View as Webpage

Market Comment:

What drives the gold price?

Following the GA Senate runoff elections, inflation expectations rose above 2% for the first time since spring 2020, but the gold price simultaneously declined by over 5%. Such a move might have been surprising for investors that believe gold serves as a hedge against unexpected inflation[1].

The recent disconnect between gold and inflation cannot be simply attributed to the short period in question. There are years when inflation expectations and gold trade together, but also many years when inflation expectations and gold trade in opposite directions. Over the last 37 years, there has been no consistent, discernable relationship between inflation and gold prices (Fig. 1).

Fig. 1: Inflation / Gold relationship by year, 1983-2020

Up / Up	Down / Up	Up / Down	Down / Down
1987	1986	1983	1985
1994	1993	1984	1989
2004	1995	1988	1991
2005	2001	1990	1992
2009	2002	1996	1997
2010	2003	1999	1998
2016	2006	2013	2000
2017	2007	2015	2012
	2008		2014
	2011		
	2018		
	2019		
	2020		

Source: Mill Creek, Bloomberg, Federal Reserve Bank of Cleveland.

On a day-to-day basis changes in real interest rates — interest rates that have been adjusted to remove the effect of inflation — have been a much better predictor of the gold price than inflation by itself. For example, in 1974 the 10-year Treasury yield was about 8%, but inflation was running at over 10%. Interest rates were high, but *real* interest rates were actually negative. Gold prices, accordingly, moved considerably higher. The opposite happened after the GA runoffs; real interest rates increased because interest rates rose faster than inflation expectations, hence the decline in gold.

One implication of this finding is that it's important to have a view on real interest rates in order to have a view on gold. For those wondering, we don't have strong view on real interest rates for 2021. Strong economic growth during the second half of the year would — all else equal — push real rates higher and create a headwind for gold. However, the Federal Reserve could certainly put a big caveat into "all else equal" and use balance sheet purchases to keep a cap on interest rates. In that scenario real interest rates could actually decline, supporting gold prices in the near term. You might feel more strongly one way or the other. Our view, simply, is that at this juncture there are more productive uses for portfolio assets than gold.

[1] As we discussed in last week's commentary, investors should be more concerned with unexpected inflation than inflation itself, as expected inflation — by definition — is priced into markets. Changes in inflation expectations are a proxy for unexpected inflation.

Updated Benchmark Performance:

Benchmark Performance by Asset Class	Week-to-Date	Month-to-Date	Year-to-Date
U.S. Large Cap Equities	1.90%	2.67%	2.67%
U.S. Small Cap Equities	2.15%	9.84%	9.84%
International Developed Equities	0.70%	2.47%	2.47%
Emerging Markets Equities	2.57%	7.88%	7.88%
Global Equities	1.66%	3.20%	3.20%
U.S. Bonds	0.01%	-0.75%	-0.75%
Intermediate Municipal Bonds	0.14%	0.15%	0.15%
High Yield Bonds	0.13%	0.48%	0.48%
Oil	-0.03%	6.81%	6.81%
Gold	1.43%	-2.07%	-2.07%
Key Rates	**1/22/2021**	**12/31/2020**	**1/22/2020**
U.S. 2 Year Treasury Note	0.13	0.13	1.53
U.S. 10 Year Treasury Note	1.10	0.93	1.77

