WORLD GOLD COUNCIL

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Why gold in 2024?

Safeguarding investment portfolios

Everything points to a soft landing but… watch out!

As we enter 2024, there is no doubt that the soft-landing narrative has been on the ascendancy. Cooling – even if bumpy at times – inflation, a strong labour market and the Fed signalling rate cuts this year have all been strengthening the case for the elusive soft landing (**Charts 1 & 2**).

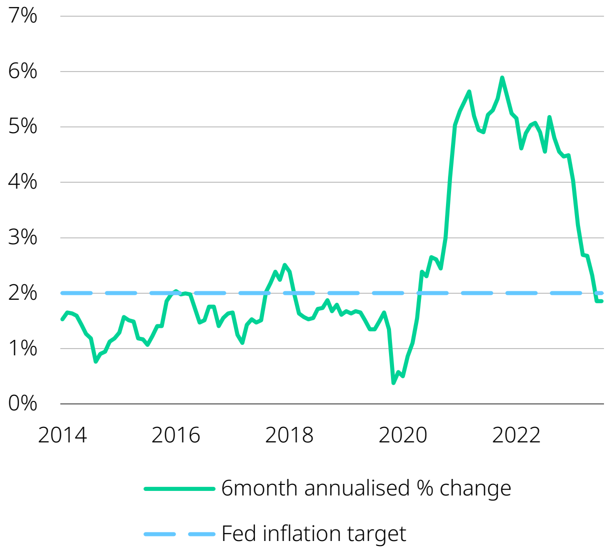
What is clear is that while the US economy is set to slow in 2024, at this juncture, the risk of recession seems to have fallen, reflecting the resilience of the US consumer combined with the robust fundamentals of the corporate sector (**Chart 3, p2**).

Overview

With the soft-landing narrative on the ascendancy, optimism is high within capital markets today.

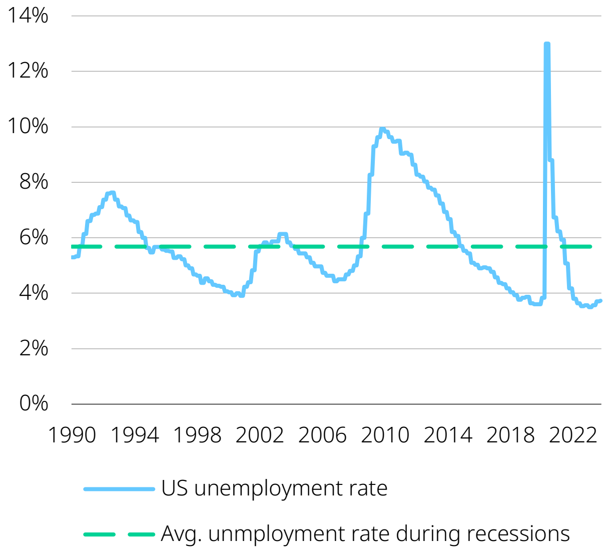
But challenges are on the horizon. As such, we believe that investors should look closely at the portfolio benefits gold can bring.

Chart 1: Disinflationary forces are in motion
PCE core inflation – 6 month annualised % change*



*Data from 31 December 2013 to 31 December 2023.
Source: Bloomberg, Bureau of Economic Analysis, World Gold Council

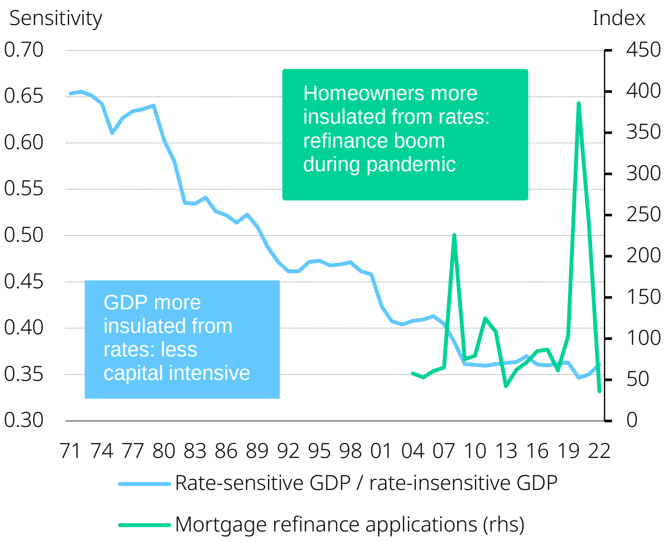
Chart 2: The US labour market shows no signs of distress
US unemployment rate*



