Gold as a strategic asset
Irish DC pension portfolios

The traditional Defined Contribution (DC) investment portfolio comprising equities and bonds made a comeback recently, delivering returns not seen for years. But faced with ongoing geopolitical risks and a highly uncertain economic backdrop, effective diversification and risk mitigation remain top of mind for pension fund investors. Could now be the time to reconsider traditional thinking? We believe investors would benefit from expanding their "safe haven" options by considering gold.

Our analysis suggests that gold can help pension funds mitigate key risks – investment risk, inflation risk and longevity risk. Gold achieves this by providing:

- diversification that works in periods of expansion and contraction, and
- improved risk-adjusted returns.

Highlights

The shift in the bond – equity correlation has presented many investors with a fundamental challenge around how to approach diversification and portfolio construction.

Gold has been particularly effective during periods of systemic risk, generating positive returns in nine of the ten worst years of performance for the global equity index.

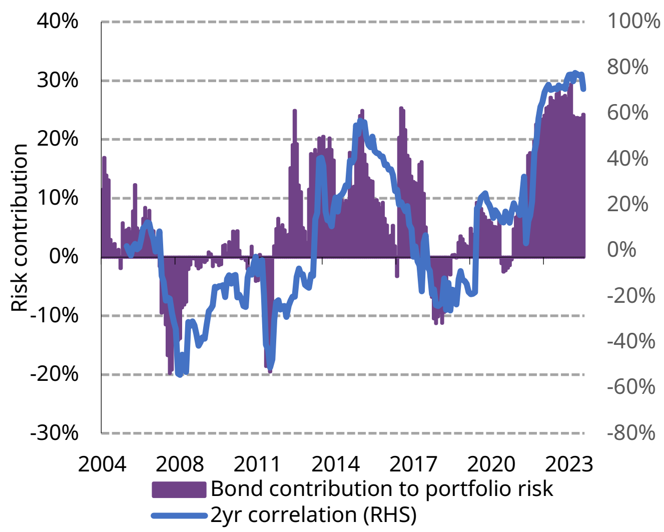
A 5% gold allocation throughout retirement can provide a more secure income.

Shortcomings of government bonds as a diversifier

For many DC investors, high quality government bonds, such as euro treasuries, have long fulfilled the traditional role of a diversifier in investment portfolios, offering protection during periods when risk assets have come under pressure. But amidst a rapidly evolving market backdrop, maintaining a diversified portfolio can feel like chasing a moving target. Indeed, the negative correlation between returns from stocks and from bonds – once the cornerstone of a balanced portfolio – has once again broken down, undermining the value proposition of high-quality fixed income assets as a diversifier. This shift has presented many investors with a fundamental challenge around how to approach diversification and portfolio construction (Chart 1). It is important, therefore, to have assets that can help weather a number of macroeconomic environments rather than rely solely on government bonds to perform the diversification role.

Chart 1: Bonds have a higher correlation to equities and therefore contribute more to overall portfolio risk

Bonds – equity correlation and share of total portfolio risk coming from bonds. Model portfolio is made up of 60% global equities/40% euro government bonds*



*Data from 31 December 2003 to 31 July 2024.
Source: Bloomberg, World Gold Council

What makes gold a strategic asset for Irish DC pension funds?

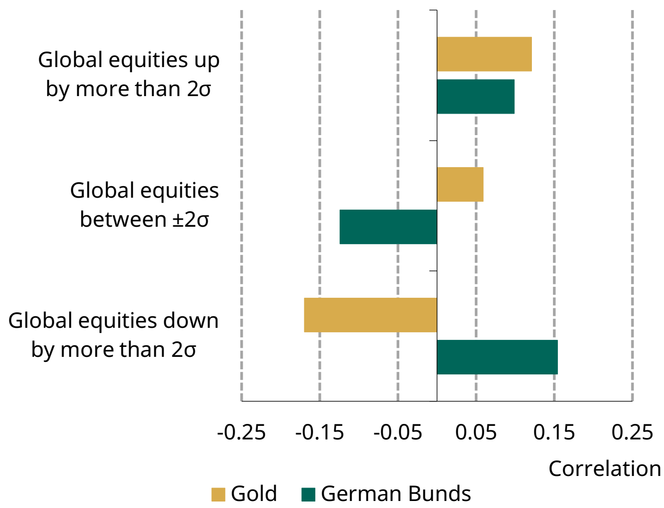
Our analysis shows gold is an effective complement to equities and broad-based portfolios. A store of wealth and a hedge against systemic risk, gold has historically improved portfolios' risk-adjusted returns and provided liquidity to meet short-term cashflow requirements in times of market stress.

