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GOLD: MONEY THAT STANDS THE TEST OF TIME

A Generational Moment for Commodity Trading Strategies

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Gold: Money That Stands the Test of Time

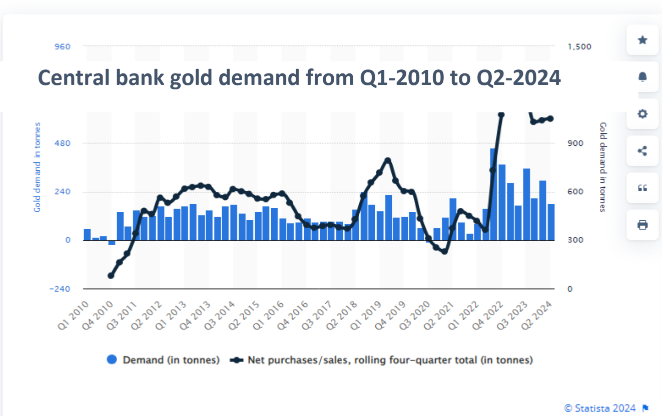
Spurred on by the West's freeze of Russian reserves, central banks are choosing gold over the dollar.

It was fitting that just after the 80th anniversary of the Bretton Woods Agreement in July, the price of a standard gold bar reached $1 million for the first time ever. After all, the current iteration of the global monetary system birthed in 1944 is largely responsible for lifting gold prices 50% over the past two years.

Today, a further sustained advance seems likely due to the growing gold appetite of many central banks seeking to end the hegemony of the U.S. dollar as the world reserve standard. The macroeconomist who arguably has been the most prescient about this developing tectonic shift in monetary policy and its enormously bullish implications for the yellow metal maintains $3,600/troy ounce is not improbable over the next few years.[1] We share that opinion.

Monetary regimes change. The world's reserve currency shifted from the Dutch guilder to the British pound sterling, and then to a U.S. dollar-denominated standard created at Bretton Woods. Initially based on a U.S. currency backed by gold bullion, Bretton Woods then pivoted to a second stage in 1971 when it jettisoned gold and established U.S. Treasuries paid in fiat currency as the principal central bank reserve asset.

That convention came under challenge with the Great Financial Crisis. Shaken by the turmoil in western financial markets, the head of the People's Bank of China called for a move away from the US dollar (USD) and for the



Source: Statistica

[1] "If Russia accepts gold for oil, gold price doubles to $3600, says Credit Suisse's Zoltan Pozsar," BMG-Group.com, December 20, 2022.

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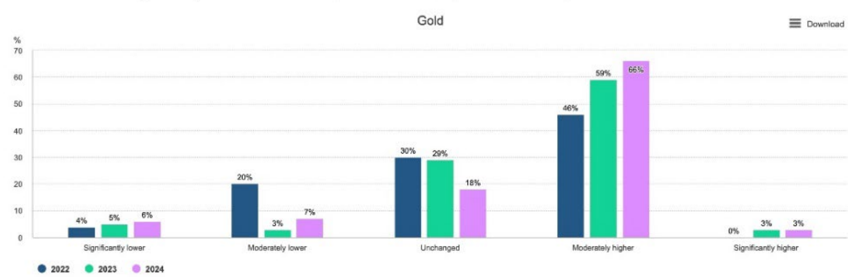
creation of a new monetary system.[2] Following the call for "de-dollarization" in 2009, four decades of gold declining as a percentage of central bank reserves gave way to a doubling of the world's central banks' gold exposure. All 14 of the countries that have increased their gold allocation by at least 5% since 2000 are emerging market nations.[3]

This trend rocketed on February 26, 2022. That was the day the U.S. and its European allies vowed to block Russia from its USD-denominated reserve assets because of its invasion of Ukraine. In an instant, the West proved how devastatingly vulnerable countries are to counterparty risk. By weaponizing the reserve system, the U.S. ruptured the architecture of the global monetary system and catalyzed the birth of what some now call Bretton Woods III — a system with multiple reserve assets, including commodity-backed currencies and assets.[4] So far, the commodity of choice has been gold, one of the few neutral liquid reserve assets that can resist sanctions and confiscation, if, as has been the case recently, central banks move their gold holdings into their own vaults.[5]

Chart 2: What proportion of total reserves (foreign exchange and gold) do you think will be denominated in gold 5 years from now? (2022-2024 responses shown).



