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Elston Insights

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Gold's allure: a diversifier and a store of value

- Historically gold is a reliable store of value
- Gold has low correlation with both equities and bonds
- Investors can get liquid access via exchange-traded products

The role of gold within a portfolio

Historically, gold has been the ultimate store of value through periods of market stress – a go-to solution for insulating and protecting. The precious metal has the potential to protect against the corrosive effects of inflation on overall value. It also provides portfolio insurance and delivers risk-based diversification. Unlike some other Alternative assets, gold is highly liquid (in terms of average daily trading volume), making it readily investable.

When looked at relative to a declining fiat currency, Sterling investors with (unhedged) gold exposure in their portfolios have benefited from a preservation of value. Gold is also a source of "true diversification" owing to the metal's uncorrelated relationship with both equities and bonds.

Fig.1. Gold and precious metals correlation matrix

	Gold	Silver	Platinum	Palladium	Global Equities	UK Gilts	Elston 60/40 GBP Index
Gold	1.00						
Silver	0.73	1.00					
Platinum	0.45	0.60	1.00				
Palladium	0.24	0.40	0.61	1.00			
Global Equities	0.09	0.22	0.25	0.32	1.00		
UK Gilts	0.39	0.22	0.05	0.01	- 0.13	1.00	
Elston 60/40 GBP Index	0.15	0.27	0.30	0.36	0.97	- 0.02	1.00

Source: Elston research, Bloomberg data, 10Y Correlation to Dec-20 (weekly data, GBP terms)

The chart above illustrates the low correlation between gold and both global equities and a traditional 60/40 equities/bonds index.

Some asset allocators despise gold as there is no income yield and no intrinsic growth potential. But then there are gold afficionados who believe that gold is the be-all and end-all of investing. A measured approach would be to recognise its historical properties as a store of value through inflationary times and to harness its diversification potential owing to its uncorrelated behaviour.

How can investors get exposure?

If you want to be able to hold your asset in the palm of your hand, you can go to a bullion dealer and buy a gold coin (like a gold sovereign). Sovereigns are free of capital gains tax as they still count as legal tender. The problem is a) you can only buy them in increments of approximately £300, b) the premium/discount to its gold value is typically quite wide and c) you can easily lose them! For more liquid and convenient access, there are a number of options in the market that give investors exposure to gold in different ways.

1. Physical Gold: for targeted exposure to the gold spot price, investors can buy exchange-traded commodity funds (ETCs) that directly own physical gold bullion.
2. Gold hedged into sterling: If you like physical gold and also tactically believe that Sterling could recover from its lows, you could look at a Sterling-hedged ETC instead. This would be simpler than running a separate currency overlay. In our view, part of gold's appeal is as a diversifier away from currency, not towards it.
3. Gold miners: rather than direct exposure to gold, investors can also look to own a group of gold miners and producers via an ETF, capturing a similar performance profile, but introducing financial and operating leverage. This can amplify short-run returns on the upside or downside.

Summary

Gold has an important role to play as an uncorrelated diversifier, as a form of portfolio insurance shock absorber and as a hedge against inflation. For investors wanting to access the yellow metal as part of their portfolio, there are a broad range of instruments that will allow you to do so in a liquid, cost-effective manner.

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