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The new gold rush

Gold has returned 22% in the last six months driving the metal to all-time highs in US dollars as well as multiple other currencies. The question investors must ask is whether this is a cyclical move, or has gold proved itself as a building block within portfolios?

Gold usage has been traced as far back as the ancient Egyptians in Nubia around 2450 B.C. Early civilisations valued the metal so preciously as it was impervious to the tarnish and decay that plagued other materials. Its attraction as a symbol of love and opulence remains. However, it is safe to say that the lustre of the precious metal as an asset class has not always stood so stoically against the test of time.

Historically, investments in the metal have delivered investors returns when interest rates are low. This is because it is absent of any yield, a tenet making it less desirable in times when cash and bonds are paying you handsomely. When interest rates are expected to fall, one can look to history to see gold demand ramps up. So, with the metal hurdling over all-time highs, is the buying a premonition of imminent cuts or are there greater forces at play?

One of the largest tectonic plates which forms the bedrock of the global financial system is the US dollar's hegemony. Like the earth's lithosphere, these colossal plates move slowly, pushing or pulling on each other but rarely forcing seismic shifts. This has largely been the case since the multilateral 'Bretton Woods' agreement was ratified following WWII meaning the 44 nations involved would have their currency pegged to the dollar, which would in turn be pegged to gold at 35$/oz. However, confidence in the maintenance of this convertibility was shaken amid fiscal deficits and inflation as spending rapidly ramped up during the Vietnam War. This led to President Nixon abandoning the gold convertibility, and thus the formation of fiat, unbacked paper currencies in 1971. Fast-forward two years into the oil crisis of '73, which formed the base of a unifying agreement to have all oil exports priced exclusively in dollars. The advent of this gave oil-exporting countries pools of paper dollars. With no fundamental use within their own economy, and due to the expiration of the Bretton Woods agreement, no defined convertibility to gold, these dollars were used to purchase hard assets, mostly stocks, in America. A seismic shift.

Fast-forward to present day, and after 50 years of ever-increasing U.S. dollars in circulation and as a share of central bank reserves, we are observing consecutive years of record central bank buying of gold, while levels of dollar reserves are falling. From here, the majority of rich central banks believe gold's share of global reserves will continue to rise in the next 5 years with an increasing amount planning to increase reserves this year. Therefore, it seems this increased demand for gold may be the fallout of another rumble under the surface.

The previously rampant strides of globalisation have quelled and perhaps even fallen into retrograde. China's trade wars with the U.S., continuing conflicts in the Middle East and Russia's invasion of Ukraine evidence the depth of disharmony that is fracturing global relations. As each country's defence spending ramps up so falls the appetite for holding a foreign currency as a large part of central bank reserves. Especially as the risks were spelled out by the U.S. who attempted to cut Russia off the dollar system and freeze their $3 billion of foreign exchange reserves after their invasion. This is a United States who are also the subject of growing concerns around an increasingly rotund budget deficit, also contributing to an easing in dollar purchases.

However, it is not solely at the expense of the dollar that gold has built its recent allure. From purely a capital protection perspective we must also remember gold's reputation as a safe haven asset as these splintering cross-border relationships raise investor angst. Couple this with the track record of the precious metal acting as a hedge against inflation, with the post-pandemic spike in prices still raw to both consumer and investors, ahead of the aforementioned rate cuts where gold historically performs well, you can see why there have been markedly more buyers than sellers this year.

My view would be that it is a concoction of all these long-term trends. Current valuations may seem rich by historical comparisons to fiat currencies but if the demand remains amid increasing geopolitical uncertainty, then we see prices remaining within this newfound range, with scope for further capital gains in coming years. At TAM, gold ETFs have been a long-term ballast within portfolios. However, for the lion's share of our precious metals allocation we have gone one layer deeper. Since the first quarter, TAM have siloed a portion of our active portfolios into a selection of assets poised to benefit from consistently higher gold prices. The Jupiter Gold & Silver fund contains gold bullion, but also silver – a material that is not only bolstered by increased industrial and investor demand but also its inextricable link to gold prices, intriguingly, according to the silver/gold ratio, from relative low levels. It's pertinent to note that this ratio can of course correct with a downward move in gold, but we see this as less likely given the current set up. The remaining beneficiaries from the positive gold move would be the miners of both, which form the rest of investments in this fund. The sector has continually been trading at discounts to both gold bullion and history, offering a corner of real diversification to the momentum seen within the artificial intelligence laden indices.

Overall, we see enough evidence that gold's fortunes are no longer almost solely intertwined with inflation dynamics. The structural shifts in market dynamics suggest that the gold price can gain a foothold at these levels and perhaps continue its ascent, cementing its place as a stalwart within portfolio construction. Where appropriate, the resulting strength in both silver bullion and miners enhance this return profile, when, and only when, embedded within a diversified portfolio. Which is perennially our aim for our clients.

If you would like to speak with us about anything in this note, or to discuss our discretionary investment management services in general, please get in touch with our UK business development manager David Terry today.

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