The relevance of gold for Australian investors in 2023

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Gold, in Australian dollars (AUD), delivered positive returns in 2022 and so far in 2023. And it has attracted attention: while global central banks bought a record level of gold in 2022, Australia's sovereign wealth fund also added gold to its portfolio.

Looking ahead, 2023 may create headwinds for most assets as stagflationary pressures intensify, our analysis, based on historical data, shows:

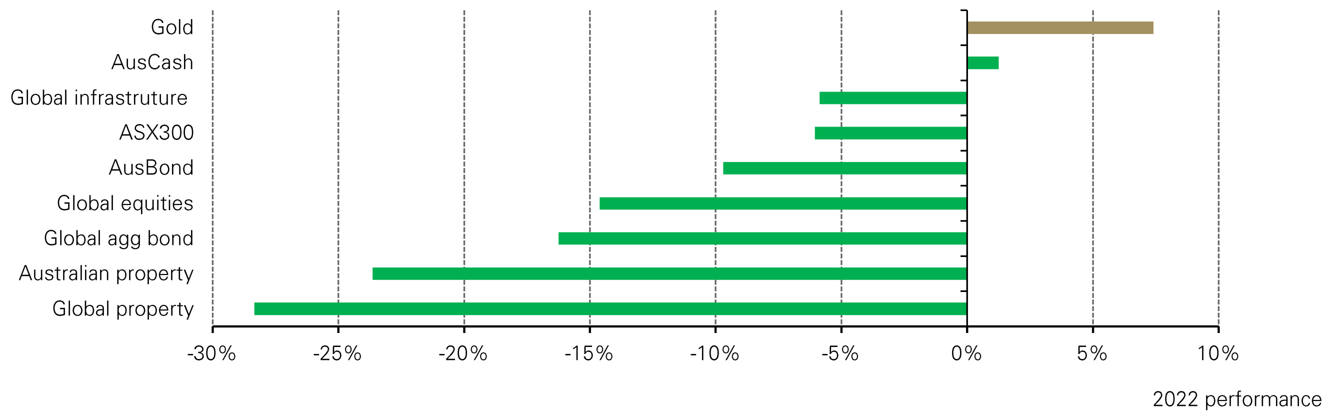
- gold has historically posted superior returns during stagflationary periods
- gold can also help super funds achieve their "CPI+X%" objectives and enhance risk-adjusted returns.

Most assets suffered drawdowns in 2022

Last year saw one of the biggest market storms in decades amid high inflation and hawkish central banks. While the MSCI World Index experienced its worst year since 2008, global bonds, proxied by the Bloomberg Barclay Global Aggregate Index, recorded their largest annual loss ever. Australian assets were not spared either. Both local equities and fixed-income assets witnessed pullbacks. But gold delivered positive returns (+6%, in AUD), mainly driven by factors including local currency weakness, geopolitical uncertainties, and inflationary concerns (**Chart 1**).

Chart 1: Gold had a positive performance while other major assets tumbled in 2022

Annual returns from major assets in Australian dollars*



*As of 31 December 2022. Based on LBMA Gold Price PM, AusBond Bank Bill Index, AusBond 0+ Composite Index, Bloomberg Barclay Global Agg, ASX300 Index, MSCI World Index, ASX300 A-REIT Index, FTSE EPRA/NAREIT Developed ex-Australia Index, FTSE Developed Core Infrastructure Index. All calculations are in AUD

Source: Bloomberg, World Gold Council

Table 1: Future Fund's summary of portfolio implications and its reactions

Portfolio implications	More alpha	More volatility	More granular	More correlation caution	More domestic exposures	More defensive levers, inflation protection
Levers activated	More private equity	Focus on liquidity and dynamic asset allocation	Detailed levers for DM/EM	Broader currency basket	Added to infrastructure	Added gold, commodities, tangibles, alternatives

Source: Future Fund, Position Paper – The death of traditional portfolio construction?, December 2022

So far in 2023, gold, in AUD, continued to post positive returns (+1%).[1] As our 2023 Gold Market Outlook noted, market consensus of a mild recession ahead should keep gold stable with some upside potential. And market developments so far have matched our baseline scenario.

