Shifting markets place spotlight on gold

While gold has long enjoyed a special status for its beauty and intrinsic value it also continues to attract a range of investors interested in its diversification potential. With the gold price rising sharply amid wider market volatility, Newton portfolio manager Suzanne Hutchins considers both the enduring appeal of gold investment and potential risks it may carry.

From precious jewelry passed down through generations to famous artwork and its use in elite sporting medals, gold has long represented power, accomplishment and wealth.

Of course, there was also the Gold Standard, in which gold was known as method of payment in the UK until 1931.

With its origins dating back billions of years, the perpetual demand for this most precious of metals continues to endure, thanks chiefly to its widespread use among a range of sectors and industries.

Jewelry, technology, dentistry and architecture are just some of the areas in which gold is used. While in the investment world, it continues to attract investors seeking to diversify their portfolios away from more mainstream assets such as equities and bonds and who view gold – rightly or wrongly – as a ‘safe haven’ asset.

Explaining gold’s investment appeal, Hutchins says: “Many investors consider gold to be a relatively safe investment type for a multitude of reasons. It’s a major financial asset for central banks as it’s used to hedge against loans made to them. It is also a physical real asset which tends to hold its value over time and cannot be printed or de-based, unlike fiat money.” she says.

As recently as 2018, the demand for gold sat at 4,345 metric tons, and reached an annual average price of almost US$1,480, when the price stood at just US$271 in 2001.3 Despite gold experiencing more volatility throughout the last five years, its time of being one of the world’s most coveted commodities and attractive investment prospects looks far from over.

Why gold?

Gold has been a favored asset to invest in for decades. Often, when real interest rates are declining, gold can become increasingly attractive relative to cash on deposit, reducing the ‘opportunity cost’ for holding gold in investment portfolios, says Hutchins.
Hutchins believes gold can also prove a strong alternative to negative yielding bonds as the cost to store gold is technically less than the cost of ‘carry’ on negative yielding bonds.

Gold is often viewed as a useful source of diversification by multi-asset investors who hope exposure will prove worthwhile when other assets are performing poorly.

“In a multi-asset portfolio, investors want to diversify their return streams. When other assets are performing poorly gold can do well, particularly in times of crisis or when inflationary pressures are mounting,” adds Hutchins. “However, it can be unstable and the price volatile. Like many other assets, gold has become highly financialized with an explosion in the gold exchange-trade commodity (ETC) market making it more vulnerable to portfolio flows and sentiment” she adds.

**Staying strong**

She adds that with the uncertainty and volatility of markets, correlations between assets tend to increase.

Occasionally some assets specifically selected to boost diversification can also correlate with more mainstream asset classes, with negative consequences. An example of this was during the 2008 financial crisis when real estate and broad commodities sold off (as did stocks and other risk assets).

Despite these wider changes in correlations, while the value of gold did initially collapse in October 2008 as real rates rose (inflation expectations dropped on recession fears), the gold price then rebounded strongly into the end of 2008, generating a powerful non correlated return stream which would have helped mitigate losses elsewhere in a diversified portfolio of assets.

How can gold prevail in such market conditions? One reason could be its low correlation to many other asset classes. At a more basic level, the relative scarcity of gold can also serve to heighten its prestige and value.

While these apparent advantages appeal to many investors, others are less swayed by the allure of gold. Despite the potential positives of investing in gold, some investors are strongly against holding it. One of the main reasons for this is the fact they see gold as a static asset with no income benefit as it doesn’t earn any income.
Rightly or wrongly, gold is also viewed as a potentially volatile asset by some investors, as its relationship with other asset prices can prove somewhat unstable at times as it is influenced by different political, economic and social powers.

**Making gold greener?**

In increasingly environmentally aware markets investors also have sustainability and wider ESG factors to consider. While investing in physical gold appears to be a sustainable approach, investing in gold mining can be more problematic.

At an environmental level, gold mining can involve the destruction of natural habitats, high energy extraction intensity and the risk of pollution from milling and the use of cyanide to leach the gold from base ore. In addition, gold mining companies can be potentially problematic as some have a reputation as poorly managed businesses.

The debate on whether gold investing should be considered ESG friendly is still quite prevalent. From Hutchins’ point of view physical gold is a sustainable asset for a range of reasons. “There’s a large stock of gold out there that was mined at some point and potentially in worse conditions than today. In that sense the production of gold is relatively immaterial, at 1% a year. There’s also minimal energy required for storage, since gold is held in vaults unlike crypto currencies,” she says.

Gold is also rarely discarded, is generally always recycled and its value doesn’t tend to disappear with age.

Beyond ESG and sustainability concerns, others may be deterred from investing in gold because of other restrictions in its use. Typically, gold is not a form of payment for everyday use. In most cases consumers cannot pay for items by giving a merchant a gold bar.

For those looking to see the investment potential physical gold can have, Hutchins says a relatively straightforward access point is though indirect investments via specialist exchange traded commodities (ETCs).

Commenting on the ETC market she adds: “With a gold ETC, investors are buying a quoted, gold denominated debt security which is underpinned by an obligation of a trust. The trust deed requires the gold denominated debt of the trust to be backed by gold assets which the trust must own in various forms. Most of the gold owned by the trust will be in the form of allocated, vaulted so-called Good Delivery Bars (another name for a gold bar within the London Bullion Market Association),” she continues.
In terms of wider direct market access to gold BullionVault is the world’s largest physical gold and silver online market, established in 2005, the market allows global private investors to buy gold bullion and own it directly as personal property, held in Good Delivery Bar form in an accredited gold bullion vault of the individual’s choice.

In the current volatile global environment, where measures such as quantitative easing (QE) appear to be distorting traditional investment markets, Hutchins believes there is a place for gold. While she adds that while putting too much gold into a portfolio could mean taking on too much counterparty risk, she believes well executed and considered investments in gold continue to hold significant potential.

“More and more people are becoming disenchanted with government policy. QE hasn’t worked, there’s money printing debasement and a huge amount of indebtedness in the global economy, and people are losing confidence in what assets are going to retain their value,” she says.

“When stock markets are crashing, investors are going to look for something to hold their value. I think that gold ultimately is one of those precious metals which, in times of crisis, cannot be confiscated and is a story of real wealth. There isn’t anything else quite like it,” she concludes.

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