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SHINING IN TIMES OF CRISIS: WHY GOLD HAS NEVER BEEN A MORE VALUABLE PART OF OUR PORTFOLIOS

Carmignac's Note

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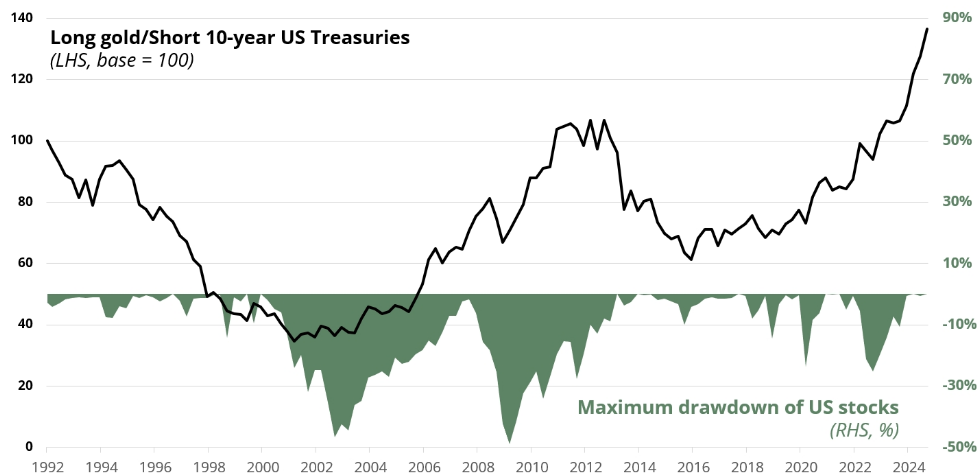

Sources: Carmignac, Bloomberg, October 2024

Performance of a long gold/short US Treasuries strategy vs. the maximum drawdown of US equities.

Gold has been climbing to fresh highs over the past few months and is up by around 35% since the start of the year. This largely reflects mounting geopolitical risk, purchases by central banks, seeking to diversify their reserves, and uncertainty about the economic cycle. Rising real interest rates and a stronger US dollar usually weigh on the price of gold, but that hasn't been the case this time around.

We believe the diversification purchases by central banks has been a major factor, given that inflation is once again "alive and kicking" and that temptation is growing for the Global South to establish an alternative to the greenback. Gold has become a strategic holding.

In this turbulent climate, gold offers diversification potential for portfolios – perhaps even more so than resilient currencies[1] or US and German sovereign bonds[2]. But why is gold such an effective diversification asset?

During times of heightened risk aversion[3] when equities have underperformed substantially[4], gold has tended to fare better than risk assets, of course, but also than core sovereign bonds. That's because short-term interest rates have a more immediate effect on gold prices, since these rates determine the opportunity cost of holding gold – a non-interest-bearing asset. Long-term interest rates, on the other hand, are more closely correlated with inflation.

The black line on the above graph shows the return on a theoretical strategy that's long on gold and short on 10-year US Treasuries. Such a strategy has delivered positive absolute returns over time. It has also performed exceptionally well in risk-averse markets, gaining 100% in the wake of the dot-com bubble and 30% in 2022 a year of high inflation, offsetting almost all the stock-market losses at times most needed. **Gold is less correlated to risky assets than bonds are, making it an appealing choice for portfolio construction. It generally offers effective protection against both economic uncertainty and inflation.**This is a welcome attribute given that persistent inflation is one of the main risk factors today and tomorrow[5], at a time when public debt levels keeps hitting new highs – making its reimbursement increasingly unlikely unless central banks print more money.

[1]Like the US dollar, Swiss franc, and Japanese yen.

[2]Bonds issued by the highest-rated sovereign issuers.

[3]2000; 2007–2008; and more recently in 2020 and 2022.

[4]Green areas on the graph indicate the max drawdowns of US equities.

[5]Given the combination of robust economic growth, high wage inflation, the energy transition, declining globalisation, and geopolitical uncertainty, we can expect to see more frequent potential inflation shocks.

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