GOLD

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What You Need To Know About The Most Popular Inflation Hedge

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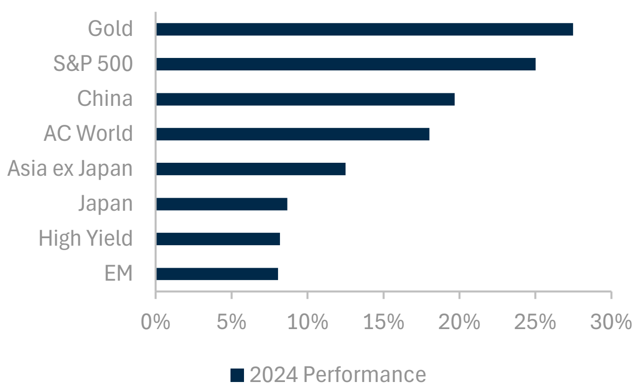
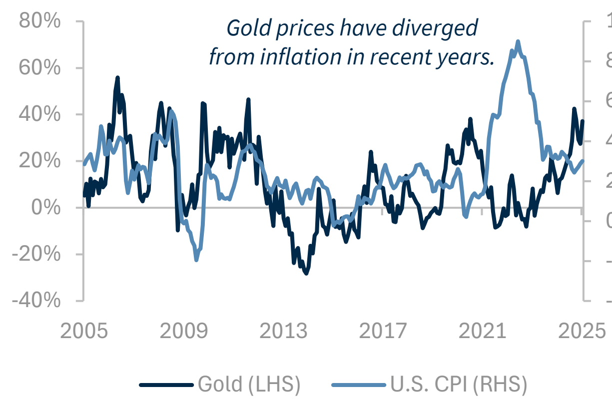
Gold is a commodity like no other. In contrast to other hard assets, gold plays a unique role in the global monetary system—simply put, gold is perceived as money. Gold's function as a store of value makes it arguably the world's most popular hedge against inflation. However, gold has its risks: this market is subject to its own price volatility, including being prone to short-term swings in sentiment, on the way up as well as down. In this report, we provide an overview of what investors need to know about the gold market and share Investment Strategy's outlook for 2025.

What Has Driven Gold To All-Time Highs?

Setting aside a few niche commodities, gold stands out for having been the best-performing asset class (+27.5%) in 2024. Moreover, YTD as of February 24, gold has outperformed the S&P 500 by ~10%. The latest rally in gold has been largely driven by record purchases from central banks and individual investors. World Gold Council data shows that central banks purchased over a thousand metric tons of gold for the third consecutive year, and investor purchases of physically-backed gold ETFs pushed their total assets under management up by 26%. Fund flows are always influenced by investor sentiment, which throughout the past 12-plus months has been dealing with geopolitical risk (Middle East and Russia/Ukraine) as well as the US election and an unusually large number of other high-profile elections around the world.





Gold Prices Outpace Inflation Over The Long Run But Also Swing With Sentiment

The vast majority of commodity markets reflect physical supply and demand. What makes gold different is that demand for it is difficult to define. In any given year, half of the gold being mined is used to make jewelry, but of course, that gold does not 'disappear' in the way that a barrel of oil or a bushel of corn does. The bulk of the other half is used for gold bullion: bars, ingots, and coins. In fact, here is an amazing statistic to keep in mind: an estimated 90% of all gold ever mined continues to exist to this day.

On a long-term basis, gold prices generally outpace inflation. Since 2000, gold is up 10x, while the US CPI has doubled. Gold gained during the global financial crisis (2008-2009) and the early part of the COVID-19 pandemic (2020). On the other hand, after gold overshot to the upside in the wake of the financial crisis, it went into a bear market (2013-2015). The chart above on the right shows that—counterintuitively—gold underperformed as inflation peaked in 2022 but then outperformed as inflation slowed. Sentiment is a major factor over shorter time periods, and it is difficult to predict which way sentiment will move prices.

Sources: FactSet, World Gold Council, US Geological Survey

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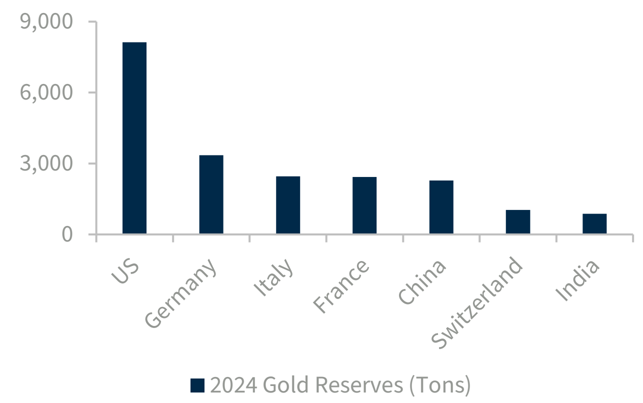
Gold's Monetary Attributes Are Seen In Hefty Ownership By Central Banks

For centuries, gold had been the basis of money supply, with wars fought and colonies established in order to secure control over gold resources. In the 21st century, there are no governments that retain the gold standard, but gold is still a store of value—which, as we learn in Economics 101, is one of the basic attributes of money. As shown below, the US government holds more official gold than any other country—a whopping 8,100 metric tons, equating to nearly 3x the world's annual mine production—followed by Germany, Italy, France, and China. Looking at incremental purchases, China's central bank is the most active, though its purchases can be lumpy—they resumed in November 2024 after a six-month pause. An important reason for China's accumulation of gold is to reduce dependence on the US dollar. In other words, China has a strategy of gradually shifting from US dollar reserves toward gold.

