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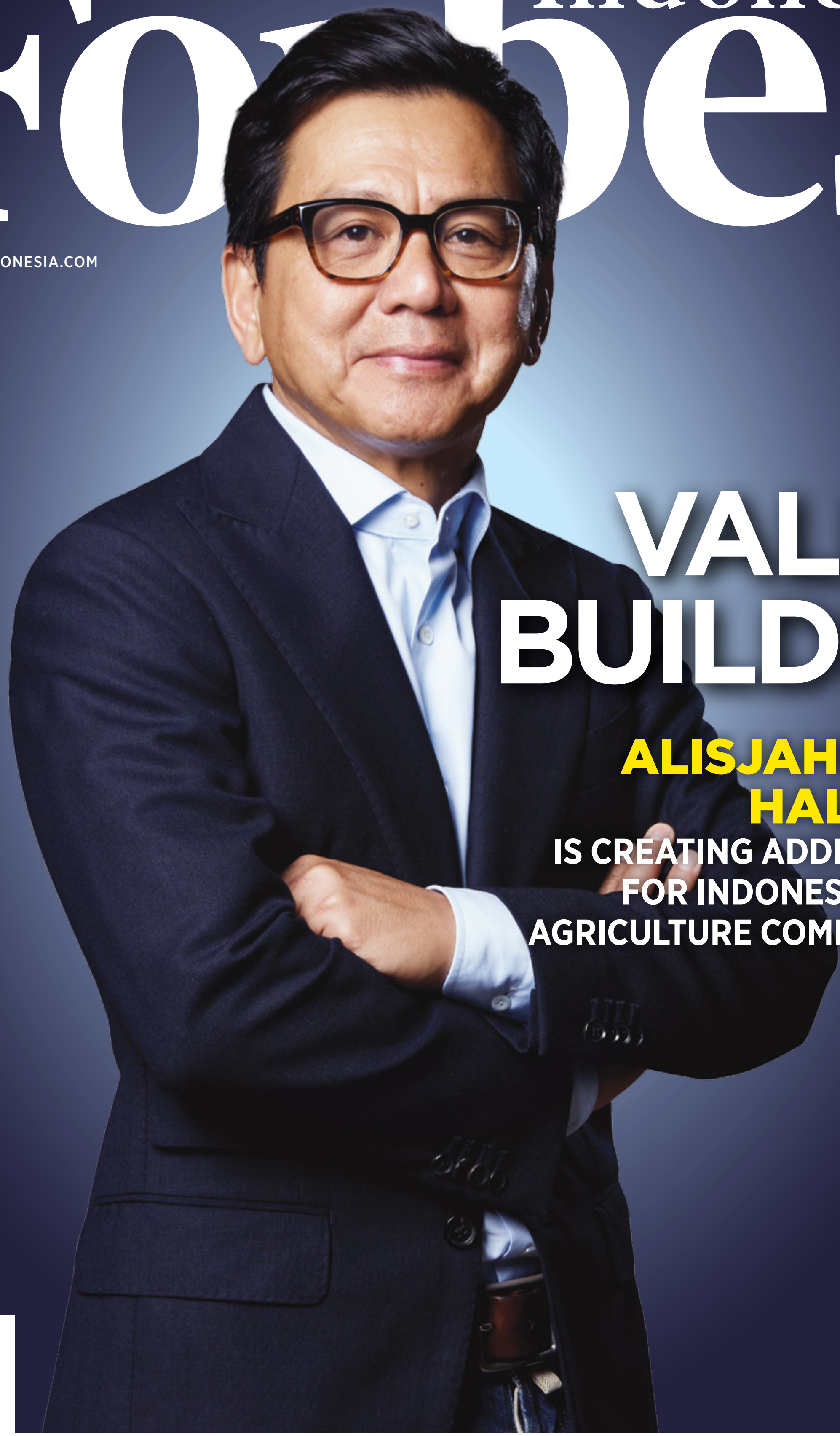

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WILLIAM GRAY IS AN EXPERT IN PRECIOUS METALS WITH OVER TWO DECADES OF ACTIVE MANAGEMENT EXPERIENCE IN THIS FIELD. HIS STERLING-BASED ARC BULLION ACCOUNT, AN ACTIVELY TRADED PHYSICAL BULLION INVESTMENT, HAS RETURNED OVER 78.88% SINCE ITS LAUNCH IN DECEMBER 2014.

GOLD IS BACK

GLOBAL MARKETS have undergone immense changes over recent years, in tandem with profound geopolitical shifts taking place across the world. In more recent times there has been mounting concern over the US-China trade war, and punitive sanctions imposed on Russia and Iran are driving nations around the world to challenge the dominance of the US dollar as the pre-eminent global reserve currency.

