Heartwood
Investment Management

09 September 2019

Our thoughts

Market observation

Anxious bond markets have given gold the Midas touch. Will it last?

Throughout the summer, increasingly uneasy investors have flocked to bonds, pushing bond yields lower and lower. As we write, the level of negative yielding debt (where investors effectively pay to lend out their capital, if held to maturity) has ballooned to historic levels, above $16trn, amid ongoing trade war escalations and concerns about the outlook for global growth. Bond markets have sent other signals of alarm too: in both the US and UK, the yield curve inverted in August, with yields on 10-year government bonds falling below those of 2-year bonds, meaning that investors required more compensation for lending out their capital over the shorter term than the longer term. This has historically been seen as a herald of recession (though without a specific timeline), and is certainly a signal of extreme near-term uncertainty.

Slim pickings in bond markets have had knock-on effects elsewhere in investment markets. The gold price has shown itself to be highly correlated to the rise in negative yielding debt, with risk-averse investors running to gold as one of the world's oldest 'safe haven' assets. As a result, gold has had an extraordinary year so far, bolstered by investor anxieties in the market selloff in late 2018, and still climbing throughout the summer months. Indeed, gold was August's best performing asset class.

A strong gold price has accompanied extraordinary levels of negative yielding debt

Gold price and negative yielding debt levels

Past performance is not a reliable indicator of future results. Source: MSCI, Heartwood

At Heartwood, we have been adding to our gold holdings throughout the year, with healthy allocations across our strategies. For us, gold acts as a portfolio diversifier and a hedge in changeable market conditions, allowing us to keep risk (and the potential for reward) on the table elsewhere in the portfolio. However, we are mindful that – like all commodities – the price of gold can fluctuate rapidly. Given the current risks to the global economy, we remain comfortable in our bond holdings at present. Nevertheless, we are mindful that gold is typically driven by the direction of real yields on bonds (the yield an investor can expect after allowing for inflation – rising inflation expectations usually lower the gold price), as well as the relative strength of the US dollar (a weaker dollar is good for gold). We therefore believe gold investors should closely watch for any announcements of economic stimulus ahead, such as by the European Central Bank at its September meeting, or perhaps by authorities in China in response to recent poor Chinese economic data, and consider the likely impact of that particular stimulus on growth, inflation expectations, and market confidence.

Graham Bishop
Investment Director

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Registered Head Office: No.1 Kingsway, London, WC2B 6AN | Registered in England Number: 4132340
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