The role of gold in an era of uncertainty

Investment summit on gold

Beijing, April 2019

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, the Far East and the US, the World Gold Council is an association whose members comprise the world's leading gold mining companies.

World Gold Council
10 Old Bailey, London EC4M 7NG
United Kingdom

T +44 20 7826 4700
F +44 20 7826 4799
W www.gold.org

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Cover picture, Central Business District, Beijing.

Foreword

David Tait
Chief Executive Officer
World Gold Council

The World Gold Council's second Investment Summit was held in April 2019 in Beijing. The location was no accident. Economic power and influence are shifting from West to East and gold demand is moving in sync. Today, China is the world's largest gold market and its exchanges are a leading example of transparency, accountability and regulation.

The Investment Summit was organised in conjunction with the Tsinghua PBC School of Finance and the China Gold Association, with co-organisers the Shanghai Gold Exchange and the Shanghai Futures Exchange. Our aim was to consider global economic, financial and political uncertainties, the challenges these place on investors and how gold can help.

We also delved more deeply into China's gold market, the internationalisation of the RMB and the evolution of a multi-currency reserve system.

The Summit was attended by more than 100 delegates, including industry experts, regulators, central bankers, academics and institutional asset owners, from the public and private sectors.

Discussions centred on China's economy, markets, currency and the role of gold. There was recognition that current policies and reforms should support gold demand. But our Summit also suggested ways in which China's gold market could become even more robust and influential.

We looked at the institutional investment landscape as well, both in China and beyond. Investors face increasingly harsh conditions, as growth slows and uncertainty increases. We considered how institutions can meet these challenges and analysed the impact of gold on their investment portfolios.

This Summit could not fail to mention central banks, as they have been purchasing gold at a rate not seen in almost 50 years. We examined the political, economic and strategic rationale behind these purchases and discussed whether that pattern will continue.

Our Summit was designed to provide much food for thought. And it did. We intend to continue the debate in September, with our third Summit, returning to New York, where we held our inaugural conference last year.

David Tait

Executive summary

The World Gold Council's Investment Summit focused on the role of gold in an era of uncertainty. We also paid particular attention to China, reflecting the Summit's location and China's central and growing position on the global gold market.

Our Summit covered six broad themes:

- Global economic prospects, as growth trends East
- The transformation of China's gold industry, the role of its exchanges and their ambitions for the future
- Maximising the potential of China's gold market
- Central banks, gold and the international monetary system
- Challenges facing asset owners at a time of slowing growth and rising uncertainty
- The investment case for gold.

Key findings

We live in a time of increasing uncertainty. Global growth has slowed, interest rates remain low across the developed world and markets are increasingly unpredictable. Against this unpromising backdrop, one trend is clear: the economic centre of gravity is shifting East. Asia is developing fast, led by China. Over time, China's power and influence will increase, with India coming close behind.

But China faces challenges, both structural and systemic. Solutions are at hand but they require careful reflection followed, in time, by action. The Global Financial Crisis and subsequent events highlighted weaknesses in the Western approach to industry and markets. Now China needs to deliver reforms that marry the best of the West with Chinese principles and a greater emphasis on social good.

The status and potential of China's economy is mirrored by the gold market. Already the biggest producer, importer and consumer of gold, China could be an even larger and more influential player if certain changes were introduced.

First, broadening access to the market so institutional investors can benefit from gold's attributes as a long-term savings tool. Second, allowing producers to sell their gold abroad, so China can develop a robust import and export market. And third, promoting internationalisation, introducing products, systems and processes that encourage international trade.

Speakers at the World Gold Council's second Investment Summit.

Such moves will not only bolster China's status and influence on the global gold market; they will also drive the internationalisation of the RMB.

Central banks may already be anticipating a greater role for the Chinese currency. Their gold purchases in 2018 were higher than at any time since 1971. Many of the most notable investments in gold were made by countries along China's Belt and Road Initiative (BRI), prompting suggestions that central banks are acquiring gold as a hedge against a shift to a new, more multi-currency reserve system.