Gold's defensive ability, among other qualities, has attracted institutional investors' attention recently. In its recent position paper, the Future Fund, Australia's sovereign wealth fund, announced the addition of gold to its portfolio. As mentioned in the paper, challenges such as high inflation levels and the weakened defensive nature of foreign currencies may have prompted its decision to buy gold (**Table 1**).

Bumpy road ahead

In 2023, markets may be vulnerable to negative shocks – notably stagflation (**Chart 2**). This was a key concern shared by the Future Fund, which highlighted that we may face an environment where inflation remains elevated and growth slows in the coming years. And this scenario could be amplified by factors such as geopolitical conflicts.

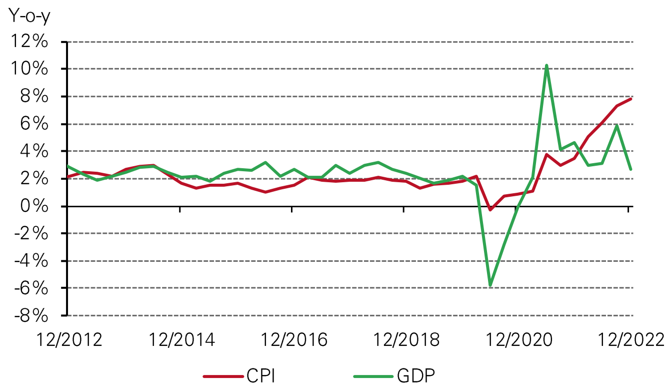
"In this kind of environment there is a real risk of simultaneous slow growth, high unemployment and rising prices…"

– Future Fund, Position Paper – The death of traditional portfolio construction?, December 2022

In Q4 2022, Australia's quarterly consumer price index (CPI) rose 7.8% y-o-y, the fastest pace in 32 years, and topped economists' consensus expectation of 7.5%.[2] As the Reserve Bank of Australia (RBA) noted in its February meeting, while inflation rose higher than expected, wage growth continued to pick up – which could put further pressure on the region's CPI.

In the meantime, the RBA dialled down its future growth projection further, to 1.5% over 2023.[3] Slower global growth and tighter financial conditions were cited as main concerns (**Chart 2**).

Chart 2: Australia's inflation kept soaring while GDP growth is set to weaken



Source: Bloomberg, World Gold Council

[1] Based on the LBMA Gold Price PM in AUD as of February 2023.

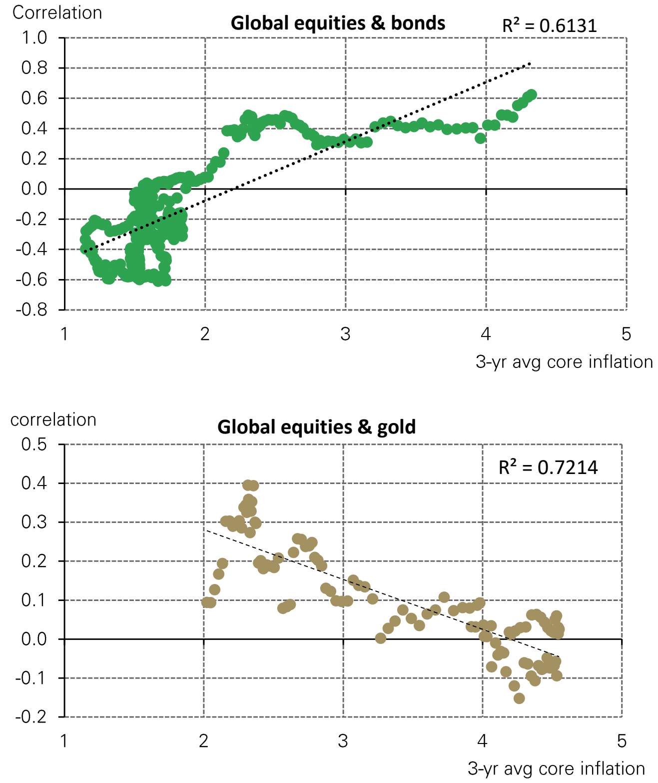
2 For more, see: Australia Inflation Rate - 2022 Data - 2023 Forecast - 1951-2021 Historical - Calendar (tradingeconomics.com)

3 For more, see: Statement by Philip Lowe, Governor: Monetary Policy Decision | Media Releases | RBA

Cross-asset implications

Elevated inflation can, broadly speaking, create significant issues for investors. For instance, the correlation between bonds and equities, accounting for the lion's share of Australian super funds, tends to rise during high-inflationary periods. Gold, on the other hand, remains an effective diversifier as inflation rises (**Chart 3**).

