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The allure of gold – an article from ETF Securities

The allure of gold is unmistakable in the current economic environment. Its attributes as a store of value have historically attracted investors during times of financial and economic uncertainty, and as a counter to inflation and currency erosion. But gold's attribute as being a portfolio diversification tool should also not be underestimated.

Many investors remain justifiably concerned about the sustainability of the global rebound. The global economy is only in the nascent stages of recovery and unemployment remains at elevated levels. Persistent concerns over the state of government finances, especially within the Eurozone, are forcing governments to tighten public purse strings. At the same time, inflationary expectations are being stoked from two fronts: surging agricultural prices are impacting food prices, while ongoing cheap liquidity and bond-buying activities by central banks are fuelling expectations about future inflationary pressures and currency debasement. In this environment investors are looking for 'hard assets' to buffer portfolios against the rising risks of pipeline inflation, the erosion of currency values and as a counter to possible government defaults.

An integral part of gold's value as a 'risk-event' hedge is its usefulness as a portfolio diversification tool. The gold price tends to move in a counter-cyclical fashion, offsetting the return profile of many other assets, in particular equity market returns. As a result, precious metals exposure can enhance the risk-adjusted return profile of a balanced portfolio. Interestingly, our analysis indicates that investors who gain exposure to gold via mining shares can enhance their portfolio returns profile by adding direct allocations of gold or other precious metals – it is not simply a choice between holding gold directly or holding mining equities. Mining company shares are not a substitute for direct holdings of precious metals because while gold responds to fundamental factors, mining company shares remain highly correlated to equity market movements and are also impacted by company specific factors. It is possible to invest directly into gold through ETFS Physical Gold (ASX Code: GOLD), which is an Exchange Traded Commodity backed by physical metal.

With gold around 40% below its all-time highs in real terms and as the risks to global economic stability remain, there would appear to be substantial scope for further appreciation. How high the gold price can go will be determined by how well governments are able to manage the dilemma of needing to control rapidly rising government debt while trying to stimulate structurally weak domestic economies. Additionally in the coming year, should developed market growth continue to recover, gold returns could be enhanced if the AUD loses ground against the USD. As US growth prospects are potentially rerated, expectations of tighter US monetary policy could weigh on the value of the AUD, thereby giving an additional boost to Australian holders of USD denominated assets, including gold.

The ETFS Physical Gold ETF has recently been added as an investment option on the BlackRock CPS.

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