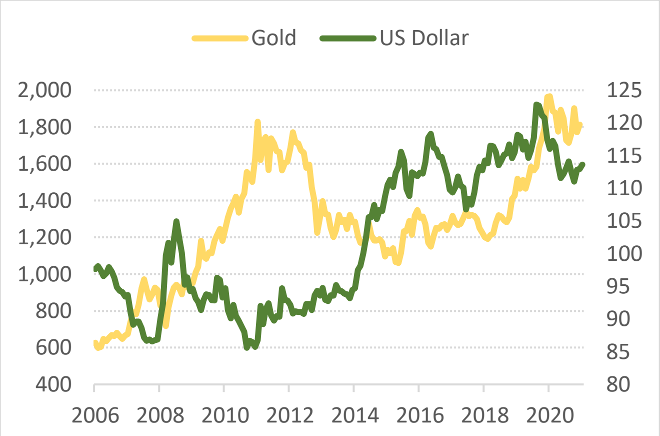
On The Mark

Is Gold Losing Its Shine?

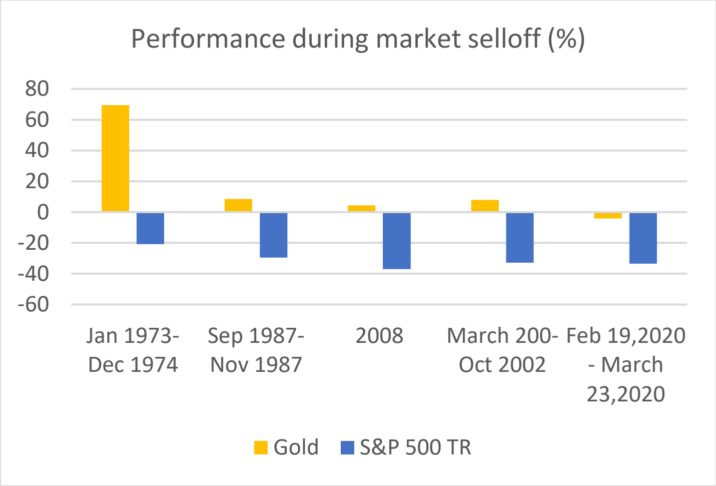
A safe haven during the 2020 pandemic, gold rose 20.9%[1] and outperformed the S&P 500 index which gained 18.7%. However, the commodity has slowed down in 2021 and is down -4.7% for the year[2] despite widespread inflation concerns. Gold is often viewed as a way to hedge inflation risk, and the recent price drop has left many investors confused. In addition to inflation, gold is influenced by many other factors. A closer look may shed some light.

Stronger US Dollar: Gold prices are inversely related to the US dollar, as seen by the historical price chart. Gold is not just a commodity but a monetary asset. The international price of gold is quoted in US dollars, so when the US dollar rises in value relative to other currencies around the world, the price of gold tends to fall in dollar terms. In 2021, the US dollar has risen in value as the US economic recovery continues, increasing the likelihood of higher interest rates down the road. Gold, while shiny, does not have a yield or dividend and can struggle when interest rates rise and offer additional options for investors seeking yield and safety.



Source: FactSet. Gold represented by NYMEX Near Term Futures (NY GOLD-FDS); US Dollar represented by Nominal Trade Weighted Exchange Rate Broad Definition (NEXRD-FDS)

The stock market boom: While gold has an inverse relationship with the dollar, its relationship with the stock market has varied over the years. Investors often perceive gold as a haven in the event of a severe market downturn and gold has proven its weight during periods of equity market selloff, as seen in the chart below.[3]

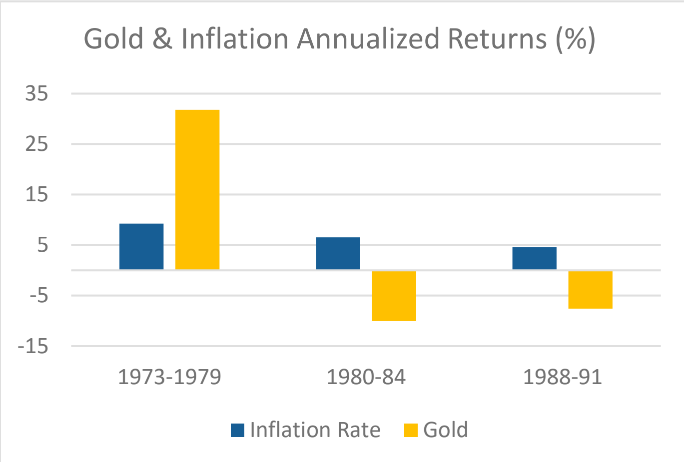


Source: Morningstar. Gold represented by LBMA Gold Price PM USD. Equity returns represented by S&P 500 Total Return Index.

In 2021, the stock markets have soared as the S&P 500 hit 53 new record highs through the end of August.[4] As investors have piled into equities for 2021, the need for a haven asset like gold has perhaps taken a backseat.

Crypto mania gains steam: Gold, the conventional way of addressing inflation, may have taken a backseat to cryptocurrencies as large gains have attracted more investors. Despite large gains, it's important to highlight cryptocurrencies are still in their infancy, and there aren't proven track records to show success as a hedge against inflation.

In the near-term, gold can be impacted by many other factors beyond inflation as discussed so far, but that still leaves the question of whether gold is a proven inflation



Source: Morningstar. Inflation represented by Consumer Price Index for All Urban Consumers, not seasonally adjusted, 1982-1984. Gold represented by LBMA Gold Price PM USD

hedge. A look at the longer-term data on the historical record of gold as a hedge against inflation shows mixed results. According to research by Morningstar, during the high inflationary period of the 1970s, where the average annual inflation rate was roughly 9.3%, gold generated stellar returns of 35%.[5] However, during the more moderate inflationary environments of the early 1980s and 1998-91, gold had negative returns.

Gold's inconsistent historical relationship with inflation and potential competition from newcomers like cryptocurrencies may give pause to some investors, who now have more investment options than ever before. However, given low correlations with equities, gold may still have a role in diversified portfolios as a hedge against potential downturn. In short, gold hasn't lost its shine, but factors such as a strong US dollar, stock market boom, and crypto mania have made today's portfolios more dynamic.

[1] Gold is represented by the Bloomberg Gold Sub Index. Return Source: FactSet.
[2] Source: FactSet. Year to date returns through August 27th, 2021.
[3] https://www.morningstar.com/articles/993455/beware-the-hype-when-investing-in-gold
[4] https://www.wsj.com/articles/global-stock-markets-dow-update-08-30-2021-11630310455
[5] https://www.morningstar.com/articles/993455/beware-the-hype-when-investing-in-gold

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