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It could be gold's time to shine

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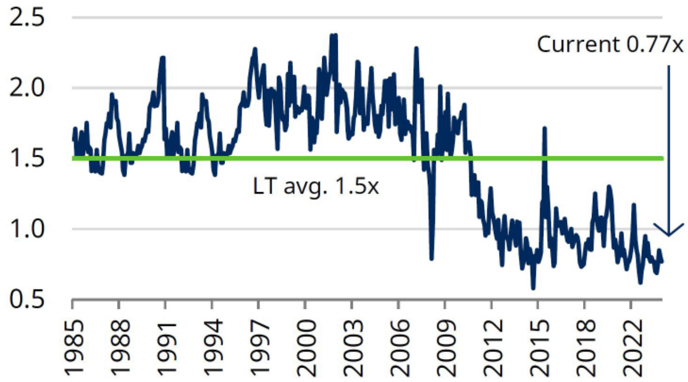
Since late February, the gold price has soared to new heights in nominal terms, trading at 2,349 dollars per troy ounce. There are various contributing factors including anticipated delays to rate cuts following stickier-than-expected inflation; rising geopolitical risks in the Middle East; and a weakening US dollar. The two biggest drivers however, appear to have been central bank purchases and algorithmic traders pushing the price up.

Gold's recent performance indicates improved sentiment towards the metal, although in real terms the price still lags 2020 levels reached during the COVID-19 crisis. Also, if we zoom out on the performance of gold equities, the asset class is trading well below its long-term average, indicating there could still be a reasonable amount of upside from here

Gold equities: rarely cheaper in the last 40 years

North American gold producer Price/ NAV valuations through time



Source: Scotia, Schroders, February 2024.

Looking across the spectrum of gold investments, bullion outperformed miners. Gold miners are more closely correlated to equities, which have performed very strongly, but only a very narrow subset of stocks have led this outperformance and gold miners didn't form part of that cohort.

Throughout history, gold has acted as a good inflation hedge, evident in the 1970-80s, but more recently in 2020-21 gold struggled to keep up with inflation due to headwinds like rising bond yields. In a similar vein, the relationship between the performance of gold and Treasury Inflation Protected Securities (TIPS) has decoupled over the past few years, with gold significantly outperforming those bonds. Only now, three years on, are we finally starting to see that relationship return.

Over the past few years gold exchange-traded products have experienced significant outflows, even during the recent rally. However, the metal saw strong demand from central banks during March from countries such as China, Poland and Turkey. Gold as a proportion of foreign reserves remains very low in these countries (just 4%[1] in China) compared with other regions such as the US, which has 70%[2] of their foreign reserves in gold. So, we could well see this demand continue.

It's not new news but it's worth highlighting that gold is an event risk hedge and a good diversifier in investment portfolios; in times of turmoil investors flock to safe-haven assets, including gold. We've observed this time and again in the past: for example, [3]the gold price increased by 17% and 33% during the 9/11 attacks and Paris bombings respectively, whilst equities significantly lagged these figures. Currently, geopolitical risk remains elevated, with continued conflict in Ukraine and the Middle East and rising tensions between the US and China, and therefore an allocation to gold could make sense.

The quality of gold investments has evolved over time and in 2012 the London Bullion Market Association (LBMA) published Responsible Gold Guidance (RGG) in order to combat human rights abuse, avoid contributing to conflict, and to comply with high standards of anti-money laundering and combat terrorist financing. More recent guidance goes further and requires refiners to provide an assessment of their environmental, social and corporate governance (ESG) responsibilities. There are various passive vehicles which track the same index but have varying levels of ESG integration. By selecting products that require adherence to more recent LBMA RGGs, investors can achieve the same performance, at the same fee, whilst reducing exposure to the aforementioned risks.

So, could it be gold's time to shine? Well, despite the recent rally there could still be upside if history is anything to go by, and with central banks increasing reserves and geopolitical risks on the rise, there is a clear investment case for holding gold. And there is also the option to invest in Exchange Traded Funds with reduced exposure to various ESG risks if the appropriate fund is selected.

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Source: [1]&[2]World Gold Council, IMF, as of March 2024, [3]Wisdom Tree, Gold Outlook to Q1 2024.

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Important notes

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