Wealth Management
PH&N Investment Counsel

Stu's View

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Gold'n'Stocks and the Six Bears

Since the Great COVID Crisis began a few months ago, I've received an increasing number of questions about gold. That is not surprising since gold is traditionally seen by many as a "safe haven" during times of crisis, when other types of assets are under pressure. Of course, we've seen significant volatility in both the equity and in the bond markets since the beginning of this year. Another factor is the massive monetary and fiscal support from governments and global central banks, which has driven the after-inflation rate of interest lower still, a boon for the price of gold. The reasons for gold's importance in the modern economy centers on the fact that it has successfully preserved wealth over thousands of generations. The same, however, cannot be said about all paper-denominated currencies.

Gold has traditionally acted as a "hedge" within investment portfolios. Historically, it has provided a degree of stability when compared to the volatility in stocks, for instance. Gold is considered one risk management tool to help manage portfolio volatility over time, as the classic investment hedge against inflation. Other risk management tools include derivatives, such as put options to hedge downside risk in equities, bonds and/or cash. As with stocks and bonds, gold is not a foolproof investment either. Its price can fluctuate based on a variety of underlying demand and supply factors, and after accounting for transaction costs, insurance costs and storage costs in the case of physical gold, the net returns can be less than what the headlines may suggest.

In this edition of Stu's View, we take a look at the performance of gold in different market environments: periods of inflation and deflation, bear markets, bear market rallies, and times of high volatility within bull markets. To be clear, we are not advocates of market timing, but rather our investment

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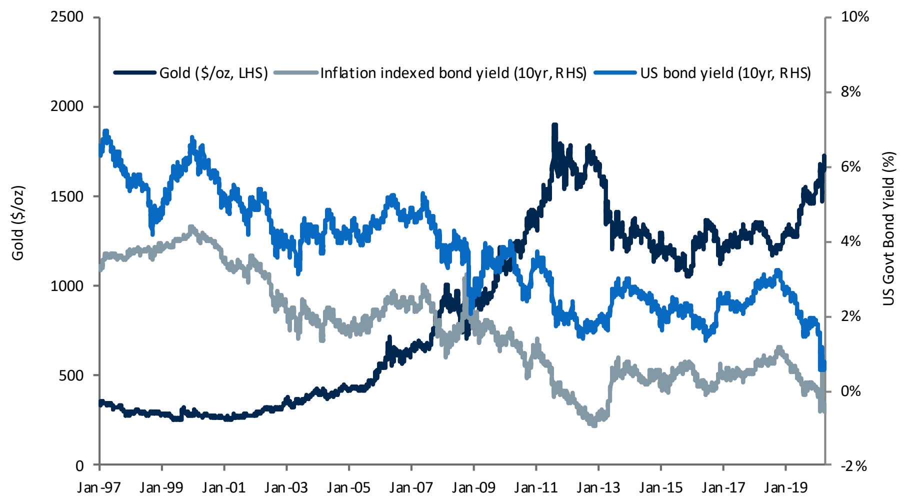
philosophy is one of time in the market. So we do not opine on the timing of any potential purchase or sale of gold. Each investor is faced with their own unique set of circumstances, risk tolerance, risk capacity and investment objectives that will determine the appropriate allocation to gold, and which gold investment vehicle(s) to use within the portfolio. We discussed liquidity risks in an earlier article “The liquidity conundrum” dated April 16, 2020. Different gold investments carry varying degrees of liquidity risk, which we will discuss at length in this note.

Summary points:

- Gold has traditionally worked well as an inflation hedge in the portfolio.
- Gold has not done well during periods of disinflation.
- Gold may perform better than some expect during periods of deflation.
- During bear markets gold has been a good hedge for equities, though it will lag equity returns during bear market rallies.
- During bull markets, gold has done well relative to equities when there is greater uncertainty in the economy and/or financial markets, and lags during other periods.
- Today there is renewed interest in gold as an investment given heightened volatility caused by economic slowdown/recession from coronavirus, and investors’ desire for more “safe-haven” assets.
- There are multiple ways in which you can invest in gold, from physical to paper to electronic investments. Each option has a set of benefits and risks as discussed in this note.

Chart 1: Gold price versus real and nominal yields



Source: RBC Capital Markets Research, reprinted with permission. As of April 30, 2020. Date of RBC Capital Markets publication May 6, 2020. Data is daily and from Jan 30/97 to Apr 30/20. Gold prices are quoted in U.S. dollars, and is represented by The LBMA Gold Price (“Benchmark”,) which is owned by London Bullion Market Association (LBMA) and ICE Benchmark Administration (IBA), who provide the auction platform, methodology as well as the overall administration and governance for the LBMA Gold Price. The LBMA Gold Price is set twice daily at 10:30 and 15:00 (London, UK time) in an auction independently operated and administered by ICE Benchmark Administration (IBA). The price is set in U.S. dollars per fine troy ounce. The futures market sets the price of an ounce of gold (called the “spot” price) at any given minute of the trading day. Because it takes cost and effort to convert a lump of gold into a specific shape and then ship it to a dealer, the mints tack on an extra fee when they sell their products to precious metals dealers. Those dealers in turn add their own mark-up. The total price above the spot value that you pay at the store is referred to as the “premium.” Inflation indexed bond yield 10-Year Treasury Inflation-Indexed Security, Constant Maturity, not seasonally adjusted. US Government Bond 10-year maturity quoted as the daily yield on the U.S. Government 10-year Treasury Bond.

