Gold: Unique in every way

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Nitesh Shah

Head of Commodities and Macroeconomic Research, WisdomTree Europe

Pierre Debru

Head of Research, WisdomTree Europe.

Key Takeaways

- In the financial world, its unique behavioural traits make it a perfect diversifier to a portfolio.
- It has exhibited equity-like returns of +8.5% per annum over the last 20 years with very minimal downside capture.

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Gold is a special asset. Simultaneously a commodity and a foreign exchange instrument. Cyclical and defensive at the same time. Used as a store of value and medium for exchange for millennia. With references to the metal in the Torah, Bible, Qur'an and Bhagavad Gita, its historical allure to humans verges on empyrean.

Different and resilient

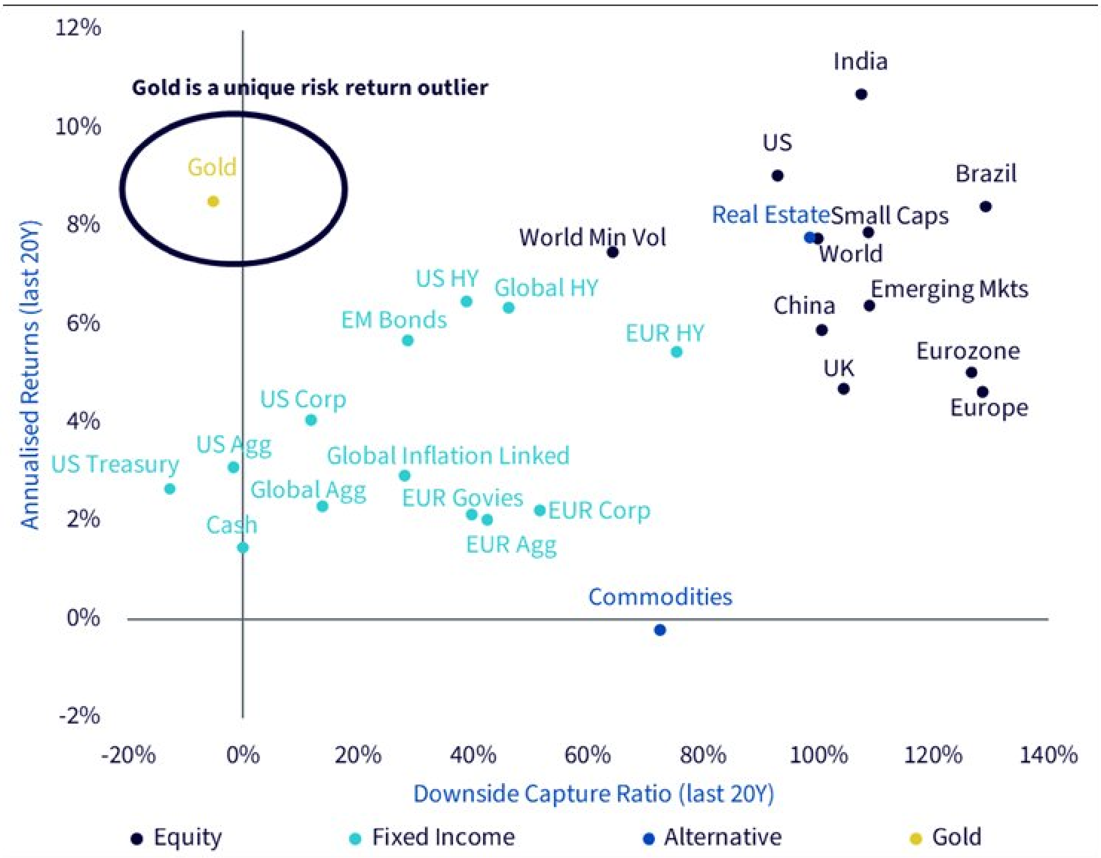
In the financial world, its unique behavioural traits make it a perfect diversifier to a portfolio. As we explored in our blog, Diversifying your portfolio with gold:

- It behaves differently to equities, bonds, commodities, crypto currencies
- It is a great inflation hedging instrument
- It is a great geopolitical shock hedging instrument
- It is a great financial shock hedging instrument
- It performs well in both recessions and strong expansions

This balance between downside protection and capacity to generate positive return over the long term is very unique to gold. As illustrated in Figure 1, asset returns for most assets are broadly proportional to risk. Assets with high equity-like returns have over the last 20 years exhibited downside capture (vs. equity markets) of around 100%. Assets with lower downside capture, like fixed income, tend to have lower returns too.

However, gold bucks the trends: it has exhibited equity-like returns of +8.5% per annum over the last 20 years with very minimal downside capture. Gold therefore is a uniquely suited asset to increase diversification and reduce risk in the portfolio without weighing on the long-term performance.