A hedge against market risk

Effective diversifiers are sometimes hard to find. In fact, many assets become increasingly correlated as market uncertainty rises. Gold, however, is different in that its negative correlation to equities and other risk assets increases as these assets sell off (Chart 2).

Chart 2: Gold becomes more negatively correlated to equities in extreme market selloffs

Correlation of global equities vs. gold in various market environments*

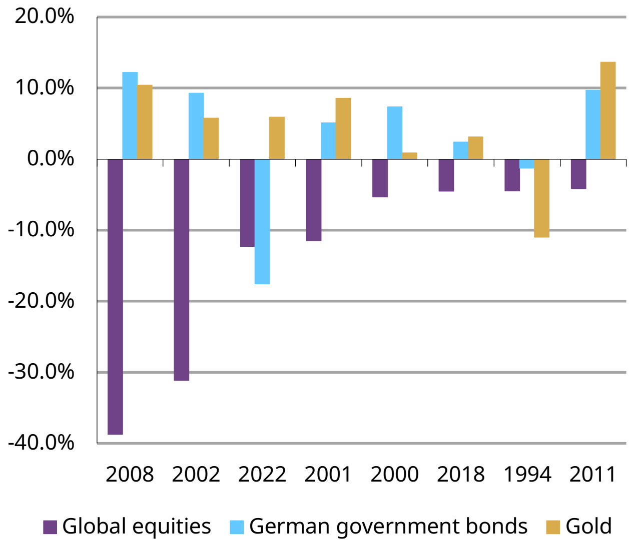


*Based on weekly returns of the FTSE Global Developed Index, LBMA Gold Price and ICE BofA German Government Bond Index using data between 31 December 1993 and 31 December 2023.
Source: Bloomberg, ICE Benchmark Administration, World Gold Council

With few exceptions, gold has been particularly effective during periods of systemic risk, generating positive returns in all years except one, at which time the FTSE All World Index posted negative returns (**Chart 3, p3**).

Chart 3: Gold provides downside protection

Global equities, German government bonds and gold returns (EUR) during periods of systemic risk*



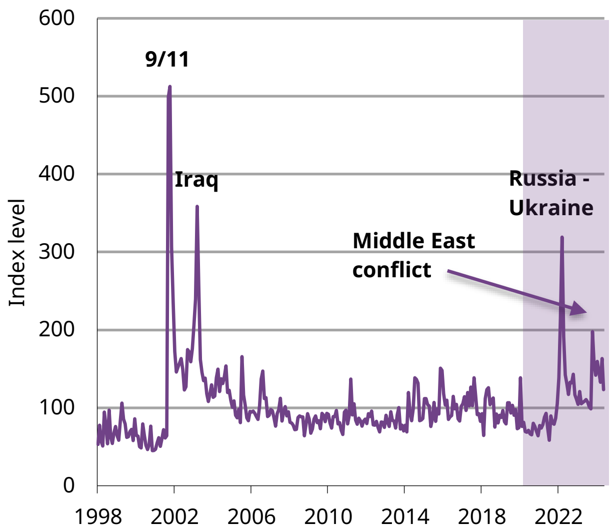
*Data from 31 December 1993 to 31 December 2023.
Source: Bloomberg, ICE Benchmark Administration, World Gold Council

A hedge against geopolitical risk

Considering today's challenging investment environment – with the potential for even greater geopolitical instability to come (Chart 4) – we believe investors should consider ways to protect their portfolio. Indeed, the timing, magnitude and duration of any geopolitical crisis is always uncertain. Such events are virtually impossible to tactically position for in advance. And at present, this is exacerbated given the tensions surrounding the US election in November and ongoing global conflicts. For that reason, long-term strategic portfolio diversification is essential, and gold can play a key role as a safe-haven asset (Chart 5).

Chart 4: Geopolitical risk has been trending up

Geopolitical Risk Index*

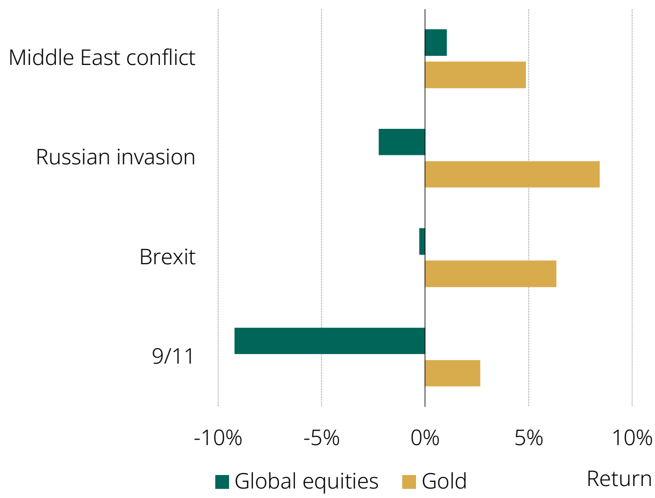


* Data from https://www.matteoiacoviello.com/gpr.htm as of May 2024.

