LOMBARD ODIER
LOMBARD ODIER DARIER HENTSCH

CIO Viewpoint

Going for gold

Investment Solutions

25 July 2019

Gold's traditional role in a portfolio has been as a hedge against inflation and equity market volatility, and as a diversification tool. This year, a combination of factors have driven gold to six-year highs. These include expectations of lower interest rates in the US, a weakening US dollar and rising geopolitical risk in the form of US-China trade and tensions with Iran in the Gulf. In addition, uncertainties around the late economic cycle and widespread negative yields have all pushed investors to look for alternative havens.

It is worth reminding ourselves that gold trades for the most part on financial demand, rather than on fundamentals (physical market). A big driver of financial demand is fear in financial markets (see Chart 1), which is why gold often acts as an effective hedge against volatility. And today, while the effectiveness of government bonds as a hedge decreases with the level of yields (the potential for lower yields is more limited when bonds are trading in negative territory), holding gold in multi-asset portfolios is necessary. In fact, the additional financial demand induced by the lack of safe haven assets is likely to limit downside risk, and given the already exceptional length of the cycle, we can expect recession fears will periodically re-emerge.

Still, a negative correlation between gold and equity should not be taken for granted. Furthermore, gold's annualised volatility has historically been comparable to equity volatility (see Chart 2). As such, adding gold to a multi-asset portfolio usually means adding to the overall portfolio risk, which is why it's key that this allocation is tactically managed. In fact, there have been striking moments where gold did not protect portfolios against equity drawdowns, notably in the financial crisis in October 2008 where both gold and US equities dropped around 20% (on global de-risking of portfolios and forced sales by funds stuck with their illiquid credit positions). Nevertheless, gold quickly attracted flows again and recovered losses, gaining almost 35% when equity markets fell another 30%.

Indeed, gold has always been thought of as the ultimate hedge against financial instability and any loss of confidence in financial and monetary institutions. Since the financial crisis, accommodative central bank monetary policies have bailed out the financial system with two negative consequences. First, they have exacerbated social inequalities by benefiting most those able to invest and take advantage of the lower cost of money and rising asset prices. That disparity, in turn, has led to an increase in populist politics, undermining political stability.

Secondly, the global economy's greater dependence on unconventional monetary policy and inflated central bank balance sheets threatens confidence in the financial system itself. If the next stage in monetary policy fails to improve economies sustainably, investors may turn away from cash and towards gold.

Stéphane Monier
Chief Investment Officer, Lombard Odier Private Bank

Key takeaways

- A series of factors have pushed gold to six-year highs, with market fears still a key driver
- Gold is an effective volatility hedge, but must be managed tactically
- Limited safe-haven alternatives should limit downside risk
- Low-to-negative sovereign yields and geopolitical tensions are likely to continue support for gold

Weekly publication of Lombard Odier – Contacts: Investment Solutions, investment-solutions@lombardodier.com
Data as of 25 July 2019 unless otherwise stated.

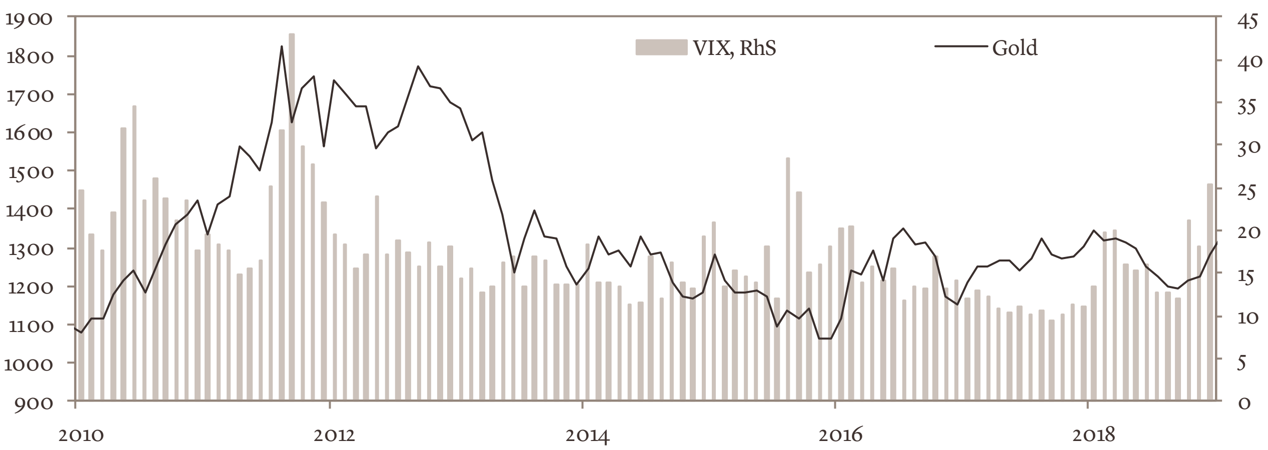
We believe the current environment justifies an allocation to gold in our client portfolios. We expect the combination of low government bond yields, uncertainty around US-China trade relations and a weakening US dollar to stay with us in the months to come. This is an environment supportive for both gold prices and gold's effectiveness as a hedge.

