The Just Word Podcast

Transcript of Episode 43: On Gold

Guest: George Milling-Stanley

Pat Bolland 00:00
George, great to chat again.

George Milling-Stanley 00:02
Good to see you Pat. I really enjoyed reconnecting with you in Toronto a couple of weeks ago. We've known each other 40 years, and we haven't seen each other in way too long. So I'm glad that we were able to reconnect.

Pat Bolland 00:13
Undoubtedly, yeah. COVID does that to a lot of relationships, no questions about it. George, as I said in the intro, gold is something I keep getting asked about. So I'll open with that question. Does gold fit in a portfolio or as a separate investment,

George Milling-Stanley 00:30
I always like to look at the performance of gold as part of a properly balanced global multi asset portfolio, I think gold performs much better there than being viewed as a standalone asset. So that's really where my focus has always been. When I say global multi asset portfolio, I mean, something that includes equities, both domestic and foreign, have various different types. Yield stocks, and growth stocks, and so on includes fixed income, both governments and corporate bonds, and again, of all different types, high yield, as well, everything, perhaps some general commodity exposure, maybe a little real estate, and perhaps some private equity, a whole array of things. And I think that gold deserves an allocation, the literature suggests somewhere between two and 10%, as an allocation and a properly balanced portfolio, can bring benefits to the performance of the whole portfolio. So that's the way that I tend to look at gold. I think historically speaking, the promise of gold for investors has always been twofold. And I like any asset that makes me two promises. And those promises are as follows. Over time, and I stress this over time, gold's performance is best measured over a decent period of time. Over time, an allocation to gold in a properly balanced portfolio can help to enhance the returns of the total portfolio. And equally over time, a small allocation to gold in a properly balanced portfolio can help to reduce risk and helps to reduce volatility. So that twofold promise basically says to me, an allocation to gold is going to improve my risk adjusted returns, or my Sharpe ratio, as the experts like to call it, and I liked that promise. And that's why I have gold in my personal portfolio.

Pat Bolland 02:18
Okay, George, but people talk about gold as a hedge against inflation. What are your thoughts on that?

George Milling-Stanley 02:24
I think that gold is, you know, a lot of people think of gold as a predictor of inflation. I don't think it's a very good predictor of inflation at all. Does it offer some protection against inflation? Yes, I think in

normal circumstances it does. Right now, with the gold price rather depressed and inflation roaring alarm at 40 year highs in the United States and in most other countries as well. People are starting to question whether gold really does offer protection against inflation. And I think the issue really is that if we have significant inflation, and it looks like the authorities are not necessarily going to tackle it, then gold is going to perform very, very well. We saw this in the 1970s. No question about that. But with the current rate of inflation, what we're seeing is that the Federal Reserve in in Washington has been saying very clearly and very consistently, we are going to do whatever it takes to bring inflation down to our long term target of 2%. And the implication is whatever pain it may cause. And by that, I think they're suggesting they would be prepared to drive the US economy into recession, if they deem that to be necessary to curb this ridiculously high inflation. So I think the fact that the Fed has said it is going to control inflation, that its commitment to bring inflation back to the long term 2%. Target is unconditional. I think that that has then meant to a lot of people. Well, if the Fed is going to take care of inflation, then we probably don't need a hedge against it. I'm not sure that that would be the right attitude. That certainly isn't the attitude that I would take. But I do think my read of it is that a lot of investors are thinking along those kinds of lines, Pat,

Pat Bolland 04:15
You know, I think of gold in supply and demand. And a lot of the demand most of the men in some would say comes from jewelry. What are your thoughts on gold as a store of wealth?

George Milling-Stanley 04:26
Yeah, I think for a lot of societies, gold in any form is regarded as a store of wealth. And I think that there's a lot to be said for that. It is especially common in emerging markets, whether you look at India or China or all across the Far East, the Middle East, and South Asia. There is a strong feeling that gold in any form is is a store of wealth. And it's a very real store of wealth for one particular class of people and I would say that is women in India, who do not have the right to, to, to own real estate they do not own the family farm that is always owned by the man in the family. But what they do home are the clothes that they stand up in, and the gold jewelry that they wear. So in a sense, gold can be said to be helping to empower women in societies where they were, perhaps they have not been empowered in the past. I think that's something that a lot of people in the West don't quite understand.