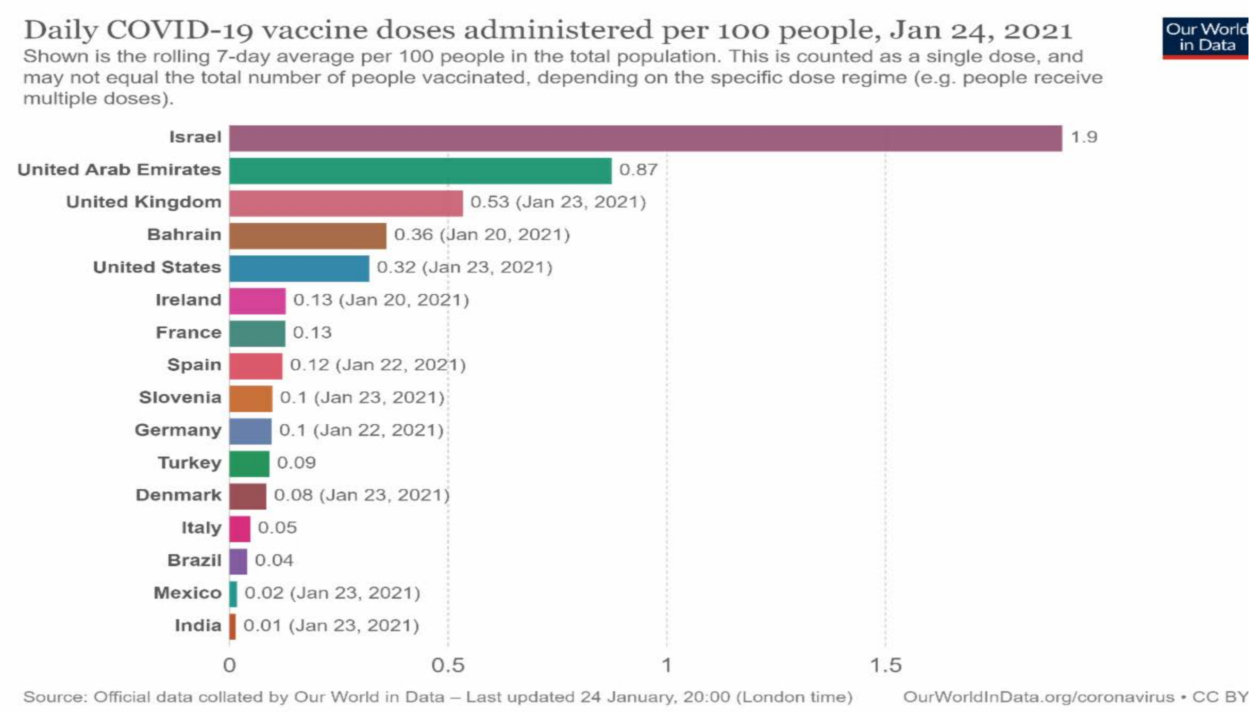
Week in Review:

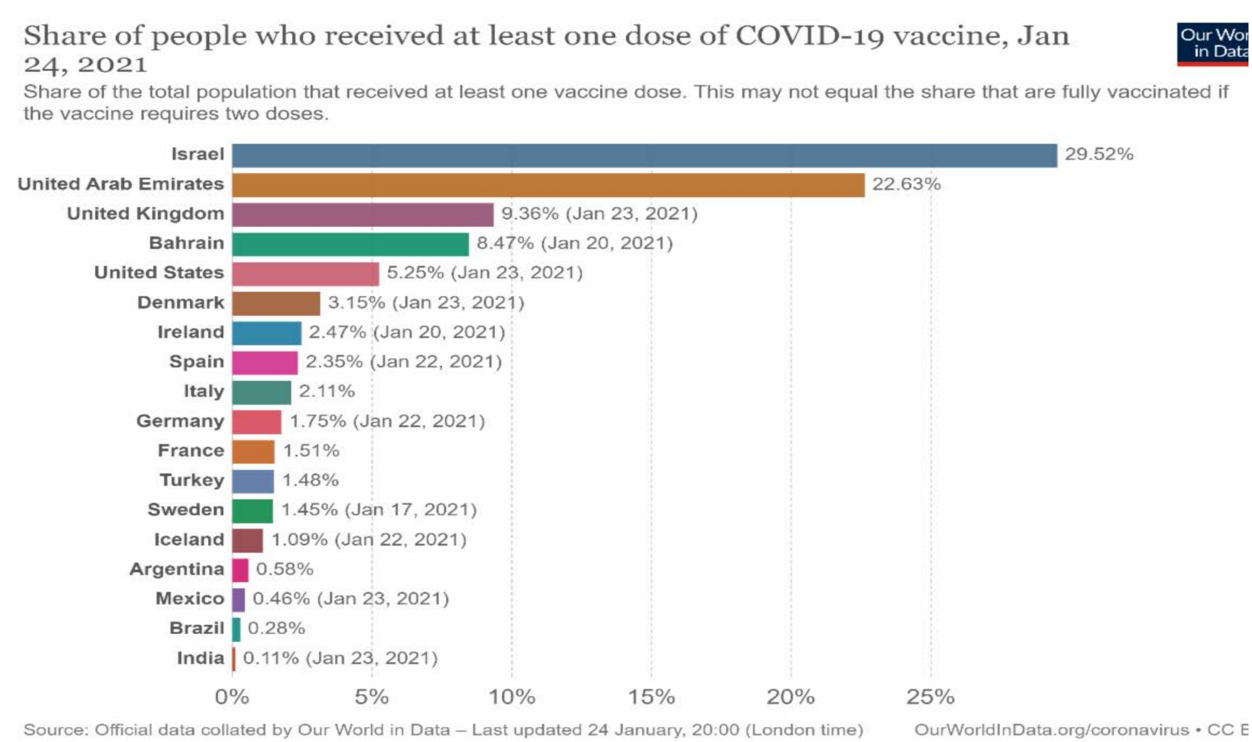
US equities gained last week as the 2021 rally continued. Earnings season has, so far, given investors reason for optimism – of the 62 companies in the S&P 500 that had reported results by the end of Thursday, 89% have beaten analysts' expectations, according to FactSet.