2024 Base: All central banks (68); Advanced economy (23); EMDE (45). 2023 Base: All central banks (57); Advanced economy (13); EMDE (44).
2022 Base: All central banks (56); Advanced economy (13); EMDE (43). See Note 2 for a detailed explanation of the answer options.

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[2] "Reform of the International Monetary System," essay by Zhou Xiaochuan, March 23, 2009.
[3] "Gold as International Reserves: A Barbarous Relic No More" by Arslanalp, Eichengreen & Simpson-Bell for the IMF, January 2023, p. 5.
[4] "Bretton Woods III," by Zolton Pozsar of Credit Suisse, March 7, 2022.
[5] "Why Central Banks are Moving Gold to Home Countries," The Economic Times, July 1, 2024.

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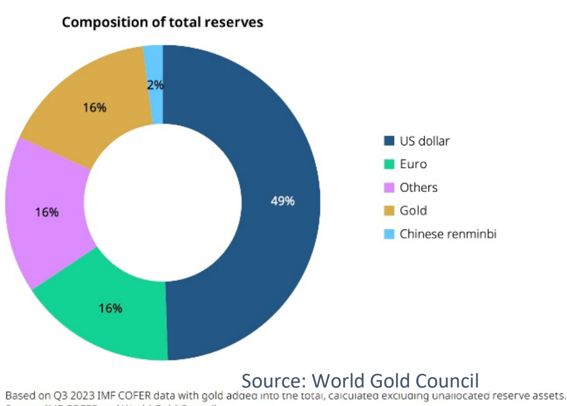
Within months of the freeze on Russian reserves, central banks added billions of USD worth of gold, their biggest increase in gold holdings in 55 years.[6] The June 2024 World Gold Council survey of central banks revealed their expectation to continue increasing gold holdings in coming years (graph above). Their gold buying unabated, emerging market countries — the core of which are the so-called BRICS nations — account for close to half of global GDP and most of its growth. We believe their economic growth will feed a demand for gold that is both long term and relatively price insensitive,[7] characteristics of central bank purchasing behavior.

Chief among the gold buyers is China. While the U.S. and other western nations are extracting themselves from the Chinese supply chain, China is extracting itself from the western monetary system. Russia and China, now united in their complementary grievances with the old monetary status quo, have accounted for roughly 80% of central bank gold demand for the past two decades.[8] Despite the Chinese central bank's prodigious buying of gold since the freeze on Russian reserves in 2022, gold still constitutes less than 5% of its total reserves (graph above). With central banks on average maintaining a 16% exposure to gold (graph below), we expect China will be buying higher volumes of gold for years, possibly decades.



Source: World Gold Council

A follow-on effect of Chinese central bank gold buying is mounting demand from Chinese individual investors. First, steady purchasing by the People's Bank of China is a "free advertisement for gold," the World

[6] "Gold as International Reserves," *op cit*, p. 4.
[7] In Gold We Trust Report 2024: The New Gold Playbook, by Incrementum, May 17, 2044, p. 29.
[8] BullionVault.com, August 12, 2024.

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Gold Council has noted.[9] Second, commercial real estate – the traditional target of Chinese retirement assets – has hit turbulence. With the Chinese population's cash holdings at record levels while investment opportunities shrink, we believe gold will make an attractive destination for idle renminbi. China and India have risen to nearly half of global consumer demand for gold, up from 29% in 2000.[10]

Abandoning the dollar for other currencies and assets is spreading quickly. In 2022, Russia switched most of its international transactions from USD and euro to the Chinese yuan. Later that year, Ghana announced a plan to buy Russian oil with gold from its mines instead of with USD. Last year, Saudi Arabia said it would sell oil in currencies other than USD. Most intriguingly, Russia and Iran are presently at work designing a Caspian Sea economic zone where transactions will be settled in gold-backed digital tokens.[11]

These efforts picked up speed in October when the BRICS members held their 2024 summit in Russia. A key agenda item was to advance talks on severing use of the USD, which would result in more gold moving from West to East. They also entertained bids from dozens of other emerging market countries to join their association, which, if approved, would add breadth to de-dollarization and gold re-monetization trends.