Inflation, deflation, and disinflation – why and when does gold perform?

Inflation: Most investors understand that gold can be used as a hedge against inflation based on gold price returns during the period of high inflation of the 1970s. The case for gold during inflationary environments is easy enough. Gold rises as interest rates decline (chart 1), and/or the U.S. dollar declines relative to other currencies, both of which can be caused by a number of factors. In anticipation of rising inflation, demand for gold exposure by investors increases in order to protect the purchasing power as paper currencies are debasing.

Deflation: Yet today, the concern may be less about inflation and more about deflation. Deflation occurs when asset and consumer prices fall over time. While this may seem like a great thing for consumers, the actual cause of widespread deflation is a long-term drop in demand, and it arguably turned the 1929 recession into the Great Depression.

So then, how does gold do in a deflationary environment?

Unfortunately there are only a few recorded instances to look back upon and see what impact deflation had on the purchasing power of gold. During the only extended period of global deflation – the Great Depression of the 1930s – the price of gold was fixed, as most countries were on the gold standard. This makes it difficult to analyze gold demand during that time period. So we are forced to concede that one does not know with any degree of certainty how gold might behave in a deflationary scenario.

One theory suggests that a protracted deflationary recession/depression scenario might see gold demand relative to paper currency hold up well. Certainly as the supply of currency rises and concerns about debt levels rise, investors may fear paper currency devaluation and look for alternative assets to hold, meaning gold. In addition, concerns about financial institution – and even government – solvency and

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counterparty risk raises demand for alternatives to paper currency (i.e. gold, and perhaps silver as well, and real tangible assets like real estate and infrastructure).

One last term to put out there is disinflation. This is not to be confused with deflation. Disinflation is decline in the rate of inflation, which could still mean positive inflation but the rate of inflation is getting lower over time. Gold tends to shine only when inflation is high and accelerating. The market is always forward-looking, so if inflation is high but decreasing, investors are not likely to lose confidence in a fiat currency, and therefore demand for gold likely declines. We do have one period in time when disinflation impacted gold prices to look back upon. Probably the most famous disinflation in the modern U.S. history is when Paul Volcker took over the position of Chairperson of the Federal Reserve in 1979, with a mandate to battle high levels of inflation. U.S. inflation, which peaked at 14.8% in March 1980, fell below 3% by 1983 as the Federal Reserve raised the federal funds rate, which had averaged 11.2% in 1979, to a peak of 20% in June 1981. Disinflation and a recession/bear market ensued, and gold peculiarly underperformed equities during a period of heightened volatility.

Bear markets, bear market rallies: Historical comparison of gold and stocks

In August of 1971, when Richard Nixon ended the convertibility of the U.S. dollar to gold, the price was roughly $US40 an ounce. Today it is close to $US1700 an ounce, which equates to an 8% return compounded annually over that time period.

In Chart 2, we break down the historical returns to gold in each decade, so a 10-year holding period only. Clearly in the period of high inflation in the 1970s, investing in gold was well rewarded with an attractive 10-year compound annual growth rate of 31%. As the 1980s experienced a period of disinflation as just described, the positive returns from the 1970s were not to be had. It wasn't until the beginning of this century, during the Great Financial Crisis of 2008, that we saw gold once again earn a positive return. It seems like the starting period mattered most to the returns over the last 50 years.

Over the last 50 years, on a relative basis to stocks, gold investments as indicated in Chart 3 have held up fairly well, with a compound annual growth rate (CAGR) of 8%, relative to the price return of the S&P 500 Index at 7.1%. Yet when we account for risk, looking at annualized volatility or standard deviation in the last two columns of Chart 3, risk-adjusted returns over the last 50 years were higher for stocks than with gold. As we see in Chart 3, your investment horizon, or starting period, did make a difference when comparing returns between stocks and gold. Hindsight is 20/20, as they say,

Chart 2: Investing in gold over the last five decades

Decade returns	Buy date	Sell date	Buy price	Sell price	CAGR
1970	Jan 1/70	Jan 1/80	$34.99	$717.00	35%
1980	Jan 1/80	Jan 1/90	$717.00	$420.75	-5%
1990	Jan 1/90	Jan 1/00	$420.75	$285.90	-4%
2000	Jan 1/00	Jan 1/10	$285.90	$1,094.75	14%
2010	Jan 1/10	Jan 1/20	$1,094.75	$1,580.10	4%

