July 2024

Beyond the Glitter, Understanding Gold as an Investment

Since the start of 2024, gold has broken multiple records, setting highs in March, April, May, and July. On the 17th of July 2024, the precious metal traded at an all-time high of $2,482.97 per troy ounce[1]. The topic of gold has become increasingly ubiquitous as record-breaking values dominate news headlines. In this article, we look at the story of gold, unpick what has been causing the gold price to soar over the past few months and options for investors looking to tap into the Midas touch.

The Journey of Gold

Gold has long been revered as a symbol of wealth and power, dating back to ancient civilisations such as the Egyptians, Greeks, and Romans. Its durability, malleability, and lustrous appeal made it an ideal medium of exchange and a store of value. The Romans were the first to mint gold coins, which facilitated trade across their vast empire. The term "troy" ounce originated from the Roman monetary system. It was later adopted in the medieval period in Troyes, France, hence the name Troy.

Transition from Gold Coins to Gold-backed Currencies

As trade expanded, gold coins became widely used, providing a reliable and universally accepted form of currency. The intrinsic value of gold coins ensured their acceptance across different regions and cultures. Eventually, the limitations of carrying and storing large amounts of gold led to the development of gold-backed currencies. This development led to the formal introduction of the gold standard[2] in the 19th century, with adoption by the UK, the USA, and many other countries, including Europe.

The Bretton Woods Agreement, established in 1944, created a new international monetary system to foster economic stability and growth post-World War II. This agreement, which was essentially a modified gold standard, established the US dollar as the world's reserve currency, pegged to gold at a fixed rate of $35 per ounce. Although the gold standard was later abandoned, the US dollar's dominance in global trade persisted, and gold is still priced in USD. The gold standard and the Bretton Woods agreement are interlinked historical frameworks that shaped the global monetary system.

Modern-day Store of Value

Today, gold continues to be a valuable asset because of its intrinsic properties and limited supply. Unlike fiat currencies[3] and cryptocurrencies, gold's tangible nature provides a sense of security and stability. While fiat currencies are subject to inflation and the monetary policies of central banks, and cryptocurrencies are known for their volatility, gold has historically maintained its value through economic fluctuations. Many investors will include gold in portfolios seeing it as a reliable store of value.

Major Gold-holding Nations

The United States holds the largest gold reserves globally, with 8,133 tonnes stored in 12 Federal Reserve Banks across the country, followed by Germany (3,353 t), Italy (2,452 t), and France (2,437 t). These countries view gold as a critical component of their monetary policy, ensuring financial stability and confidence in their currencies. Recently, a notable trend has emerged, with many countries strategically boosting their gold reserves to reduce dependence on the US dollar. Russia (2,333 t) and China (2,192 t), in particular, have been significant buyers, motivated by a desire to strengthen their financial independence by reducing reliance on the US dollar and mitigating geopolitical risks.

Economic Conditions Affecting Gold Prices

- **Interest Rates:** Gold prices often exhibit an inverse relationship with interest rates. When interest rates rise, the opportunity cost of holding gold increases, leading to lower prices. Conversely, when interest rates fall, gold becomes more attractive as a store of value. Historical data demonstrates this inverse relationship. For example, the low-interest-rate environment following the 2008 financial crisis contributed to a significant rise in gold prices. The chart below indicates how gold behaved in the 2008 Global Financial Crisis and during the COVID-19 pandemic in 2020 – showing declining interest rates and rising gold futures prices.