America's housing market is on fire as prices soar. According to the Commerce Department new home construction has reached levels not seen since 2006. However, supply side constraints will provide some headwinds for the industry in early 2021 – lumber prices doubled in 2020 and the pandemic has led to a shortage of labor.

- The most recent data provided by the S&P Case Shiller Index, a measure of national home prices, indicated an 8.4% year-over-year increase in prices as of October.
- Housing starts, a measure of U.S. homebuilding, rose 5.8% in December and are now above pre-pandemic levels.
- Residential permits, which can provide an estimate for future home construction, increased 4.5% in December vs. economists' forecasts of a 1.8% fall.
- 30-year fixed mortgage rates stand near 2.8%, just above record lows.

As the Covid-19 vaccination rollout continues, the United States leads the world in number of doses administered, but the country lags Israel, UAE, UK, and Bahrain in doses per 100 people (see below charts - data as of Sunday, January 24, 2021).


Daily COVID-19 vaccine doses administered per 100 people, Jan 24, 2021
Shown is the rolling 7-day average per 100 people in the total population. This is counted as a single dose, and may not equal the total number of people vaccinated, depending on the specific dose regime (e.g. people receive multiple doses).
Our World in Data
Israel 1.9
United Arab Emirates 0.87
United Kingdom 0.53 (Jan 23, 2021)
Bahrain 0.36 (Jan 20, 2021)
United States 0.32 (Jan 23, 2021)
Ireland 0.13 (Jan 20, 2021)
France 0.13
Spain 0.12 (Jan 22, 2021)
Slovenia 0.1 (Jan 23, 2021)
Germany 0.1 (Jan 22, 2021)
Turkey 0.09
Denmark 0.08 (Jan 23, 2021)
Italy 0.05
Brazil 0.04
Mexico 0.02 (Jan 23, 2021)
India 0.01 (Jan 23, 2021)
0
0.5
1
1.5
Source: Official data collated by Our World in Data – Last updated 24 January, 20:00 (London time)
OurWorldInData.org/coronavirus • CC BY


Share of people who received at least one dose of COVID-19 vaccine, Jan 24, 2021
Share of the total population that received at least one vaccine dose. This may not equal the share that are fully vaccinated if the vaccine requires two doses.
Israel 29.52%
United Arab Emirates 22.63%
United Kingdom 9.36% (Jan 23, 2021)
Bahrain 8.47% (Jan 20, 2021)
United States 5.25% (Jan 23, 2021)
Denmark 3.15% (Jan 23, 2021)
Ireland 2.47% (Jan 20, 2021)
Spain 2.35% (Jan 22, 2021)
Italy 2.11%
Germany 1.75% (Jan 22, 2021)
France 1.51%
Turkey 1.48%
Sweden 1.45% (Jan 17, 2021)
Iceland 1.09% (Jan 22, 2021)
Argentina 0.58%
Mexico 0.46% (Jan 23, 2021)
Brazil 0.28%
India 0.11% (Jan 23, 2021)
0%
5%
10%
15%
20%
25%
Source: Official data collated by Our World in Data – Last updated 24 January, 20:00 (London time)
OurWorldInData.org/coronavirus

Economic Calendar:

- Consumer Confidence Index – Tuesday, January 26th
- Durable Goods Orders – Wednesday, January 27th
- Fourth Quarter GDP – Thursday, January 28th

This week's contributors: Michael Crook, CAIA and Dusko Jankovic, CFA, CAIA

Indices Used: U.S. Large Cap equities: Russell 1000 Index, U.S. Small Cap Equities: Russell 2000 Index, International Developed Equities: MSCI EAFE Index, Emerging Market Equities: MSCI Emerging Markets Index, U.S. Bonds: Barclays Aggregate Bond Index, U.S. 10 Year Treasury Note: Bloomberg 10 Yr. Treasury Note, Municipal Bonds: Barclays Intermediate Municipal Bond Total Return Index, High Yield Bonds: Barclays U.S. High Yield Total Return Index, Oil: Bloomberg WTI Crude Sub-Index Total Return Index, Gold: Bloomberg Gold Sub-Index Total Return Index