Source: RBC PH&N Investment Counsel, and FactSet. As of April 30, 2020. Returns in this table are in U.S. dollars, and are compound annual rates of return (CAGR). The table does not include transaction costs, investment management fees or taxes, and does not reflect the cost of storage, and insurance as it relates to gold. If such costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results. Gold prices are quoted in U.S. dollars, and is represented by The LBMA Gold Price ("Benchmark",) which is owned by London Bullion Market Association (LBMA) and ICE Benchmark Administration (IBA), who provide the auction platform, methodology as well as the overall administration and governance for the LBMA Gold Price. The LBMA Gold Price is set twice daily at 10:30 and 15:00 (London, UK time) in an auction independently operated and administered by ICE Benchmark Administration (IBA). The price is set in U.S. dollars per fine troy ounce. The futures market sets the price of an ounce of gold (called the "spot" price) at any given minute of the trading day. Because it takes cost and effort to convert a lump of gold into a specific shape and then ship it to a dealer, the mints tack on an extra fee when they sell their products to precious metals dealers. Those dealers in turn add their own mark-up. The total price above the spot value that you pay at the store is referred to as the "premium."

Chart 3: Return, risk with gold, stocks over the last few decades

				Returns CAGR (%)			Annualized Volatility (Std Deviation)	
Investment (beg of year)	Holding period (Yrs)	Gold (USD spot)	US stocks (S&P500)	GOLD	STOCKS	Difference (Gold minus stocks)	GOLD	STOCKS
1970	50.3	35.08	93.00	8.0%	7.1%	0.9%	19.7%	17.2%
1975	45.3	175.00	70.23	5.1%	8.6%	-3.4%	19.3%	17.4%
1980	40.3	559.50	105.76	2.8%	8.6%	-5.8%	18.9%	17.9%
1985	35.3	305.50	165.37	5.0%	8.5%	-3.5%	15.8%	18.3%
1990	30.3	399.00	359.69	4.9%	7.1%	-2.2%	15.8%	18.2%
1995	25.3	380.90	459.11	6.1%	7.6%	-1.5%	16.4%	19.2%
2000	20.3	281.50	1,455.22	9.3%	3.5%	5.8%	17.4%	19.9%
2005	15.3	427.75	1,202.08	9.4%	5.9%	3.5%	18.2%	19.8%
2010	10.3	1,121.50	1,132.99	4.1%	9.6%	-5.4%	15.9%	17.4%
2015	5.3	1,172.00	2,058.20	7.3%	6.7%	0.5%	13.7%	18.6%

Source: RBC PH&N Investment Counsel, and FactSet as of April 30, 2020. Returns in this table are in U.S. dollars, do not include dividends for S&P500 stocks, and are compound annual rates of return (CAGR). Length of days represents number of trading days from start to end period. An investment cannot be made directly into an index. The table does not include transaction costs, investment management fees or taxes, and does not reflect the cost of storage, and insurance as it relates to gold. If such costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results. The S&P 500 Index includes 500 companies across many sectors of the U.S. economy. The index is weighted by market capitalization so bigger companies make up a larger proportion of the index than smaller companies. The index is designed to measure performance of the broad U.S. economy through changes in the aggregate market value of the largest U.S. companies. Gold price here is quoted in U.S. dollars, and is represented by The LBMA Gold Price ("Benchmark"), which is owned by London Bullion Market Association (LBMA) and ICE Benchmark Administration (IBA), who provide the auction platform, methodology as well as the overall administration and governance for the LBMA Gold Price. The LBMA Gold Price is set twice daily at 10:30 and 15:00 (London, UK time) in an auction independently operated and administered by ICE Benchmark Administration (IBA). The price is set in U.S. dollars per fine troy ounce. The futures market sets the price of an ounce of gold (called the "spot" price) at any given minute of the trading day. Because it takes cost and effort to convert a lump of gold into a specific shape and then ship it to a dealer, the mints tack on an extra fee when they sell their products to precious metals dealers. Those dealers in turn add their own mark-up. The total price above the spot value that you pay at the store is referred to as the "premium." Annualized volatility has been calculated based on daily returns, in U.S. dollars, and annualized based on the number of trading days in a given year. The standard deviation is a measure of the amount of variation or dispersion of a set of values. A low standard deviation indicates that the values tend to be close to the mean of the set, while a high standard deviation indicates that the values are spread out over a wider range.

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and suggests that marketing timing is quite difficult at best.

In Chart 4, we analyzed the performance of gold relative to stocks during each bear market going back to the 1970s. We found that relative to stocks, gold held up well as a "safe-haven" asset during each bear market, with the exception of the 1980-82 bear market. This protracted bear market which lasted 630 days, occurred during a period of disinflation, which we described earlier as an environment where gold may not live up to its status as a safe-haven asset class. In this environment the demand for gold will decline as the rate of inflation declines.

In Chart 5, we analyze the performance of gold versus stocks in other periods of high market volatility. The most recent period, the Great COVID Crisis, we looked at the period of market declines from peak to recent trough. As you can see, while stocks declined from peak to trough by 33.9%, gold held steady and actually increased in price by 8.2%. A 42.2% return differential.