Pat Bolland 05:27
I did not know that. I've never heard that before.

George Milling-Stanley 05:32
Well, we all learn something new every day, don't we? I've been looking at this for a long time. I've visited India many times. And I'm talking of the rural societies here, obviously, not there have been sophisticates in Mumbai and Delhi. But that is that is the truth if, if a man passes, if a man passes away, his property does not go to his wife. It goes to the senior male of his family, whether that's his son, or a brother or a cousin, but it doesn't go to the wife what she has, if, if she is widowed or divorced, what she has is the clothes that she takes with her her beautiful saris and her beautiful gold jewelry. So empowering women.

Pat Bolland 06:15

Wow. Okay, personally, I've never looked at gold from either those perspectives. I've always thought of gold as a competing currency, if you will, okay, not one that you can necessarily put in your pocket and take around the world. But it still is a currency per se, and it competes with other currencies. You disagree?

George Milling-Stanley 06:37
No, I think I see gold as as definitely as a part of the currency complex. For example, if we see really solid strength in the US dollar, as we're seeing currently, with the dollar at 20 year highs against most other currencies, you know, the one other currency that gold is not at a 20 year high against is probably gold, if you think about it from that point of view, because the gold price is way better than it was 20 years ago, when we came into to this century Pat, and my memory goes way back way further than that. But when we came into this century, the gold price was 250. US dollars an ounce at 1675. This morning. And I think we can say that, that there's no question. The dollar is not at a 20 year high against gold, but it is against most other currencies. And I think that that has been limiting any potential upside for the gold price for a good part of this year.

Pat Bolland 07:35
Okay, so let's get to that discussion. What do you forecast for gold, and I'm not talking six months or even a year, let's say five to 10 years from now.

George Milling-Stanley 07:45
I think that, over that period, we will see gold prices quite possibly lower than where they are, although I think that the prospects of that are rather limited. But I'm very confident when we see gold prices a lot higher than where they are today, too. So I'm expecting a reasonable degree of volatility in the stock market in the gold market. Not as much as you see in the stock market, I think gold has typically been less volatile than than the s&p 500 in the US, for example. But I'm expecting some volatility in the price. But I believe that the balance of probabilities is to the upside. If we look in the very short term, here we are approaching, you know the end of September. Typically speaking, the Indian festival season in October, generally marks the beginning of a period of very strong consumer demand in India, but also through most of the emerging markets as well. As soon as that festival season is over by the end of October in India, then they start the wedding season, which goes on for another six months. And again, gold is a very important gift for parents to give to their daughters and for guests at a wedding to give to the bride. So I'm I'm pretty confident that in the short term, we will see some recovery in the price that will be tempered by just how seriously the Fed demonstrates its intentions of curbing inflation. There is no some talk that the next FOMC meeting in a couple of days, they might even raise interest rates by a whole percentage point, which is, if anything, probably unprecedented. But so I think that that any potential rise in the gold price is liable to be tempered by the action of the Fed. But I do believe that we are going to see higher prices. When my team the gold strategy team at State Street we were putting together our thoughts for 2022. Back in December of last year. We were confident the gold price was likely to spend the bulk of 2022 between $1,800 and $2,000 an ounce. It has done that the average is comfortably above that $1,800 level. We're currently in what I would call out base case scenario, which call for the price to be between 16 118 100. And that, you know, we expected to spend some time there. I hope we don't spend too much time there. But our bullish case, looked at Gold above $2,000 an ounce. We were there. As recently as August of 2021. We hit our all time high of $2,067 an ounce. And

I believe that over the timeframe, you're talking about, say six months to five years, I'm very confident that we'll see prices back above that $2,000 level.

Pat Bolland 10:34
You know, it's funny, George, you've talked about demand. What about the supply side? And are there supply issues, and in particular, I'm thinking regulations around mining and those kinds of things.

