# GOLD – A GLAMOROUS COMEBACK OF AN ASSET CLASS?

At the beginning of 2019, gold has broken out of a multi-year phase of bottom formation. Meanwhile, the gold price (EUR) has reached a new 6-year high. In practice, we find that investors and banks have very different approaches to gold as an asset class. We took this as an opportunity to discuss the topic with a "gold expert".

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**Mr. Stöferle, what reasons do you see for the rise in the gold price in recent months?**

We must first make the following clarification, because the gold bull market has been going on for quite some time, but only recently on a USD basis. Compared to the previous year, gold has increased significantly in all major currencies. In CAD, AUD, EUR, CHF, GBP, gold is currently trading at or near its all-time highs, resp. the purchasing power of the respective currencies in gold is at a historical low.

In USD, however, the gold price is still below the all-time high despite the significant price increases in recent months. This shows two things:

1. There is a general bullish trend in gold, it is up against all paper currencies.
2. The USD has upgraded against the other major currencies in recent years.

The reasons for this positive development in recent months are, in my opinion, primarily the resumption of expansionary monetary policy (interest rate cuts, MMT, QE) in the wake of rising recession threats. However, until recently, the US has resisted this trend with a total of nine rate hikes and a reduction in the balance sheet of the Federal Reserve (quantitative tightening). With the rate cut in July and followed by the second rate cut on the occasion of the FOMC meeting in September, the US has again changed its monetary policy stance. A depreciating USD should further boost the gold market. At the same time, the yield levels on the global bond markets have once again imploded. The steady increase of bonds with negative yields makes gold, which does not pay interest, look comparatively attractive. In other words, the opportunity costs of the gold investment continue to decline. In addition, political (geo) insecurity has increased in recent months, whether in the Middle East, China, or even the wrangling around the Brexit. US President Donald Trump's repeated attacks on Federal Reserve Chairman Jerome Powell are seen as an attack on the independence of the central bank and thus on the stability of the US dollar. As a result, stock markets suffered losses of 20 percent and more in the fourth quarter of 2018.

**Will this development continue? What is your short and medium term assessment?**

The question can be answered from two different perspectives. Technically, the resistance range was breached on the upside from $1360 to $1380. That was at least once again a clear sign of life of gold and has caused a lot of attention. From a fundamental point of view, however, a new bull market is especially then to be expected, when the fear of recession proves true and new fiscal and monetary stimuli are set. That's exactly what we expect.

**Is gold more than a "crisis currency"? How should an investor handle this asset class?**

Of course, the fear aspect is a key driver for the demand side. Currently, we see a significant increase in interest from financial investors, which is reflected in the increased volumes of gold ETFs as well as in mining stocks. However, one must not forget that emerging countries are also playing an increasingly important role in the gold market, accounting for almost 70% of physical demand. And with the rising prosperity there, the importance continues to increase. In the coming year, the emerging economies will together account for around half of the global gross domestic product. In 2000, the share was only 19 percent. Especially in India and China there is a strong demand for gold - from the private and public sectors, i.e. from the central banks there. The interesting thing is that the demand is very constant and less cyclical. Figuratively speaking, the gold flows from west to east.

**Physical gold, gold ETFs, gold mining stocks, etc. There are many ways to invest in gold. What should the investor pay attention to?**
Gold can have two properties. We therefore use the terms performance gold and security gold.