*Data from 30 March 1990 to 31 December 2023.
Source: Bloomberg, Bureau of Labor Statistics, World Gold Council

Chart 3: US economy and households insulated against rate rises

Rate-sensitive GDP/rate-insensitive GDP and mortgage refinance applications*



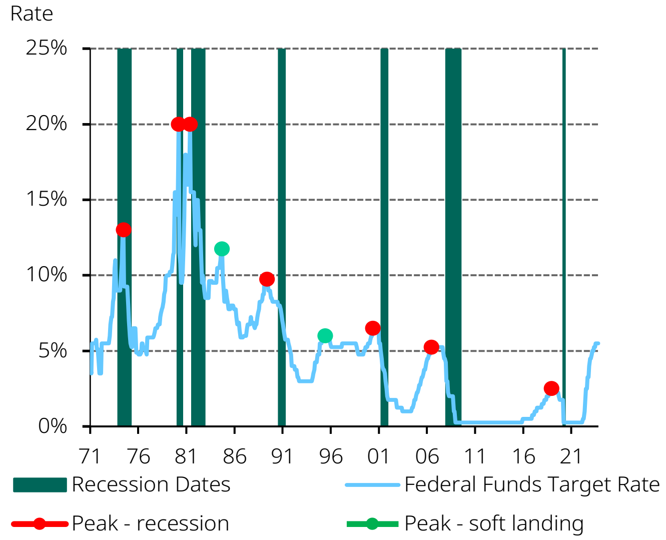
*Annual data from 31 December 1971 to 31 December 2022.
Source: Bloomberg, Bureau of Economic Analysis, World Gold Council

All eyes on S&P 500(0)

Against this backdrop, much optimism can be found within financial markets today. With the recent surge in equities, many major stock markets have now broken through prior all-time highs.[1] But one of the most important questions for investors is whether the tighter monetary conditions can indeed bring about a soft landing for the global economy.

Chart 4: A soft landing is a rarity

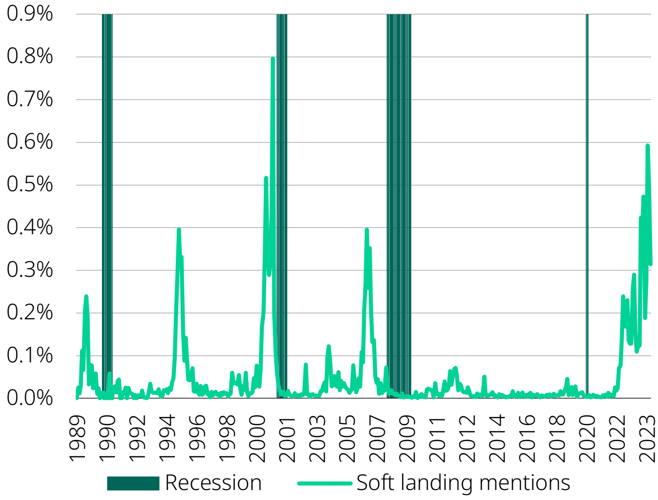
Seven out of the past nine hiking cycles resulted in a recession*



*Data from 29 January 1971 to 31 December 2023.
Source: Bloomberg, Federal Reserve, NBER, World Gold Council

Chart 5: Soft-landing talk on the rise

% of Bloomberg articles mentioning "soft landing" as a proportion of total monthly articles*



*Data from 31 December 1989 to 31 January 2024.
Source: Bloomberg, Deutsche Bank Research, NBER, World Gold Council

Past experience suggests that this will be difficult; monetary tightening has almost always preceded downturns and soft-landing talk has often gathered pace prior to recessions (**Charts 4 & 5**).

