JUNE 2024 CLIENT QUESTION OF THE MONTH

GOLD

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WINTHROP WEALTH

History of Gold as an Investment

Gold has long been admired for its natural beauty and versatility, playing a crucial role in human history as a symbol of wealth and power. The use of gold dates back to around 3000 BCE when ancient Mesopotamians crafted it into jewelry and decorative items due to its malleability and luster.

The Egyptians also honored gold, associating it with the gods and the afterlife, as evidenced by the treasures found in pharaohs' graves, including the iconic mask of Tutankhamun. In South America, pre-Columbian civilizations such as the Incas used gold for ceremonial objects and decorations, symbolizing divine and royal authority.

Gold was not only respected for its decorative and symbolic uses, but also for its role in early economies. The Lydians, located in present-day Turkey, minted the first gold coin around 600 BCE. This simplified trade and established gold as the standard for monetary systems.

Ever heard of the anecdote that a high-quality men's suit has always cost about one ounce of gold? It's an echo of its ability to preserve purchasing power across generations.

Today, gold reserves are held by central banks and it remains a popular investment for individuals, continuing its legacy as a trusted store of value.

The History of Gold in the United States[1]

Here's a look at the critical periods in U.S. history when gold played a pivotal role in monetary policy.

Pre-1971: The Gold Standard, 1933 Devaluation of the Dollar, and Bretton Woods

- **Gold Standard:** In the late 19th century, the U.S. embraced a fixed gold standard, known as the Gold Standard Act of 1900, where every dollar was directly tied to a fixed amount of gold.
- **1933 Devaluation of the Dollar:** President Franklin D. Roosevelt suspended the fixed gold standard to stabilize the economy amidst the Great Depression, marking a pivotal shift in U.S. monetary policy. By executive order, U.S. citizens were required to exchange their gold for paper currency. Subsequently, the Gold Reserve Act of 1934 effectively devalued the dollar by 40%. This devaluation aimed to combat deflation, stimulate economic growth, and increase the money supply.
- **Bretton Woods and Post-War Era:** In 1944, representatives from 44 nations met in Bretton Woods, New Hampshire to design an international framework aimed at promoting economic stability in the post-World War II period. The agreement established a system of fixed exchange rates where each participating country pegged its currency to the U.S. dollar. Furthermore, dollars were convertible to gold at $35 per ounce. The new global system facilitated international trade and established the dollar as the dominant reserve currency, which it still maintains today.

1971 to Present: The End of the Gold Standard, the Rise of Fiat Currencies and its Impact on Gold

- **End of the Gold Standard:** In 1971, President Nixon ended the fixed gold standard, commonly referred to as the "Nixon Shock," transitioning the U.S. to a fiat currency. This move was driven by the need for more flexible monetary policy to address trade deficits and inflationary pressures without being constrained by gold reserves.
- **Rise of Fiat Currencies:** Following Nixon's decision, the U.S. dollar became a fiat currency. Fiat currency is not backed by a physical commodity. Instead, its value is determined by supply and demand, backed by the creditworthiness of the issuing government.
- **Impact on Gold:** Without the obligation to exchange dollars for gold, the price of gold was no longer fixed at $35 per ounce. Instead, it was allowed to float freely in the open market, leading to significant fluctuations in its price.

For a deeper dive into the historical context and its implications, you can refer to this Federal Reserve article.

Why Do People Buy Gold?

Gold appeals to buyers for different reasons, not only its visual appeal (though that certainly helps!). Unlike fiat currency, which can be printed at will, gold has historically been a scarce resource and has grown slowly in value, making it a precious and desirable asset. This enhances its appeal as a long-term investment.

Gold is often sought-after during periods of economic turmoil and geopolitical conflicts, acting as protection against high sustained inflation, economic instability, and currency devaluation. When fiat currencies lose their purchasing power, gold provides a refuge, offering a means to preserve wealth amidst uncertainty.