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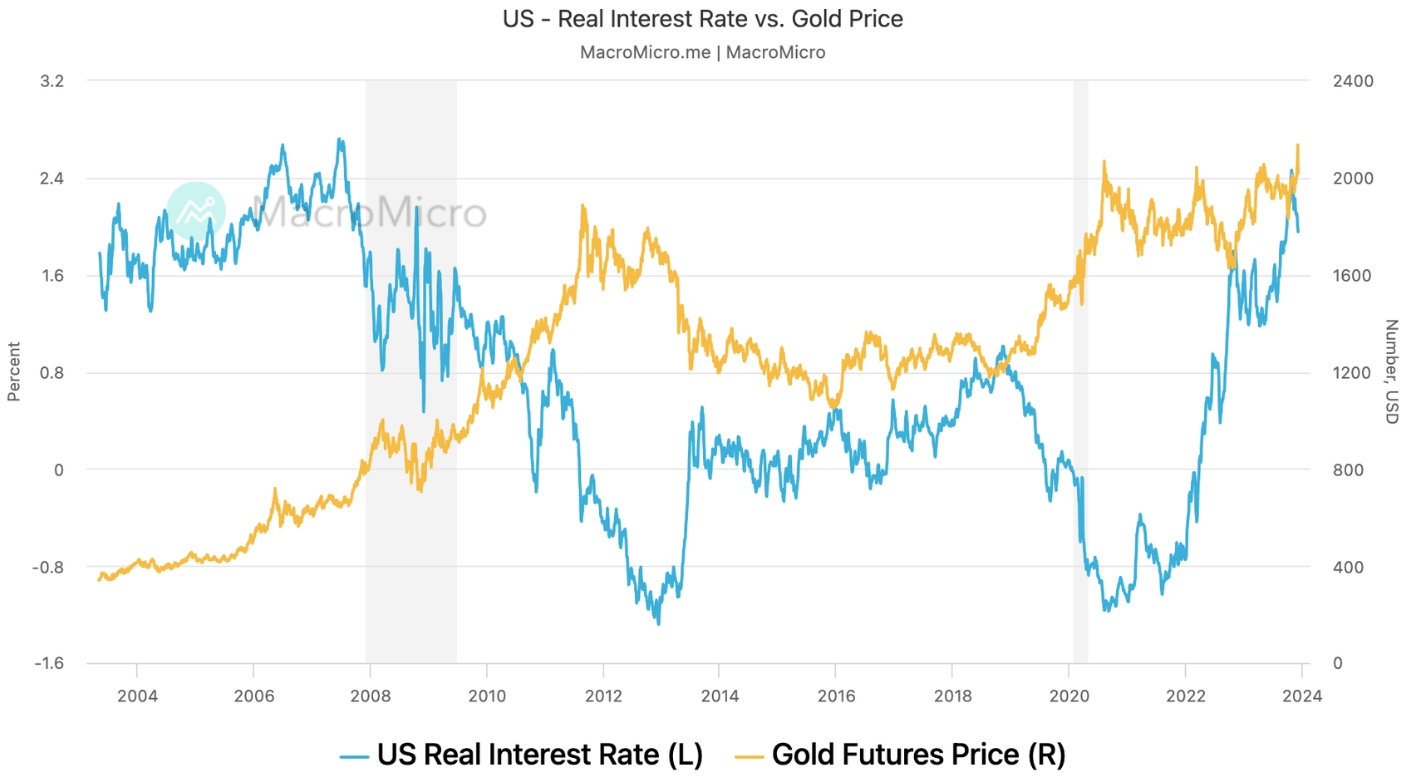

Source: MacroMicro

- **Geopolitical Events and Wars:** Gold is considered a safe haven during geopolitical tensions and conflicts. Investors seek the stability and security of gold when faced with uncertainties, driving up its price. Recent geopolitical events, such as trade tensions between major economies and regional conflicts, have increased the demand for gold. The chart below demonstrates peaks in the gold price during notable global events.

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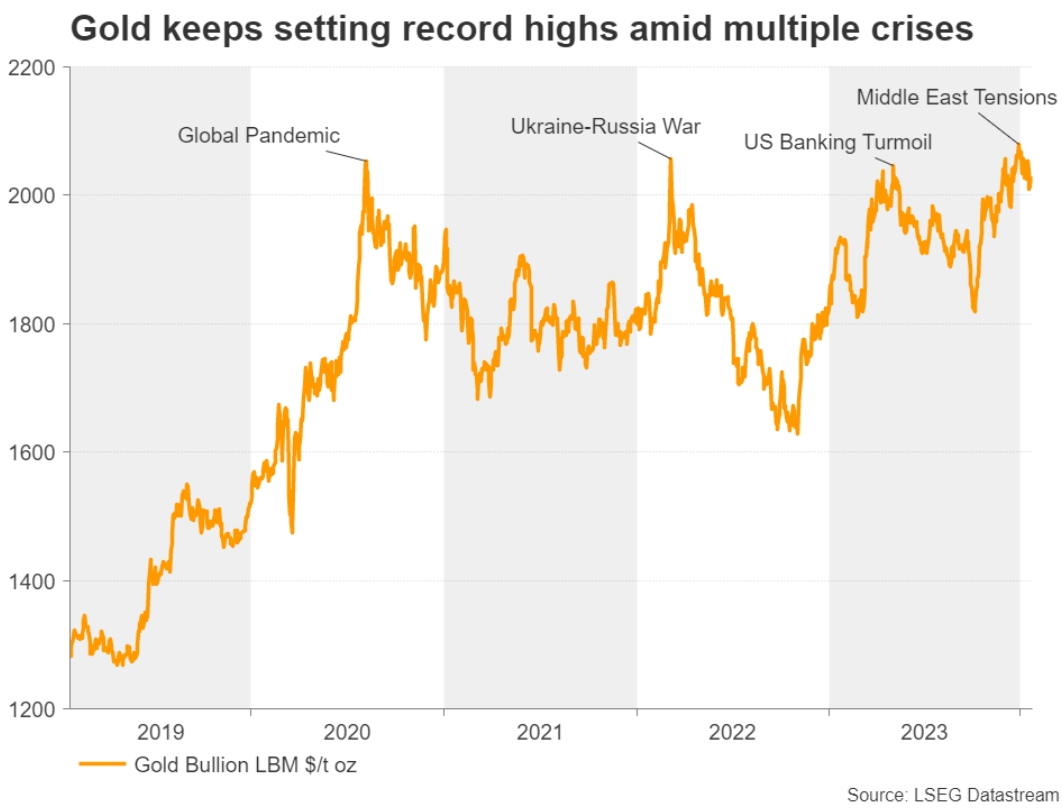