Recent performance and our tactical positioning

After trading around USD 1,300/oz over the first five months of this year, gold rallied 8% in June and finished the month at USD 1,410/oz. The precious metal is now trading at USD 1,426/oz. While we may see some profit taking at these levels (prices have now exceeded our 12-month price target of USD 1,400/oz and any repricing of market expectations for the Federal Reserve would push gold prices closer to our target), the case for a gold allocation in a multi-asset portfolio remains strong.

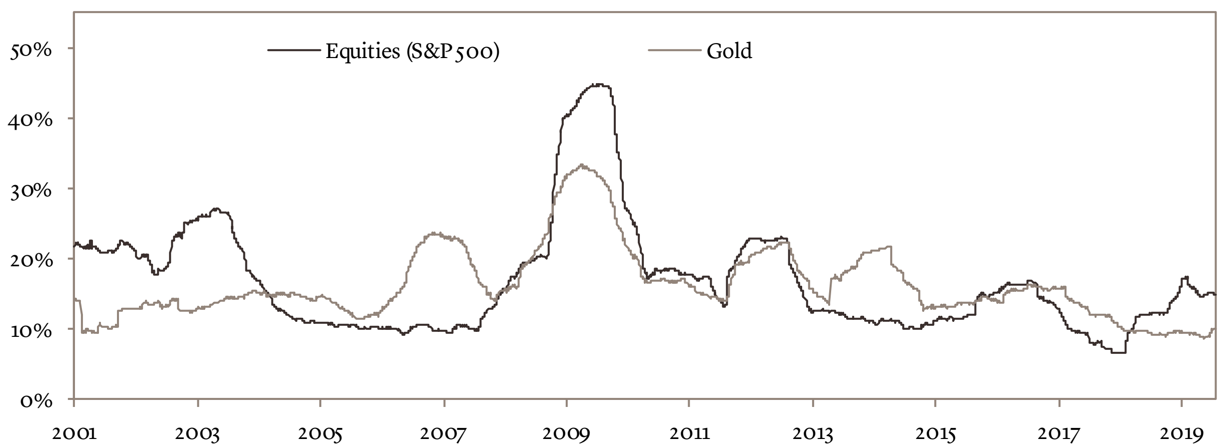
As mentioned earlier, we believe in the importance of managing gold allocations tactically, and in January we started by switching a diversified commodities exposure into gold. We bought the metal at USD 1,282/oz and built a 3% overweight position compared with our strategic benchmark. We then reinforced our position in April, adding another 2% to portfolios. More recently, we reduced the allocation by 2% and are now holding an allocation of 3% across all portfolios.

Chart 1: Gold is trading in line with our 12-month target at USD 1,400/oz



Sources: Bloomberg; LO Calculations

Chart 2: Gold volatility can be close to equity markets volatility
12-month realised volatility



Sources: Datastream, LO calculations

Important information

Israel: This marketing communication has been approved for use in Israel by the Israel Representative Office of Bank Lombard Odier & Co Ltd, an entity not supervised by the Supervisor of Banks in the Bank of Israel, but by the Swiss Financial Market Supervisory Authority, which supervises the activities of Bank Lombard Odier & Co Ltd.
South Africa: This marketing communication has been approved for use in South Africa by the South Africa Representative Office of Bank Lombard Odier & Co Ltd, an authorised financial services provider Registration number 48505.
Switzerland: This marketing communication has been approved for use in Switzerland by Bank Lombard Odier & Co Ltd Geneva, a bank and securities dealer authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).
United States: Neither this document nor any copy thereof may be sent to, taken into, or distributed in the United States of America, any of its territories or possessions or areas subject to its jurisdiction, or to or for the benefit of a United States Person. For this purpose, the term "United States Person" shall mean any citizen, national or resident of the United States of America, partnership organised or existing in any state, territory or possession of the United States of America, a corporation organised under the laws of the United States or of any state, territory or possession thereof, or any estate or trust that is subject to United States Federal income tax regardless of the source of its income. This marketing communication may not be reproduced (in whole or in part), transmitted, modified, or used for any public or commercial purpose without the prior written permission of Lombard Odier.
Media: Lombard Odier would like to offer you for your information the enclosed CIO Viewpoint. In connection with the use of the enclosed document Lombard Odier kindly draws your attention to certain particular items/conditions. The information sent is for your personal use only. In case of quoting please cite Lombard Odier in no other capacity than as source of information only. For the sake of good order Lombard Odier would like to remind you that responsibility regarding quoted content and compliance with applicable regulations rests with you. The information provided does not constitute the provision of investment advice or an offer of any financial services especially not to the public.
Data protection: You may be receiving this communication you have provided us with your contact details. If this is the case, note that we may process your personal data for direct marketing purposes. If you wish to object to this processing, please address your objection to the Group's Data Protection Officer: Bank Lombard Odier & Co Ltd, Group Data Protection Officer, 11, Rue de la Corraterie, 1204 Geneva, Switzerland. E-Mail: group-dataprotection@lombardodier.com. For more information on Lombard Odier's data protection policy, please refer to www.lombardodier.com/privacy-policy.

