Two Key Drivers of Gold Demand: Fear Trade and Love Trade

Since the beginning of recorded history, gold has been treasured for its scarcity and lasting value. Investors look to the yellow metal as a store of value during times of uncertainty, as gold can be a portfolio diversifier, often moving inversely to other assets. Gold is also prized in the form of jewelry for gift-giving during times of celebration. We call these drivers the Fear Trade and the Love Trade.
After gold swiftly rose from around $200 per ounce in 2002 to over $1,900 in 2011, it took a tumble over the next few years, finally steadying at $1,280 by the end of 2018. The yellow metal is known as a store of value and hedge against drops in other asset classes. In fact, gold has actually outperformed the broader market for several time periods, despite its price swings.

While the S&P 500 finished 2018 down 6.24 percent, gold was down only 1.55 percent. Even more impressive is that for the century so far, the yellow metal has returned a massive 345.30 percent, while the S&P has only returned 146.57 percent. Gold, after all, has historically had a strong negative correlation with the market. Despite gold trending lower from its 2011 peak, investors continue to see its value.

Gold Has Crushed the S&P 500 So Far This Century
Dec. 31, 1999 – Dec. 31, 2018

What emotions and events drive investors to buy gold?

U.S. Global Investors CEO and chief investment officer Frank Holmes believes that gold could surge again in coming years on the heels of growing jewelry demand, central bank buying and peak supply of the metal. In his 30 years of experience in the investment space, Frank has observed both fear and love driving investors to buy gold.

We call this the Fear Trade and the Love Trade.

The Fear Trade

The Fear Trade is what you often hear about in the media, particularly from doom-and-gloomers. The demand driver is triggered when people feel as if they need to buy gold as a hedge against poor government or central bank policies that might result in currency devaluation, inflation, deficit spending and negative real interest rates. When inflation is greater than the nominal interest rate, you get negative real interest rates. When rates are negative, gold tends to rise in that country’s currency.

Gold also correlates strongly to U.S. national debt, which passed $21.97 trillion in December 2018. According to the National Inflation Association (NIA), there’s a 91.2 percent correlation between the price of gold and national debt. The organization suggests that the yellow metal could continue to surge over the long term as we add to the debt every year.
The Love Trade

The Love Trade, on the other hand, deals with the purchase of gold in the form of jewelry or coins for loved ones during special occasions and holidays. This is largely a seasonal pattern driven by festivals and celebrations in China and India, affectionately known as “Chindia,” which are the world’s two largest consumers of the yellow metal.

China’s Lunar New Year, celebrated in late January or early February, is one such Love Trade holiday. Later in the year near October or November, Indians celebrate Diwali. Next comes Indian wedding season, when it is considered auspicious to give gold to the bride. These types of cultural events, observed every year by billions of people worldwide, account for a significant portion of gold demand. So much, in fact, that we can reliably see their effects on the metal’s price action. For example in January, we historically see gold rise as retailers restock their inventories of gold leading up to Chinese New Year.

The Love Trade: China and India Gift Gold for Weddings and Other Celebrations

[Diagram showing the correlation between gold price and national debt with source attribution]
Gold Outlook for 2019

According to the World Gold Council (WGC), central banks globally added 651.5 metric tons of gold – worth some $27.7 billion – to their official holdings in 2018. This is an astonishing 74 percent increase from 2017 and the most on record going back to 1971. A metric ton is equal to 1,000 kilograms, which is about 2,204 pounds. In the last quarter of the year alone, central banks bought 195 metric tons of the yellow metal, the most for any quarter on record, according to GFMS.

Looking ahead five years, we believe the investment case for gold and gold miners gets even more attractive. Precious metals consultancy firm Metals Focus projects a gradual increase in gold consumption between now and 2023, supported by strong jewelry demand and physical investment.

Gold Consumption Forecast Through 2023

*This forecast is not guaranteed. Source: Metals Focus, U.S. Global Investors
The Golden Rule:

At U.S. Global Investors we advocate the Golden Rule – having a 10 percent portfolio weighting in gold and gold-related securities. We believe that 5 percent should be in physical gold and 24 karat gold jewelry and the other 5 percent in well-managed gold mutual funds, ETFs and high quality gold stocks.

Gold can help diversify a portfolio, as it often moves in the opposite direction of other asset classes, such as the stock market. U.S. Global Investors offers two mutual funds for investors to gain exposure to the gold market.

The Gold and Precious Metals Fund (USERX) is the first no-load gold mutual find in the U.S., founded in 1974. The fund invests in senior gold producers that are currently pulling gold, silver or other precious metals out of the ground.

The World Precious Minerals Fund (UNWPX) gives investors exposure to junior and intermediate gold and silver mining companies that are more focused on exploration, in addition to the production of precious metals.

To learn more about both funds and investing in gold, visit www.usfunds.com/gold.

U.S. Global Investors, Inc. is an innovative investment manager with vast experience in global markets and specialized sectors. The company, headquartered in San Antonio, Texas, has a longstanding history of global investing and launching first-of-their kind investment products. U.S. Global Investors is well known for expertise in gold and precious metals, natural resources and emerging markets.

Please carefully consider a fund’s investment objectives, risks, charges and expenses. For this and other important information, obtain a fund prospectus by visiting www.usfunds.com or by calling 1-800-US-FUNDS (1-800-873-8637). Read it carefully before investing. Foreside Fund Services, LLC, Distributor. U.S. Global Investors is the investment advisor.

Gold, precious metals, and precious minerals funds may be susceptible to adverse economic, political or regulator developments due to concentrating in a single theme. The prices of gold, precious metals, and precious minerals are subject to substantial price fluctuations over short periods of time and may be affected by unpredicted international monetary and political policies. We suggest investing no more than 5% to 10% of your portfolio in these sectors.

All opinions expressed and data provided are subject to change without notice. Some of these opinions may not be appropriate to every investor.

The S&P 500 Stock Index is a widely recognized capitalization-weighted index of 500 common stock prices in U.S. companies.