PARTNERS CAPITAL

Insights 2022

Asset Class Investment Strategies

Gold

Major Trends

The economic case for gold has diminished: developed market central banks have begun to tighten monetary policy, causing US real yields to rise. Gold has a strong relationship with real yields, typically falling in value when real yields increase.

Geopolitical risks are elevated: Gold continues to be a useful hedge against geopolitical risks such as Russia/Ukraine or flare-ups in the Middle East.

Golden Rules

Gold is an attractive portfolio diversifier at times but should not be regarded as a structural position because: a) it provides no income or yield, b) it can be very volatile - over the last 30 years the standard deviation of the gold price has been 15% p.a., similar to that of equities, and it has twice suffered a peak-to-trough decline of nearly 40% over that period.

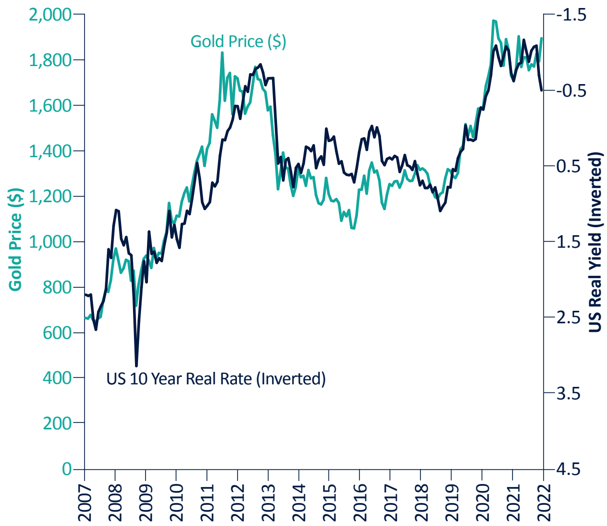
2022 Strategic Priorities

Measure the asymmetry: As a store of value, gold is prone to large swings in sentiment which skews the return outlook. We will only allocate to gold when the expected probability-weighted upside materially exceeds the downside risks.

Focusing on fundamentals: Geopolitics is inherently difficult to predict, and we prefer to base our outlook on economic forecasts. In our base case scenario of gradual normalisation, inflation expectations will remain anchored and nominal yields will steadily rise to 2.5% over the next 12-18 months. This should put gradual downward pressure on the price of gold over the medium-term as real yields rise.

Harvest risk premium: This will typically have us redeeming gold when fear is elevated and adding to gold during times of complacency. Our modelling suggests that a gold price of $1,600 is approximately fair value when the US real yield is -0.5%. As of mid-February 2022, gold was trading at around $1,900. This leaves gold vulnerable to a sharp correction if the Ukraine situation is peacefully resolved.

Exhibit 1
Geopolitical risks have caused a break in the correlation of gold and US real yield



***Source:** Bloomberg*

Expected 12-Month Returns

Exhibit 2
Expected returns by scenario

	Recovery Falters (10%)	Stagflation (10%)	Gradual Normalisation (60%)	Reflation 2.0 (20%)	Expected Value
Gold	-10.5%	-2.6%	-10.5%	-5.2%	**-8.6%**
Notes	As of 31 January the gold price had been inflated by geopolitical risks in Ukraine. Our assumption is that this risk premium will subside and gold will revert to pricing off economic fundamentals and real yields, dropping to $1,600 in our base case of gradual normalisation.				

***Note:** Return assumptions are for the 12 months from 31 January 2022.*

Hypothetical return expectations are based on simulations with forward looking assumptions, which have inherent limitations. Such forecasts are not a reliable indicator of future performance.

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