How are investors using gold?

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Key Takeaways

- Investors typically view gold as a hedge against inflation, financial market turbulence, economic stress, and geopolitical chaos.
- While some of these risks may not be at the forefront of investors' concerns today, hedging against the potential escalation of tail risks remains highly valuable.
- Gold also serves as an excellent portfolio diversifier and WisdomTree's analysis confirms that incorporating gold into a portfolio enhances overall outcomes—improving returns while effectively managing risk.

36% of 800 professional investors surveyed by WisdomTree noted 'diversification' as their primary reason for holding gold[1]. Our analysis shows that gold has a low correlation with both equities and bonds and, thus, should contribute strongly to a diversification effort.

Figure 1: Correlations between assets

	Commodity	MSCI World All Country	S&P 500	Global Aggregate Bond	Gold	
Commodity	1.00					
MSCI World All Country	0.43	1.00				
S&P 500	0.33	0.94	1.00			
Global Aggregate Bond	0.24	0.36	0.27	1.00		
Gold	0.37	0.12	0.02	0.41	1.00	

Source: Bloomberg, WisdomTree, Monthly data from November 1990 to November 2024. Commodity is Bloomberg Commodity Index, MSCI World All Country is a equity index, S&P 500 is a US equity index, Global Aggregate Bond is the Bloomberg GlobalAgg Index covering government, corporate and securitized

fixed income, Gold is spot gold prices. Historical performance is not an indication of future performance and any investments may go down in value.

Our survey respondents flagged ‘inflation hedge’ as the second most popular reason to hold gold (35%), followed by ‘financial market volatility hedge’ (31%) and ‘geopolitical volatility hedge’ (27%)[2].

Optimal holding of gold in a portfolio

Putting gold into a portfolio of other assets can increase a portfolio’s Sharpe ratio[3] and reduce worst 12-month performances[4]. We illustrate with an example based on data from 1973 to 2024.

1. We start with a portfolio of bonds (60%) and equities (40%) and no gold: that is the 0 point on the horizontal axis. The Sharpe ratio of this portfolio is 0.41 and the worst 12-month performance is -17%.
2. As we move along the horizontal axis we introduce some gold to the portfolio. The remainder of the portfolio maintains a 60/40 ratio of bonds to equities.
3. As we increase gold holdings, Sharpe ratios rise and worst 12-month performances decline, up to a point (before they deteriorate again).
4. The maximum Sharpe ratio (portfolio A) is achieved with 13% gold (where the remainder of the portfolio is 52% bonds and 35% equities). The Sharpe ratio is 0.45 in this portfolio.
5. The minimum worst 12-month performance (portfolio B) is achieved with 30% gold (where the remainder of the portfolio is 42% bonds and 28% equities). The worst 12-month performance is -13% in this portfolio.

Figure 2: Optimal gold holdings

Source: WisdomTree, Bloomberg. Period January 1973 to September 2024. Calculations are based on monthly returns in USD. The portfolio is rebalanced semi-annually. Equities are proxied by the MSCI World Gross Total Return Index and Fixed Income is proxied by the Bloomberg Barclays US Treasury Total Return Index. You cannot invest directly in an index. Above numbers include backtested data. Historical performance is not an indication of future performance and any investments may go down in value.

Our survey indicates that the mean average holding of gold is only 5.42%[5], well below the optimal to maximise the Sharpe ratio. In fact, less than 14% of investors surveyed[6] hold enough gold to maximise their Sharpe ratio (assuming equities and bonds are the mainstay of their portfolio).

Hedging risks

We established that investors hold gold to hedge various risks, but what is the market’s perception of those risks today and how could they evolve?

Financial market risks

Several metrics gauge market anxiety, including the VIX[7] and MOVE[8] alongside direct investor surveys. At present, none of these measures indicate immediate concern. However, risks can escalate rapidly, as seen in August 2024, when a yen carry trade unwind sparked fears across global financial markets.

With various equity indices reaching all-time highs—and concerns that these gains are heavily concentrated—many investors are seeking ways to hedge against a potential market reversal. Gold serves as a key tool in this context.

Economic risks

The global economy has shown resilience through the past cycle, with the likelihood of a recession in the next year considered low[9]. However, policy uncertainty remains a significant concern for many investors.

In the United States, a new administration has risen to power with a strong focus on trade policies. Should President-Elect Trump impose new tariffs, rather than using them as negotiation tools, it could pose challenges to global economic growth. In this scenario, gold may become a preferred asset for hedging these risks.

Geopolitical risks

Throughout 2024, gold prices were supported by heightened geopolitical tensions. The Russia-Ukraine war and the Israel-Hamas/Hezbollah conflicts dominated investor concerns. More recently, the fall of the Assad regime in Syria has created uncertainty, particularly for Russia, a key ally of Assad. Russia's military bases in Syria now face an uncertain future, raising concerns about potential escalations.

In November 2024, Ukraine's use of US and UK-supplied long-range missiles prompted retaliatory strikes from Russia. Coupled with amendments to Russia's nuclear doctrine, fears of further escalation remain.

President-Elect Trump has promised a swift resolution to the Russia-Ukraine conflict. However, achieving this without significant concessions from Ukraine and NATO seems unlikely, suggesting that geopolitical risks may persist.

Iran, another key supporter of the Assad regime, faces a similarly precarious situation. The weakening of Hamas, Hezbollah, and the Assad alliance undermines Iran's regional influence. Additionally, the US may enforce sanctions against Iran more rigorously, which could prompt unpredictable responses from Tehran.

Despite speculative positioning in gold futures slipping slightly—from over 300,000 contracts net long in early October 2024 to just below that level today—the ongoing geopolitical tensions may drive positioning higher once again.

Professional investors rightly view gold as a hedge against inflation, financial market turbulence, economic stress, and geopolitical chaos. While some of these risks may not be at the forefront of investors' concerns today, hedging against the potential escalation of tail risks remains highly valuable.

We also align with the surveyed investors' belief that gold serves as an excellent portfolio diversifier. Our analysis confirms that incorporating gold into a portfolio enhances overall outcomes, improving returns while effectively managing risk.

At WisdomTree, we offer investors a range of solutions for investing in gold, ranging from physically backed gold exchange-traded products to short and leveraged gold exposures. Physical gold exchange-traded commodities (ETCs) provide an easy and cost-efficient exposure to gold bullion held in vaults in London or Zurich from reputable and highly secure custodians.

Discover our wide range of gold products that cater to different investor objectives and preferences here.

Sources

[1] WisdomTree Pan European Professional Investor Survey, June-July 2024, 800 respondents, conducted by Censuswide.

[2] Ibid.

[3] The Sharpe ratio compares the return of an investment with its risk. It's a mathematical expression of the insight that excess returns over a period of time may signify more volatility and risk, rather than investing skill.

[4] Similar risk concept to drawdowns but rather than look at peak to trough performance, we look at fixed 12-month declines.

5 WisdomTree Pan European Professional Investor Survey, June-July 2024, 800 respondents, conducted by Censuswide.

[6] Ibid.

Important Risks Related to this Article

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