

Why Is *Gold* Going Up?



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Gold is making headlines in 2020, as its performance leads most other asset classes year-to-date and investors are starting to take notice. In particular, Warren Buffet's recent purchase of a gold mining stock has caught the attention of the media. Those who only think of gold as a "safe-haven" investment have been surprised by its strong performance even as the stock market rallied from its March low. But fundamentally, we believe that gold is not an investment at all. Instead, it's just another form of money like the U.S. dollar or the Euro. So, if it's not an investment, what's driving this big rally in gold? While the answer can be complex, we'd argue that there are two main areas on which to focus when it comes to understanding the price of gold: the money supply and investor sentiment.

If you think of gold as an alternative currency to the dollar, then its price should increase over time as the amount of dollars in the world increases. The math is fairly simple: the amount of gold stays relatively constant from year to year (very little new gold is mined annually) while more dollars are being created on a continual basis. **More dollars chasing the same amount of gold means the price of gold should continue to appreciate over time.** This phenomenon is now in hyperdrive since the current economic crisis has seen a dramatic increase in the supply of dollars as both the federal government and the Federal Reserve print money at a record pace to try and support the economy. The stimulus from the federal government has totaled over \$3 trillion so far, with more stimulus in the works for the second half of the year. Compare this to the entire 2019 annual budget of just under \$1 trillion. More dollars putting upward pressure on the price of gold—check.

From a long-term standpoint, we believe that the money supply will be the ultimate driver of the price of gold. In the short term, however, investor sentiment matters a lot. Money printing has abounded this past decade, but the widely held confidence that the Fed and other central

banks have things under control has kept gold sentiment muted. In other words, central banks are seen as a source of stability and protection. But what if that sentiment shifts? What if the current faith in central banks is called into question? Perhaps central banks aren't all powerful and don't have the appropriate tools to control economic growth and inflation ad infinitum. In years past, pensions and institutions have had core positions in gold to protect against these concerns. But today, these same institutions hold very little in the way of gold. Perhaps the recent purchase by Warren Buffet is a sign that sentiment is changing. **Even a small shift in the sentiment of gold and modest allocations by institutions could lead to a big surge in demand and price.**

We believe in gold for the long term, but over the short term, we think it's likely to be volatile. There are many sentiment-related risks that could push the price of gold meaningfully to the downside. For example, if a promising vaccine comes out ahead of schedule, gold could take a hit based on investor sentiment that the economy is slated to turn around. Or if the U.S. gets the virus under control and starts to grow out of the current crisis at a much faster pace than Europe or Japan, we may regain our status as the "cleanest dirty shirt." In this scenario, the dollar may strengthen, causing gold to suffer. Given this likely volatility in the price of gold, in a perfect world, we'd love to see our clients own gold in a safe and not have to see the volatile price performance on their monthly statements (by the way, we feel similarly about all long-term assets). There are several complications that make this approach impractical unless clients are holding large dollar amounts in gold (e.g., added costs, risk of theft, inconveniences). Instead, we propose that our clients spend some time with us understanding our long-term rationale for gold. Our hope is that education and understanding will allow our clients to ride any short-term volatility waves to achieve our aim of long-term stability.