George Milling-Stanley 10:46
You know, mining is a pretty well regulated business in most of the civilized world. And there's no doubt that the focus, the growing focus over the last 20 odd years on environmental issues, has, I think, limited any tendency for growth in Goldmine production. We've also seen a number of other things that have limited that and that has been actions of foreign governments taking over assets, taking over minds the moment they were ready to come to production. And the government saying, well, thank you very much this, this now belongs to the people of X country. Goodbye, and thank you for your efforts. So that has also been, I think, something of a limitation. The biggest limitation on supply that I see though, is that, you know, with every ounce that we produce, that is one ounce fewer left in the ground for gold mining companies to find they have been spending record amounts on exploration and development, both Greenfield in new areas and brownfield around existing operations. And they've been spending these record amounts of money for years now. And they're not coming up with with enough new gold deposits that are economically recoverable at current price levels, to make the companies happy, or to make their shareholders happy, because shareholders don't even want to just see sustained production, they want to see growth in the fortunes of their of their company. So I think that's why gold mining stocks have been probably even more depressed than the gold price in the last couple of years, is because the mining industry is simply not having the kind of success it would wish for in exploration and development. So I see very limited prospects for any significant growth in Goldmine production in the in the foreseeable future, we may see gains of one or 2% a year, from time to time, they will be balanced by losses of one or 2% a year in terms of production. So I'm not seeing any significant growth there. And I'm certainly not seeing gold mine production as likely to be a threat to the advances that I'm predicting in the gold price.

Pat Bolland 12:54
Okay, let's talk about central banks, because in the United States, they came off the gold standard decades ago. And so central blank banks have played a much larger role in dictating the price of gold, some like it like China, I guess, some don't so much, Canada would be an example of that. What are your thoughts on central banks and what they're doing in the market right now?

George Milling-Stanley 13:15
Look, I think that the central banks of the world divide pretty neatly into two camps. And they're very, very different camps. You have the the advanced economies of Western Europe and North America that were during the heyday of the gold standard from the 1870s. Through the 1971. They were the economic Titans. They were the ones that people use their currencies and settlement of international trades, and transactions and so forth. They were the reserve currencies if you like. And so because of the rules of the gold standard, as they issued more currency that people wanted, in order to settle international transactions, they had to buy gold in order to back their currency. That was essentially the

regulation, if you like of the gold standard. So as a legacy of those days, in spite of some selling that we saw in the period between 1989 and 2009, or 220 year period, when the central banks of Western Europe and North America was significant net sellers to the private sector markets, in spite of that, that that group of countries on average holds more than 70% of its reserves in gold. I know Canada is very much a significant outlier here, with somewhere close to 0% in its official reserves as far as gold is concerned, but on average that Germany's the Americas and so on, have around 70%. Then you look at the emerging market countries, on the other hand, now, China and India, they had the high times as far as their economies were concerned, we're in the 14th and 15th centuries that China and India were probably the biggest economies in the world at that time. Perhaps partly because nobody had invented the United States by that time. But during the heyday of the gold standard 1870 to 1970, China, India and the rest of the emerging market didn't really amount to a hill of beans in economic terms. Nobody wanted to use their currencies or anything. So they were forced to use the currencies of the United States of the UK and France and Germany and so on, they were forced to use their currencies. So they did not have the need to issue more of their own currency. And they did not therefore have the need to buy gold to back their their currency issue. So again, they have no large legacy gold holdings in the way that the advanced economies of Western Europe and North America, on average, emerging market countries have less than 5% of their reserves in gold. And that contrasts with more than 70%, for the advanced economies. And because they have so little gold, then they tend to have the major reserve currency, the US dollar is the biggest single asset that they have, on average, again, across the emerging markets, more than two thirds of their reserves are in the form of the US dollar. Now, long term, and I'm not talking short term here very definitely long term, they do not have a great deal of confidence in the very long term future of the US dollar. They believe that like all reserve currencies in the past, at some point, the US dollar is going to lose value, and will probably even lose its role as a major reserve currency. We may be decades or centuries away from that, but the central bank's look in the long term. So for the last 20 years, central banks have been primarily sellers of US dollar based assets and buyers of gold in order to try to redress what they regard as a dangerous imbalance. So in spite of you know, something like 20 years worth of buying, there are still less than 5% in gold, and still more than two thirds in the US dollar. That I think is a trend that is going to continue. And it is significant in terms of the balance between supply and demand, which is what ultimately tends to determine prices. Emerging market, net central bank purchases by the emerging market central banks, since the year 2011, have accounted for somewhere between 10 and 15% of total global gold demand every year, year after year, that has been very significant in terms of price determination. And I believe it is going to continue to be significant. They slowed down a little during COVID. Many things around the world, not just in the gold market slowed down during the height of COVID. But central bank purchases have resumed so far this year. And we're not just talking one or two countries, I think that China, Russia, and to a lesser extent Turkey have grabbed the headlines in terms of because they've been significant purchase of hundreds of metric tons of gold. But Brazil and Mexico have also bought India has bought Iraq has bought Azerbaijan and Kazakhstan and Uzbekistan and Korea and Thailand. Singapore has been a buyer, it's a whole raft of countries, not just one or two, we're talking 20 plus countries have been significant buyers of gold, and have shown every intention of continuing to do so. So that I think has been part of the bedrock of gold prices for a long time. And I don't see it going away anytime soon.