We also analyzed periods of heightened market volatility during the last bull market in order to see how gold performed relative to stocks. As expected, gold held up in every instance of geopolitical or financial market turmoil relative to stocks. In most cases, relative returns on a gross basis were quite impressive. It's also worth noting that each of these periods is relatively short, generally less than one year. This should make it clear that timing is difficult at best. For short periods of heightened volatility, gold can offer some protection to downside capital losses. An alternative approach to market timing would be to make a modest allocation in the portfolio to

Chart 4: Gold and stocks in bear markets, and bear market rallies

Market	Start	End	Length (days)	US stocks (S&P500)	Gold (USD spot)	Gold vs US Stocks
Bear market	**Nov-68**	**May-70**	**543**	**-36.1%**	**-8.4%**	**27.6%**
Bear market rally	27-Feb-69	19-May-69	81	7.0%	2.8%	-4.2%
Bear market	**Jan-73**	**Oct-74**	**630**	**-48.2%**	**139.2%**	**187.5%**
Bear market rally	21-Aug-73	28-Oct-73	68	10.4%	-16.6%	-27.0%
Bear market rally	11-Feb-74	16-Mar-74	33	9.5%	20.7%	11.2%
Bear market	**Nov-80**	**Aug-82**	**622**	**-27.1%**	**-35.8%**	**-8.6%**
Bear market rally	16-Feb-81	25-Mar-81	37	8.0%	7.7%	-0.2%
Bear market rally	25-Sep-81	1-Dec-81	67	11.8%	-10.7%	-22.5%
Bear market rally	8-Mar-82	26-Apr-82	49	11.1%	8.0%	-3.1%
Bear market	**Aug-87**	**Dec-87**	**101**	**-33.5%**	**2.4%**	**35.9%**
Bear market rally	19-Oct-87	21-Oct-87	2	14.9%	3.4%	-11.5%
Bear market	Mar-00	Oct-02	929	-49.1%	9.8%	59.0%
Bear market rally	12-Oct-00	7-Nov-00	26	7.7%	-3.1%	-10.8%
Bear market rally	20-Dec-00	1-Feb-01	43	8.6%	-1.8%	-10.4%
Bear market rally	3-Apr-01	22-May-01	49	18.3%	10.5%	-7.8%
Bear market rally	21-Sep-01	7-Dec-01	77	19.9%	-6.3%	-26.2%
Bear market rally	21-Feb-02	12-Mar-02	19	7.8%	0.5%	-7.3%
Bear market rally	23-Jul-02	22-Aug-02	30	20.7%	-4.5%	-25.2%
Bear market	**Oct-07**	**Mar-09**	**517**	**-56.8%**	**24.4%**	**81.2%**
Bear market rally	17-Sep-08	19-Sep-08	2	8.5%	6.9%	-1.6%
Bear market rally	27-Oct-08	4-Nov-08	8	18.5%	1.5%	-17.0%
Bear market rally	20-Nov-08	31-Dec-08	41	20.0%	17.9%	-2.2%
Bear market	**Feb-20**					
Bear market rally	23-Mar-20	30-Apr-20	29	31.4%	11.6%	-19.8%
Average (bear market rally)			**43**	**12.2%**	**2.9%**	**-9.3%**
Average (bear market)			**557**	**-41.8%**	**22.0%**	**63.8%**

Source: RBC PH&N Investment Counsel, FactSet and Credit Suisse LLC. Used with permission. As of April 30, 2020. Returns in this table are in U.S. dollars, do not include dividends for S&P500 stocks, and are not compound annual rates of return (CAGR). Length of days represents number of trading days from start to end period. An investment cannot be made directly into an index. The table does not include transaction costs, investment management fees or taxes, and does not reflect the cost of storage, and insurance as it relates to gold. If such costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results. The S&P 500 Index includes 500 companies across many sectors of the U.S. economy. The index is weighted by market capitalization so bigger companies make up a larger proportion of the index than smaller companies. The index is designed to measure performance of the broad U.S. economy through changes in the aggregate market value of the largest U.S. companies. Gold price here is quoted in U.S. dollars, and is represented by The LBMA Gold Price ("Benchmark"), which is owned by London Bullion Market Association (LBMA) and ICE Benchmark Administration (IBA), who provide the auction platform, methodology as well as the overall administration and governance for the LBMA Gold Price. The LBMA Gold Price is set twice daily at 10:30 and 15:00 (London, UK time) in an auction independently operated and administered by ICE Benchmark Administration (IBA). The price is set in U.S. dollars per fine troy ounce. The futures market sets the price of an ounce of gold (called the "spot" price) at any given minute of the trading day. Because it takes cost and effort to convert a lump of gold into a specific shape and then ship it to a dealer, the mints tack on an extra fee when they sell their products to precious metals dealers. Those dealers in turn add their own mark-up. The total price above the spot value that you pay at the store is referred to as the "premium."