From reviewing my analysis and writings on gold since the Forbes Indonesia column in 2012 through to my last contribution in July 2018, it is clear that the world has seen the most significant change in gold storage behavior since WWII. In the July 2018 issue, I commented that countries had been increasingly repatriating gold to their respective central bank vaults, and stressed that this was a highly significant change in behavior, indicating a fundamental rethink over the structure of global finances. I believe that even more strongly today. It begs the question whether governments are beginning to lose trust in, or at least becoming wary of the financial system itself, because it is plagued with bad debt. In the case of the US Federal Reserve, this debt figure is around $22 trillion, causing the system to become less stable.

As 2018 ended and the year's statistics on gold acquisitions became available, another notable change became apparent. Central banks had not only changed the way they stored gold, but had, at the same time, gone on a bullion buying spree, with acquisitions of such size that it pushed gold demand in 2018 to the highest level of annual net purchases since the suspension of dollar convertibility to gold in 1971. This would seem to imply that central banks are behaving as if they are in mid preparation for something big, the possible advent of the next financial crisis, perhaps led by Italy's toxic debt problem looming over Europe. Big changes in the manner in which wealth is stored and to the asset allocation of central banks are not made without reason!

It is a decade since the 2008/9 global financial crisis, but financial stability looks as uncertain today as then. Central banks have as a result reacted to rising macroeconomic and geopolitical pressures; they have taken the correct action, in my opinion, of increasing their gold holdings and diversifying their reserves away from paper-backed assets in US dollars, euro or other mainline currencies and, in doing so, re-focused their attention on the principal objective, simply that of investing in safe and liquid assets.

It is interesting to note that Hungary, albeit not a major global player, made one of the largest individual purchases in 2018, when the country increased its gold reserves 10 times to 31.5 tonnes. The Hungarian central bank cited gold's role succinctly as a hedge against future structural changes in the international financial system. In addition, bullion's obvious lack of counterparty or credit risk was also given as a reason for this very large increase in the country's reserves.

One of the largest holders of US dollar or paper-denominated debt is China, which announced that it had added to its gold reserves in 2018. This announcement came as no surprise since China has been acquiring a considerable amount of gold in recent years, which might suggest that it is concerned about a default on its US dollar-based holdings, or a sharp fall in the value of the US dollar due to the sweeping changes seen in recent years. After all, China, Russia and the Middle East have been collaborating in doing everything possible to end the US monetary hegemony, with a negative impact on the US dollar.

These are all positive signs for the role of gold, but it should also be considered that gold is taking a far more mainstream position. Statistics show that, since 2001, investment demand for gold worldwide has grown, on average, 15% per year. This has been driven in part by the advent of gold-exchange-traded funds (ETFs) and a renewed focus on its role in effective risk management, following the 2008–2009 financial crisis.

Today more and more investors are drawn to gold's role as a diversifier, for the obvious reason of its low correlation to most mainstream assets and because it is also a hedge against systemic risk, and strong stock market pullbacks. Many simply elect to use it as a store of wealth, and as an inflation and currency hedge.

As a strategic asset, gold has historically improved the risk-adjusted returns of portfolios, delivering returns while reducing losses and providing liquidity to meet liabilities in times of market stress. Its role is not only beneficial in periods of higher uncertainty as its pricing over time indicates. The gold price has increased by an average of 10% per year since 1971, the time when gold began to trade freely.

There is a good reason behind gold's price performance; it trades in a huge and liquid market yet, unlike paper money, this tier-one asset is rare, being of limited supply. Gold benefits from a global market which, on current estimates, indicates that the physical gold holdings of investors and central banks are worth approximately $2.9 trillion.

Over the past century, gold has significantly outperformed all major currencies as a means of exchange. This becomes even more significant when instances of major economies defaulting, sending their currencies spiraling down, are included. One of the reasons for this strong performance is that the available above-ground supply of gold has remained almost stagnant over time, increasing in the past two decades by only approximately 1.6% per year through mine production. By contrast, fiat money can be printed in unlimited quantities to support monetary policies.

When considering investment in bullion one should consider the argument for diversification. Today this is especially important given the current status of developed stock markets, and their overvalued position. I am certain that most investors would agree on the relevance of diversification, but I would underline the fact that today effective diversifiers are very difficult to find. Correlations tend to increase as market uncertainty and volatility increases, driven in part by risk-on/risk-off investment decisions. Consequently, many so-called diversifiers fail to protect investment portfolios when investors need it as their life blood.

For example, during the 2008–2009 financial crisis hedge funds, broad commodities and even trusted real estate, long deemed portfolio diversifiers, were sold off alongside stocks and other risk assets. However, this was not the case with gold. Gold historically benefits from flight-to-quality inflows during periods of heightened risk. It can often provide positive returns and reduce investment portfolio losses. It has been especially effective during times of systemic crisis when investors tend to withdraw from stocks. Gold has also allowed investors to meet liabilities, while less liquid assets in their portfolios were undervalued and possibly misplaced. Importantly, the greater a downturn in stocks and other risk assets, the more positive the relative position of gold to these assets becomes.

Changes are afoot and the role of gold will arguably become more prominent, which will support its value. There are many dangers in the debt market today any of which could trigger a default. In this case, the investor holding gold would "rule", and its value would increase significantly. F