Different Forms of Purchasing Gold

In recent decades, financial instruments have been able to provide ease of access to gold. Investors can purchase gold in several forms, the most common ones include:

- **Physical Gold:** This includes gold bars, coins, and jewelry. While owning traditional forms of physical gold provides a tangible asset, it requires secure storage and insurance to protect against theft or loss. Transactions costs, such as premiums above the spot price and dealer fees, can become significant.
- **ETFs (Exchange-Traded Funds):** These funds track the price of gold and allow investors to invest in gold without taking physical possession of the metal. Gold ETFs are traded on stock exchanges, providing liquidity and ease of access. They are a convenient way to gain exposure to gold prices with lower transaction costs compared to buying physical gold. However, ETFs carry risks, such as potential discrepancies between the ETF's market price and the actual gold price (known as tracking error), and they may involve management fees.
- **Gold Mining Stocks:** Investing in gold mining companies offers indirect exposure to gold prices. However, this method involves additional risks related to the operational performance and geopolitical risks in mining regions that can cause these mining companies' stock price to be more volatile than the gold price itself.

In summary, investors have choices for purchasing gold, each with a set of their own distinct risks and characteristics. Ultimately, the choice between the different forms of gold depends on individual preferences, investment objectives, and risk tolerance.

Strategies for Investing in Gold

Incorporating exposure to gold into investment portfolios can be achieved through various strategies, including:

- **Buy-and-Hold:** Determining a long-term strategic allocation and sticking with it regardless of short-term fluctuations. As we'll discuss later, since 1971 gold has produced an annualized return that exceeds inflation, but performance is not consistent. Gold has historically been volatile over shorter time periods and has experienced prolonged periods of underperformance compared to many other assets.
- **Trading:** Trading gold can be challenging due to its price volatility. Successful trading requires a deep understanding of market dynamics and often involves significant risk. Tactical gold trading is tough even for professionals; returns are often lumpy and volatile.

When investing in gold, we favor a buy-and-hold strategy. In our view, an investment in gold is best viewed as a long-term commitment that provides the individual with a safe haven asset and a hedge against inflation. *No strategy assures success or protects against loss.*

Historical Returns

According to George Milling-Stanley, Chief Gold Strategist at State Street Global Advisors, historical performance since 1971 can be broken down into three distinct bull and bear market periods: 1971 to 1980, 1980 to 2000, and 2001 onward through the early 2020s.[2]

- **1971 – 1980:** The price of gold skyrocketed in the 1970s when the Bretton Woods system collapsed, allowing gold trade freely in the open market for the first time in history and letting investors buy and sell it without limitations. At the time, the economic instability and higher inflation led investors to seek gold as a safe haven, driving its price higher.
- **1980 – 2000:** Throughout the 1980s and 1990s, gold experienced a prolonged period of lackluster performance. Despite occasional spikes, the overall trend was flat or declining, reflecting relative economic stability and low inflation.
- **2001 – early 2020s:** In the late 2010s and early 2020s, gold prices again showed significant volatility. The COVID-19 pandemic and global economic uncertainties pushed prices to new highs, but fluctuations continued, highlighting gold's unpredictable nature.

The following chart shows the calendar year returns of gold from 1971 through 2023, the annualized returns by decade, and the annualized performance through 2023 at various starting points. Since 1971, gold has provided an annualized return of about 7.9% exceeding the total CPI inflation rate of approximately 4.0%. However, the starting point matters as gold will fluctuate based on various economic, political, and market factors.