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gold, and revisit that allocation every few years. Such allocations should balance the need for liquidity in the portfolio, the need for downside protection (limiting volatility), or perhaps for other reasons (which we discuss next).

Protection from a prolonged recession/depression: possibly a reason for gold in the portfolio

The demand for gold investments has increased more recently due to the expansion of central bank balance sheets, and most importantly the increasing size of the U.S. Federal Reserve's balance sheet as debt is issued, in response to the COVID-19 crisis (Chart 6). The Federal Reserve's balance sheet has expanded and contracted over time, while gold maintains a scarcity factor relative to other financial assets (i.e. it cannot be printed). During the 2007-08 financial crisis and subsequent recession, total assets increased significantly from $870 billion in August 2007 to $4.5 trillion in early 2015. Then, reflecting the Federal Reserve's balance sheet normalization program that took place between October 2017 and August 2019, total assets declined to under $3.8 trillion. Beginning in September 2019, total assets started to increase, and now total $6.7 trillion.

In addition to the growing Federal Reserve balance sheet to support financial markets and corporations, we continue to see elevated amounts of debt outstanding at negative yields (Chart 7). Negative yielding implies buyers holding the securities to maturity are guaranteed to make a loss. There are natural buyers for this debt who are less concerned with the prospect of locking in a loss at purchase. Persistently low interest rates may continue, according to RBC Global Asset Management, due to slower economic growth, aging demographics, stable inflation for now given globalization/automation

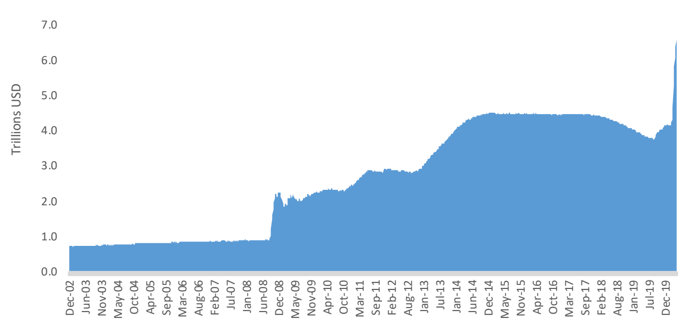
Chart 5: Gold and stocks during other periods of market volatility

OTHER PERIODS OF HIGH VOLATILITY

Great COVID Crisis	Gold (USD spot)	US stocks (S&P500)	Difference (Gold minus S&P500)
19-Feb-20	1,604.20	3,386.15	
23-Mar-20	1,736.25	2,237.40	
Price change	8.2%	-33.9%	**42.2%**
U.S./China Trade war/FOMC Autopilot			
September 1, 2018	1,187.25	2,896.72	
January 4, 2019	1,279.90	2,531.94	
Price change	7.8%	-12.6%	**20.4%**
China: RMB Devaluation (Currency Wars)			
August 11, 2015	1,108.25	2,084.07	
February 8, 2016	1,193.25	1,853.44	
Price change	7.7%	-11.1%	**18.7%**
US Government Debt downgrade			
April 18, 2011	1,493.00	1,324.46	
August 2, 2011	1,637.75	1,254.05	
Price change	9.7%	-5.3%	**15.0%**
European Debt crisis			
January 4, 2010	1,121.50	1,132.99	
July 26, 2012	1,618.00	1,360.02	
Price change	44.3%	20.0%	**24.2%**
Long Term Capital Management Fund Crisis			
August 1, 1998	286.15	1,112.44	
September 23, 1998	288.90	1,066.09	
Price change	1.0%	-4.2%	**5.1%**

