The use of gold in institutional portfolios

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From the COVID pandemic to the Russia–Ukraine war, the global economy has sustained significant and varied shocks over the last few years. And as monetary tightening has recently gathered significant momentum amid exceptionally high inflation, investors are operating in uncharted territory.

To better understand how investors are navigating this complex landscape, we partnered with Coalition Greenwich. They interviewed over 400 key decision makers at global investment institutions on their portfolio allocations and views on markets and gold.[1] The survey ran during a period in which the world economy was adjusting to a new policy reality, having benefited from enormous fiscal and monetary stimulus throughout much of the previous 18 months. The responses in our survey reveal that:

- interest rates and liquidity concerns are key drivers of allocation decisions
- investors who own gold do so overwhelmingly for diversification and inflation-hedging purposes
- the vast majority of gold allocations are strategic, typically held for more than three years.

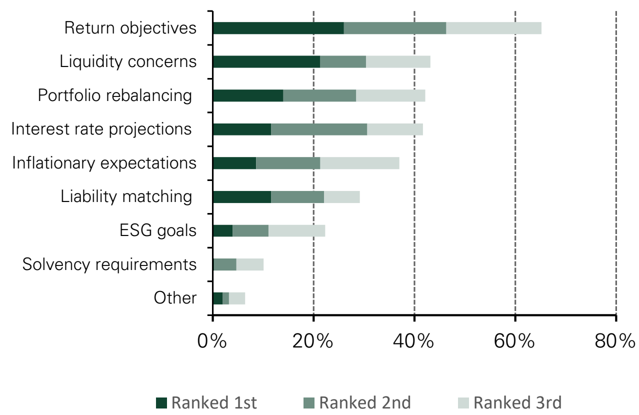
Portfolio positioning amid global monetary tightening and slowing economic growth

Unsurprisingly and as in our previous 2020 survey, return objectives remain the primary factor driving portfolio allocations in both the long and short term (**Chart 1** and **Chart 2**, p2). But the secondary drivers – and shifts in their relative importance since our previous survey – highlight the challenges of achieving this return objective in the current environment.

The ebb and flow between high prevailing price levels, uncertainty surrounding policy responses, and the threat of a recession continue to keep investors on edge, with institutions citing liquidity concerns, portfolio rebalancing, and interest rate projections as equally important drivers of short-term portfolio allocation decisions.

Chart 1: Return objectives remain top, but interest rate and liquidity concerns are now on an equal secondary footing with portfolio rebalancing

% of respondents giving each short-term factor a top 3 ranking



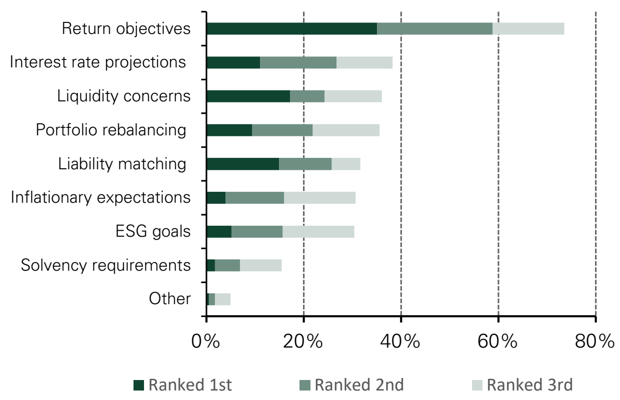
Q: Please rank the top three factors or objectives that drive your short-term (within the next year) allocation decisions.

Source: Coalition Greenwich, World Gold Council

1 Coalition Greenwich surveyed 408 institutional investors between November 2021 and March 2022. Regional composition of respondents: North America: 163; EMEA: 137; APAC: 106; Latin America: 2. Surveys were conducted online.

Chart 2: Interest rates and liquidity also remain a key factor driving long-term allocation decisions

% of respondents giving each long-term factor a top 3 ranking

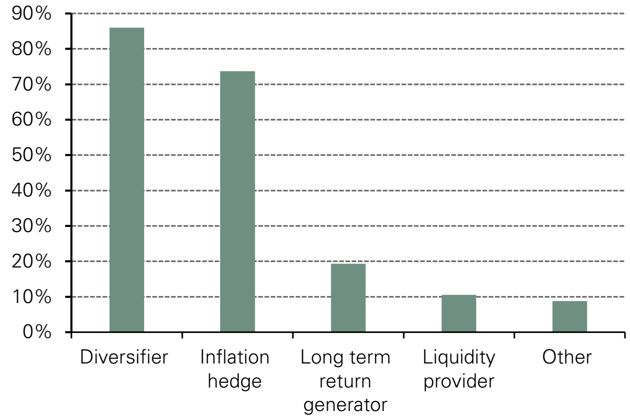


Q: Please rank the top three factors or objectives that drive your long-term (3–5 years in the future) allocation decisions.

Source: Coalition Greenwich, World Gold Council

Chart 3: Gold's diversification and inflation-hedging properties are valued

Respondents selecting each role, %



Q: What role does your gold allocation play in your overall portfolio? Respondents could select multiple options.

Source: Coalition Greenwich, World Gold Council

This is a notable change from the 2020 study, in which interest rate projections and liquidity concerns lagged notably behind portfolio rebalancing short-term drivers. There is a similar – if less pronounced – shift in the relative importance of these factors in shaping long-term allocation decisions.

Comparing long-term and short-term drivers reveals one notable difference: ESG goals are significantly more important in driving long-term allocation decisions compared to short-term decisions.