In the face of this international clamoring for gold, U.S. investors have been slow to embrace gold's bull market. During the past two-year bull run, gold ETFs experienced outflows each quarter until the most recent period. In the U.S. investment advisor community, 71% have an allocation to gold of 0-1%.[12] GDX, a popular gold mining stock ETF, is priced where it was 18 years ago, when gold was just one-quarter of its current price. Clearly, American investors are not exhibiting the hyper-bullishness typically seen at market tops.

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[9] ShaoKai Fan of the World Gold Council, quoted in "China's gold buying break seen as fleeting given its long-term needs," Reuters, July 16, 2024.
[10] "India and China make up nearly 50% of global gold demand," in OilPrice.com, June 28, 2023.
[11] "Zoltan Pozsar on his next big move and the coming monetary divorce," Odd Lots / Bloomberg podcast, June 30, 2023, at 29 minutes 10 seconds.
[12] "Gold Allocation of Investment Advisors, In Gold We Trust, by Incrementum, on Instagram, September. 6, 2024.

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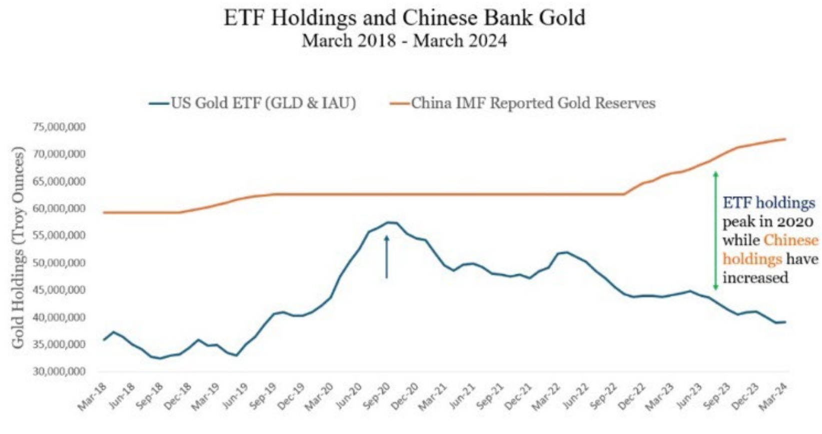
To be sure, factors other than investor sentiment and central bank demand will affect gold prices. Traditional currency debasement – stemming from historically large federal deficits and a swollen money supply – is alluring to governments that want to spend more and need to service their debt.



Note: Bloomberg tickers GDTRAUOZ Index, ISHGOLD Index, CNGFGOLD Index

We believe debasement pressures are combining with the long-lasting effects of broken trust in U.S. treasuries as a reserve asset to stoke ever-mounting demand for gold. Meanwhile, gold's supply remains scarce and prospects for any unusual expansion of supply appear remote. We expect this supply/demand imbalance will make gold an attractive opportunity into the next decade.

This report is part of an ongoing series from Titan Advisors that analyzes the opportunity set in the commodity sector.

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GRAPH TOP OF PAGE 2, DETAILED EXPLANATION OF THE ANSWER OPTIONS: The proportion of gold in total reserves (foreign currency and gold) on which respondents were asked to base their view was different in each survey year: 16% (2024), 15% (2023), 14% (2022). Correspondingly, the answer options varied in each survey year and are therefore presented with descriptions in this chart. The answer options in each year were: Significantly lower: less than 10% (2024), less than 10% (2023), less than 10% (2022); Moderately lower: between 10-15% (2024), between 10-14% (2023), between 10-13% (2022); Unchanged: 16% (2024), 15% (2023), 14% (2022); Moderately higher: between 17-25% (2024), between 16-25% (2023), between 15-25% (2022); Significantly higher: greater than 25% (2024), greater than 25% (2023), greater than 25% (2022).
SOURCE: World Gold Council's 2024 Central Bank Gold Reserves Study

Cover art: Graph courtesy of Investing.com

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