

Has gold lost its shine?

Global Matters Weekly

28 November 2022

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As we approach the end of 2022, it is worth reflecting on asset class returns this year. Global equities and bonds have both suffered significant declines and as a result the traditional balanced portfolio, anchored by these two asset classes, has struggled. Risk assets have had a torrid time due to a combination of factors including bleak economic and earnings outlooks, inflation concerns and heightened geopolitical tensions, which have all weighed on investor sentiment. Surprisingly, gold which has traditionally been deemed as a 'safe haven' asset has also disappointed this year. Gold is often thought of as a hedge during market downturns and in an inflationary environment, so why has it struggled this year? And does it still warrant a place in investors' portfolios.

Gold attracts its fair share of criticism as an 'unproductive' asset, but the same can be said of cash. Unlike cash, gold doesn't pay any income, which makes it difficult to value.

It is worth exploring gold's relationship with other 'income' producing safe haven assets and inflation. This year we have witnessed a significant repricing in nominal interest rates across most advanced economies, the most notable being in the US where rates have risen from close to 0% to 4% today. All else being equal, as nominal rates rise, the opportunity cost of holding non-income bearing assets increases and therefore dents the appeal of the yellow metal for savers looking to earn a positive yield. However, we have also experienced rapidly rising inflation which erodes the purchasing power of paper money and theoretically should increase the attractiveness of gold. So why haven't we seen this in terms of gold prices?

The final piece of the puzzle which provides a better explanation to gold pricing is its relationship with real (inflation-adjusted) interest rates. The two are negatively correlated: as real rates increase; the price of gold is driven down. Despite high levels of inflation, investors have been placing more emphasis on the pace of the rise in nominal rates which has proved to be a major headwind for gold.

Historically, gold has proven its ability to preserve its purchasing power when compared to fiat money as it cannot be devalued by central banks

Although the relationship is weaker, we believe that US dollar strength has also provided another headwind for gold in the past year, as this makes it more expensive for investors holding currencies other than dollars, since gold is priced in dollars.

Despite the headwinds mentioned above, it is worth reminding ourselves of gold's role in multi-asset portfolios. Historically, gold has proven its ability to preserve its purchasing power when compared to fiat money as it cannot be devalued by central banks, and it serves as an insurance policy at times of geopolitical tensions or any systemic / credit events. Typical insurance policies pay out should a specified event occur, but in a truly dire scenario this is no more than a pledge and you must question the ability of the counterparty to deliver. This is a fundamental risk in all insurance as historically there have been scenarios in which the private sector was unable to cope, requiring intervention from the state. Gold does not bear this type of default or counterparty risk. Lastly, gold has shown to have little to no correlation with other risk assets over the long-term and certainly at the peak of severe market shock.

Whilst it is difficult to predict, we believe that the Fed is getting close to peak rates with the significant portion of rate rises behind us, and in our view the US dollar is also nearing its peak; both of which could be supportive for gold. Severe market stress occurs infrequently however it happens often enough to justify an allocation to this precious metal. The recent turmoil in cryptocurrency is a useful reminder for investors as to what is the ultimate alternative to fiat currency. Gold's long and illustrious status can continue to shine.

The Marketplace

- Global equities rallied 1.7% on the week
- China locked down one-fifth of the country due to a COVID-19 outbreak
- Brent crude lost 4.6% on the week, down to \$83.6 a barrel
- Gold returned 0.2% on the week to trade at \$1754.9 an ounce

Market Focus

US

- US equities rallied 1.5% on the week, despite being closed for Thanksgiving on Thursday. Utilities, Metals and Miners outperformed while Oil, Gas, and Energy sectors underperformed
- Federal Reserve staff economists briefed policymakers this month that the chances of a US recession in the next year had risen to almost 50% due to risks of slower consumer spending, global economic risks and further interest-rate hikes
- US flash Purchasing Manager Indexes (PMI) for November prompted a significant move in markets after they significantly underwhelmed expectations. In particular, the Manufacturing PMI fell to 47.6 (vs. 50.0 expected), which is its lowest level since the initial wave of the pandemic. The Composite PMI fell to 46.3 (vs. 48.0 expected), which is its second-lowest level since the pandemic

Europe

- European equities returned 1.5% on the week with Travel, Leisure, Oil and Gas outperforming while Auto Parts and Financial Services underperformed
- The German IFO's business climate indicator surprised on the upside with an 86.3 reading (vs. 85.0 expected), as did the expectations component at 80.0 (vs. 77.0 expected). This marked the second consecutive monthly improvement for both measures
- Talks between European Union nations on where to set a proposed Group of Seven price cap on Russian oil are said to have become bogged down on Wednesday evening as governments are split over how to design the plan
- Euro Area composite PMI unexpectedly ticked up to 47.3 (vs. 47.0 expected), with the Manufacturing and Services numbers also better than expected

UK

- UK equities rallied 1.5% on the week
- The UK Government scrapped a controversial plan to give itself an intervention power over financial regulators, saying it already has the necessary authority to slash red tape and boost competitiveness of the Financial Services sector

Asia/Rest of The World

- Global emerging market equities jumped 4.6% on the week
- Chinese equities fell 3.1% on the week. One-fifth of China is in lockdown due to a recent COVID-19 outbreak causing widespread protests including in Beijing, with some in Shanghai calling on Xi Jinping to step down
- Japanese equities rose 2.6% on the week. The flash PMIs from Japan showed a contraction in manufacturing for the first time in nearly two years, with the PMI falling to 49.4 in November.