Some central banks are also buying gold as part of a deliberate policy of dedollarisation, while the heightened level of geo-political and economic risk, in both emerging and advanced economies, is underpinning demand for gold as a strategic asset.

In this regard, emerging markets may find gold's safe-haven attributes particularly beneficial. Their allocation to gold has historically lagged that of advanced economies. In future, the gap is likely to narrow.

Across the world, investors are striving to generate returns, reduce volatility, preserve capital and ensure liquidity. Gold addresses each of these challenges. As such, it can make a valuable contribution to investment portfolios, particularly at a time characterised by economic uncertainty, trade tensions, rising populism and market unpredictability.

Institutional access to China's gold market is limited today but asset owners are finding solutions, such as ETFs, Fund of Funds and Manager of Managers. They are innovating and they are likely to continue doing so, as they strive to help Chinese savers benefit from gold's long-term attributes.

China's decision-making processes can sometimes be hard to gauge from outside the country. Steps are taken slowly, results are tested, actions are adjusted. As recent decades have shown however, China is on a growth trajectory and its gold market is following suit. Now responsible for 30% of global demand, China's role and influence on the global gold stage are almost certain to develop over the coming years.

Mr Song Xin, Chairman, China Gold Association.

Mr Zhou Yanli, Former Deputy Party Secretary and Vice Chairman of China Insurance Regulatory Commission.

1: Economic outlook: trending East

When the G7 was founded in 1975, its members were chosen because they were considered the most advanced economies in the world. This group – Canada, France, Germany, Italy, Japan, the UK and the US – were collectively responsible for well over half of the world's net wealth.

Their dominance dates back to the Victorian era. And even by the turn of this century, the group's combined GDP significantly exceeded that of the 200 emerging market nations.

Over the past two decades however, a remarkable shift has been underway, as emerging markets, led by China, have delivered consistently stronger economic growth than the G7. Today, for the first time in recent history, emerging countries' combined GDP equals that of the G7.

This is a pivotal moment on the global stage but it is more than that – it is part of an inexorable trend. Over the next 30 years, economists at our Investment Summit predicted with confidence that the axis of economic growth will shift increasingly towards the East.

How can they be so certain?

Today, China is the world's largest economy on a purchasing-power parity basis, while India is rapidly becoming a global powerhouse. Both countries have delivered many years of double-digit or close to double-digit growth.

Growth rates have slowed recently but our Summit pointed out that both China and India are still delivering quarter-on-quarter growth consistently in excess of 6%. This year, the IMF predicts annual growth of 6.3% for China and 7.3% for India, compared to 2.3% for the US and 1.3% for the Eurozone.

The numbers may change in the decades ahead but Asia's outperformance is likely to be a constant.

Nonetheless, there are challenges to overcome. As speakers at our Summit outlined, both countries face issues around investment. China continues to invest heavily in its development, prompting worries about over-heating and bad debts. Indian investment has fallen as a share of GDP and it needs to increase if the country is to maintain growth rates of 7% or more.

There are demographic issues too – an ageing population in China that may have a long-term effect on GDP growth; a rapidly increasing population in India, that needs to be educated and employed.

Trade tensions between China and the US are a serious concern as well. They have eased but they have not disappeared. Indeed, they can be seen as symptomatic of the Eastward shift in economic power. As our Summit discussed, the US has dominated the global economy for more than 50 years. Changes in the balance of power are likely to create stresses and strains in multiple ways over the coming decades.

Dr Duvvuri Subbarao, Former Governor, Reserve Bank of India.

Supplement – China in focus

Over the past four decades, China's economic model has witnessed fundamental change, as the country has gradually opened up and developed a more market-based approach to business and finance.

It has been a period of tremendous change. Economic output has soared, private enterprise has flourished and hundreds of millions of people have been lifted out of poverty.

