Role of Gold in a Multi-Asset Portfolio

Prepared by: Affin Hwang Asset Management

Gold is gaining its lustre this year as skittish investors make a dash for the safe haven asset amidst heightened volatility in markets.

A whirlwind of factors including rising inflation, Russia-Ukraine tensions and prospects of slower economic growth is fuelling gains in the precious metal which is flirting around its all-time high of US$2,000 at the time of writing.

With gold proving its mettle yet again as the go-to asset class in times of crisis, we explore the 3 vital roles that gold can play in a portfolio.

1 Store of Value

In a world of macro extremes where geopolitical fissures can easily erupt into a full-blown conflict overnight, gold acts as a reliable store of value for investors due to its intrinsic properties.

Beyond its sparkle and luminosity, it is also malleable, non-toxic and does not corrode making it highly in-demand amongst developed and emerging countries to make gold bars, jewellery and even electrical components.

However, the biggest net buyer of gold has to be from central banks because they store massive amounts of it in their vaults. Over 66% of the US Federal Reserve and Germany's central bank foreign reserves are kept in the form of gold because it is seen as a medium of exchange that helps protect the value of their currencies. (Source: World Gold Council, as at 31 Dec 2021)

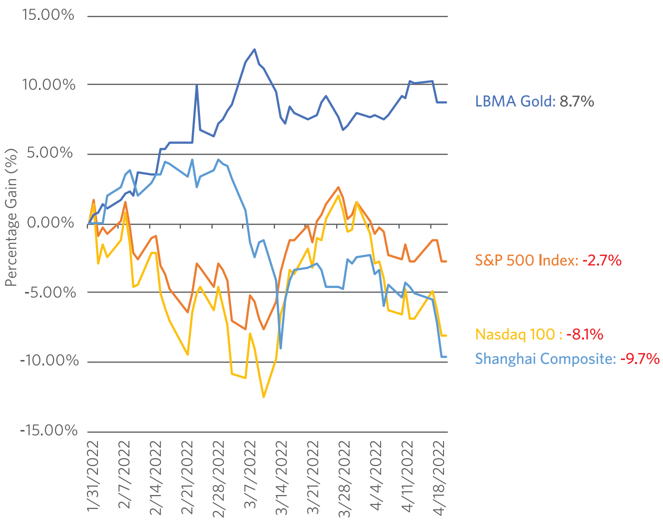
Gold's value also comes from its scarcity because there is a finite supply of the commodity in the world. This is unlike paper currencies that can be printed, but then loses its value over time because there is now more money in circulation. That's why investors through the ages still continue to keep gold in their portfolios as a form of wealth insurance to provide financial coverage especially in a crisis.

2 Portfolio Diversifier

With a negative correlation against risk assets like equities, gold also acts an effective portfolio diversifier so that losses in one asset class are offset by gains in another. This helps shield portfolio returns especially in a market downturn, so that investors have the holding power to ride the rebound when markets eventually recover.

This is evident from Graph 1 which shows a clear opposite mirror image of the price movements of gold and major equity benchmark gauges this year. It can be seen that the LBMA Gold Price index climbed 7.7%, while the S&P 500 floundered at 0.1% in the 1Q'22 as markets were jolted by escalating tensions between Russia and Ukraine as well as rising inflation.

Graph 1



Source: Bloomberg. All prices quoted in USD. Period 31 Jan 2022 – 18 April 2022

However, the myth that gold prices move slowly and only provide sub-par returns especially during an upcycle may dissuade some investors from keeping gold because they see it as a drag to their overall portfolio performance.

But this myth is easily dispelled if we look at the historical performance of gold. Based on a report by the World Gold Council, gold has provided an average annual return in excess of 10% over a 50-year period (1 Jan 1971 – 31 Dec 2021), which is not far behind equities in general. As such, the trade-off in returns between gold and equities isn't that large as perceived.

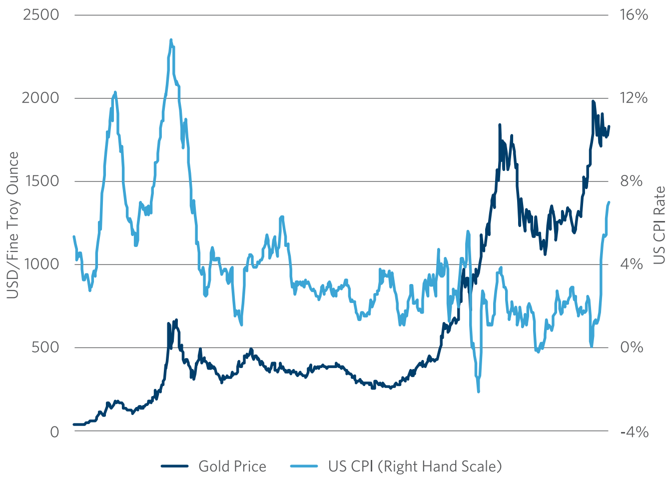
The goal of any portfolio is diversification and gold can play an essential role in lowering volatility. By providing a buttress to one's portfolio, gold can not only protect but also enhance returns over the long-term, making it a vital asset staple in any portfolio.

3 Inflation Hedge

With inflation on everyone's mind, investors are searching for ways to stave off price pressures from eating into their purchasing power and eroding their savings. Once again, gold shines as a valuable inflation-fighting tool because its price tend to rise in an inflationary environment.

However, some argue that gold's effectiveness as an inflation hedge only works in theory, but not in practice. This is because when inflation rises, central banks would turn hawkish and start to raise interest rates which diminishes the appeal of gold. To investors, gold which is a non-income generating asset is now deemed less attractive compared to fixed income which yields more due to a higher deposit rate.

But historical performance shows little evidence of a consistent inverse relationship between gold prices and interest rates. For instance, gold prices continued to soar even as interest rates moved upwards throughout the 1970s.



Data: Bloomberg, to 31 May 2021.

According to a report by the World Gold Council that spans more than 50 years (1 Jan 1970 to 31 December 2021), gold has provided a return of 15% p.a. on average when inflation was higher than 3%. Conversely, when inflation was lower than 3%, the returns of gold still averaged over 6% p.a.

Thus, gold as an asset class is able to perform and provide decent returns in both inflationary and deflationary periods.

Strike Gold In Your Portfolio

Holding a strategic allocation in gold provides a gilded safety net for investors to weather through market cycles that are becoming shorter and sharper.

The Affin Hwang Shariah Gold Tracker Fund offers a convenient way for investors to gain exposure to gold through a Shariah- compliant structure to preserve wealth.

Scan here:

Book an appointment with us or scan the QR code **https://affinhwangam.com/get-in-touch/book-an-appointment**