Figure 1: Long term performance and downside risk for different assets over the last 20 years



Source: Bloomberg, WisdomTree. In USD. 31 January 2004 to 31 January 2024. **Historical performance is not an indication of future performance and any investments may go down in value.**

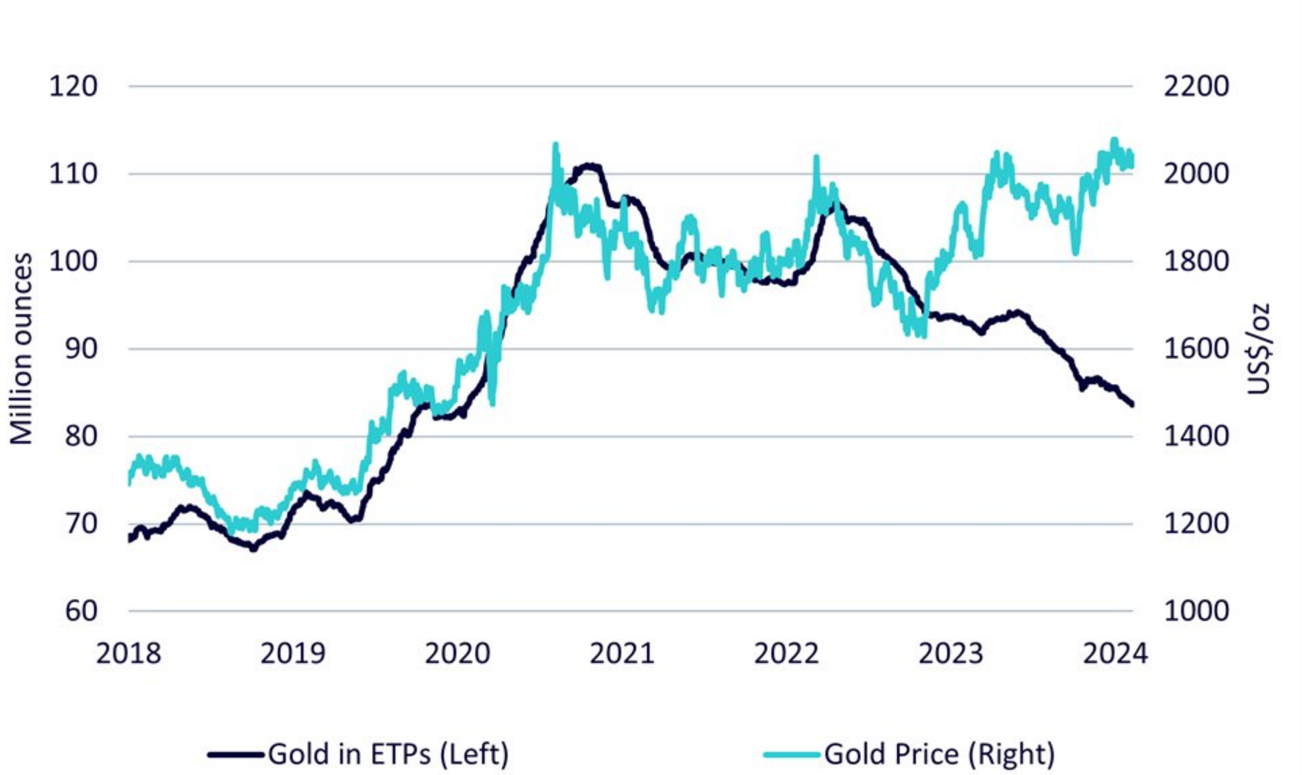
The perfect diversification tool…

As the late Markovitz said, “The only free lunch in the world of investing is diversification”. With that diversification, enhanced by low correlations, we estimate that an optimal portfolio should have somewhere between 16-19% in gold (assuming the rest in bonds and equities)1.

…yet shunned by many investors today

We know from our Professional Investor Survey2 this is far more than what most people hold in the venerated metal. But curiously, judging by exchange traded (ETP) flows over the past three years, professional gold investors appear to have turned their back on the metal (Figure 2). With repeated attempts to break above the US$2,050/oz mark, there has been no tailwind from the ETP market. If gold successfully gets above that level, we could see ETP investors return and that could fuel a stronger rally.

Figure 2: Gold price and ETP holdings



Source: Bloomberg, WisdomTree. 1 January 2018 to 8 February 2024. **Historical performance is not an indication of future performance and any investments may go down in value.**

Gold poised to reach a new high

Although soft-landings have historically not provided the best setting for gold to shine, in this rate cycle we have seen gold hit a fresh high in December 2023, when markets were expecting a decisive Federal Reserve (Fed) pivot in 2024. Some of those gains have been given back as markets reassessed the Fed's urgency, but our Gold Model points to gold rising to a higher high by the end of this year3, on account of bond yields declining and the US Dollar depreciating. Gold could reach US$2,210/oz, close to 10% higher at the time of writing (6 February 2023). Achieving the lauded soft-landing is easier said than done (and that is why we have so few observations to look at). We could face a bumpy road in 2024, with the Fed and markets clearly having a different view of the rate path ahead of us. Gold's hedging capabilities may once again prove to be the antidote to volatility elsewhere.

Solutions

WisdomTree is a leading provider of physically-backed gold exchange-traded commodities (ETCs). Since creating Europe's first physical gold ETC almost two decades ago, we have continued to build our suite of gold products, offering clients best in-class features and price competitive solutions. WisdomTree Core Physical Gold (WGLD), for example, was launched in December 2020 with the highest responsible gold standards applied and custodians were asked to act on a best-efforts basis to only allocate 2019 or later London Bullion Market Association (LBMA) gold bars. It also has a management fee of only 12 basis points. Today, WisdomTree offers a comprehensive range of physical gold ETCs that cater for different investor objectives and preferences.

Sources

1 The Role of Gold in a Portfolio

2 WisdomTree, Censuswide. Pan-Europe Professional Investor Survey Research, Survey of 803 professional investors across Europe, conducted during August 2023.

3 Gold Outlook to Q4 2024: From one high to the next

Important Risks Related to this Article

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