Source: RBC PH&N Investment Counsel, and FactSet. As of April 30, 2020. Returns in this table are in U.S. dollars, do not include dividends (for S&P500 stocks), and are not compound annual rates of return. Length of days represents number of trading days from start to end period. An investment cannot be made directly into an index. The table does not include transaction costs, investment management fees or taxes, and does not reflect the cost of storage, and insurance as it relates to gold. If such costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results. The S&P 500 Index includes 500 companies across many sectors of the U.S. economy. The index is weighted by market capitalization so bigger companies make up a larger proportion of the index than smaller companies. The index is designed to measure performance of the broad U.S. economy through changes in the aggregate market value of the largest U.S. companies. Gold price here is quoted in U.S. dollars, and is represented by The LBMA Gold Price ("Benchmark"), which is owned by London Bullion Market Association (LBMA) and ICE Benchmark Administration (IBA), who provide the auction platform, methodology as well as the overall administration and governance for the LBMA Gold Price. The LBMA Gold Price is set twice daily at 10:30 and 15:00 (London, UK time) in an auction independently operated and administered by ICE Benchmark Administration (IBA). The price is set in U.S. dollars per fine troy ounce. The futures market sets the price of an ounce of gold (called the "spot" price) at any given minute of the trading day. Because it takes cost and effort to convert a lump of gold into a specific shape and then ship it to a dealer, the mints tack on an extra fee when they sell their products to precious metals dealers. Those dealers in turn add their own mark-up. The total price above the spot value that you pay at the store is referred to as the "premium." Events described in the table: U.S./China Trade war/FOMC Autopilot – September 1/18 through December 24/18 judged to be period of heightened tension between U.S. and Chinese officials, higher equity market volatility which ended around Jan 4/19 when Federal Reserve Chairman Powell walked back previous hawkish "autopilot" statements, indicating there "is no preset path for raising interest rates and adjusting the balance sheet." China: RMB Devaluation – August 11, 2015 through February 8, 2016 a period of high volatility in financial markets when The People's Bank of China (PBOC) surprised markets with three consecutive devaluations of the yuan renminbi (RMB), knocking over 3% off its value. By February 2016, the currency had settled back to pre-August 2015 levels. U.S. Government Debt Downgrade – On April 18, 2011, U.S.-based rating agency S&P issued a "negative" outlook on the U.S.'s "AAA" (highest quality) sovereign-debt rating for the first time since the rating agency began in 1860, indicating there was a one-in-three chance of an outright reduction in the rating over the next two years. On August 2/11 they downgraded U.S. government debt one notch to AA+. European Debt Crisis – January 4, 2010 through December 29, 2011. While there is not a consensus for the official start and end period for the European Debt Crisis, generally most economists agree it began in late 2009/early 2010, when the Greek government disclosed that its budget deficits were far higher than previously thought. It carried on over the next two years, due to arguably successful fiscal consolidation and implementation of structural reforms in the countries being most at risk and various policy measures taken by EU leaders and the European Central Bank. On July 26, 2012, European Central Bank President Mario Draghi delivered a speech where he said: "Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough." Most market participants believed this marked the end of the European Debt Crisis. Long-term Capital Management (LTCM) Fund Crisis – August 1, 1998 through September 1, 1998, LTCM ran an absolute return strategy with high degree of financial leverage that collapsed in the late 1990s, with larger losses during the Russian financial crisis in August 1998. The Federal Reserve Bank of New York organized a bailout of US$3.625 billion by the major creditors to avoid a wider collapse in the financial markets in September 1998.

Chart 6: U.S. Federal Reserve balance sheet (USD trillions 2002-2020)



Source: Board of Governors of the Federal Reserve System (US), Assets: Total Assets: Total Assets (Less Eliminations From Consolidation): Wednesday Level [WALCL], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/WALCL, May 5, 2020. Amounts shown are not seasonally adjusted.

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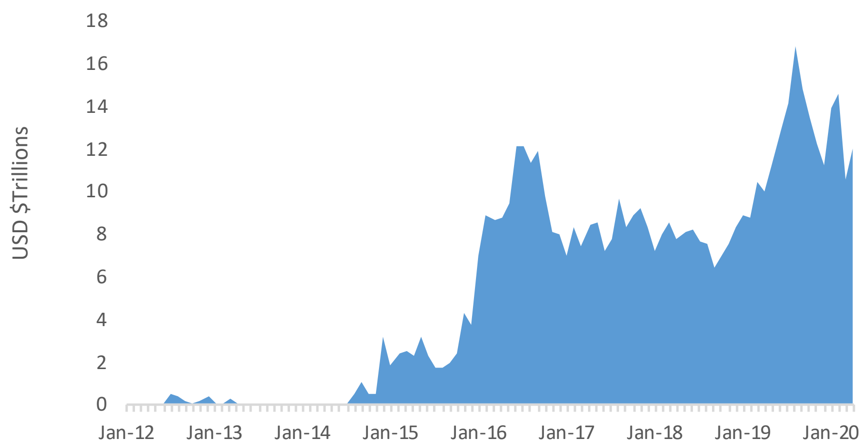
trends, a shortage of safe debt in the world rather than a surplus of it, central banks keeping rates low to keep borrowing affordable in heavily indebted economies. Also, extremely low interest rates in Japan and Europe have exerted downward pressure on other markets such as the U.S., U.K. and Canada.

This downward pressure on yields elevate gold as an alternative investment to fixed income, not only as a safe haven during these unusual times, but given the yield differential between gold and fixed income investments historically has not been in favour of gold. Since gold carries a negative yield as well (after storage/insurance costs), they are more on par with negative yielding fixed income instruments today when solely comparing the two on a yield basis.

Chart 7: Market value of negative yielding debt (global, in USD trillions)



Source: RBC GAM, Bloomberg, monthly outstanding debt globally represented by Bloomberg Barclays Aggregate Global Negative Yielding Debt Index, as of April 30, 2020, in U.S. dollars.

Not all that glitters is gold – risks to gold exposure

Before we discuss some popular gold investment options, here are key risks that should be considered.

