TIME FOR GOLD TO SHINE

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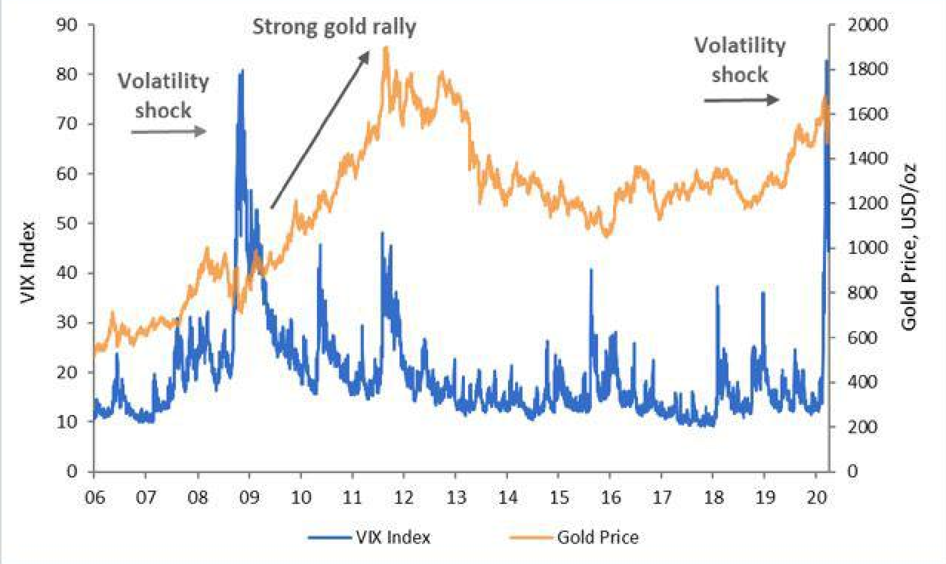
During times of heightened economic uncertainty or market volatility, investors typically turn to gold to preserve the real value of their portfolios. Such events serve as reminders of the value of the precious metal in a strategic asset allocation, i.e. nobody knows when a black swan will land. They can also provide attractive entry points for tactical and strategic investors alike. While there are no certainties as to how the price of an asset will move in the future, history can be our guide in identifying helpful leading indicators. If gold behaves as it has in the recent past in response to financial market volatility and economic uncertainty, it may be in for a strong bull run.

A volatility shock like before

Financial market volatility has often retreated quickly following sharp surges historically creating spikes as evident in the VIX Index (CBOE Volatility Index). Some spikes are relatively contained, like the one in February 2018 which resulted from trading activity in the VIX derivatives market. A broad market meltdown did not manifest thereafter, and volatility levels dropped back quickly. There are however only 2 instances when the VIX spiked to more than 4 times its historic average of 18 since the index started in 1994. The first one was in October 2008 and the second, in March 2020 (Figure 1).

A shock of this nature is symptomatic of something fundamentally shaking market confidence. In 2008, it was the banking crisis and now, it is the coronavirus pandemic. In 2008, VIX peaked above 80 and retreated very gradually and now, it surpassed 80 in March and is descending leisurely. In 2008, markets endured losses as the global economy fell into recession and now, markets have fallen as the global economy has come to a standstill. In 2008, we saw gold embark on a strong bull run that lasted nearly 3 years and now, we may see something similar.

Figure 1: Market volatility has previously propelled the gold rally



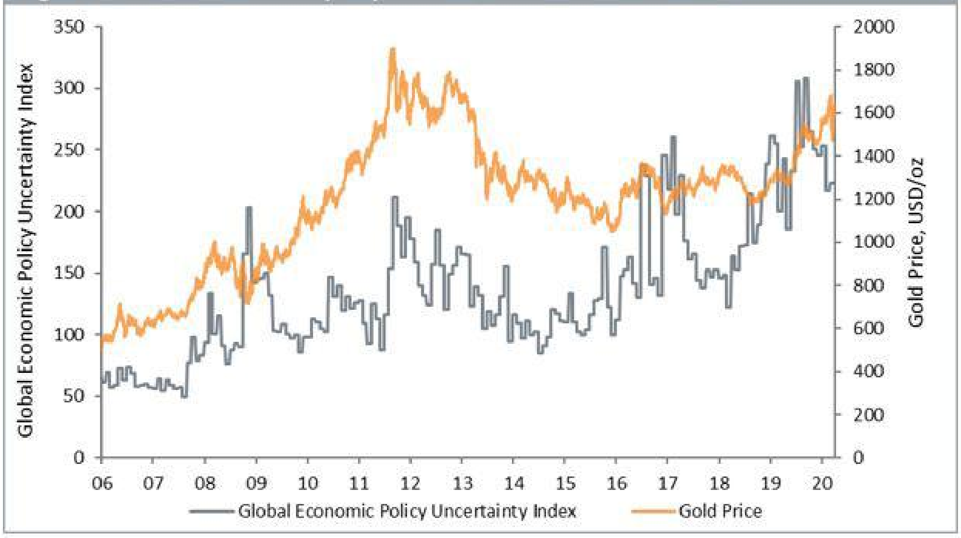
Source: WisdomTree, Bloomberg. Data as at 06/04/2020. VIX Index refers to the Chicago Board Options Exchange's (CBOE) Volatility Index.

You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.

An economic shock like never before

The coronavirus pandemic is creating unprecedented global economic uncertainty. Yes, the world has seen pandemics and recessions before but lockdowns at such vast scales, in a world more interconnected than ever, are novel like the virus itself. Economic uncertainty challenges policymakers who are now scrambling to introduce emergency monetary and fiscal measures to prevent the global economy from crippling. In the past, rising economic uncertainty has helped lift gold prices, i.e. gold's lure as a safe-haven is augmented when economic risks are profound. The scale and duration of the current shock, its impact on the global economy and the potency of policy measures are all unknown variables. The uncertainty shock may be larger than the one associated with the 2008-2009 financial crisis (Baker, Bloom, Davis and Terry 2020)[1]. This may manifest in significantly higher readings in the Global Economic Policy Uncertainty Index (Figure 2) when the index is computed for March and subsequent months. It may even accelerate the paradigm shift[2] Ray Dalio proposed in 2019 towards gold in the face of depreciating value of money as central banks endeavour to deepen the liquidity injection.

Figure 2: Economic uncertainty helps increase demand for safe havens



Source: WisdomTree, Bloomberg. Data as at 06/04/2020. Latest data point available for the Global Economic Policy Uncertainty Index is February 2020.

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Gold has historically come into favour when there is financial market volatility or economic uncertainty. Today, we have both. We believe this provides strong reasons for investors to seek the precious metal. Now may be the time for gold to shine.

Source

[1] Paper by Scott Baker, Nick Bloom, Steven J. Davis and Stephen J. Terry titled “COVID-Induced Economic Uncertainty” as of 04 April 2020.

[2] Linkedin post by Ray Dalio, Co-Chief Investment Officer, Co-Chairman and Founder of Bridgewater Associates titled “Paradigm Shifts” published on 17 July 2019.

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