All that glitters...

Blog Post April 2024

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As gold has reached new all-time highs and is making headlines once again, the question on some investors' minds is whether there is a role for an allocation to this precious metal as part of a wider investment portfolio. In the following post we outline ebi's views on this topic.

ebi's investment philosophy is rooted in an evidence-based approach, which can be seen as 'the process of systematically reviewing, appraising and implementing academic research findings to aid the delivery of optimum investment solutions to investors.' The outcome reached from this process results in an approach of buying and holding a highly diversified portfolio of low-cost, equity and bond index funds and, and rebalancing/trading as infrequently as possible to minimise costs. On reviewing the academic literature for gold and other commodities, we do not believe that the long-term return potential for these assets driven by the future demand or 'hard asset' investment case (that is, that their price will appreciate due to greater demand from future investors) outweighs their zero cashflow generative nature.

While gold tends to have occasional periods of strong performance, over the past half century or so these have typically been short-term in nature, with the return profile of gold being more limited when compared to, for example equities. Recent months have seen another short-term rally in the gold price, leading to significant current media attention on the asset (and a wave of inflows off the back of this). However, the continuation of this rally is of course not guaranteed – such as the situation seen in the aftermath of the rally in gold in 2020, with a significant drop in gold returns occurring after a preceding rally.

Alongside this, there is a fundamental question of how to access gold safely, accurately, and consistently as an asset class. While many in the investment industry are accessing gold through ETFs such as GLD, or similar fund structures, there is a core trust assumption being made through this approach. That is, that the manager of the fund (and its custodian) does indeed hold all of the gold claimed for by the ETF/fund in its entirety, a claim which is extremely difficult, if not impossible to accurately test and prove. History is full of examples, including in recent years, of gold bars that include tungsten in their core (rather than gold), creating the illusion of a far greater gold weight than is actually the case. Research suggests that in comparison to the $10-15 trillion value of all gold reserves held above ground, there are 'paper' claims over that gold (ETFs, gold contracts, futures, and options) valued at potentially some $200-$300 trillion in place. The consequences of this if even mildly accurate are stark – meaning there's potentially only 1-1.5 units of gold for every 20-30 claims on that gold, and that the perceived ownership of gold for the vast majority of apparent owners, is in fact an illusion. The way to combat this is of course to take custody of physical gold (as we see occurring at, for example, the individual level, through physical gold coins, and at the central bank level, through physical gold bars). However, doing so safely involves expensive security and ownership practices, which simply aren't feasible for the vast majority of market participants.

Finally, there are additional outside risks on gold's value that are often dismissed but should be considered when completing full due diligence on gold as an asset class. One of these include that there are an estimated 20 million tonnes of gold in the oceans (compared to the c.200,000 – 300,000 tonnes that have been mined); while this is inaccessible using current technology, the potential of future technological developments leading to a cost-effective acquisition of this resource can't be written off, which of course would lead to a mass down-grading of the value of gold. It's a similar story for asteroids – with gold being a metal present in some asteroids, future technological developments may lead to access of this resource, and to the same potential outcome as the ocean-based case.

While we can understand why gold is being considered as a potential asset class at this juncture (in light of significant global inflation and a short-term run in the asset class), we do not think it is an appropriate investment to hold in our portfolios at this point in time. Nonetheless, we continue to research a wide variety of asset classes on an ongoing basis, consistently kicking the tyres of our investment philosophy, while remaining open to evolving our position in the face of new developments in the global investment market or geopolitical landscape, as appropriate.

If you would like more information on any of the areas covered above, then please don't hesitate to get in touch with us through your usual ebi representative, or by emailing us at: enquiries@ebi.co.uk.

A Suite 7, Beecham Business Park, Northgate, Aldridge, WS9 8TZ | T 01922 472 226 | W ebi.co.uk | E enquiries@ebi.co.uk

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Suite 7, Beecham Business Park, Northgate, Aldridge, WS9 8TZ 01922 472 226 ebi.co.uk enquiries@ebi.co.uk