- **Supply and demand dynamics are different from other commodities:** Unlike most other commodities, saving and disposal play larger roles in affecting the price of gold than its consumption.
- **Consumer demand for gold may decline in a recession:** As we have seen to date, consumer demand has declined in regions where most consumer demand originates. According to RBC Capital Markets, in the largest consumer markets, China and India, we saw 46% and 17% declines in year-over-year consumer demand in the first three months of 2020. Personal demand via jewelry has been a material portion of demand for gold.
- **Central bank demand for gold reserves can fluctuate and impact the price of gold:** According to the World Gold Council's First Quarter 2020 Gold Demand Trends report, while central bankers around the globe were focused on the measures needed to contain the economic impact of COVID-19, the need for robust, liquid and diversified international reserves was apparent. And positive net purchases of gold confirm that it remains an important component of those reserves. But the number of gold buyers was lower: six central banks increased their gold reserves – by at least a tonne – in the first quarter, compared to 10 in the first quarter of 2019.
- **Explicit costs:** Transaction costs associated with buying/selling any form of gold investment must be considered, as well as taxes. At times, the physical gold carries large bid-offer spread, and metallurgical assay costs.
- **Physical gold:** You could lose it and if it is stolen, then it is gone. No book of record exists.
- **Correlation to interest rates:** It is generally accepted that the price of gold is closely related to interest rates. As interest rates rise, the general tendency is for the gold price, which earns no interest, to fall, and vice versa. Gold carries negative yield when you factor in the carrying costs of storage and insurance related to physical gold.
- **Liquidity:** Depending on the investment option, liquidity can differ materially.
- **Crowding in gold during volatile periods:** As we show in Chart 8, gold as an investment is typically at or near a peak when we are in a crisis, or during volatile periods. As with any investment, we need to be cautious near-term when everyone seems to be singing the investment's praises.

Getting exposure to gold: How and what are the benefits and risks?

There are multiple ways that investors can gain exposure to gold. Here we discuss the more popular choices, along with the pros and cons to each option. Some investors have chosen to further diversify their gold exposure across more than one of these options.

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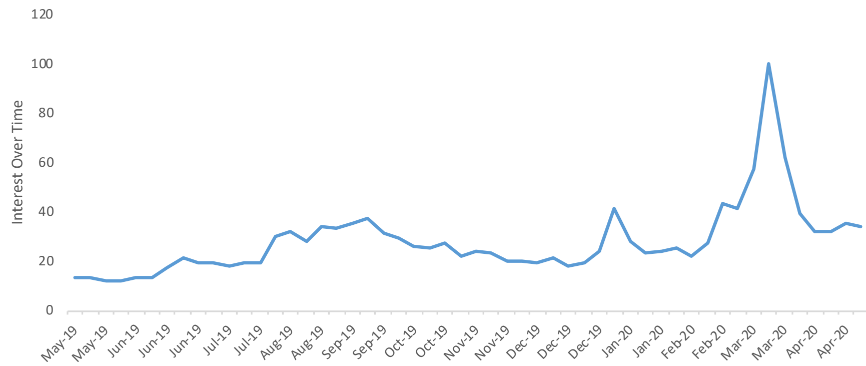
Physical gold (coins, bars): Some long-term investors prefer to own their gold in physical form as a form of money that will still have purchasing power should fiat paper-based currency suddenly become valueless. Some have pointed to Venezuela or Argentina today where citizens in these countries would trade millions of their currency for a small measure of gold. However, buying gold in the physical sense (bars, bullion coins) carries with it the burden of storage, liquidity and possibly insurance costs. Since there is no formal book of record for physical gold, if you lose it or if it is stolen, it is gone unless it is properly insured. Also, from a liquidity perspective, the physical gold bars are the least liquid option amongst gold investments. To trade or exchange for goods, the gold may have to be converted to another currency, and possibly might need to be refined, which comes at a cost.

Buying sovereign gold bullion coins is another way to purchase physical gold that reduces some of the illiquidity risk to owning physical gold. These coins are usually guaranteed by the federal government, and have buyers ready from banks and dealers. These are coins currently minted each year by select governments around the world; most notably the Eagle (U.S.), Buffalo (U.S.), Maple Leaf (Canada), Krugerrand (South Africa), Philharmonic (Austria), Panda (China), Kangaroo (Australia), and Sovereign (U.K.).

Storing your gold can be done at home (usually via a safe), through a safety deposit box at a bank, or it can be stored through a third-party storage firm, known as a depository. Each storage options carries with it different costs and risks, and each storage option depends on how much of your personal wealth you want to store. Some depositories can liquidate your physical gold in relatively short periods of time, and are usually located in London, Zurich or Hong Kong where there are active buyers/sellers.

Chart 8: Google search trends for "gold as an investment"



Source: RBC GAM, Bloomberg, monthly outstanding debt globally represented by Bloomberg Barclays Aggregate Global Negative Yielding Debt Index, as of April 30, 2020, in U.S. dollars.