Source: Matteo Iacoviello, World Gold Council

Chart 5 The gold price tends to increase after a geopolitical event

Post event 5-day return*



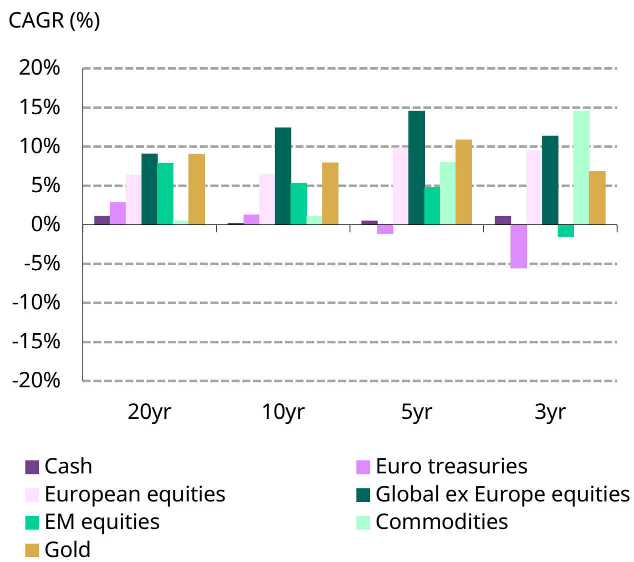
*Return computations in EUR for 'Global equities': FTSE All World Total Return Index and 'gold': LBMA Gold Price PM. Dates used: September 11: 11/9/2001; Brexit: 23/6/2016; Russian invasion: 24/2/2022; Israel-Hamas: 7/10/2023.
Source: Bloomberg, ICE Benchmark Administration, World Gold Council

A contributor to growth

Investors have long considered gold a beneficial asset during periods of uncertainty. Yet, historically, gold has generated long-term positive returns in both good and bad economic times, outperforming many other major asset classes over the past 20 years (Chart 6).

Chart 6: Gold has outperformed most broad-based portfolio components over the past two decades

Annualised returns of key global assets in EUR*



*Data from 31 December 2003 to 31 December 2023.
Source: Bloomberg, ICE Benchmark Administration, World Gold Council

Case study – the impact of gold in DC investment portfolios

In the current environment, a traditional equity/bond portfolio may not deliver the type of diversification and resilience achieved historically. As a result, we believe DC investors should consider alternative and complementary assets to high quality government bonds, such as gold.

With member outcomes being a key factor in setting all aspects of DC strategy, we assess how an allocation to gold can impact the future retirement incomes for investors.

Using long-term asset class forecasts (see Appendix for more details) and assumptions around starting salary, salary increases and contributions (Table 1), we project the range of potential pension outcomes for a lifestyle strategy with and without gold.

Table 1: Monte Carlo assumptions

Starting salary at age 20	€30k
Annual salary increases	2%
Annual pension contributions	10%

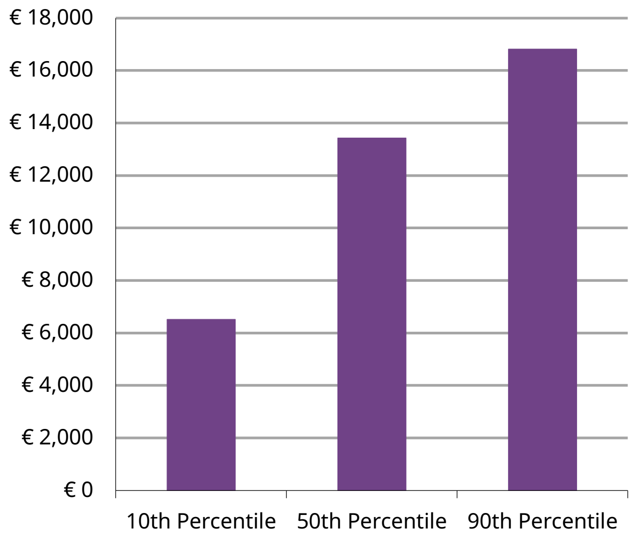
The lifestyle strategy on the right has a modest but meaningful 2.5% allocation to gold. This allocation grows to 5% over the consolidation phase of the retirement journey, when protecting against market downturns becomes particularly important given the relatively little time left to recover negative returns (Chart 7).