Now, however, China is at a pivotal point. Having rapidly become the world's largest exporter, the focus is shifting towards domestic consumption. Having rapidly developed its infrastructure and manufacturing capabilities, the focus is shifting towards services. And, having established new markets and exchanges, there are ongoing discussions about how best to liberalise still further.

Our Summit revealed a genuine appetite for continued change. But in a measured and considered way. It is abundantly clear that China is opening up to the outside world. The Belt and Road Initiative (BRI) is bolstering cross-border trade, encouraging Chinese companies to become more international and broadening the use of the RMB. Further liberalisation will follow but, the Summit heard, Chinese authorities prefer to take a long-term view. They move slowly, cautiously so as to avoid mistakes made by other nations and develop their own path.

China is keenly aware of global challenges, such as climate change, populism, protectionism and slowing economic growth. Strategies have already been adopted to address some of these – advancing green technology to tackle greenhouse gas emissions, for example, and loosening fiscal and monetary policy to stimulate economic growth. Similar and fresh policies are likely to follow but our Summit highlighted the need for careful thought on all these issues.

Speakers suggested, for instance, that trade tensions and persistently conservative trade policies could jettison economic growth and even precipitate another financial crisis. It was felt that concessions should be made to ensure that trade can continue to evolve and develop so that the benefits of economic growth can be shared by all.

In a similar vein, emphasis was placed on the need for financial markets to serve the real economy and support fundamental growth, with institutions supporting public and private sector investment, without encouraging businesses to become overleveraged and unable to service their debts.

Speakers expressed the view that this approach will require a change, both in management culture and financial markets. Some business leaders still look back to the old ways of working. They need to look forward, it was said.

In the same vein, some financial institutions and regulators still operate in ways that are not consistent with international standards. Speakers acknowledged that reform is underway but suggested that it needs to continue, while regulatory oversight has to increase.

This prompted discussions around risk, as speakers considered how China can develop a dynamic approach to risk, so that businesses and markets are not afraid to take risks if doing so can deliver stronger growth and economic development. Technology may prove helpful here – and China is at the forefront of research and innovation in this field. Looking ahead, speakers felt that technology should focus on developments that genuinely benefit society and advance people's welfare.

Perhaps the most fundamental insight to emerge from our Summit with regard to China was this: that China has made enormous strides in the past four decades but there are still huge opportunities. Seizing those opportunities is likely to require structural reforms, further market liberalisation and the confidence to recognise that the best is yet to come.

Skyline in Shanghai: China is changing at a fast past.

2: China's gold market, two decades of transformation

China's affinity with gold stretches back over hundreds of years. Gold is part of China's history and culture – with an integral role in its traditions and customs.

Over the past 20 years however, China's gold market has undergone a dramatic transformation, a reflection of its ancient past, its growing economic power and concerted efforts by the Chinese authorities.

Today, China produces more gold than any other country, consumes more gold than any other country and imports more gold than any other country. The Shanghai Gold Exchange (SGE) is the biggest physical spot gold exchange in the world, Shanghai Gold is developing as an international benchmark and the Shanghai Futures Exchange (SHFE) enjoys active trading in gold products.

This evolution is the result of years of planning, policy-making and gradual liberalisation, conducted by the Chinese authorities, curated by the People's Bank of China (the PBOC) and the China Gold Association, and supported by the World Gold Council.

Until 2001, the PBOC set the price of gold, purchased it from domestic producers and sold it to fabricators. In 2002, however, the SGE was launched, establishing a market mechanism for gold trading and investment.

The SHFE introduced its first gold futures contract in 2008; the SGE set up its international board in 2014 to allow overseas market participants to trade on the exchange, and in 2016, an RMB-denominated gold price was created, Shanghai Gold.

The pace of change has been dramatic and the results have been impressive. Today, China's gold market is not only large and active; it is also among the most transparent in the world, with fair, clear and audited systems, comprehensive access to data and strong regulatory oversight.

Nonetheless, there are challenges and areas for improvement. Our Summit recognised achievements to date but, more importantly perhaps, we highlighted future potential.