Gold Calendar Year Returns: 1971 - 2023

Total Annualized Return: 7.9%

Positive Years: 34 (64%)

Negative Years: 19 (36%)

		1998 -0.8%	2011 8.9%			
		2018 -0.9%	2012 8.3%	2003 19.9%		
		1994 -2.2%	2016 8.1%	1986 19.0%		
		1989 -2.8%	1985 6.0%	2019 18.4%		
		1990 -3.1%	2004 4.6%	2005 17.8%	2010 29.2%	
		1976 -4.1%	2008 4.3%	1993 17.7%	2002 25.6%	1979 126.5%
		2021 -4.3%	1995 1.0%	1971 16.7%	2009 25.0%	1973 73.0%
1997 -21.4%	2015 -12.1%	1996 -4.6%	1999 0.9%	1980 15.2%	2020 24.6%	1974 63.8%
1975 -23.7%	1988 -15.3%	2000 -5.4%	2001 0.7%	1982 14.9%	1987 24.5%	1972 48.8%
2013 -27.3%	1983 -16.3%	1992 -5.7%	2022 0.4%	2023 14.6%	2006 23.2%	1978 37.0%
1981 -32.6%	1984 -19.4%	1991 -8.6%	2014 0.1%	2017 12.7%	1977 22.6%	2007 31.9%
Less than -20%	-20% to -10%	-10% to 0%	0% to 10%	10% to 20%	20% to 30%	Greater then 30%

Annualized Returns By Decade

	1970s	1980s	1990s	2000s	2010s	2020 - 2023
Gold	30.7%	-3.3%	-3.1%	14.1%	3.1%	8.0%
CPI Inflation	7.3%	5.0%	2.9%	2.6%	1.8%	4.6%

Annualized Performance Through 2023 At Various Starting Points

	1971 -	1980 -	1990 -	2000 -	2010 -	2020 -
Gold	7.9%	3.0%	5.0%	8.5%	4.5%	8.0%
CPI Inflation	4.0%	3.2%	2.6%	2.6%	2.6%	4.6%

Source: Bloomberg. LBMA Gold Price PM Index. Past performance does not guarantee future results and it is not possible to invest directly into an index.

Historically, gold tends to outperform in environments of economic instability, sustained high inflation, and currency devaluation, as investors seek safety for wealth preservation. On the other hand, it often underperforms during periods of strong economic growth, moderate inflation, and stable geopolitical climates, when equities and bonds become more attractive investments.

While the historical performance of gold has exceeded CPI inflation, it's essential to recognize that returns are not consistent. Its price history is dotted with multi-year periods of both strong gains and disappointing losses, underscoring the importance of understanding gold's nature as an investment when considering it as part of a diversified portfolio. An allocation to gold has historically worked well over long-periods for investors who understand that the ride might will not always be smooth.

SOURCES

1. Federal Reserve Bank of St. Louis. (2020). Changing relationship of trade and America's gold reserves. *Regional Economist, First Quarter 2020*. Retrieved from https://www.stlouisfed.org/publications/regional-economist/first-quarter-2020/changing-relationship-trade-americas-gold-reserves
2. G. Milling-Stanley, personal communication, June 4, 2024.

DISCLOSURES

Content in this material is for general information only and not intended to provide specific advice or recommendations for any individual. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and may not be invested into directly.

The economic forecasts set forth in this material may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

ETFs trade like stocks, are subject to investment risk, fluctuate in market value, and may trade at prices above or below the ETF's net asset value (NAV). Upon redemption, the value of fund shares may be worth more or less than their original cost. ETFs carry additional risks such as not being diversified, possible trading halts, and index tracking errors.

The fast price swings in commodities will result in significant volatility in an investor's holdings. Commodities include increased risks, such as political, economic, and currency instability, and may not be suitable for all investors.

Asset allocation does not ensure a profit or protect against loss. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio.

Diversification does not protect against market risk. All investing involves risk which you should be prepared to bear.

The LBMA Gold Price PM Index measures the performance of setting price of gold, determined twice each business day on the London bullion market by the five members of The London Gold Market Fixing Ltd. It is designed to fix a price for settling contracts between members of the London bullion market, but informally the gold fixing provides a recognized rate that is used as a benchmark for pricing the majority of gold products and derivatives throughout the world's markets.

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