Source: LSEG Datastream

- **Economic Uncertainty and Recessions:** During economic downturns and recessions, gold serves as a hedge against market volatility and economic uncertainty. Investors turn to gold to preserve wealth when other assets are underperforming.

  Gold's highest prices tend to correlate with periods of economic uncertainty, high inflation, and geopolitical conflict. Gold last reached these levels in 1980, during a period of stagflation marked by soaring oil prices, the Iranian Revolution of 1979, and the Soviet invasion of Afghanistan. At that time, the price peaked at $700, equivalent to $2,250 today when adjusted for inflation.

Potential Factors Behind the Recent Gold Price Rally

- **Interest Rates:** Weaker than expected US inflation data released on the 11th of July 2024 suggested that inflation is moving in the right direction towards the Fed's 2% target. This data heightened expectations for the Federal Reserve to cut interest rates based on minutes taken from the Federal Open Market Committee (FOMC[4]) in June, which indicated an intention to cut interest rates once that target becomes more realistic.
- **Economic Uncertainty and Recessions:** The assassination attempt on US electoral candidate Donald Trump increased speculation that the former President would defeat President Joe Biden in November's presidential election. Trump's talks of higher tariffs and tax cuts and his tendency to exacerbate international relations contribute to political uncertainty, leading investors to seek safe-haven assets.
- **Geopolitical Events and War:** The ongoing Russian invasion of Ukraine, which began in March 2022, continues to impact global affairs. Additionally, the outbreak of war in Gaza between Israel and Hamas has intensified regional instability. The situation has become even more complicated with the death of Iranian President Ebrahim Raisi in May due to a helicopter

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crash. This crash occurred amid growing unrest within Iran over several political, social, and economic crises.

- **Supply and Demand:** Amongst other emerging market countries, China has been purchasing record levels of gold over the past two years. An article by the Times of India earlier this year mentioned that "In March, the People's Bank of China added to its gold reserves for a 17th straight month. Last year, the bank bought more gold than any other central bank in the world, adding more to its reserves than it had in nearly 50 years. Beijing is buying up gold to diversify its reserve funds and reduce its dependence on USD. China has been reducing its US treasury holdings for more than a decade. As of March, China had about $775 billion worth of US debt, down from about $1.1 trillion in 2021."

Different Ways to Invest in Gold

- **Direct Investment in Gold (Bullion):** Investing directly in physical gold, such as bars and coins like Krugerrands, provides tangible ownership of a valuable asset. The drawback is that physical gold requires secure storage and insurance and can involve higher transaction costs.
- **Gold Exchange-traded Funds (ETFs):** ETFs provide investors with exposure to gold by tracking changes in its price - allowing investors to profit from price changes without owning the physical asset. The performance of a gold ETF might not perfectly match the price movements of gold due to management fees and other factors.
- **Gold Mining Companies:** Investing in gold mining companies involves purchasing shares in companies that extract and produce gold. This approach provides indirect exposure to gold prices and has the potential for higher returns than investing in physical gold. Gold mining stocks can offer significant returns, especially during periods of rising gold prices. Additionally, some mining companies pay dividends, providing investors with regular income. However, investing in mining companies carries risks and can be influenced by factors beyond the gold price, such as company-specific challenges like operational issues, regulatory changes, and geopolitical risks.
- **Diversified Mining Companies:** Diversified mining companies extract a variety of metals and minerals, providing exposure to multiple commodities. This diversification can help reduce risk and potentially enhance returns, depending on market conditions. Compared to pure gold miners, diversified miners offer a broader risk and return profile. While they may not benefit as directly from rising gold prices, their exposure to a range of commodities can provide greater stability and growth opportunities. One can also access these companies by purchasing shares.