Looking first at gold production, speakers underlined the need for miners to be environmentally responsible, taking action wherever necessary to improve standards, reduce emissions and drive ecological awareness.

Mr Cai Esheng, Former Vice Chairman of the China Banking Regulatory Commission, Chairman of the Finance Centre for South-South Cooperation.

Speakers also suggested that the SGE and the SHFE should broaden access both domestically and internationally.

Today, the SGE and the SHFE are dominated by domestic retail investors. Granting access to institutional investors, such as pension funds and insurers would deepen the market and allow these asset owners to diversify their portfolios to the benefit of long-term savers across China.

There were also calls for greater internationalisation of both exchanges. The Shanghai International Gold Exchange has been expanding steadily over the past five years: overseas trades now account for 10% of total volumes and the SGEI is responsible for 38% of total gold imports.

But the SGE is keen to improve its infrastructure, systems, services and user experience to encourage greater international participation. There are moves afoot to expand the use of Shanghai Gold as well. Already active in Dubai, Shanghai Gold is expected to gain further advocates in Asia and the Middle East, ultimately becoming a reliable, traceable and auditable benchmark backed by standards that align with the international market.

The drive towards greater internationalisation will involve closer engagement with other exchanges too. The SGE is already cooperating with exchanges in Hong Kong, Moscow and Budapest, but our Summit heard that discussions have been initiated with the Chicago Mercantile Exchange, the world's largest gold futures market.

Looking to the future, the SGE is keen to bolster its international agenda, connecting with markets along the Belt and Road Initiative, attracting global investors to the SGEI and raising the international standing of China's gold market.

The SHFE will play a key role in this endeavour. As the second largest gold futures market in the world, there are ambitions to develop gold derivative products and forge more international links. An e-trading platform has been launched in Hong Kong and Singapore, allowing local customers to trade on the Chinese market. This innovative tool could be used to facilitate international expansion.

Across China's gold market, there is a determination to drive change. Speakers at our Summit were clear about how far the market has come. But they were equally clear about where it can go and the steps required to maximise potential. The next 20 years may well be another period of extraordinary progress, helping long-term savers in China and overseas to reap the benefits of gold's unique investment attributes.

Mr Jiao Jinpu, Chairman, Shanghai Gold Exchange.

Mr Jiang Yan, Chairman, Shanghai Futures Exchange.

3: Maximising the potential of China's gold market

The gold market is one of the largest and most liquid in the world, with around US$110 billion (bn) traded every day.[1]

As the largest producer, importer and consumer of gold, China plays a significant role along the entire gold value chain.

But China's gold market could be significantly larger, more dynamic and more widely respected than it is today. Crucially too, the market could contribute to the internationalisation of the RMB, thereby driving and promoting China's influence on the global stage.

Speakers at our Summit were clear about how best to maximise this potential.

Today, gold trading activity in China is dominated by retail investors. Institutional asset owners, such as insurers, pension funds and social security funds, have limited access to the market and their participation is relatively low. If restrictions were lifted, these institutions would play a far more active role, thereby increasing liquidity, fostering long-term investment and driving resilience.

Ms Wu Xiaoling, Chairwoman of the Board of the PBC School of Finance (PBCSF), Tsinghua University, Former Deputy Governor of the People's Bank of China (PBC).

Greater institutional involvement would also help to place China's gold market on a par with London and New York, still the two most dominant global centres for gold. And our Summit made clear that Chinese asset owners are keen to participate more extensively in the gold market, recognising the contribution that gold can make to their customers' pensions and long-term savings.

Importantly too, our Summit heard, China should lift the ban on bullion exports and relax import quotas. The current system was described, perhaps a little harshly, as 'a lame-duck market' – one that is neither fully functional nor effective. Creating a dynamic two-way model would attract long-term institutions to the market and encourage the internationalisation of the RMB.

This would have material consequences for China's status not just within the gold market but more broadly, on the international currency stage.