SWITZERLAND

GENEVA

Bank Lombard Odier & Co Ltd[1]
Rue de la Corraterie 11 · 1204 Genève · Suisse
geneva@lombardodier.com
Lombard Odier Asset Management (Switzerland) SA
Avenue des Morgines 6 · 1213 Petit-Lancy · Suisse
Support-Client-LOIM@lombardodier.com
Management Company regulated by the FINMA.

FRIBOURG

Banque Lombard Odier & Cie SA · Bureau de Fribourg[1]
Rue de la Banque 3 · 1700 Fribourg · Suisse
fribourg@lombardodier.com

LAUSANNE

Bank Lombard Odier & Co Ltd[1]
Place St-François 11 · 1003 Lausanne · Suisse
lausanne@lombardodier.com

VEVEY

Banque Lombard Odier & Cie SA · Agence de Vevey[1]
Rue Jean-Jacques Rousseau 5 · 1800 Vevey · Suisse
vevey@lombardodier.com

ZURICH

Bank Lombard Odier & Co Ltd[1]
Utoschloss · Utoquai 29-31 · 8008 Zürich · Schweiz
zurich@lombardodier.com

EUROPE

BRUSSELS

Lombard Odier (Europe) S.A. Luxembourg · Belgium branch[2]
Avenue Louise 81 · Box 12 · 1050 Brussels · Belgium
brussels@lombardodier.com
Credit institution supervised in Belgium by the Banque nationale de Belgique (BNB) and the Financial Services and Markets Authority (FSMA).

LONDON

Lombard Odier (Europe) S.A.· UK Branch[2]
Queensberry House · 3 Old Burlington Street · London W1S 3AB · United Kingdom ·
london@lombardodier.com
The Bank is authorised and regulated in the UK by the Prudential Regulation Authority (PRA) and subject to limited regulation by the Financial Conduct Authority (FCA) and the PRA. Details of the extent of our authorisation and regulation by the PRA and regulation by the FCA are available from us on request. Registered in Luxembourg No. B169 907.
Lombard Odier Asset Management (Europe) Limited
Queensberry House · 3 Old Burlington Street · London W1S 3AB · United Kingdom ·
london@lombardodier.com
Investment firm authorised and regulated by the Financial Conduct Authority (FCA register No.515393).

LUXEMBOURG

Lombard Odier (Europe) S.A.
291, route d'Arlon · 1150 · Luxembourg · Luxembourg
luxembourg@lombardodier.com
Credit institution authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.
Lombard Odier Funds (Europe) S.A.
291, route d'Arlon · 1150 · Luxembourg · Luxembourg
luxembourg@lombardodier.com

MADRID

Lombard Odier (Europe) S.A. · Sucursal en España[2]
Paseo de la Castellana 66 · 4ª Pl. · 28046 Madrid · España · madrid@lombardodier.com
Credit institution supervised in Spain, by the Banco de España and the Comisión Nacional del Mercado de Valores (CNMV).
Lombard Odier Gestión (España) S.G.I.I.C, S.A.U.
Paseo de la Castellana 66, 4ª Pl. · 28046 Madrid · España · madrid@lombardodier.com
Management Company supervised by the Comisión Nacional del Mercado de Valores (CNMV).

MILAN

Lombard Odier (Europe) S.A. · Succursale in Italia[2]
Via Santa Margherita 6 · 20121 Milano · Italia
milano-cp@lombardodier.com
Credit institution supervised in Italy by the Commissione Nazionale per le Società e la Borsa (CONSOB) and la Banca d'Italia.

MOSCOW

Bank Lombard Odier & Co Ltd · Representative Office Moscow
Letnikovskaya st.2, bld.1 · 115114 Moscow · Russian Federation · moscow@lombardodier.com
Under the supervisory authority of the Central Bank of the Russian Federation.