Unit Trust funds can invest across the above spectrum with some managers selecting a specific mining share or gold ETF within their portfolio. There are also unit trusts that are purely gold-focused and only invest in equities issued by companies around the globe involved in gold mining.

A Gold View from Fund Managers

Ninety One Managed Fund (July 2024): "We have been long-term holders of the gold ETF as a hedge against inflation and geopolitical risks as well as being a rand hedge. We are tactical holders of gold equities, both global and local and we currently hold AngloGold locally and Barrick and Pan American Silver (a silver and gold miner) offshore. The shares are low quality but have positive revisions. We tend to prefer offshore gold shares to local given the better liquidity and the tactical nature of our holdings. One of the key reasons we hold gold and gold shares is our concerns about high and rising debt levels in the US, China and Japan. We believe that we are in a structurally higher inflation environment in the medium term, as central banks look to cut interest rates before reaching inflation targets as opposed to only hiking when they were above. Post the Global Financial Crisis in 2008, politicians used the word "austerity" but not since Covid, as populism is increasing as wages lag profits and nominal GDP. Currencies are being debased but gold remains a store of value. We expect the gold price to be supported by central bank buying given increasing de-dollarisation."

Coronation Fund Managers (July 2024): "The role of gold in our multi-asset funds can best be summarised as a diversification tool, given its low correlation to most other asset classes, especially in risk-off scenarios (when you need it most). Consequently, it features most prominently in our absolute multi-asset funds (typically ranging between 1-3% exposure to physical gold). The size of the allocation (if any) depends on various factors, including:

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- The valuation of other asset classes.
- The opportunity cost of owning gold, given that it is not a yielding asset class.
- Our assessment of a normal gold price, which our gold analysts work on to determine a fair value for gold stocks. Our normal price is closer to $1,900 which is significantly below spot.
- The relative attractiveness of gold shares. On occasion, we have been able to buy discounted gold protection through owning gold shares at cheap valuations."

To Trade or Not to Trade

Trading gold can be challenging, and many investors make decisions that result in poor outcomes. This phenomenon often stems from psychological biases and a lack of a disciplined strategy.

Case Study #1 - Gold Price Surge in 2011

- **Background:** After the 2008 financial crisis, gold prices surged due to heightened economic uncertainty and fears of inflation. Prices climbed steadily, reaching a peak of approximately $1,900 per ounce in September 2011.
- **Investor Behaviour:** Many investors flocked to gold as a safe haven, resulting in significant buying activity as prices approached their peak.
- **Outcome:** Prices fell sharply after peaking, dropping to about $1,200 per ounce by 2013. Those who bought at the peak faced significant losses.

Case Study #2 - COVID-19 Pandemic in 2020

- **Background:** During the COVID-19 pandemic, gold prices spiked due to economic uncertainty and global market volatility. In August 2020, prices reached a new high of over $2,000 per ounce.
- **Investor Behaviour:** Many investors bought gold during this surge, driven by fear and the desire for a safe haven.
- **Outcome:** Gold prices fluctuated and ended 2020 at around $1,850 per ounce. Investors who bought at the peak and sold during the decline saw losses.

Gold markets are volatile and influenced by a multitude of factors, such as geopolitical events, economic data, and market sentiment. Effective trading in gold requires both expertise and ongoing market monitoring. We believe that professional fund managers are best suited for this task, as they have the resources, experience, and tools required to make informed decisions on when to trade and what type of gold exposure to seek.

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[1] Troy ounce is a unit of weight used primarily for measuring precious metals, such as gold, silver, platinum, and palladium. Troy ounce = 31.1035 grams

[2] The gold standard is a monetary system where a country's currency or paper money has a value directly linked to gold.

[3] Fiat currency is a type of money that is not backed by a physical commodity like gold or silver. Instead, its value is derived from the trust and confidence that people have in the government that issues it.

[4] The FOMC is a key component in setting US monetary policy, particularly influencing interest rates and the growth of the money supply.