Economic shifts in recent years have prompted a growing belief that the international monetary system needs to change. That conviction is even stronger today, amid persistent geopolitical tension, slowing growth and genuine concerns about financial stability. As the Summit explained, the current system is widely considered to be overly-reliant on the dollar. This can create imbalances and does not fully reflect global flows and influences.

The International Monetary Fund has already added the RMB to the basket of currencies that make up the Special Drawing Right (SDR), an international reserve currency designed to supplement member countries' official reserves. This addition is helpful but more can be done to increase the RMB's global influence.

Speakers at our Summit suggested that liberalisation of the gold market in China, especially increased trading and settlement in RMB, would be an important stage in its status and use as an international currency.

China's gold market has developed at an extraordinary pace over the past two decades. It is large, transparent, sophisticated and respected. But, as China continues to mature and develop, the gold market needs to do likewise. Our Summit was confident that gold can make an important contribution to China's continuing evolution, helping to address challenges and leverage the opportunities that lie ahead.

1 Refer to www.gold.org/goldhub/data/trading-volumes

4: Central banks: risks, responses and reserve management strategies

In 2018, central banks purchased more gold than at any time since the collapse of the Bretton Woods system in 1971. Total purchases amounted to over 650 tonnes (t), with 19 central banks adding materially to their reserves during the year. Today, central banks own almost 34,000t of gold and gold is the third largest reserve asset in the world.

Our Summit considered why there has been such concerted buying of gold among central banks. We assessed the role of gold as a reserve asset, both in China and across the world. And we discussed the possible link between gold purchases and the move towards a multi-currency reserve system.

Central bank reserve managers have three core objectives: safety, liquidity and return. As a highly liquid, counter-cyclical asset that carries no counter party risk and preserves its value over the long term, gold can help central banks achieve each of these objectives.

Its unique status has become increasingly clear since the Global Financial Crisis highlighted the vulnerability of financial assets previously considered almost risk-free. Recent geopolitical events have served to highlight gold's role still further.

Considering the macro-economic perspective first, our Summit looked at recent IMF forecasts, which predict GDP growth of below 2% among developed markets this year and next. Among emerging economies, the IMF expects growth of 4.4% this year, falling to 4% in 2020. The figures do not inspire confidence and, our speakers suggested, downside risk is everywhere.

In the US, debt levels are at record highs, monetary policy has become more doveish and the outlook for the dollar is unclear. In Europe, growth appears to be slowing, businesses lack confidence and Brexit is a major concern. Globally, trade tariffs could further derail economic prosperity, causing long-term issues for developed and emerging economies.

The panel for the major sources of global uncertainty session.

Speakers at our Summit agreed that these factors have certainly encouraged central banks to look more closely at gold, not least because it has little or no correlation to other reserve assets. Our Summit heard too, that European reserve managers increase the returns on gold assets by active gold management, such as gold loans.

However, speakers at our Summit suggested that recent central bank buying is not simply based on political and macro-economic factors: it is strategic.

Close examination of central bank gold purchases reveal that most have come from countries participating in China's Belt and Road Initiative. Adding to their gold reserves may be a way for these countries to protect themselves, in anticipation of changes to the international reserve system.

The Hungarian Central Bank, for example, increased its gold reserves ten-fold last year and explained its decision in strategic terms, suggesting that gold may play a stabilising role under extreme market conditions or in times of structural change to the international financial system.

More broadly, gold can help reserve managers navigate the shift from West to East. Transitions are often characterised by instability and gold can act as a bulwark within a central bank portfolio at such times.

But there are other motivations too. Russia, for example, has been the largest buyer of gold over the past decade. The country has adopted a policy of dedollarisation, reducing the amount of dollars in its reserves. In the process, the central bank has almost doubled its reserves to 2,000t and the pace of buying has accelerated since 2014.

The PBOC has been a committed purchaser of gold in recent times too. Reserve managers bought gold steadily last year and have continued to do so in 2019, both to counter rising uncertainties and to take advantage of attractive pricing levels. Our Summit heard that this interest in gold is likely to persist, with the PBOC expected to take advantage of any pricing dips to amass more gold.

