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Do we continue to have a positive view on Gold?

We have held a positive view on Gold for many years. The money printing underway had us concerned about inflation. We looked at the inflationary 1970s and that Gold had done very well during that period (~30% IRRs). Hence, Gold – as a form of currency – seemed a good hedge against geopolitical conflict and very high inflation with baseline return which would be close to index returns in India. With this backdrop, we had recommended our partners consider 3-5% exposure to gold at their asset allocation level.

However, despite ideal conditions for Gold - significant money printing, a geopolitical conflict with superpowers on different sides, Gold has not done well. This has made us introspect on what we could be missing in our thesis.

A difference in the situation today vs the 1970s was that in the 1970s Central Bankers waited too long before raising interest rates. However, at present they are signalling strong willingness to raise rates to crush inflation, even if that means a recession and putting people out of jobs. Secondly, post the high inflation of the 1970s, Gold has done well in short term spurts, but not done well consistently for an extended period. This has two implications – Central Bank determination to crush inflation and explicit communication vs the 1970s reduces the risk of very high inflation due to policy errors. Steeply rising interest rates reduces the attractiveness of Gold to a yield seeking investor. The other realisation which dawned on us was for Gold to truly work as a hedge, it would have to be at least 10- 15% of the portfolio vs. 3-5% range we had recommended. Given the points discussed above, we don't think it is prudent to take such a high exposure. Hence, for an investor optimizing for long term outcomes, we are not as optimistic about Gold as we originally recommended.