Performance gold offers the opportunity to participate in certain price movements. The range of investment opportunities is large. For example, you can buy futures, mining stocks, exchange-traded funds (ETFs) or gold certificates. Although one does not come into the physical possession of gold, one can still actively trade because of the low trade and storage costs and, for example, speculate on inflationary tendencies. Since gold correlates little or even negatively with most other asset classes, the adding of gold, such as gold certificates, can significantly improve portfolio characteristics. Mining stocks mostly move in line with the price of gold, but are more volatile on the way up as well as on the way down and therefore it is for real professional investors. But also with gold certificates caution is necessary. Although these are used to acquire a claim to physically deposited gold, considerably more certificates are issued than gold actually lies in the vaults. This means that one can say, that the same game is played here as with a Fractional-Reserve Bank. Those who are buying gold for the reason of hedging against a major crisis in our monetary system should buy security gold, i.e. physical gold, and keep it safe outside the banking system (and possibly even outside the country).
Security gold is a buy-and-hold investment, an insurance against a system collapse. The big advantage of buying physical gold is that it has neither a maturity risk nor a commodity risk, and above all, no counterparty risk. For the paper market, on the other hand, the promises of various counterparties are elementary.
As long as confidence and trust is high and the economy is doing well, a good with no counterparty risk is unattractive. However, as concerns over potential failures increase, commodities such as gold can rapidly gain in importance. The attractiveness of gold is therefore an inverse function of the monetary system. And since this system is not sustainable and is increasingly hanging by a thread, the prospects for gold are currently outstanding.

**How big is the gold market compared to the stock and bond markets?**
With a daily trading volume of just under $30 billion, gold is an extremely liquid asset class resp. currency. The total gold stock currently stands at 193 000 tons, which is equivalent to a cube with an edge length of 21 meters. The annual gold production amounts to 3300 tons and is expected to stagnate over the next few years. The value of gold holdings currently stands at just below $8 trillion, while global debt is at 217 trillion and equity market capitalization is worth around $70 trillion.

**Is it known who has increased their gold stocks in recent years?**
The central banks - especially in the emerging markets - have recently been very important buyers. In 2018 the central banks made the largest purchases since the end of Bretton Woods in 1971 with 657 tons. Russia (274.3 tons), Kazakhstan (50.6 tons) and India (42.3 tons) were the largest buyers. But also the central banks of some EU states appeared as net buyers in 2018. Hungary has increased its gold stocks tenfold. Poland, also a non-euro country, is one of the

top 5 buyers and has handled the largest purchase since 1998.

**Above all gold is called as value store. So one knows the statement "1 ounce of gold buys a good suit". Do you know any similar comparisons?**
In fact, there are several examples that point to he long-term buying power of gold. For example, in ancient Rome an officer's uniform cost around half an ounce of gold. If you research today on the Internet, you will find uniforms at around 600 euros.

**This roughly corresponds to the same value as then. Why is this?**
Gold has unique physical characteristics. It is de facto indestructible, but easy to work with. But gold is also the only metal that remains unchanged over time and is imperishable. This may explain the psychological phenomenon of people's continued enthusiasm for the yellow metal. As mortal and finite beings, we are fascinated by a material that outlasts time. That's why people have always wanted gold and hoarded it in the form of art or as a pure gold object. Also, to commemorate special moments, gold is often used as a piece of jewelry that allows us to keep the emotions alive. All these characteristics show that gold is a commodity and not a consumer good. The use of gold is to hoard it. This has ultimately led to a steady increase in the gold stock that has already been mined, but compared to the gold that has already been mined, the new stock is low. This is about 1-3% per year. On the supply side, gold is pretty stable, at least more stable than the vast majority of other goods. Therefore, the yellow metal is ideal as a store of value.

**What is the optimal allocation in % for a portfolio with at least 8 years investment horizon?**
This is difficult to say, it of course depends on the rest of the portfolio. In our gold studies, we are very focused on gold in the portfolio context and have always concluded that gold is an excellent insurance against rising inflation, stock market crashes and recessions. Moreover, it is largely uncorrelated or negatively correlated to the other major asset classes. In the "big picture" we see it as - still cheap - insurance, because nobody knows how the biggest monetary experiment of all time will end. It is possible that the alleged omnipotence of the central banks will eventually turn into impotence. It is therefore better to have an insurance that you do not need than to not have one when you need it. Gold fulfills exactly this function. Consequently, gold will continue to be an indispensable component to the portfolio, allowing investors to sleep soundly even in stressful situations on the financial markets.