PARIS

Lombard Odier (Europe) S.A. · Succursale en France[2]
8, rue Royale · 75008 Paris · France. RCS PARIS B 803 905 157 · paris@lombardodier.com
Credit institution supervised in France by the Autorité de contrôle prudentiel et de résolution (ACPR) and by the Autorité des Marchés Financiers (AMF) in respect of its investment services activities. Business permit No.23/12. Registered in Luxembourg - No.B169 907. Insurance intermediary authorised by the Commissariat aux Assurances (CAA) No.2014 CM002. The registration with the CAA can be verified at www.orias.fr.

AFRICA | AMERICAS | MIDDLE EAST

ABU-DHABI

Bank Lombard Odier & Co Ltd · Abu Dhabi Global Market Branch
Al Maryah Island · Abu Dhabi Global Market Square · Al Sila Tower · Abu Dhabi · abudhabi@lombardodier.com
Arranging Deals in Investments · Advising on Investment or Credit · Arranging Credit. Regulated by the ADGM Financial Services Regulatory Authority.

BERMUDA

Lombard Odier Trust (Bermuda) Limited
3rd Floor, Victoria Place · 31 Victoria Street · Hamilton HM 10 · Bermuda · bermuda@lombardodier.com
Licensed to conduct Trust, Investment and Corporate Service Provider Business by the Bermuda Monetary Authority.

DUBAI

Bank Lombard Odier & Co Ltd · Representative Office Dubai
Conrad Business Tower · 12th Floor · Sheikh Zayed Road · P.O. Box 212240 · Dubai · UAE ·
dubai@lombardodier.com
Under the supervisory authority of the Central Bank of the UAE.

ISRAEL

Israel Representative Office · Bank Lombard Odier & Co Ltd
Alrov Tower 11th floor · 46 Rothschild Blvd. · Tel Aviv 6688312 · Israel · telaviv@lombardodier.com
Not supervised by the Supervisor of Banks in the Bank of Israel, but by Swiss Financial Market Supervisory Authority which supervises the activities of Bank Lombard Odier & Co Ltd.

JOHANNESBURG

South Africa Representative Office · Bank Lombard Odier & Co Ltd
140 West Street · Sandton · Johannesburg 2196 · South Africa
johannesburg@lombardodier.com
Authorised financial services provider Registration number 48505.

MONTEVIDEO

Lombard Odier (Uruguay) SA
Luis Alberto de Herrera · Torre 2 · Oficina 2305
11300 Montevideo · Uruguay
montevideo@lombardodier.com
Supervised by Banco Central del Uruguay.

NASSAU

Lombard Odier & Cie (Bahamas) Limited
Goodman's Bay Corporate Centre · West Bay Street · P.O. Box N-4938 · Nassau · Bahamas · nassau@lombardodier.com
Supervised by the Central Bank of the Bahamas and the Securities Commission of the Bahamas.

PANAMA

Lombard Odier & Cie (Bahamas) Limited · Representative Office in Panama
Oceania Business Plaza Torre 2000 · Oficina 38-D · Blvd. Pacifica · Urb. Punta Pacifica · Corregimiento de San Francisco · Panamá · panama@lombardodier.com
Supervised by the Central Bank of the Bahamas and the Superintendencia de Bancos de Panamá.
Lombard Odier (Panama) Inc.
Oceania Business Plaza Torre 2000 · Oficina 38-D · Blvd. Pacifica · Urb. Punta Pacifica · Corregimiento de San Francisco · Panamá · panama@lombardodier.com
Supervised by the Superintendencia del Mercado de valores de Panamá. Licensed to operate as an Investment Adviser. Res. SMV No.528-2013.

ASIA - PACIFIC

HONG KONG

Lombard Odier (Hong Kong) Limited
3901, Two Exchange Square · 8 Connaught Place · Central · Hong Kong · hongkong@lombardodier.com
A licensed entity regulated and supervised by the Securities and Futures Commission in Hong Kong.

SINGAPORE

Lombard Odier (Singapore) Ltd.
9 Raffles Place · Republic Plaza #46-02 · Singapore 048619 · singapore@lombardodier.com
A merchant bank regulated and supervised by the Monetary Authority of Singapore.

TOKYO

Lombard Odier Trust (Japan) Limited
Izumi Garden Tower 41F · 1-6-1 Roppongi, Minato-ku · Tokyo 106-6041 · Japan · tokyo@lombardodier.com
Regulated and supervised by the Financial Services Agency (FSA) in Japan. It holds a trust business license (FSA No.208) and is registered with Kanto Local Finance Bureau for Financial Instruments Business Operator (No.470).

[1] *Private bank and securities dealer authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).*

[2] *Branch of Lombard Odier (Europe) S.A., a credit institution based in Luxembourg, authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.*

06.2019