How does gold stack up?

Gold has been glittering for some time, but many share market investors have outperformed.

In early November four men were charged over the 2019 theft of an 18-carat gold toilet from Blenheim Mansion, the former home of British Prime Minister Sir Winston Churchill.

Valued at around A$9 million based on its weight in gold, the fully functioning toilet created by Italian artist Maurizio Cattelan and titled "America" is still missing in action.

It may never turn up again. Since America was stolen, the price of gold has surged more than 33%, from just under US$1,500 an ounce to almost US$2,000 an ounce. By now the glistening loo may have been melted down into gold ingots and converted into hard cash.

The gold price has been on an upward trajectory for the last decade. In November 2013 gold was trading at US$1,240 an ounce – about 60% below its current price.

That's a good total return, but gold has done even better in Australian dollar terms. In November 2013 it cost A$1,370 to buy an ounce of gold. The current price is over A$3,050 an ounce (as of 24 November) based on the U.S. dollar exchange rate. This equates to an Australian dollar gold price gain of more than 124% over the last decade.

These returns are before any investment fees or taxes.

Gold price drivers

Behind the gold price is a complex mix of economic, geopolitical, supply and demand factors.

As an economic or geopolitical crisis hedge, gold has a solid history, driven by its lack of credit risk and negative correlation to risk assets. It is

considered a physical store of wealth, because as a substance gold can't be dissolved.

According to the World Gold Council, central banks account for almost a fifth (18%) of gold demand to help diversify their reserves.

Central banks bought a net 77 tonnes of gold in September, with China alone purchasing 26 tonnes of the precious metal. Poland bought a further 19 tonnes.

In the past, many central banks have been forced to print more money, but this increase in supply, while helping to stave off economic turmoil, has carried the cost of devaluing their currency.

Gold, by contrast, is a finite commodity whose supply can't easily be added to. It is therefore a natural hedge against inflation.

Gold supply is ultimately driven by the production output from gold mines around the world, and gold demand continues to exceed supply.

Ongoing strong demand also continues to come from consumers buying gold jewellery, and from technology companies needing to use gold within computers, mobile phones and other devices.

In addition, investors in listed gold investment funds, which purchase physical gold, have also been strong demand drivers.

Investment return comparisons

While gold may seem alluring to some as an investment, it's important to understand its characteristics as an asset class.

First and foremost, gold investors need to solely rely on price growth over time because, like all commodities, gold itself does not generate an income stream.

On this level, it's worth comparing the 10-year return from gold with the total investment returns from the Australian share market, the U.S. share market and from international shares since November 2013.

As noted above, the 10-year return from gold in U.S. dollar terms (25 November, 2013 to 24 November, 2023) has been 60.6%.

In Australian dollar terms, over the same period, the return has been 124.9%. In other words, the U.S. dollar to Australian dollar exchange rate has provided a strong tailwind for Australian investors.

By comparison, let's use an example of an Australian investor who in November 2013 invested A$10,000 into the broad the Australian share market using an index-tracking investment fund.

Unlike gold, share market index funds are paid dividends from the listed companies they invest in, which are later passed through to the fund's underlying investors as income distributions.

By 31 October 2023, when measured by the performance of the S&P/ASX All Ordinaries Total Return Index over the 10 years, and assuming all the investment income earned over time was reinvested back into the same

fund, a A$10,000 initial investment would have grown to A$20,067.

That's a 100.7% return before any investments fees or taxes.

Using the exact same criteria, an investor who invested into an index fund that invests in international shares (when measured by the MSCI World ex-Australia Net Total Return Index – in Australian dollars) would have achieved a total return of 216.4%. Their initial A$10,000 investment would have grown to A$31,638.

Finally, if they invested their capital into a U.S. share market index fund, their initial A$10,000 investment would have grown to A$43,234 over the last 10 years. That's a 332.3% total return when measured by the S&P 500 Total Return Index (in Australian dollars).

Conclusion

While gold has achieved strong growth over the last decade, when measured in U.S. dollar terms it has underperformed Australian, U.S. and international share markets on a total return basis.

But it has outperformed the Australian share market when measured by its performance in Australian dollars, thanks to the fall in the value of the Australian dollar.

For investors, the main things to understand is that any returns from gold can only be realised upon a sale of physical bullion, and that unlike shares, bonds or cash, gold can never generate an income stream.

Notes: Historical gold prices supplied by World Gold Council. Share market performance data supplied by Vanguard Digital Index Chart and Andex Charts Pty Ltd.

Source:

https://www.vanguard.com.au/personal/learn/smart-investing/investing-strategy/how-does-gold-stack-up

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