Another important question for investors is that even if a recession is avoided, will the economy and profits meet current investor expectations or will asset prices need to correct? In fact, we see a number of risks in the equity market at present.

First, concentration in US equities continues to be a risk. The 2023 equity rally was unusually concentrated and a sign of investor fervour for stocks that could benefit from the growth of AI. The gap between the S&P 500 and the equal-weighted index was at its highest since 1998 during the dot com bubble (**Chart 6**).

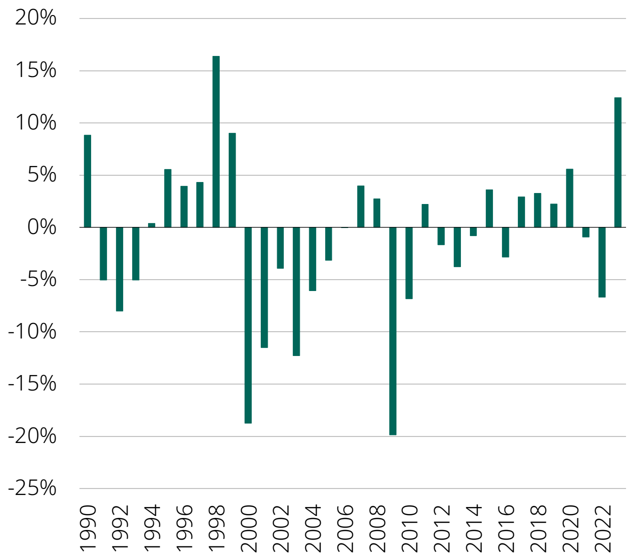
Such disparities inevitably draw attention, particularly at a time when regulatory scrutiny has been increasing, evidenced, for example, by the looming implementation of the European Union's Digital Markets Act or the European Commission's antitrust case against Apple. Continued regulatory pressure has the potential to impact the profitability of the so-called Magnificent Seven reducing investor enthusiasm.[2]

1 The S&P 500 surpassed 5,000 for the first time in the history of the index in February 2024.

2 The Magnificent Seven stocks are a group of high-performing and influential companies in the US stock market: Magnificent 7 Stocks: What You Need to Know (investopedia.com)

Chart 6: S&P 500 saw the biggest outperformance over the equal-weighted version since 1998

Performance difference between S&P 500 and S&P 500 Equal-Weighted*

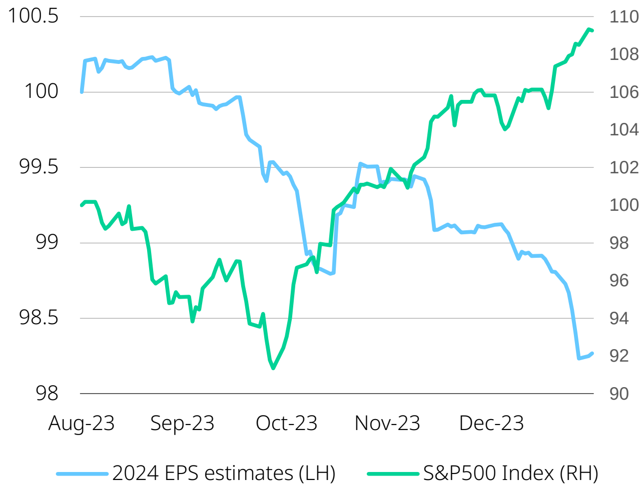


*Data from 29 December 1989 to 31 December 2023.
Source: Bloomberg, Deutsche Bank Research, World Gold Council

Secondly, we are seeing a divergence between the logical link of index price performance and future earnings of the S&P 500 (**Chart 7**). Despite the softening earnings expectations, the market seems willing to pay up for lower expected earnings.

