

Should you invest in gold?

By Jacques Munnik, Investment Writer

Gold is one of the precious metals recognised worldwide for its tremendous value, which is why many investors looking to protect their money against inflation or governmental instability hold gold. The future value placed on gold has always continued to draw investors into the metal.

Historically, the world has shown a tendency to store gold because they realised that metal is much more durable than fiat currencies (money not backed by a tangible asset) and can be exchanged for more value later. From an inflation protection perspective looking back at the past half a century, gold prices have kept pace with inflation, and the metal's purchasing power has risen as a result.

Gold has also proved to be a safe haven during economic and political instability. A more recent example would be during the height of the Covid pandemic in 2020 when the yellow metal not only outperformed both stocks and bonds but also set a record high. The World Gold Council avers that its performance during times of crisis has risen to become the "top reason for central banks to hold gold." It should be remembered that there is no guarantee that this will always be the case and past performance may not be repeated.

To date, global inflation has risen hugely, and speculation prevails that the trend may continue. There is a consensus expectation that central banks may continue to increase interest rates to curb inflation aggressively, which should stifle growth. Gold has, by tradition, served as a hedge against inflation and geopolitical tensions. But has the yellow metal seen the end of its gains? Or are there further gains to be seen?

Market Overview

On Tuesday, 12 July, Spot gold, XAU/USD, dropped to an almost ten-month low of \$1,723 an ounce against a soaring U.S. Dollar, on the back of higher-than-expected increases in U.S. jobs to near the lowest unemployment rate since the late 1960s. This year's gold price has been wedged between elevated inflation risks and growing concerns over a recession, whilst the Greenback has benefited from safe-haven flows. As the Fed has quoted an "unconditional" commitment to curbing inflation, it is the view of Stephen Bonnyman, manager of the **SVS Sanlam Global Gold & Resources Fund**, that the risk of rising rates is currently overpowering any defensive characteristics.

On the upside, although UBS, in their second half of 2022 outlook, forecasted a step-down in gold prices, targeting USD 1,700/oz by year-end, they did add that if equity markets were to decline further, gold's recognised characteristics as a potential safe haven could "shine again". They also maintained that bullion investment still hedges against geopolitical and recession risks.

Last week the gold price outlook turned bullish again as comments made by central bank chief Powell at the July FOMC Meeting signalled that peak Fed hawkishness has passed. Powell said at his press conference that another substantial hike would be data-dependent, signifying that policymakers may slow the pace of the tightening cycle in the future.

More news supporting gold was the latest fall in U.S. business activity. U.S. GDP tightened again for the second consecutive quarter this year, increasing the probability of further rapid growth declines.

Increasing talks of a recession also support the outlook that Fed officials may take a more dovish stance later this year. In the meantime, the IMF has revised their baseline forecast, with growth slowing from last year's 6.1 percent to 3.2 percent this year and 2.9 percent next year, reflecting stalling growth in the world's three largest economies—the U.S., China, and the euro area. Gold could shine in this environment.

What are the risks?

From a risk perspective, investors must first consider that significant divergence exists between physical gold bullion and shares of gold miners. Gold mining has potential risks, e.g., geopolitical, financing, pricing, environmental, correlation to stock market volatility, and even jurisdictional and labour unrest risks. Gold Bullion risks include supply and demand fundamentals which affect value and availability, excessive paper gold vis-à-vis physical gold because of the exchange of futures contracts, and the sensitivity inherent in the pricing of gold in relation to fiat currencies. There have, however, always been (and still are) advantages to investing in gold mining companies and

direct gold.

Gold Mining Stocks

Mining shares can deliver leveraged positive returns during a rising dollar price in gold. Although the mining industry is capital intensive and cyclical, selecting top mining companies with low production costs tends to be the most profitable and least likely to rely heavily on debt to fund growth. Moreover, they have proven their ability to produce profit regardless of economic conditions. Unlike bullion, mining stocks have the potential to generate income. Also, high-quality gold stocks can offer handsome pay-outs by launching new mines and increasing their production, even if gold goes sideways for a prolonged period.

Direct Gold Bullion

One of the primary advantages of investing in gold is that it historically offers protection against inflation risks, as, over the years, gold has outperformed the rate at which money devalues (past performance is not a guide to how it may perform in future). Gold bullion has appreciated more than gold mining shares over the past 45 years, with significantly lower volatility. In the long run, bullion ownership has proved to be a form of wealth insurance whilst protecting portfolios during market declines.

Since gold does not change its value similarly to stocks and bonds, it can be an excellent way to diversify investments. At the same time, history has proved that holding physical gold within an investment portfolio improves the risk-return profile. Moreover, some allocation to gold in a portfolio not only introduces lower volatility but also effectively lowers positive correlation with other assets. The stable nature of gold prices relative to other assets is another reason for its popularity as a diversifier, as it has proved to have value over many centuries.

Where to from here?

The current global economic backdrop, mixed views on the outlook for markets, and the impact of the increased uncertainty have resulted in an extraordinary variance in potential outcomes for investors this year. Those who seek protection against the risk of ongoing economic declines and the ability to gain from opportunities that could arise in a potential soft-landing or reflationary scenario should consider holding on to gold and resources.

Furthermore, gold's flat performance during the first half of 2022 may seem dull, but the precious metal was nonetheless one of the best-performing assets. Bullion delivered positive returns and below-average volatility, which helped investors ease losses. This is against a backdrop of equities and bonds, which typically make up the bulk of investors' portfolios, having been down during the year's first half.

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Although expected rate hikes may generate headwinds for gold, many of these aggressive policy expectations will have already been priced in. Still, continued inflation and geopolitical risks should sustain demand for gold as a hedge. Many analysts believe that the risk of a stagflationary season has increased materially. The underperformance of stocks and bonds in such an environment may also be positive for gold. Coupled with simmering geopolitical tensions, this bodes well for the current case for gold.

A common question, however, on investors' lips this year is – have they missed the gold “growth boat”? Perhaps they have, at least for the time being. That said, judging history, the combination of gold mining stocks, as part of the total tactical equity allocation of an investor's portfolio, along with physical gold with its extensive history of value over centuries, has maintained its rightful place in a well-diversified investment portfolio.

It is true that all types of investments carry risks, and investing in gold is no different. The idiosyncratic gold market can be unforgiving and takes a long time to learn. Therefore, OEICs funds, like the SVS Sanlam Global Gold & Resources Fund (the Fund), can be a prudent choice for many investors looking for exposure to gold within their portfolios.

Past performance is not a guide to future performance and may not be repeated. All investment views are presented for information only and are not a recommendation to buy or sell. Forecasts are not guaranteed and should not be relied upon. The value of investments and any income from them can fall and you may get back less than you invested.

Fund risks

The Fund invests in shares of gold mining and precious metals companies. The price of gold or other natural resources may be subject to unexpected and substantial fluctuations, this may lead to significant declines in the values of any companies developing these resources in which the Fund invests and significantly impact the Net Asset Value of the Fund. The Fund has holdings which are denominated in currencies other than sterling and may be affected by movements in exchange rates. Consequently the value of an investment may rise or fall in line with the exchange rates.