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Asset Class/Region	Currency	Currency returns			
		Week ending 25 Nov. 2022	Month to date	YTD 2022	12 months
Developed Market Equities					
United States	USD	1.5%	4.1%	-14.7%	-13.4%
United Kingdom	GBP	1.5%	5.9%	7.5%	8.8%
Continental Europe	EUR	1.5%	7.3%	-9.3%	-8.2%
Japan	JPY	2.6%	4.6%	3.8%	2.3%
Asia Pacific (ex Japan)	USD	0.1%	14.2%	-19.5%	-21.0%
Australia	AUD	1.5%	6.2%	1.8%	2.5%
Global	USD	1.7%	6.3%	-15.1%	-14.2%
Emerging markets equities					
Emerging Europe	USD	4.6%	17.6%	-72.6%	-73.1%
Emerging Asia	USD	-0.2%	14.4%	-23.3%	-25.0%
Emerging Latin America	USD	0.4%	-2.9%	9.7%	12.1%
BRICs	USD	-1.6%	11.1%	-26.3%	-29.9%
China	USD	-3.1%	20.5%	-31.1%	-36.0%
MENA countries	USD	-1.4%	-3.5%	-4.0%	-4.2%
South Africa	USD	1.7%	16.7%	-2.3%	1.1%
India	USD	1.0%	4.3%	-1.4%	-2.4%
Global emerging markets	USD	-0.1%	11.1%	-21.6%	-22.8%
Bonds					
US Treasuries	USD	0.9%	2.3%	-11.8%	-11.3%
US Treasuries (inflation protected)	USD	1.5%	1.2%	-12.3%	-11.6%
US Corporate (investment grade)	USD	1.4%	4.8%	-15.4%	-14.7%
US High Yield	USD	0.9%	1.8%	-10.6%	-9.2%
UK Gilts	GBP	0.6%	3.6%	-20.7%	-21.2%
UK Corporate (investment grade)	GBP	1.1%	4.7%	-18.0%	-18.3%
Euro Government Bonds	EUR	0.4%	2.2%	-14.7%	-15.4%
Euro Corporate (investment grade)	EUR	0.6%	2.5%	-12.8%	-12.9%
Euro High Yield	EUR	1.2%	3.8%	-10.8%	-10.5%
Japanese Government	JPY	-0.4%	-0.3%	-4.2%	-4.2%
Australian Government	AUD	0.2%	1.1%	-8.8%	-7.7%
Global Government Bonds	USD	0.8%	4.7%	-17.1%	-16.5%
Global Bonds	USD	1.0%	5.1%	-16.8%	-16.2%
Global Convertible Bonds	USD	0.7%	4.6%	-18.9%	-20.6%
Emerging Market Bonds	USD	1.9%	7.3%	-25.3%	-24.2%

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Property					
US Property Securities	USD	1.7%	4.4%	-22.1%	-18.9%
Australian Property Securities	AUD	2.6%	4.6%	-20.3%	-18.6%
Asia Property Securities	USD	2.2%	15.3%	-11.3%	-14.6%
Global Property Securities	USD	1.7%	7.7%	-21.7%	-20.3%
Currencies					
Euro	USD	0.7%	5.2%	-8.6%	-7.2%
UK Pound Sterling	USD	1.8%	5.5%	-10.6%	-9.2%
Japanese Yen	USD	0.8%	6.8%	-17.3%	-17.1%
Australian Dollar	USD	1.1%	5.4%	-7.3%	-6.2%
South African Rand	USD	0.9%	7.4%	-6.9%	-6.9%
Swiss Franc	USD	0.8%	5.9%	-3.6%	-1.0%
Chinese Yuan	USD	-0.6%	1.9%	-11.3%	-10.9%
Commodities & Alternatives					
Commodities	USD	-1.2%	0.1%	18.2%	16.1%
Agricultural Commodities	USD	-0.7%	0.4%	6.9%	6.9%
Oil	USD	-4.6%	-11.8%	7.5%	1.7%
Gold	USD	0.2%	7.3%	-4.1%	-1.9%
Hedge funds	USD	0.2%	-0.1%	-4.6%	-5.1%

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