

A Gilded Rally

By Sean Mills



We find ourselves in a rare circumstance where investment markets are signaling two seemingly extreme opposing views.

This year global equities and gold have both reached simultaneous all-time highs, with the S&P 500 at \$6,600 and Gold at \$3,680 (at the time of writing). At first glance this might seem paradoxical, one represents the de facto 'risk on' asset while the other represents the de facto 'risk averse' asset. However, this is more than a simple contradiction, it is more likely that a novel structural divergence is taking place due to confounding factors. Investors are gravitating toward the extreme ends of the risk spectrum: high growth, tech heavy equities on one side, and hard physical asset hedges like gold on the other. Bonds, the traditional anchor of diversification, have stalled – burdened by a host of concerns that have eroded their status as a reliable safe-haven and the standard risk off asset.

So how have we got to this point?

Well, equities remain buoyant thanks to a continuous flow of resilient corporate earnings which are reinforced by the structural growth story around artificial intelligence (Oracle rose 36% in a single day after announcing a \$300bn AI cloud deal with OpenAI). An accommodative monetary policy backdrop also continues to support valuations, and while inflation is elevated it appears to be stabilising – a favourable outlook for both equities and gold. Importantly, the equity rally is narrow and concentrated, dominated by mega-cap tech and AI themes, rather than broad-based which is adding to some concerns surrounding concentration risk.

Gold is also rising for a combination of reasons: inflation protection, future monetary easing, and declining real yields (which increases gold's relative appeal). Gold also retains its demand as a safe-haven asset and a hedge against both geopolitical shocks and the movement toward so call de-dollarization (the global desire to reduce reliance on US Dollar currency). Most notably the recent gold rally may have also been triggered by a desire for greater insurance against an increasingly frothy equity environment while government bonds struggle to provide that protection due to their own issues.

Bonds, which are traditionally the standard safety valve in a diversified portfolio, are facing issues surrounding high fiscal deficits, debt sustainability (over \$35trillion in the US alone), and concerns regarding central bank independence. These factors bring doubt over sovereign bonds continuing to perform the role of a pure safe-haven asset. This is exacerbated by governments that continue to issue debt placing further pressure on bond prices. Sticky inflation expectations have also undermined long duration bonds by risking the interest rate pathway. In the UK inflation is quite high, nearing 4% which is double the target rate of 2% - that in and of itself limits the room for further monetary policy easing.

However, in the US, the already plentiful liquidity conditions have just received another shot of stimulus as the Federal reserve resumed the lowering of its policy rate in September which has provided a further boost to equities and gold. It's worthwhile to note that claims current monetary policy have been "restrictive" so far are seemingly inconsistent with the overall economic, inflation, and asset price trends we are experiencing – so there emerges a risk of a policy mistake by central banks if they lower rates too much should inflation spike any further down the line.

In essence, investors seeking protection from systemic, or tail risks are instead choosing to invest in gold over sovereign debt as confidence in sovereign debt has fallen to atypically low levels. Gold is currently seen as a better hedge against inflation, geopolitical shocks, and insurance against equities and so treasuries/gilts have lost their monopoly as the go to safe asset for diversifying risk in the standard portfolio. Market sentiment is “I don’t want to miss out on equity growth if the prevailing theme of systemic change through technological advancement comes true... but I want hard insurance against this not happening” and gold is able to provide this more safely currently vs government debt for all the issues mentioned above.

It may seem paradoxical, but this is a structural divergence where investors are choosing the poles of the risk spectrum high growth equities concentrated and focused on the US and in AI and Mega Cap buckets on one hand and large allocation to Gold as a hard physical asset hedge on the other. This is a new barbell, growth and innovation with hard asset insurance, as long bonds are caught in the crossfire of fiscal and term-premium issues. This is the rare scenario of stocks and gold being both at all time highs while bonds struggle – *A Gilded Rally*.

Sean Mills, CFA

Senior Portfolio Manager within Capital International group of companies

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