TIM
UNDERWOOD

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The noticeable feature of this year has been the very strong gold price from which we have benefited. In dollar terms it is higher by +18% in the last three months and that is after a good 2024 rising by +26%. Why is this?

It is said that the gold price rises when inflation is high and that it is a good store of value. While that might be true over the long term over a shorter time period the link is not so close. This year for example we have seen inflation come down in the main economies, or at least not rise and yet the gold price is strong. Of course the quoted inflation rate is below the real underlying rate as Governments ignore key inputs like energy and food. They also calculate it in odd ways such as in the USA where housing costs are an input for rental estimates, basically a guess in the dark. They also ignore taxation which is another cost people face. Despite the lower quoted inflation rate the gold price has been strong.

Another factor is said to be lower interest rates. As gold pays no interest, if interest rates are high then there is an opportunity cost to investing in gold. In 2023 interest rates rose significantly as central banks tried to hold down inflation resulting from the Covid lockdowns but the gold price had a strong year and higher rates did not harm the price.

Perhaps the more important factor on the gold price is the general sense of well being in the global economy. If economic and financial fears are rising then people like to hold some gold and as the supply is limited and the more the demand the greater the price. Those fears are high at the moment.

There is also an odd feature in the way the USA Central bank values its gold reserves.

It is well known that the USA government has the largest reserves of gold bullion in the world mainly held at the US Army base of Fort Knox in Kentucky but also in Denver, West Point and New York. What people might not know is that the gold is valued at $ 42 per ounce when the true market price is around $ 3,000 today. This means the gold is valued at $ 11 billion by the US treasury when its actual value is more like $ 770 billion.

The reason for this odd situation is historical and goes back to the early 1970s and it has never been adjusted. Other countries adjust their gold valuation on a regular basis but not in the USA. Now there is talk about correcting the valuation and this would see a significant uplift in the Treasury's reserve. This raises 3 questions :

1. What would be the effect on the gold price ?

2. Would other assets be impacted ?

3. Will the USA do this ?

1. Such attention on gold would be global and likely positive for the price. In the past wealthy individuals held a much higher percentage of their assets in gold than they do now and additional demand can be expected. Furthermore gold ETFs have been out of favour in the USA recently as investors focus on the top companies in the SP500 rather than gold. This could also change and more demand would lead to a higher price as the supply is limited.

2. Given that gold miners would then have a higher price for their product and cost would not rise by a similar amount, the benefits to gold mining companies would be significant. The largest company by value in the USA is Apple which at 3 trillion dollars is worth 60 times the value of the largest gold miner Newmont Mining. The former has a price/earnings of 32 while the latter, is half at 16. It is likely that investors would see the gold miners as more attractive than currently and bid up company valuations.

3. If the Trump administration did this the headlines might read "Trump finds an extra $ 770 billion for the USA" or " Trump finds $5,000 for each household in the USA". which would be seen as very positive for the administration. However there are calls to audit the amount of gold held, to check if it really does exist. This itself would be a big event and focus on gold. If the amount held was actually below the claimed amount, that would be a huge shock and very positive for gold.

I do not know if such a revaluation will occur but even without that happening it makes sense to hold some gold and some gold mining company shares in a portfolio.

But bear in mind that the gold price can go down as well as up. The last time gold had a poor year was in 2013 but that was at the end of a very long positive period which moved the price from $300 to $1,700. We can expect some pull backs from time to time but it was only in September 2023 that it broke out firmly above the 2012 high. Interest rates are currently low and going lower in Europe and the USA which is supportive, added to which the world does not seem to have a good sense of economic and political well being at the moment. Quite the contrary.

Best wishes

Tim Underwood 4 April 2025