Portfolio Manager Insights

Gold and Silver: Current Portfolio Perspectives

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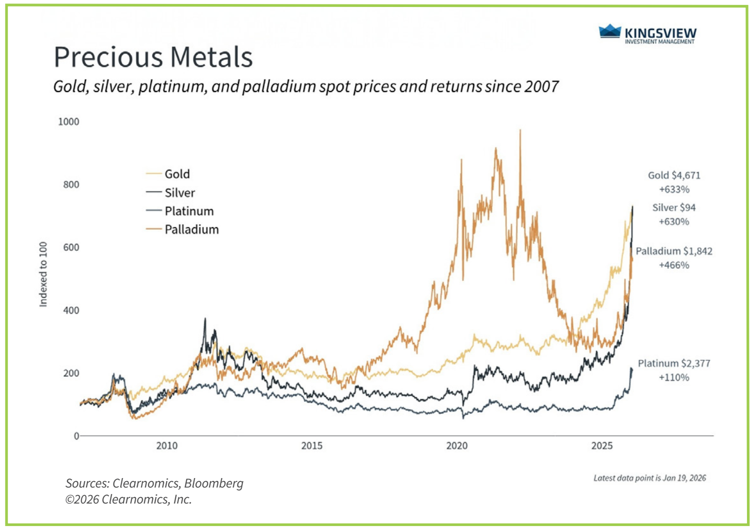
Investment Committee

Gold, silver, and other precious metals have rallied over the past two years, capturing investor attention. Gold recently surpassed $4,700 per ounce while silver now trades above $90 per ounce, marking historic milestones for both metals. This strong recent performance may lead some investors to wonder whether they should be investing in these assets. As with all investments, it's important to maintain a broader perspective to understand their history and how they fit into a well-constructed portfolio.

PRECIOUS METALS OFTEN RESPOND TO UNCERTAINTY



While many investors often turn to precious metals as "safe haven" investments, these and other commodities are prone to boom and bust cycles. In today's environment, the rallies in gold and silver are occurring alongside many other asset classes due to heightened uncertainty around monetary policy, fiscal policy, and geopolitical risk. It's important to view these assets not as speculative trading instruments, but as components of a broader investment strategy aligned with financial goals.

Several factors have driven the surge in gold and silver prices. One of the most important has been the recent tension between the White House and the Fed. This has raised questions about central bank independence and the direction of monetary policy, especially as Jerome Powell's term as Fed chair ends in May 2026. Lower rates and the prospect of inflation put downward pressure on the dollar, so it's natural for some investors to seek assets that can serve as a "store of value."

Equally important is that central banks around the world have been consistent buyers of gold in recent years as they have diversified away from dollar-denominated reserves. Central banks need to hold enough reserves to manage their monetary policy and maintain the value of their currencies. These purchases of gold and other assets have accelerated amid heightened geopolitical uncertainty and concerns about currency stability.

Both metals have also benefited from their industrial applications, including in electric vehicles, solar panels, and artificial intelligence hardware. Thus, they serve roles as precious metals, safe haven assets, as well as industrial commodities.

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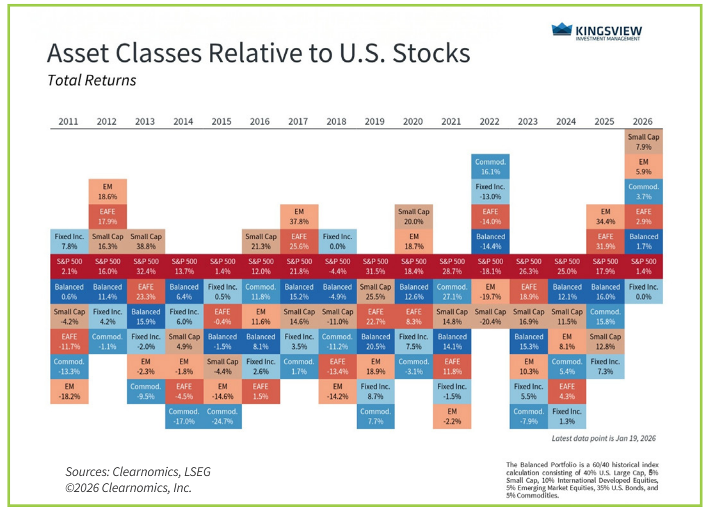
PRECIOUS METAL RALLIES ARE DIFFICULT TO PREDICT