Pat Bolland 18:26

Okay, you've convinced me, George, I need to have some gold. But what's the best way to invite to invest in that area? You are not so convincing, I would say on gold stocks, the miners per se. But what about gold itself? Yeah

George Milling-Stanley 18:42
Yeah, but I think that the first thing I would say is that there is no bad way to gain exposure to movements in the gold price, which is what we're really talking about. You can go buy physical gold coins, or bars, whatever you want to do. But in general, the average investor is going to pay a significant premium when he buys gold coins or gold bars. And when I say significant, I'm thinking it could be 5% or I've heard of even larger premiums being charged. And often when an investor comes to sell, he suffers a discount of a similar magnitude. So if you're paying a 5% premium to get into gold coins, and then you're suffering a 5% discount when you come to cash out, gold's gonna go up 10% before you break even that, to me, is perhaps not the easiest bet for people. A lot of people do want to have their gold in their hands. But and I'm not immune to the visceral appeal. I have gold coins as well and I have some small gold bars. But gold backed ETFs I think took a lot of the friction out of investing in gold. What are you paying for GLD for example, the State Street product that State Street markets, you're paying ... the bid/ask spread is around about a penny wide and American cent wide, which is very, very low. And you're paying 40 basis points per year of average daily net asset value as the expense ratio. And all the investors paying on top of that is whatever Commission has broken decides to charge. And that adds up to a heck of a lot less than than the 10% that we're talking about very often, with people buying physical gold, and the custody and storage and insurance costs are all taken care of in that expense ratio, that very, very low expense ratio. So because it's exchange traded funds spread amongst a whole bunch of investors, then is that how that works? Yeah, exactly. And because the custodian that GLD uses, was confident that GLD would would a massive significant quantity of physical gold bars to back the shares in issue. Then they were they were able to give the sponsor, the World Gold Council, the sponsor of GLD, was able to get a very, very advantageous custody fee. And I think that's held up there's, there's $51 billion worth of GLD shares outstanding. In the custodians vault, that's $51 billion worth of gold bars backing those shares up, there's no cash, no derivatives or anything else involved. So, you know, that is a significant quantity of gold for someone to, to hold, even if the custody charges are low, the amount that we're talking about is sufficiently big, that the bank makes a decent profit out of its custody. So it is I think, you know, the suggestion was made that that the launch of GLD, and North America in 2004, took the friction out of gold investing. And I think that's a very, very good way of putting it.

Pat Bolland 21:51
Okay, George, just between you and me. If there's all this gold being held for the exchange traded funds, do we know where it is?

George Milling-Stanley 22:00
Absolutely. And it is made public in the prospectus over the GLD. It is in the vaults of HSBC bank in London. And I won't be any more specific, because I would probably have to, to make sure that you were never able to tell anybody if I weren't more specific. And I don't know exactly the address. I was in a car with black windows. Last time I was taken to the vault. But you know, so I can't be more specific, but it is in London, and it is in the vaults of HSBC bank.

Pat Bolland 22:34
So given it was a blacked-out window, you really don't know where it is, George. But George ...

George Milling-Stanley 22:38
I don't know whether we drove around in circles or whether we drove in a straight line. That was the thing that I was unable to tell.

Pat Bolland 22:45
George, great to chat. I appreciate your time.

George Milling-Stanley 22:48
Pat, I really appreciate it. It's nice to reconnect. Let's do this again sometime soon. I'd love that.

Pat Bolland 22:53
I look forward to it.

George Milling-Stanley 22:54
Thank you.

Pat Bolland 22:55
George Milling-Stanley is the chief gold strategist State Street Global Advisors. Thanks for joining us.