Looking ahead, experts at our Summit were confident that central banks will continue to build up their gold reserves to hedge against growing political risk, slowing economic growth and structural changes in the international monetary system.

Ms Isabelle Strauss-Kahn, former Lead Financial Officer, World Bank and former Director of Market Operations, Banque de France.

Supplement – Emerging market central banks and the role of gold

Developed markets' central banks collectively hold around 12% of their reserves in gold. Some, such as the US and Germany, have allocations of more than 60%. Among emerging economies however, the figure is less than 5%.

Our Summit heard that the gap between advanced and advancing economies is likely to shrink, as emerging markets build up their reserves to increase their resilience and address changes in the global economic order.

Speakers suggested that, in certain respects, gold is an even more valuable asset for emerging market central banks than their developed market counterparts.

Across the world, the dollar is the pre-eminent reserve asset, accounting for more than 50% of global central bank reserves. Emerging market central banks in particular have worked hard to build up their dollar reserves since the Asian crisis of the late 1990s, both to advance their international credibility and provide liquidity in times of need.

The strategy has certainly helped emerging market countries secure better terms on international bond markets but it does leave those nations highly exposed to dollar fluctuations and vulnerable to US domestic policy, our Summit heard.

This vulnerability has come into sharp relief since the Global Financial Crisis. Many emerging market countries were experiencing relatively robust economic growth at that time. Their banks and insurers were financially sound, their current accounts were in surplus and they were well respected abroad. But the events of 2008 precipitated a flight to the dollar, as investors focused on its status as the number one reserve currency. Emerging market currencies sank – some by double digits over the course of a few weeks – and central bank reserve managers were left scrambling to find sufficient dollars to stabilise their foreign exchange positions.

There have been several occasions since, when domestic US monetary policy has affected the stability of emerging market currencies and, by extension, their economic growth.

For emerging market central banks, this posed an obvious question: was there another asset that could provide liquidity, safety and return, without exposing them to US policy and foreign exchange risks?

Our Summit heard that there had been high hopes for the euro, when it was launched in 1999. But those were dashed, not least by the euro-crisis of 2012 and subsequent political turmoil. Central banks have also wondered whether the RMB could play a role as a reserve currency, given China's increasing global heft. This would be a logical development but, speakers at our Summit suggested that the necessary conditions are not yet in place. The Chinese authorities appear keen to internationalise the RMB and ensure its position within the SDR basket: they take a longer-term perspective over their currency's potential as a reserve asset.

For emerging market central banks therefore, gold has a clear role to play as a reserve asset, as our Summit explained. Gold decreases their reliance on the US dollar; it reduces the need to run to the IMF for help at times of crisis; it shows that they are financially robust and, in many cases, it resonates with local citizens.

As the world's axis shifts East, the dollar's dominance is called into question and advanced economies focus on their domestic agenda, speakers at our Summit were confident that emerging market central banks will increase their gold holdings over the coming years. The main question facing these institutions is not so much whether or even when, but by how much?

5: Institutional investors: asset allocation in a time of uncertainty

Governments, central banks and individual savers have long recognised gold's role as a risk-mitigation and value-preservation tool. But institutional investors have not always been as alive to gold's attributes and the contribution it can make to their portfolios.

In recent years, however, there has been a noticeable shift in attitude. The Global Financial Crisis highlighted the fragility of asset classes previously considered completely secure, such as sovereign bonds. This underlined gold's role as the ultimate safe-haven asset.

Even though most equity markets have delivered strong returns in the intervening decade, institutional interest in gold has persisted. And today, amid growing uncertainty about global political, financial and economic prospects, that interest is perhaps more acute than ever.

Our Summit heard from a range of international and Chinese institutional investors, including social security funds, pension funds, insurance and high-net-worth individuals. They were unanimous in their conviction that investment portfolios do better with gold. It protects their clients against market turbulence, reduces risk and enhances long-term returns.