PRECIOUS METALS SHOULD BE ALIGNED WITH FINANCIAL GOALS



Throughout history, periods of monetary policy uncertainty have coincided with strong precious metals performance. In the 1970s, for instance, both gold and silver climbed dramatically as stagflation hit the economy, peaking around 1980. Similarly, both rose from 2008 to 2011 during the global financial crisis, and then again during the 2020 pandemic.

In each of these cases, investors turned to precious metals when uncertainty about monetary policy and economic conditions peaked. However, both gold and silver prices began to reverse soon thereafter once conditions began to improve.

This creates at least two challenges for investors who are attracted to these investments based on recent performance. First, attempting to forecast gold and silver prices amounts to predicting the path of interest rates, inflation, and other factors like terms of trade. As the past several years have shown, these factors are difficult to forecast with certainty. Many concerns among investors and professional economists as inflation spiked in 2021 and 2022 did not materialize as expected.

Second, while it's understandable that investors are drawn to assets that have performed well, history shows that precious metal rallies are notoriously difficult to time. The 1970s gold rally, for instance, was followed by two decades of declining prices. Gold peaked above $800 in 1980, a level it wouldn't reach again until 2007.

The accompanying chart shows gold's performance compared to the S&P 500 since the 2007 market peak. While gold has had periods of strong performance, the stock market has also performed well over these periods. For investors focused on recent precious metals rallies, this longer-term perspective may seem surprising. However, it makes sense since the stock market has historically risen over long periods of time.

This pattern extends to silver as well. Despite its strong industrial demand story, silver has experienced long periods of underperformance between rallies. For instance, silver experienced a strong rally in the late 1970s. As stagflation pushed silver higher, a famous episode occurred in which the Hunt brothers attempted to corner the market by accumulating stockpiles and buying futures contracts. While they drove prices higher for a time, prices eventually plummeted as new supply entered the market and when regulators introduced restrictions on leveraged buying of commodities.

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Other precious metals exhibit similar behavior. Between 2016 and early 2022, palladium gained over 500%. This rally was driven by restricted global supply and greater use in applications such as catalytic converters for cars. However, after peaking, prices declined sharply over a two-year period.

These episodes demonstrate that, in situations where it makes sense for investors to have exposure to precious metals and commodities, gold and silver are best viewed as components of a broader commodities allocation or as part of alternative investments. The Bloomberg Commodity Index, for instance, currently allocates 14.9% to gold and 3.9% to silver, alongside other commodities such as industrial metals, energy, and agricultural products. This diversified approach to commodities exposure helps manage the volatility inherent in any single commodity.

The case for including precious metals in portfolios is based on the fact that they behave differently from stocks and bonds. Their value derives from scarcity, their roles as stores of value, and industrial uses. This means they often react to market and economic events differently from traditional asset classes, which can help to stabilize portfolios.

However, precious metals also carry important limitations. Most notably, they generate no income, unlike bonds or dividend-paying stocks. This lack of income also makes these assets difficult to value, which is another reason they are prone to booms and busts. A portfolio inappropriately weighted toward gold and silver may sacrifice the long-term growth potential of equities and the income generation of fixed income. So, even if precious metals might help in specific market environments, they may not be aligned with long-term goals.

The accompanying chart shows that many asset classes have contributed to portfolio returns recently, not just precious metals. While gold and silver have certainly performed well, there will always be individual investments that shine in particular periods. The key is constructing portfolios that can benefit from various market conditions rather than concentrating on recent winners.

The bottom line? Gold and silver have experienced rallies over the past two years, but long-term investors should view them in a portfolio context. Their value lies not in their recent performance, but in how they contribute to portfolio balance across different market environments.