Chart 3: Correlation patterns of bonds & equities and gold & equities at different inflation levels*



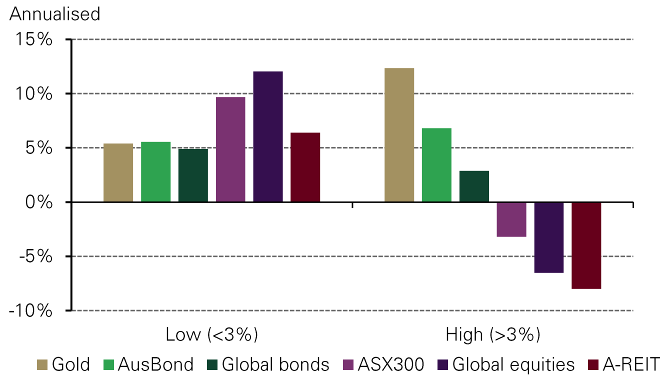
*Note: Based on monthly data of MSCI World Index, Bloomberg Global Treasury Index (AUD hedged) and LBMA Gold Price between 1990 and 2021. All calculations in AUD.

Source: Bloomberg, World Gold Council

In fact, gold has long been considered a hedge against inflation, and historical data confirms this (**Chart 4**). Also, the annualised return of 7.6% in AUD over the past 20 years has outpaced the Australian and world CPIs.[4]

Chart 4: Gold has historically performed well in periods of high inflation

Major asset returns in AUD as a function of quarterly inflation*



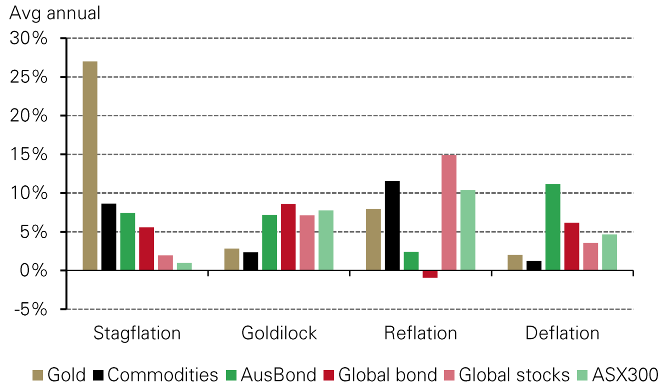
*Based on Australian quarterly CPI, AusBond 0+ Composite Index, Bloomberg Barclay Global Agg, ASX300 Index, ASX300 A-REIT Index and MSCI World Index between Q4 1992 and Q4 2022 due to data availability. All calculations in AUD.

Source: Bloomberg, World Gold Council

Additionally, stagflationary pressure poses challenges for institutional portfolios. Stagflation can severely disrupt financial markets and hamper the performance of major assets. But historical data shows that gold, a safe-haven asset, has benefited investors with attractive returns during such periods (**Chart 5**).

Chart 5: Gold, in AUD, has delivered superior performances during stagflationary periods in Australia

Major asset returns in AUD during different economic scenarios*



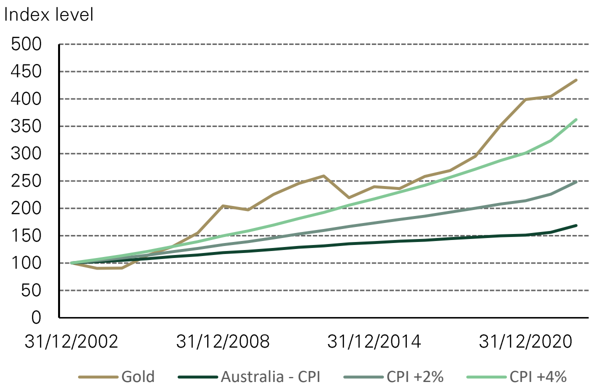
*Data between Q1 1973 and Q4 2022. Part of the indices only date back to 1990s. All calculations in AUD. Based on quarterly data of Australian GDP, CPI, LBMA Gold Price PM, AusBond 0+ Composite Index, Bloomberg Barclay Global Agg, ASX300 Index, MSCI World Index and Bloomberg Commodity Index.