Paper gold solutions (Exchange Traded Funds, gold certificates): If the risks of physical gold ownership aren't for you, you may want to consider investing in gold through a growing number of Exchange Traded Funds (ETFs) or Exchange Traded notes (ETNs). These securities trade on financial markets, similar to stocks. They are essentially funds that have exposure to the price of the precious metals, either by owning bullion or futures contracts. If your time horizon in gold is intentionally short in years, then these financial market assets might be suitable for you, as the more popular products tend to have liquidity in the market to buy or sell, and the carrying costs are zero compared to owning the physical gold. Usual brokerage transaction costs, and bid/ask spread, applies of course.

The downside here of course is that most gold ETFs/ETNs are not fully backed by bullion, though some are and can be converted to physical gold. Most ETFs provide investors only fractional, undivided interest in a trust so you are a shareholder of the trust, not a gold owner. Most ETFs are exposed to counter-party risk, which is why they are often referred to as "paper gold." So these are not the same investment vehicles as the physical option. Most often these instruments are used as a way of expressing a view on the price of gold. There are multiple additional types of ETFs and ETNs for those really looking to take big risks on the price direction using leverage, which we would not advise.

Gold certificates may be another paper-based option that avoids the risks and costs associated with the transfer and storage of physical bullion. Certificates are typically issued by banks, at a cost, and carry counterparty/credit risk, and are usually less liquid than electronic gold investments such as ETFs, ETNs, or gold mining companies.

Banks may issue gold certificates that might be allocated (fully reserved) or unallocated (pooled). Unallocated gold certificates are a form of fractional reserve banking and do not guarantee an equal exchange for metal in the event of a run on the issuing bank's gold on

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deposit. Allocated gold certificates should be correlated with specific numbered bars, although it is difficult to determine whether a bank is improperly allocating a single bar to more than one party.

Gold miners/companies/funds: A third option for gaining exposure to gold in the portfolio is through direct investment in mining companies and mutual funds/pooled funds that invest directly in mining companies. While there are hundreds of gold mining companies and funds to choose from, not all gold mining company stocks, or funds, correlate with the price of gold. Like other stocks, the underlying price of a gold mining stock may fluctuate based on a number of market and company-specific factors that are beyond the underlying price of gold itself. Company specific factors include production costs, reserves, mining exploration and development costs, exposure to other metals/minerals, and management skill and credibility with the investment community. As with any of the approaches to investing in gold discussed here, investing in gold mining companies might be useful as a complementary investment strategy, and perhaps another way to diversify your investment in gold.

Of all of these approaches, we stress the risk that past performances do not guarantee future results. As shown in this article, the price of gold is volatile, and can change rapidly. We are not proponents of speculating on the price of gold. Gold may be another risk management tool for investors to hopefully dampen volatility during stressful periods in the market. Similar to stocks and bonds, and other investments, investing in gold is not foolproof. Investing in gold always carries with it a potential for loss, which is why it may only form a portion of your well-diversified portfolio that reflects your financial goals and objectives, your risk tolerance and risk capacity, liquidity constraints, and investment time horizon, and any unique circumstances.

What We Are Watching (as of May 4, 2020)

Factor	Achieved?
Significant disease containment	Yes
Major government stimulus	Yes
A decline in the number of new daily cases in Italy	Yes
Decline in U.S. new cases/day	Tentatively
Decline in global new cases/day	Maybe
Decline in global new fatalities/day	Maybe
Credible plan to end quarantine	No
Quarantining significantly reduced	No
Development of an important therapeutic	No
Development of a vaccine	No
Achievement of herd immunity	No
Return to economic growth	No
Return to prior level of output	No

Source: RBC Global Asset Management Inc. as of May 4, 2020

Update: What we are watching

Sights have turned to watching for any recurrence of COVID-19 as most of the developed economies enter the next phase of this crisis – the re-opening phase.

From a bottom-up company perspective, some issues are becoming clear. First, earnings trends in the next few quarters will likely get worse, but analyst estimates are resetting appropriately for the next stage of the crisis. The market's overall reaction has been somewhat positive over the last four to six weeks despite the decline in company expectations that have been reported. This may suggest that the markets are finding a level equilibrium, which is no doubt supported by the ample liquidity provided by global central banks over the last few months.

There is some renewal of U.S. and China trade tensions that perhaps haven't fully run their course just yet, and the most recent period of the crisis may have been a hiatus in theory. As it stands at the time of writing, the March 23 low in the market has held, and we have not come close to re-testing that just yet. Renewed trade tensions between China and the U.S. may be cause for concern, as perhaps is the U.S. election, which takes place in November. We'll have more to say on that in the coming newsletters.

For now, we hope that you and your family are remaining well and staying safe. As always, if you have any questions or concerns related to your investments, please reach out to your RBC PH&N Investment Counsellor.

Be well,
Stu

Wealth Management
PH&N Investment Counsel

S&P 500 Index: The S&P 500 Index includes 500 companies across many sectors of the U.S. economy. The index is weighted by market capitalization so bigger companies make up a larger proportion of the index than smaller companies. The index is designed to measure performance of the broad US economy through changes in the aggregate market value of the largest US companies.

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