress or in a non-earning account, both do not have as much value as an asset purchased with money that produces income or additional money. If I had to choose between 1) an ounce of gold at \$1750 per share, 2) dollar bills totally \$1750, or 3) the stock of a good company valued at \$1750 dollars that produces income of \$150 dollars per year of income or land worth \$1750 (today maybe a half to a third of an acre) that produces income, I would take the later (stock or farmland) every time. The stock of a company and the farmland produce income. The other two do not. Saying that, does not mean that a person should not own gold or hold some cash. Gold worth 5% to 10% of a person's portfolio can serve as diversification and protection in a crisis or panic. Cash of 10% or more can also serve to protect a portfolio from volatility and allow a person to take advantage of bargain prices in a panic. But, in my mind neither has the utility of an asset that produces income on an ongoing basis.

What produces real value? To me, value is produced by an asset that produces ongoing income.

Remember every investor's situation is unique and it is important to review your specific situation with a financial professional.

Ed Douglas is a Certified Financial Planner/Consultant, Chairman Emeritus of Citizens Bancshares and author of three books, "Making a Million With Only \$2000-Every Young Person Can Do It", "The Money Marathon: 7 Simple Steps to Financial Freedom" and book "25 Truths: Winning Wisdom for a Better Life", available at [www.eddouglas.com](http://www.eddouglas.com). Ed can be contacted for financial planning services or seminars based on his books at [ed@eddouglas.com](mailto:ed@eddouglas.com) or 660-646-2066 or at his office at 601 Locust. *25 TRUTHS: WINNING WISDOM FOR A BETTER LIFE* TRUTH NUMBER 17: Play to Win. Ed's books are available at [eddouglas.com](http://eddouglas.com), Hy-Vee, Amazon, or Boji Stone.