Source: Bloomberg, ICE Benchmark Administration, World Gold Council

4 For more, see: Gold Price Returns | Gold Prices | World Gold Council

Chart 6: Gold could help achieve a CPI+X% return objective

Gold vs Australian CPI levels*



* Note: Based on LBMA Gold Price PM in AUD and Australian CPI between 2002 and 2022.

Source: Bloomberg, ICE Benchmark Administration, World Gold Council

Gold helps achieve return targets and enhance portfolio performance

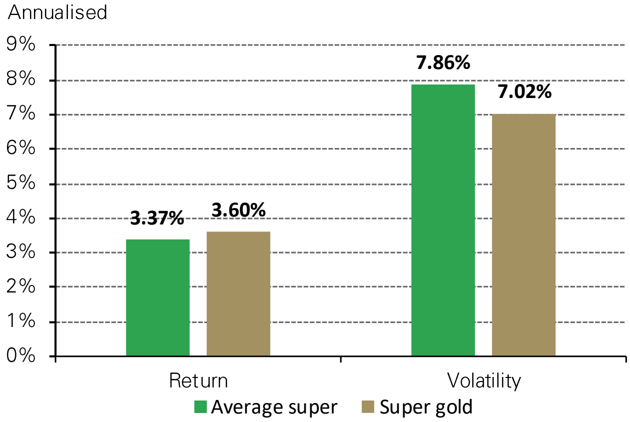
While we acknowledge that the benchmark test introduced by the "Your Future, Your Super" reform (YFYS) in 2020 has created a number of challenges for super fund managers – notably introducing performance mismatches across certain asset classes resulting in unnecessary tracking error at the portfolio level – Australian investors could utilise gold to cope with above-mentioned macroeconomic challenges, as the Future Fund did.

Moreover, superannuation funds continue to be subject to a multitude of other performance measures, particularly the fund's own target return for members (typically CPI+X%). The inclusion of real assets such as gold could help meet this objective and protect the real value of members' savings over time (**Chart 6**).

And historical data suggests gold is also able to improve an average super portfolio's performance (**Chart 7**).

Chart 7: Gold is also able to enhance an average super fund portfolio's performance

Risk-adjusted return comparison between a hypothetical average super fund portfolio and the portfolio with 5% gold*



*The hypothetical average super fund portfolio is based on Q3 2022 APRA published super fund industry asset allocation and indices from the YFYS reform document here and in **Chart 1**. Computation based on monthly data between the past 15 years (Dec 2007 ~ Dec 2022) due to data availability.

Source: Australian Prudential Regulatory Authority, Bloomberg, World Gold Council

Conclusion

Gold, in AUD, has delivered a steady return in 2022 while major assets including equities and bonds plunged. Its stability and defensiveness, among other qualities, have caught global and local institutions' attention.

Looking at 2023, we see potential challenges of elevated inflation and an economic slowdown, key ingredients of stagflation. This could severely disrupt financial markets and hurt investors' portfolios. By examining past data, we found that not only can gold remain an effective equity risk diversifier when inflation is elevated, it also posts superior performances during the stagflationary environment.

Furthermore, gold strategic role in Australian super fund portfolios may increase in importance as it helps achieve their CPI+X% target and enhance risk-adjusted returns.

About the World Gold Council

We're the global experts on gold.

Leveraging our broad knowledge and experience, we work to improve understanding of the gold market and underscore gold's value to individuals, investors, and the world at large.

Collaboration is the cornerstone of our approach. We're an association whose members are the world's most forward-thinking gold mining companies. Combining the insights of our members and other industry partners, we seek to unlock gold's evolving role as a catalyst for advancements that meet societal needs.

We develop standards, expand access to gold, and tackle barriers to adoption to stimulate demand and support a vibrant and sustainable future for the gold market. From our offices in Beijing, London, Mumbai, New York, Shanghai, and Singapore, we deliver positive impact worldwide.

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