Drivers of institutional demand for gold

Against the broader drivers of portfolio allocation decisions, our survey narrowed in on the factors driving specific allocations to gold. And it transpires that they align closely with the drivers of broader shifts in asset allocation.

Our interactions with institutional investors tell us that diversifying return drivers, dampening portfolio volatility, and inflation protection are among the main motivations for allocating outside of fixed income and equities (**Chart 3**). A Mercer poll similarly concludes that asset owners and managers are 'revisiting their strategic asset allocations to consider the resilience of their portfolios against increasing inflationary pressures, volatility, and potential disruptions to economic growth'. T. Rowe Price Group agrees: their clients are increasingly seeking help in evaluating 'various sources of diversification… [the scope of] which has broadened to include inflation risk'.

Our survey results suggest that gold could play a role in this re-evaluation of asset allocation. When asked to name the primary role that gold plays in their portfolios, the vast majority of those who own gold ranked diversification and inflation-hedging above all other considerations.

Overview of gold allocations among institutional investors

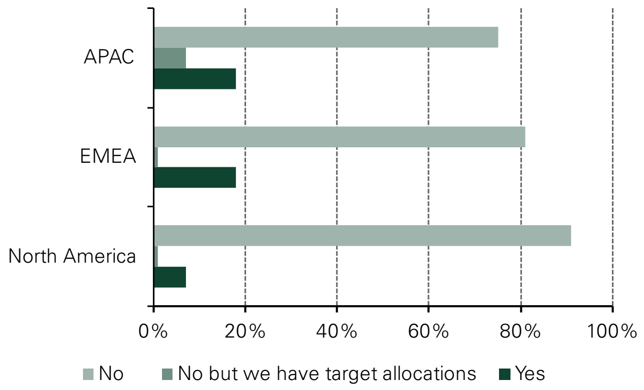
One of the primary goals of our study was to see how investors are reacting to the circular risks surrounding inflation, interest rates and economic growth, and to discover whether – and how – these risks are affecting their views of gold.

Ownership of gold among the investors queried remains relatively low, with only about 15% of institutions having specific gold positions in their portfolios. Allocations are most common among institutions in EMEA and APAC (18% of respondents in each region, **Chart 4**, p. 3) and among the larger institutions with more than US$10 billion in assets under management (18%).

But despite modest overall participation by institutional investors, the average allocation to gold is a relatively healthy 4%. Notably, one of the survey's top line findings is that these institutional investment holdings seem to be 'sticky'. Of the investors who allocate to gold, the vast majority plan either to maintain or increase their current allocation to gold over the next three years, with only a very small minority expecting to reduce their allocation.

Chart 4: Gold allocations are more likely among institutions in EMEA and APAC

% of institutions allocation to gold, by region



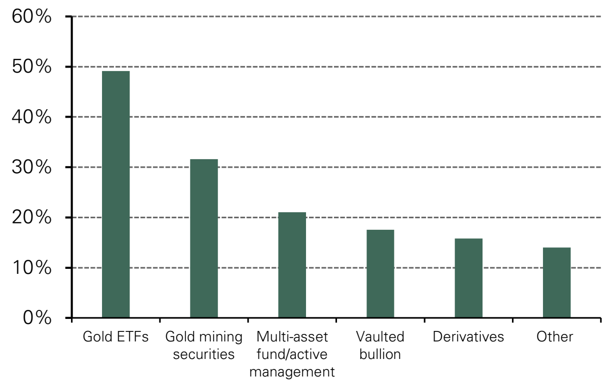
Q: Does your portfolio contain specific allocations to gold?
Source: Coalition Greenwich, World Gold Council

Moreover, more than half of investors who hold gold expect the minimum holding period of their gold allocation to be more than three years, highlighting gold's significance in their long-term asset allocation strategy. The most favoured route for allocating is via gold ETFs, followed by gold mining securities (**Chart 5**). Relatively few gained their exposure to gold through either vaulted bullion or derivatives.

Our research also indicated that a gold allocation can straddle a number of classifications within a portfolio. Investors who own gold most commonly hold it within their commodities allocation and/or see it as its own individual asset class.

Chart 5: Gold ETFs are the primary vehicle for allocating to gold

Respondents selecting each instrument, %



Q: How do you currently hold exposure to gold in your portfolio? Respondents could select multiple options.
Source: Coalition Greenwich, World Gold Council

Conclusion

As investors position their portfolios amid this very difficult macro environment, institutional allocations to gold will continue to have a role to play. These meaningful gold allocations reflect institutions' mounting concerns about inflation and their increasing need for effective portfolio diversifiers at a time of pronounced uncertainty about both short- and long-term market direction.

Furthermore, geopolitical risks remain with the ongoing Russia–Ukraine war and heightening tensions between the US and China. The need for some downside protection in this challenging environment should sustain institutional demand for gold going forward.

About the World Gold Council

The World Gold Council is the market development organisation for the gold industry. Our purpose is to stimulate and sustain demand for gold, provide industry leadership, and be the global authority on the gold market.

We develop gold-backed solutions, services and products, based on authoritative market insight, and we work with a range of partners to put our ideas into action. As a result, we create structural shifts in demand for gold across key market sectors. We provide insights into the international gold markets, helping people to understand the wealth preservation qualities of gold and its role in meeting the social and environmental needs of society.

Based in the UK, with operations in India, China, Singapore and the USA, the World Gold Council is an association whose members comprise the world's leading gold mining companies.

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