Chart 7: Expected earnings and price returns are diverging

S&P 500 earnings per share estimates vs price*



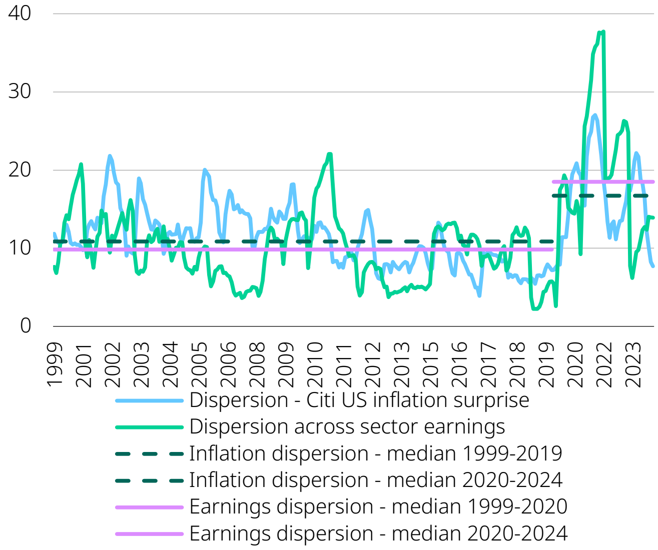
*Data from 31 August 2023 to 31 January 2024.
Source: Bloomberg, World Gold Council

And while this break in relationship can last for a long time,[3] it is nonetheless noteworthy and warrants caution, particularly as equity analyst expectations for 2024 imply that S&P 500 companies, in aggregate, will grow earnings by circa 10% – a lofty assumption in a year where below-trend economic growth is expected.

Lastly, uncertainty around the future Fed funds rate, due to an ambiguous inflation environment, makes the outlook harder to read. Analyst estimates of future S&P 500 equity earnings growth across sectors are more dispersed now than before the pandemic (**Chart 8**). This presents another reason for investors to be cautious, as asset prices become more volatile when investors are presented with new information that proves prior assumptions false.

Chart 8: The outlook is harder to read

Dispersion across US equity sector earnings growth estimates has increased as inflation surprises have risen*



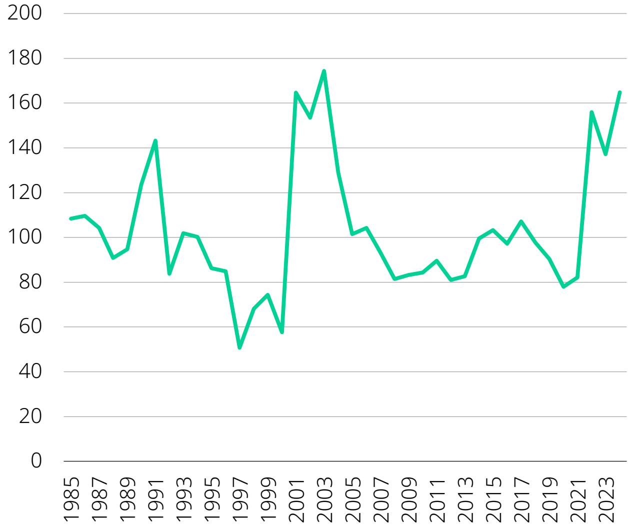
*Data from 31 December 1998 to 31 January 2024.
Source: Bloomberg, Macrobond, World Gold Council

As we move into a more challenging investment environment, one with the potential for greater geopolitical instability (**Chart 9**), we believe investors should consider ways to protect their portfolio.

