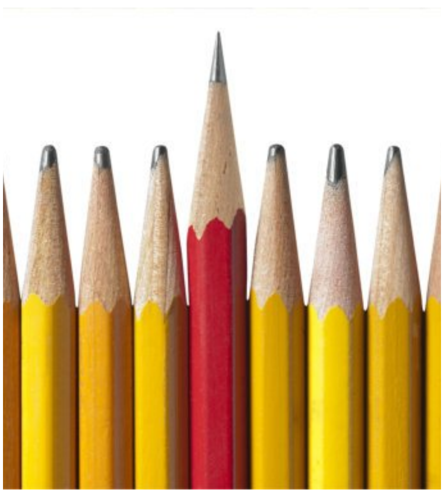
Why hold Gold?

6 September 2024

- **A useful diversifier**
- **An inflation hedge**
- **Protection against market shocks**



Key points

1. Gold remains a useful diversifier because of its uncorrelated relationship with other asset classes.

2. As a "liquid real asset" It has inflation-protecting characteristics.

3. Gold provides protection against geopolitical risks and insurance against market shocks.

Top Line

No other asset has stood the test of time quite like gold: it is a time-honoured diversifier. It is an effective hedge against adversity that has proven itself time and again throughout history. In a crisis, it is a valuable safe haven and in ordinary market circumstances its uncorrelated nature means it is a useful way to diversify portfolios and reduce risk.

Why do we like gold?

Gold is uncorrelated to both equities and bonds

We see ourselves as 'gold bugs' – we like gold as an asset and we recommend an allocation within multi-asset portfolios as a diversifier. There are three main reasons for this:

- gold is uncorrelated to other assets including equities and bonds, meaning it doesn't move in tandem. This makes it a powerful diversifier.
- It acts as an effective hedge against macroeconomic shocks.
- It is a hedge against long-term inflation and a real alternative to fiat money – that is, nominal money like cash and, to some extent, bonds.

The counter-argument

The 'gold bears' argue that gold produces no income, that it has no future cash flow discount, no dividends, and no capital growth. In their view, investing in gold is simply speculating on the price movement of a metal dug out of the ground. While it can make attractive jewellery it should not be considered a true financial asset with intrinsic value. According to financial theory, bonds are valued according to their future cash flows and equities according to their future dividends. So how do you value gold when it doesn't produce anything, and therefore has no return?

The lower the correlation, the higher the diversification

We believe that this argument misses the point. It is the price movement of gold that is its return pattern and the fact that it does move in such an uncorrelated manner with equities and bonds makes it a useful investment tool. While gold is not a total return solution it is an ideal diversifier in portfolios because of its uncorrelated structure. The lower the correlation, the higher the diversification..

What makes a typical gold allocations

In a balanced portfolio, we would want to have at least between 2% and 4% in gold, but in times of market stress or inflation risk we might go as high as 10%. We also have an equal-weight portfolio that has 25% each in equities, bonds, gold and cash.

Recent drivers of the gold price

Emerging market central banks have been significant buyers of gold recently

In August the gold spot price hit a new all-time high of US$2,531 per troy ounce. We see three main drivers for this impressive rise. One has been emerging market central bank buying. Central banks have been diversifying their reserves away from US Treasuries having seen Russia sanctioned following its invasion of Ukraine, with its assets seized and frozen. The second driver has been fears about oversupply of US Treasuries, with gold therefore offering an alternative to hold as a long-term safe asset. The third thing is portfolio flows; Exchange Traded Products (ETPs) had been selling out of gold despite central banks buying more, but this trend has recently reversed and now ETPs are moving back in.

Bitcoin has no historic intrinsic value

There is a place for gold in almost any portfolio

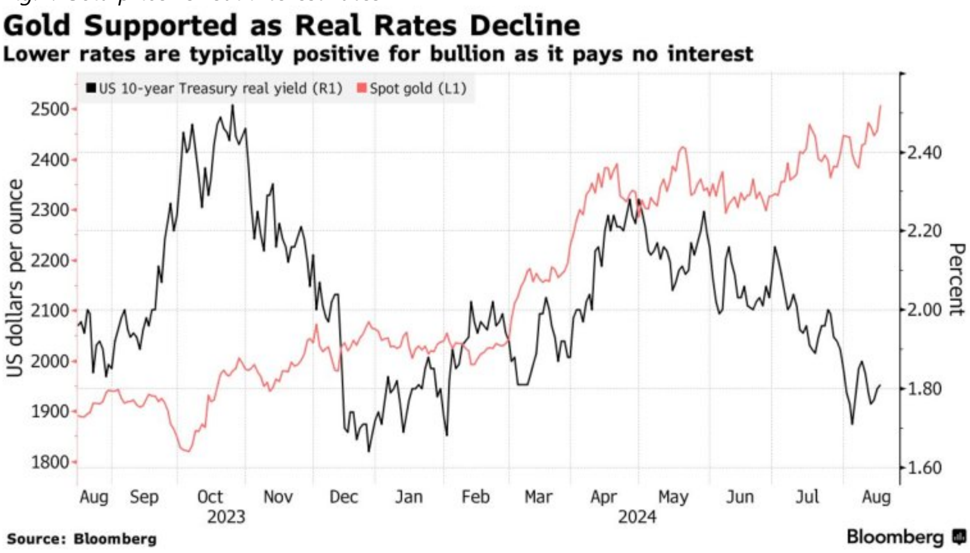
Is Bitcoin the new gold?

There are many reasons why we are not a fan of Bitcoin. We see it as a speculative asset that has no intrinsic value, essentially the same argument some people have made against gold. But you can't wear Bitcoin, you can't carry it with you, if you lose your digital wallet, it's gone. Although both gold and Bitcoin are uncorrelated, only one of them has a global and historic value and most likely, will still be able to be spent one hundred years from now.

Relationship with interest rates

As real (inflation-adjusted) interest rates are expected to decline, gold becomes relatively more attractive. By contrast, when real rates higher, bonds are relatively more attracted compared to Gold. Furthermore, given concerns over the level of debt issuance in the US economy, gold provides an old-world hedge against so-called "fiat" money that is based on a Central Bank's "promise" to honour its debts.

Fig.1. Gold price vs real interest rates



With prices at an all-time high, where next for gold?

Speculating on the direction of gold would require some bravery given the gold price today. We don't speculate on gold's directionality. We maintain continuous exposure within a balanced portfolio by way of an inflation hedge. When Russia invaded Ukraine in 2022, one of the few assets to actually increase in value was gold, when both equities and bonds took a hit. Gold is proven to work as an insulator in times of market shock.

Bottom Line

Gold is a powerful diversifier and we the case remains for a long-term allocation within a multi-asset portfolio.

Getting in touch

If you would like to find out more or discuss any of the above, please contact your financial adviser.

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