Gold Valued For 40,000 Years

BY: **MICHAEL KOVACS**

The history of humankind's use of gold can be traced back as far as 6000 BC when it was fashioned into rudimentary jewelry and objects which may have been used as stores of value due to its scarcity. Some archaeological evidence claims to have found flakes of gold in Paleolithic caves dating back 40,000 years. No doubt through the ages gold's scarcity, non-corrosive, non-tarnishing, and malleable qualities have given it high value for individuals and governments as a marker of value.

Fast forward to August 15, 1971, when President Richard Nixon removed the U.S. from the gold standard, an international monetary system that was set up at the end of World War II to allow nations to fix their currencies to the U.S. dollar which would be convertible (fixed) to gold at US$35 per ounce.

Value Of Gold

Over the ensuing 47 years, the interest and global trading value of gold has sky-rocketed with the introduction of a plethora of vehicles allowing institutions and individuals alike to trade and build positions in gold for speculation or as part of a portfolio risk allocation system. With this activity, gold has traded in the free market increasing in price to as high as US$1,895 per ounce in 2011 and currently trading at closer to US$1,275 an ounce.

Speculation aside, one of the key underlying uses of gold as an investment has been to provide diversification and defensive positioning to preserve wealth in times of market corrections, inflationary pressures, a weakening U.S. dollar, and regional or global conflict. As highlighted by World Gold Council in its report, 'The Relevance of Gold as a Strategic Asset (2019),' the inverse correlation also becomes more apparent as downside market volatility increases (See E*xhibit 1*).

Sometimes even the hint of a potential regional conflict can send the price of gold spiralling upward in a very short time. Though these short bursts can be driven by speculative trading, the negative or low correlation to stock markets can help preserve wealth or lower market volatility in a portfolio and this is true even as recent as the 2018 pullback (See *Exhibit 2*).

The case for maintaining an allocation to gold as a portfolio diversifier and hedge to inflation has been well-documented. The investment appetite for gold can also ebb and flow depending on economic circumstances, but it is considered prudent to allocate a position to gold for diversification. As *Exhibit 3* highlights, from the World Gold Council's report on 'The Relevance of Gold as a Strategic Asset (2019),' historically having a position in gold has been beneficial for a portfolio's risk adjusted return metrics.

As mentioned earlier, ways to get exposure towards gold have morphed into several products over time. These include holding bullion directly (wafers and bars in a safety deposit box), gold futures contracts, gold mining shares, gold ETFs and mutual funds which can hold a variety of stocks and metal contracts or the bullion physically, and other structured and derivative-based products. The number and variety of products around the world and trading on major markets is overwhelming and the choice of investment can be daunting for an individual investor.

Performance Has Varied

While the case for gold the commodity has been well documented, gold equities performance has varied at different times of the economic cycle. There are times, however, that holding the gold

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mines’ sector has meaningfully outperformed gold and can be seen more as a tactical allocation. At points in history when the gold mining sector becomes as cheap as it is now across multiple valuation metrics, there is a strong tendency for the gold mines to strongly outperform the price of gold and the performance of the equity market (See *Exhibit 4*).

In developing the Harvest Global Gold Giants Index ETF (HGGG:TSX), the objective was to provide an index product that would track the performance of the top 20 global gold producers by market capitalization. With this approach to the gold market, investors don’t have to own the commodity directly, store it, and insure it while it generates zero earnings

Political risk has always been a part of the gold miner modus operandi when accessing less politically friendly jurisdictions. Over time, environmental regulations have grown to also be an area of risk as the process to get a mine built can be very complex, slow, and can even be halted if the environmental protocols aren’t met. In many cases, well-established mining operations and cash flows are much better positioned through diversification to shutter mines in less desirable, higher risk locations.

Commodity Suppressed

As the commodity has been suppressed for a number of years, mining companies have had to become more efficient in their operations and, in order to attract investors, have had to be more shareholder friendly with the capital allocations: initiating dividends, share repurchases, and expending capital only on the better quality assets. This couples with the attractive valuations and low expectations for the commodity and sector due to the robust economic conditions that have been in place for some time.

Do we have a lofty call on gold bullion prices? No, but we do expect to see increasing activity in the sector as the economy extends into extra innings and slower growth expectations start to take hold of investors coupled with political risk elevating as we move through 2020. **BPM**

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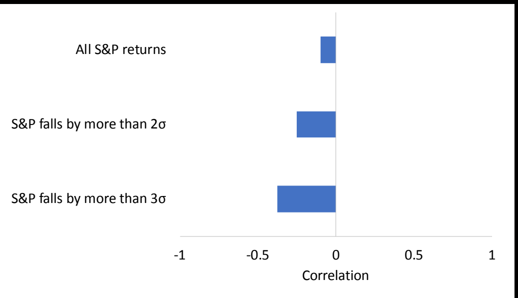
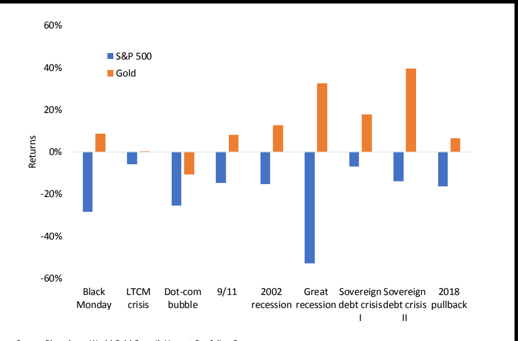
Exhibit 1 - Price Of Gold Increases More When Equities Sell Off Sharply



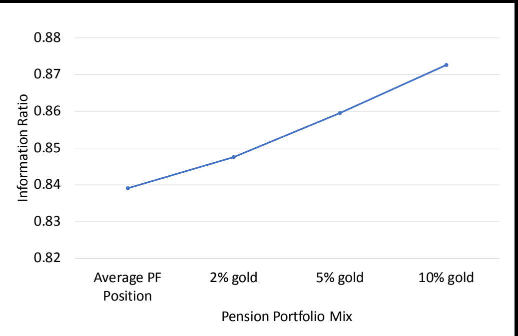
* based on weekly returns between Jan 1987 to Dec 2018
Source: Bloomberg, World Gold Council

Exhibit 2 - Price Of Gold Increases Sharply During Short Market Outbursts



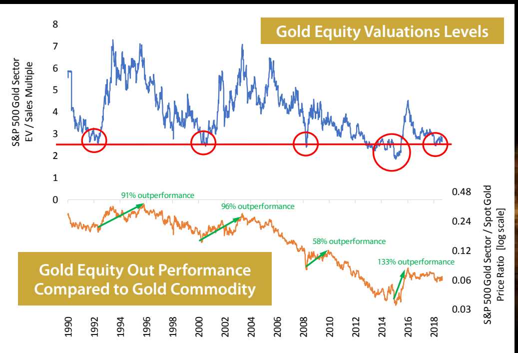
Source: Bloomberg, World Gold Council, Harvest Portfolios Group

Exhibit 3 - Average Pension Fund Allocation to Gold Risk Adjusted Returns Improve With an Allocation



Source: Bloomberg, ICE Benchmark Admin, World Gold Council

Exhibit 4 - Performance of Gold Equities Compared to Gold When Multiples were Low -Gold Equities Outperformed



Source: Bloomberg, Harvest Portfolios Group