3. Valuation ratios and the long-run stock market outlook: an update – Campbell and Shiller.

Chart 9: Geopolitical risks have risen substantially

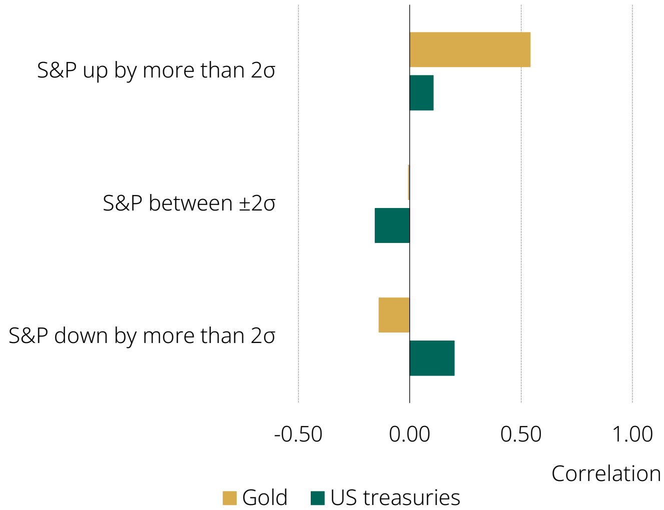
Average annual GPR index*



*Data from 1 January 1985 to 5 February 2024.
Source: Bloomberg, Geopolitical risk (GPR) index, World Gold Council

Chart 10: Gold becomes more negatively correlated with equities in extreme market selloffs

Correlation of US stocks vs gold and US treasuries in various environments of US stock market performance*



*Based on weekly returns of the S&P 500 Index, Barclays US Treasury Index and LBMA Gold Price using data between 31 December 1993 and 31 December 2023.
Source: Bloomberg, ICE Benchmark Administration, World Gold Council

What makes gold a strategic asset?

Gold has a key role as a strategic long-term investment and as a mainstay allocation in a well-diversified portfolio. Our analysis shows gold is a clear complement to equities and broad-based portfolios. Gold has historically provided returns, diversification and liquidity. These characteristics combined mean that gold can materially enhance a portfolio's risk-adjusted returns.

Beyond gold's strategic appeal and considering the potential challenges on the horizon, we believe that investors should look closely at the portfolio benefits gold can bring in 2024.

A hedge against market risk

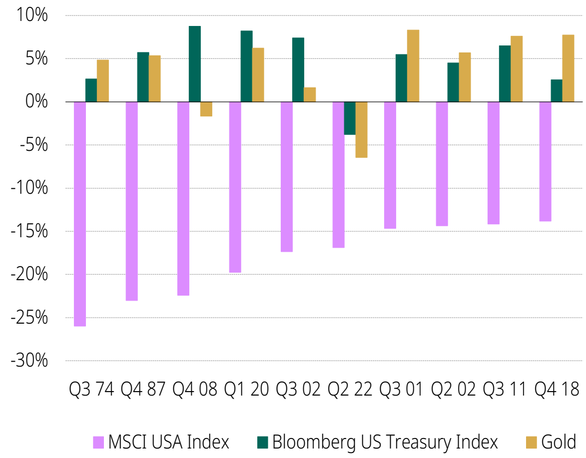
For many investors, high-quality government bonds, such as US treasuries, have long fulfilled the traditional role of a diversifier in investment portfolios, offering protection during periods when risk assets have come under pressure.

And while the return potential of US treasuries has improved recently, there are several advantages to diversifying the sources of safety in an investment portfolio beyond just high-quality government bonds. Gold can play a role alongside US treasuries. In fact, its negative correlation to equities and other risk assets increases as these assets sell off (**Chart 10**).

With few exceptions, gold has been particularly effective during periods of systemic risk, generating positive returns in 8 of the 10 worst quarters of performance for the MSCI USA index. Of the remaining two quarters, gold outperformed the MSCI USA index in both cases reducing overall portfolio losses (**Chart 11**).

Chart 11: Gold provides downside protection

Gold returned positive performance in 8 out of the 10 worst quarters for US equities*



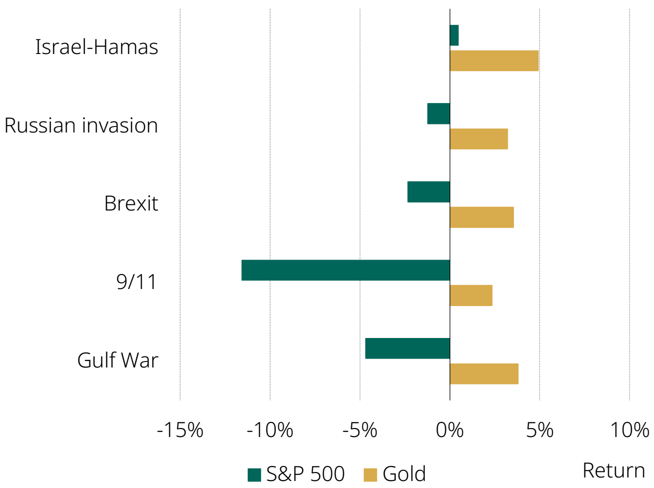
*Data from 31 March 1973 to 31 December 2023.
Source: Bloomberg, ICE Benchmark Administration, World Gold Council