Some international asset managers suggest allocations of 10-15% are appropriate in today's uncertain climate, characterised by rising global indebtedness, fully-valued equities and persistently low interest rates. They point to serious social and environmental challenges too, such as climate change, ageing populations, technological advances and structural tensions as the global economic axis shifts from West to East.

China's institutional asset owners agree that gold is a valuable asset to hold in today's uncertain times. Domestic legislation limits their access to gold but our Summit heard that efforts are underway to ease current restrictions and facilitate institutional investment in this asset.

As speakers pointed out, this would be particularly helpful, as China navigates economic and structural challenges, combined with increased market volatility.

Prof Zhou Hao, Associate Dean, PBC School of Finance; Mr Roland Wang, Managing Director, World Gold Council.

Mr Wang Zhongmin, Former Vice President, National Council for Social Security Fund.

Currently, our Summit heard, around 70% of China's insurance assets are invested in domestic fixed-income products, which may increase portfolio risk. Other asset owners are concerned about equity market unpredictability and the risks inherent in overseas investment, particularly at a time when the US dollar's global pre-eminence faces long-term structural challenges.

Gold has little or no correlation with other assets; it carries no counter party risk, holds its value against all major global currencies and delivers consistent, long-term performance. Thus, it offers valuable downside protection and sustainable returns to investors.

These characteristics were discussed during our Summit. Speakers explained how, in the face of restrictions, Chinese institutions are using innovative tools to access gold, such as the HuaAn YiFu Gold ETF, the leading gold-backed ETF in China. Asset owners are also using Fund of Funds and Manager of Managers to access gold. Indeed, gold was described as "an anchor" for any long-term, diversified portfolio.

Looking ahead, our Summit agreed that institutional investors will almost certainly increase their gold holdings to protect and enhance their clients' savings. Chinese institutions are particularly likely to follow this path if restrictions are lifted. Many are keen to see a more developed gold derivatives and futures market in China too, as these would enhance risk management strategies.

Research has shown that optimal gold allocation is not fixed. Conservative portfolios, where the majority of assets are in high-grade bonds, benefit from a gold allocation in low single figures. This rises steadily, as portfolios become more equity-focused and bond-light.

Over time, however, our Summit highlighted the contribution that gold can make to any institutional portfolio. As one Chinese speaker said: "Gold is like water: we must always make sure we have enough of it."

The panel on the wealth and economy session.

6: Making the case for gold

Investors today face multiple challenges: return generation, market volatility, capital preservation and the risk of illiquidity. Our Summit heard that gold can help overcome each of these issues. Gold generates returns, is highly liquid, provides portfolio diversification and enhances long-term performance.

Considering returns first, gold has performed as well as or better than stocks, bonds, cash and commodities on a 50-year view and a 20-year view. Gold has underperformed stocks over the past ten years but equity markets have enjoyed a decade-long bull run and are now showing increased signs of volatility.

Over the long-term however, gold tends to rise in price when US stocks increase but, importantly, when US markets tumble, gold does not. In other words, our Summit heard, gold is negatively correlated to equity markets when investors need it to be.

Gold is one of the most liquid global assets too, with average daily trading volumes of over US$100bn, more than the Dow Jones, German Bunds and certain currency pairs as well.

Perhaps the most compelling attribute of gold is its impact on a diversified portfolio, based ongold's historical performance. Our Summit analysed a hypothetical average US pension fund portfolio, comprising stocks, bonds, real estate and some alternative assets. Adding 4.2% of gold to this portfolio increased returns from 5.6% to 5.7% over a ten-year period ending in December 2018, but it also reduces volatility from 13.1% to 12.1% and cuts maximum drawdown (the maximum loss from peak to trough within a portfolio) from -43.5% to -38.9%.[2]

Gold also preserves returns, particularly in a high inflation environment, and it preserves its long-term value significantly more than any major currency, including the US dollar, the Euro, the Yen and the pound.