Most of us, of course, will never be invited to Fort Knox or the world's other gold vaults. The decisions about when central bank gold is bought and sold are made by the same policymakers who set interest rates. While central banks have been net buyers in recent years, that trend may eventually subside and perhaps even reverse, as happened during the period of low inflation in the 1990s and 2000s.



Global Gold Mine Production (metric tons)

	2019	2020	2021	2022	2023	2024
Australia	330	328	330	314	310	290
Canada	180	170	170	206	200	200
China	420	365	370	372	370	380
Russia	310	305	300	310	310	310
South Africa	90	96	100	89	100	100
US	200	193	180	173	170	160
All Other	1,770	1,573	1,550	1,596	1,540	1,860
World	**3,300**	**3,030**	**3,000**	**3,060**	**3,000**	**3,300**
%Change		**-8%**	**-1%**	**2%**	**-2%**	**10%**

Gold Output Is Mostly Stable From Year To Year

While gold demand can be hard to gauge, the supply side of the equation is much more straightforward. There is no mystery about how much gold is mined from year to year. As shown above, global mine production has been flattish from pre-COVID levels, bouncing around 3,000 metric tons per year. Perhaps surprisingly, the world's largest producer of gold is China, albeit with a modest 12% of the volumes in 2024. Some of our readers might be thinking of the famous Witwatersrand gold field near Johannesburg, but gold mining in South Africa peaked all the way back in 1970. In any case, volumes since 2019 are down in Australia, China, and the US; and they are flattish in Russia and South Africa.

If you are investing in gold as a commodity, of course you welcome the fact that annual mine production is approximately the same as it was five years ago. There are metals where the market can occasionally be in oversupply mode—for example, lithium is a case study of that—whereas that is *not* an issue for gold. On the other hand, if you own shares in gold mining companies, be aware that overall industry volumes are essentially flat. This is the result of geological and operational constraints at mining sites—if companies were able to produce more, they would. Also, approximately one-quarter of the gold supply—above and beyond what's mined each year—comes from recycled sources, mainly jewelry.

Sources: FactSet, World Gold Council, US Geological Survey

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Our Outlook For Gold In 2025 – Can The Recent Outperformance Continue?
Following gold's best year since 2010, we maintain a tepid outlook as the risk/reward calculation looks broadly balanced. As we have highlighted, the gold market has largely been driven by sentiment-related factors. Here are a few reasons why we expect the recent surge in gold to slow, with prices remaining range-bound this year.

Geopolitical Uncertainty Starting To Subside – Is The Worst Case Priced In?
In our *Ten Themes* report, we highlighted that global uncertainty, both economically and politically, is at historically elevated levels. In Washington, key question marks remain on trade and fiscal policy—and gold's status as a perceived safe haven means it could get short-term headline boosts from these areas. However, markets have become acclimated to this uncertainty, as shown by the fact that the VIX ('fear index') has averaged below 20 YTD, and there is the potential for uncertainty to subside. For example, if the ceasefire in Gaza is sustained, and if Russia/Ukraine peace talks gain momentum, this could pose a downside risk for gold. Additionally, if Trump's tariff rhetoric is solely a bargaining play and tariffs do *not* go into effect, demand for gold could wane. Reduction of geopolitical risk could swing sentiment away from gold.

Correlations To US Equities & The Dollar May Pose A Headwind
While, historically, gold had little to no correlation with US equities, this relationship has changed in recent years. Since 2022, gold has exhibited a positive correlation with the S&P 500—meaning, they both tend to trade in the same direction, thereby contributing to short-term volatility in gold prices. With valuations for both asset classes at stretched levels, this will likely lead to increased volatility. Trade policy could also prove to be a headwind, as US-imposed tariffs could push the US dollar higher. Given that gold prices are denominated in US dollars, and gold has a negative correlation to the USD, this could limit gold's upside.

Further Cooling Of Inflation May Reduce Demand For Gold
While gold has served as an inflation hedge over the long run, it sometimes deviates from this trend. As we mentioned earlier, US inflation (CPI) has markedly slowed from its peak of 9% in 2022. Despite the cooling of inflation over the past three years, gold has traded sharply upward, setting new all-time highs, which suggests that sentiment has been the main driver of the rally. It is worth mentioning that the Raymond James CPI forecast for the full year 2025 is 2.9%, implying further cooling from recent levels. Lower inflation could serve as a headwind for the gold market, all else being equal.

Sentiment & Fund Flows Suggest Crowded Positioning
Central banks and individual investors purchased gold at a record pace in the past three years. Central banks will continue to purchase gold, but probably at a slower pace, and these purchases are subject to political considerations. Global physically-backed gold Exchange Traded Funds (ETFs) saw $3.4 billion of net inflows in 2024, and investor net longs in gold are elevated versus history—again, suggesting that prices have been driven by sentiment. This crowded positioning could lead to increased volatility.

Bottom Line – Gold Likely Range-Bound Over Next 12 Months
Putting everything together, we believe that most of the 'easy money' in gold has been made, and the recent gains—largely driven by sentiment, we would argue—have left the gold market vulnerable to pullbacks. As a base case, we expect gold to be range-bound over the next 12 months around current levels, although volatility will likely be elevated during that time.

Sources: FactSet, World Gold Council, US Geological Survey

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CONSUMER PRICE INDEX | The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

S&P 500 | The S&P 500 Total Return Index: The index is widely regarded as the best single gauge of large-cap U.S. equities. There is over USD 7.8 trillion benchmarked to the index, with index assets comprising approximately USD 2.2 trillion of this total. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

VIX | The Chicago Board of Exchange (CBOE) Volatility Index (VIX), also known as the Fear Index, measures expected market volatility using a portfolio of call and put options on the S&P 500.

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