A hedge against geopolitical risk

Furthermore, the timing, magnitude and duration of any geopolitical crisis are always uncertain. They are hence virtually impossible to position for in advance. This will likely be exacerbated in a year with major elections taking place in the US and worldwide. For that reason, long-term strategic portfolio diversification is essential where gold can play a key role as a safe-haven asset (**Chart 12**).

Chart 12: The gold price tends to increase after a geopolitical event

Post-event 5-day return*



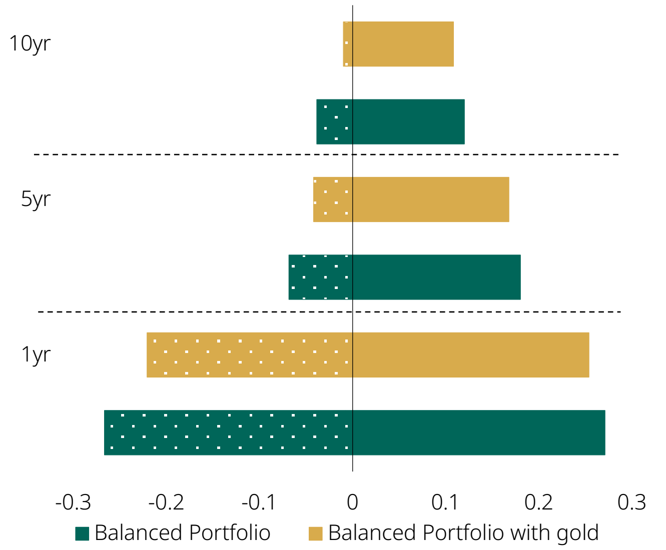
*Return computations in US dollars for 'US equities': S&P 500 Total Return Index and 'gold': LBMA Gold Price PM. Dates used: Gulf War: 2/9/1990; September 11: 11/9/2001; Brexit: 23/6/2016; Russian invasion: 24/2/2022; Israel-Hamas: 7/10/2023.
Source: Bloomberg, ICE Benchmark Administration, World Gold Council

A contributor to growth

Not only is gold a good strategic asset because it is beneficial during periods of uncertainty, it can also generate long-term positive returns in both good and bad economic times. In other words, gold can help reduce the worst outcomes without being overly detrimental to long-term portfolio growth (**Chart 13**).

Chart 13: Maximum and minimum real annualised returns over various investment horizons

Best and worst performance based on annualised real returns over a rolling 1-year, 5-year and 10-year basis*



*Data from 1972 to 2023. Computations based on y-o-y returns for each rolling window. Hypothetical balanced portfolio: 60% equities (MSCI USA Index), 40% bonds (US 10 year treasury index). Hypothetical balanced portfolio with gold: 60% equities (MSCI USA Index), 30% bonds (US 10 year treasury index), 10% gold (LBMA gold price).
Source: Bloomberg, World Gold Council

Conclusion

A soft landing remains the most likely scenario but the likelihood of the Fed steering the US economy to a safe landing with interest rates above 5% is by no means certain. And taking into consideration the strong equity returns over the last year and the potential macroeconomic challenges further down the line, we believe investors should consider ways to protect their portfolio and narrow the range of potential outcomes.

As outlined, gold can help mitigate the key risks ahead by providing diversification that works, and enhancing risk-adjusted returns.

World Gold Council

We are a membership organisation that champions the role gold plays as a strategic asset, shaping the future of a responsible and accessible gold supply chain. Our team of experts builds understanding of the use case and possibilities of gold through trusted research, analysis, commentary and insights.

We drive industry progress, shaping policy and setting the standards for a perpetual and sustainable gold market.

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