Mr John Reade, Chief Market Strategist and Head of Research, World Gold Council.

2 The optimised portfolio was developed using New Frontier Advisors Re-Sampled efficiency. The resulting portfolio included a 4.2% allocation in gold based on the LBMA Gold price, 30.5% in the Russell 3000, 18.7% in MSCI ACWI ex US, 16.1% Barclays US Aggregate, 3.6% Barclays Global Aggregate ex US, 1.4% JPMorgan EM Global Bond Index, 1% ICE BAML short-term Treasuries, 6.7% FTSE REITs Index, 8% HFRI Hedge Fund Index, 8.2% S&P Private Equity Index and 1.6% Bloomberg Commodity Index.

All these attributes – returns, liquidity, stability and diversification – make gold a valuable asset not just for international investors but also for Chinese institutions.

Our Summit analysed gold's performance specifically in the context of Chinese financial markets and discovered that gold outperformed bonds and money market funds between 2007 and 2017.[3] Equities, as represented by the CSI 300 index, generated higher returns during this period but with far greater volatility. Notably too, gold outperformed all asset classes, including Chinese equities, between 2016 and 2018.[4]

Chinese investors can also benefit from allocating to gold, as it has little or no correlation with RMB-denominated assets.[5] And the domestic market is highly liquid, as the Shanghai Gold Exchange is the largest spot market in the world, complemented by the Shanghai Futures Exchange and domestic, gold-backed ETFs.[6]

The World Gold Council has calculated that the optimal gold allocation for a hypothetical Chinese institutional investor ranges between 3% and 6%. Portfolios that have more than 85% of their assets in fixed income and a tiny percentage in equities, would benefit from a lower allocation to gold. Those with more than 15% of their portfolio in equities would benefit from a higher allocation.

For both international and Chinese investors, the advantages of gold are clear – perhaps more so today than in many years. Financial markets are volatile, protectionism is rising and economies are slowing. The Federal Reserve has signalled its intention to keep rates at 2.5% until 2021, European rates are at zero and German Bunds are in negative territory. The outlook for the dollar is uncertain and political tensions are pervasive.

Against this backdrop, gold's risk-reduction characteristics come to the fore. However, unlike most assets, our analysis shows that gold benefits both from periods of economic growth and periods of uncertainty (see: The relevance of gold as a strategic asset, March 2019).

During difficult times, investors seek out gold as a safe-haven asset. But, when economies are growing, consumers, industry and investors turn to gold for jewellery, technology and as a long-term savings tool. Collectively, these account for more than 60% of annual gold demand.

Looking ahead, tensions and turmoil should support demand for gold. But structural reforms in economies such as China and India are also likely to bolster demand for gold, as individuals grow wealthier, markets liberalise and institutional investment increases.

3 Annualised gross nominal returns from January 4 2007 to December 29 2017 of AU9999, CSI Money Fund Index, ChinaBond AAA Corporate Bond Index, ChinaBond Financial Bond Index and ChinaBond Government Bond Index.

4 Annualised gross nominal returns from December 31 2015 to December 28 2018 of AU9999, CSI Money Fund Index, ChinaBond AAA Corporate Bond Index, ChinaBond Financial Bond Index, ChinaBond Government Bond Index and CSI 300 Index.

5 For example, the correlation between gold and CSI 300 index had a correlation of 0.08 over the 10 years period between January 2008 and December 2018. For more information on gold's correlation to Chinese assets, see: www.gold.org/goldhub/data/gold-and-major-index-correlations.

6 Based on the average daily unilateral trading volumes of gold contracts in Shanghai Gold Exchange(37.5 billion yuan), Shanghai Futures Exchange (18.2 billion yuan) and gold-backed ETFs listed in stock exchanges (1.2 billion yuan).

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World Gold Council
10 Old Bailey, London EC4M 7NG
United Kingdom

T +44 20 7826 4700
F +44 20 7826 4799
W www.gold.org

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