These forward-looking projections provide us with key insights (Chart 8):

- the distribution of outcomes at retirement (age 65) for a lifestyle strategy with gold is skewed towards the right-hand side, meaning the median portfolio at retirement is higher and the potential worst outcomes are reduced
- a 5% gold allocation throughout retirement can provide a more secure income. A portfolio without gold will exhaust its assets faster than a portfolio that contains gold.

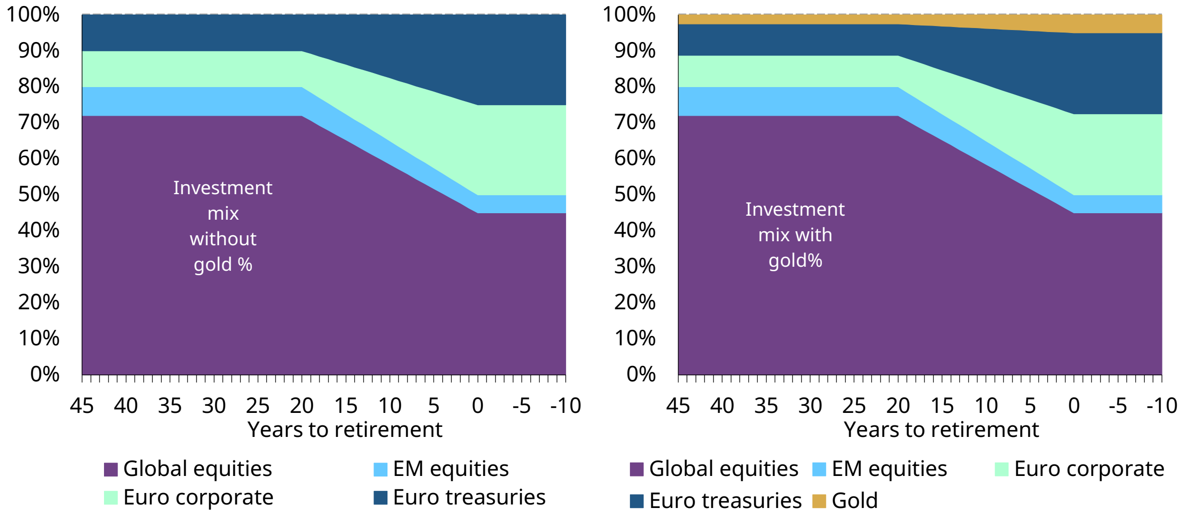
Chart 8: A lifestyle strategy with gold consistently outperformed a lifestyle strategy without gold

Difference in balance at retirement between a lifestyle strategy with gold and without gold*



*Data as of 31 July 2024.
Source: Bloomberg, Portfolio Visualizer, World Gold Council

Chart 7: Hypothetical lifestyle strategy with and without gold



*Data as of 31 July 2024.
Source: World Gold Council

Conclusion

We believe that a strategic allocation to gold as a "diversifying alternative" can be a cornerstone of a well-constructed portfolio. This approach offers the potential for diversification but does not compromise on returns. Ultimately, it leads to greater portfolio resilience and the ability to navigate evolving market dynamics. In fact, there are advantages to diversifying the sources of safety in an investment portfolio and looking beyond high-quality government bonds. Going forward, the performance of gold and government bonds is likely to diverge, and that feature alone should interest DC investors.

As demonstrated in the case study, gold can help mitigate the key risks faced by DC investors – investment risk, inflation risk and longevity risk – by providing diversification that works, protection against high and extreme inflation, and by enhancing risk-adjusted returns.

Appendix

Asset class forecasts:

- Gold: the World Gold Council has developed a framework to better understand gold valuation. Our Gold Valuation Framework powers our web-based tool, Qaurum, which allows users to assess the potential performance of gold under customisable hypothetical macroeconomic scenarios provided by Oxford Economics.
- Equities and bonds: we have used Blackrock's long-term asset class forecasts. These forecasts are forward-looking estimates of total return, generated through a combined assessment of current valuation measures, economic growth, inflation prospects and yield conditions, as well as historical price patterns.

World Gold Council

We are a membership organisation that champions the role gold plays as a strategic asset, shaping the future of a responsible and accessible gold supply chain. Our team of experts builds understanding of the use case and possibilities of gold through trusted research, analysis, commentary and insights.

We drive industry progress, shaping policy and setting the standards for a perpetual and sustainable gold market.

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