Weekly Market Flash

What's Going On With Gold?

October 25, 2024

Over a very long history as a mainstay of the economic landscape, gold has been many things to many people. During the Second Industrial Revolution, from around the 1870s to the outbreak of the First World War, the precious metal was the sole arbiter of international monetary policy. Any nation aspiring to a place in the energetic world of global trade in those days had its currency indelibly fixed to the value of an ounce of 11/12 fine gold (that precise measurement translated into three British pounds sterling, seventeen shillings and nine pence, a unit of exchange to which everything else that mattered from US dollars to French francs and Russian rubles was anchored).

A Hedge Against What?

Many decades have passed since gold was last a major factor in global monetary policy (that ended when then-President Nixon closed the exchange window on gold for a fixed amount of $35 dollars per ounce in 1971). Its principal role since then, arguably, has been to serve as a hedge of sorts against movements in other kinds of assets, or against general economic inflation. During the notorious "stagflation" years of the late 1970s, with double-digit consumer inflation and anemic real economic growth, the price of gold soared while investors in equities and fixed income during that period largely got burned.

It's interesting, then, that gold has more recently been behaving in a rather atypical fashion. The post-pandemic inflation we have all been living with for four years peaked in 2022, with the Consumer Price Index topping out at nine percent in June of that year. The price of gold was essentially flat that year, with an ounce of spot market gold trading around $1,810 at the beginning of January and the end of December. No need for an inflation hedge, apparently.

But maybe that was because interest rates were also going up in 2022, right? Gold doesn't pay interest, so when rates go up for the safest of assets, that should take some of the shine off the metal. Sounds reasonable – but then again, the price of gold increased by around 25 percent from November 2022 to May 2023, a period during which the Fed raised the Fed funds target rate by 1.75 percent. There doesn't seem to be a consistent inverse correlation with fixed income, either.

Against Everything, Maybe

That brings us to today. We're not writing about gold in 2024 because of what it did in 1979 or even 2022, but because it has gone up in value by 39 percent from the same time one year ago. Was gold just part of a broad-based rally that has included most equity asset classes? Not according to the time-tested view of gold as a risk-off asset, which one would expect to be underperforming during a period of risk-on growth for equities. The S&P 500 is up 22 percent or so for the year as we write this – a nice return, but trailing gold's 31 percent gains since January. Most recently, since the Fed's decision to cut the Fed funds target by 0.5 percent in September, the yield on the 10-year Treasury has actually gone up by a whopping 0.6 percent to its highest level since July – and gold has rallied right alongside the spike in the bond yield.

In fact, there most likely is not one specific thing to which one can point and say – aha, gold is hedging against that. Perhaps it is not one thing but, rather, everything – everything that one could be nervous about today but cannot pinpoint exactly. Geopolitical unrest, historically high peacetime deficits, the stability of the dollar-based global trade system – heck, the political stability of some of the world's leading economies. Things you can't quantify in terms of magnitude or timing in your scenario planning exercises, things that may or may not be actualizable risks today or tomorrow or ever, but things that keep you up at night anyway.

We have a process by which we look to traditional equity and fixed income asset classes and ask ourselves: are these exposures providing all the solutions we believe we need to accomplish the three goals of growth, safety and income for each of the portfolios under our management? If yes, then no need to venture farther afield – Ockham's razor applies (simplest solution that achieves the target outcome). But we always need to be aware of what else is out there, to understand the properties of alternative asset exposures, and to decide when and how they may be necessary additions. We do not take these decisions lightly, and we do not act rashly in jumping onto short-term market trends. But we always have to ask "why?" and decide if there is something there worth pursuing.

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