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MARKET REPORT

31 07 2024

FUNDHOUSE
investment clarity

		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol1	10yr Vol1
LOCAL MARKET INDICES									
SA Equity	ZAR	9.0%	9.4%	8.3%	10.1%	11.1%	7.6%	16.8%	14.3%
SA Listed Property	ZAR	10.6%	14.0%	28.2%	12.9%	1.5%	3.0%	27.1%	21.3%
SA Bonds	ZAR	10.1%	9.4%	15.0%	8.2%	8.2%	7.9%	8.8%	8.3%
SA Cash	ZAR	2.1%	4.9%	8.6%	6.6%	6.1%	6.6%	0.5%	0.4%
Balanced Benchmark	ZAR	7.5%	8.9%	11.8%	10.0%	10.6%	8.6%	11.6%	9.8%
SA Inflation (1 month lag)	ZAR	0.5%	2.4%	5.1%	6.0%	5.0%	5.0%	1.4%	1.4%
GLOBAL MARKET INDICES BASED TO USD									
Global Equity	USD	8.5%	13.5%	18.5%	7.0%	12.2%	9.7%	17.8%	15.1%
Emerging Markets Equity	USD	4.0%	7.0%	5.2%	-3.3%	2.9%	2.3%	18.6%	17.4%
Global Property	USD	10.0%	1.1%	6.8%	-4.1%	0.4%	2.6%	20.9%	16.9%
Global Bonds	USD	4.2%	-0.6%	2.9%	-5.1%	-1.5%	-0.1%	7.6%	6.3%
US Cash	USD	1.4%	3.2%	5.5%	3.3%	2.3%	1.6%	0.6%	0.5%
MAJOR INDICES BASED TO RANDS									
SA Equity	ZAR	9.0%	9.4%	8.3%	10.1%	11.1%	7.6%	16.8%	14.3%
Global Equity	ZAR	4.8%	11.8%	21.2%	15.0%	17.9%	15.6%	15.9%	15.8%
Emerging Markets Equity	ZAR	0.5%	6.4%	7.6%	3.9%	8.1%	7.8%	13.9%	13.7%
Global Property	ZAR	6.3%	-0.4%	9.2%	3.1%	5.5%	8.1%	18.9%	17.3%
SA Bonds	ZAR	10.1%	9.4%	15.0%	8.2%	8.2%	7.9%	8.8%	8.3%
Global Bonds	ZAR	0.7%	-1.1%	5.3%	2.1%	3.6%	5.3%	13.5%	13.8%
COMMODITIES									
Gold (US Dollars)	USD	5.1%	17.6%	23.0%	9.8%	11.0%	6.3%	14.4%	13.6%
Gold (Rands)	ZAR	1.5%	16.9%	25.8%	18.1%	16.7%	12.1%	18.1%	16.9%
CURRENCIES									
Rand / Dollar	ZAR	3.2%	0.5%	-2.1%	-7.6%	-5.1%	-5.4%	14.2%	14.8%
Rand / GBP Pound	ZAR	0.6%	-0.3%	-1.9%	-4.8%	-6.2%	-2.6%	12.3%	14.2%
Rand / Euro	ZAR	2.0%	2.5%	-0.3%	-4.3%	-4.5%	-3.2%	11.8%	13.1%

KEY

Asset Class	Represented By:
SA Bonds	Satrix Bond Index Tracker
SA Cash	STeFi
SA Equity	Satrix ALSI Index Tracker
SA Listed Property	Satrix Property Index Tracker
Emerging Markets Equity	iShares Emerging Markets Equity Index Tracker
US Cash	Fidelity Institutional Liquidity The United States Dollar
Global Bonds	iShares Core Global Aggregate Bond ETF
Global Equity	iShares Developed World Index Tracker
Global Property	iShares Developed Real Estate Index Tracker

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REDFIN WEALTH

INVESTMENT - RETIREMENT - FINANCIAL PLANNERS

July 2024

Spot Rates		31-Jul-24	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago
CURRENCIES							
Rand/US$	Rand	18.2	18.3	17.8	14.2	10.7	6.3
Rand/GBP	Rand	23.4	23.1	22.9	17.4	18.1	11.4
Rand/EUR	Rand	19.7	19.6	19.6	15.8	14.3	7.5
RATES							
SOFR 6m $	US$	5.5	5.7	5.9	2.2	0.3	2.0
Repo Rate	Rand	8.25	8.25	8.25	6.50	5.75	8.00
Prime	Rand	11.75	11.75	11.75	10.00	9.00	11.50
All Bond Index Yield	Rand	9.9	10.3	11.6	9.5	8.5	9.7
COMMODITIES							
Gold ($/oz)	US$	2,421.9	2,326.3	1,968.4	1,427.7	1,286.1	390.2
Platinum	US$	972.0	1,012.0	949.0	873.0	1,472.0	818.0
Oil (Brent Crude) $	US$	80.6	86.4	85.6	64.7	105.8	41.7
INFLATION							
SA Inflation	%	5.1	5.2	4.7	3.9	6.4	9.4

data provided by FE Analytics

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Fundhouse was founded in 2007 by professionals from the investment management industry. We currently operate from offices in the United Kingdom and South Africa, where we cover the local and global fund industry first hand. Our business is 100% independent and owner managed which means we can offer objective advice and services in the best interests of our clients.

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