

# Gold's Relationship With the Dollar

## Don't Count Gold Out With a Strong Dollar

The dollar and gold often move in opposite directions, but not symmetrically, in part because there are other factors that drive the gold price. We believe that gold is an effective portfolio diversifier, and that investors shouldn't necessarily sell their gold allocations when the dollar is rising.

### Exploring The Gold-Dollar Asymmetry

Ever since President Richard Nixon ended the dollar's peg to gold in 1971, the prices of both have tended to move opposite to one another. In other words, a weakening dollar has historically pushed the gold price up and vice versa (Figure 1). However, this relationship has been asymmetrical. The price of gold has historically risen about three times as much during periods when the dollar weakens as it has fallen during strong-dollar ones (Figure 2).

There are various reasons why the asymmetry between gold and the dollar exists. We believe that two of those reasons stand out. First, gold is one of the multiple currencies that exist in the monetary system, as its use by central banks in their foreign reserves makes clear. So, the link between gold and the dollar should not be seen in isolation, but in relationship to other currencies as well. Second, while important, the dollar is just one of the many drivers that influences gold, and that complexity can alter the negative correlation between the two.

**Figure 2: Gold Performance In Strong & Weak Dollar Regimes January 1972-June 2016**



Source: World Gold Council, Bloomberg Finance L.P.  
**Past performance is not a guarantee of future results.**

**Figure 1: Dollar Zigs, But Gold Doesn't Always Zag**



Source: Bloomberg Finance L.P. 12/31/1970-12/31/2015.

The US Dollar Index (DXY) Index measures the performance of the US Dollar against a basket of currencies: EUR, JPY, GBP, CAD, CHF and SEK.

Gold price is based on LBMA Gold Price, which is determined twice each business day (10:30 a.m. and 3:00 p.m. London time) by participants in a physically settled, electronic and tradable auction.

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In periods of uncertainty, the dollar typically benefits from flight-to-quality flows. But so does gold. At such times, both the price of gold and the dollar can go up. Investors have seen this in recent years, including during the 2008–2009 financial crisis, the 2010–2011 European sovereign debt crisis or, more recently, in the aftermath of the UK referendum to leave the European Union.

In contrast, weak-dollar periods typically coincide with other factors that are supportive of gold. For example, falling interest rates, growth in emerging markets, or higher inflation expectations.

In sum, it may thus be intuitive to see why the asymmetric relationship between gold and the dollar works in gold's favor.

### Gold's Potential Diversifying Benefits Outweigh Potential Headwinds A Strong Dollar Brings

This asymmetric historical relationship helps illustrate our belief that given gold's overall value as a portfolio diversifier, investors should not reflexively unload gold holdings at times when the dollar is strengthening.<sup>1</sup>

One key point is that gold's correlation to other assets has historically remained low no matter whether the dollar is weak or strong, as the following table shows. Adding gold may potentially boost a portfolio's diversification, tamping down volatility. Broader diversification, in turn, may lower volatility and potentially improve risk-adjusted returns.<sup>2</sup> It is worth noting, of course, that diversification alone does not ensure a profit or guarantee against loss.

#### Average Annualized Statistics of Gold Performance

From January 1972 through June 2016

|                            | Conditional Analysis |              |           |             |
|----------------------------|----------------------|--------------|-----------|-------------|
|                            | Full Period          | Falling US\$ | Flat US\$ | Rising US\$ |
| Correlation to Treasuries  | 0.03                 | -0.03        | 0.07      | 0.09        |
| Correlation to Equities    | 0.00                 | -0.16        | 0.04      | 0.13        |
| Correlation to Commodities | 0.28                 | 0.27         | 0.16      | 0.31        |

Reference notes at the end of this article.

Source: Bloomberg Finance L.P., World Gold Council.

Data from January 1972 – June 2016.

The correlation coefficient measures the strength and direction of a linear relationship between two variables. It measures the degree to which the deviations of one variable from its mean are related to those of a different variable from its respective mean. Past performance is not a guarantee of future results.

### Long-Term, the Dollar's Influence Over Gold is Likely to Diminish

Over the longer term, as the financial system moves into a multi-currency world, the dollar may not be the only sought-after asset, potentially reducing its influence as a reserve currency. For example, in recent years there has been a wider push by Chinese authorities to make China's currency, the yuan, more accepted internationally.



Source: World Gold Council, Gold Investor, Volume 8, March 2015.

### Other Factors Influence the Price of Gold

While the dollar is an important driver, there are, in all, seven factors that interact with one another, jointly influencing the gold market and the price of gold. The influence of each of these factors is not static, and responds to changes in the gold market, including structural shifts that may occur, such as the increasing relevance of Asian markets or the advent of gold-backed ETFs, to name a few.



Source: World Gold Council, Gold Investor, Volume 8, March 2015.

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### ...Gold Remains A Strategic Long-Term Asset

Looking at the big picture, the dollar matters, but it does not define gold's relevance for investors.

In fact, the dollar strength that has prevailed for much of the past few years actually highlights gold's potential function as a diversification and risk-management portfolio asset. These can be increasingly important roles, particularly as both stocks and bonds may deliver lower-than-average returns in the coming years.

<sup>1</sup> Over the past 25 years, the correlation of gold to stocks, bonds and other commodities was -0.01, 0.19, and 0.44, respectively. Source: SSGA, Bloomberg Finance L.P., as of 12/31/2015. Computed using monthly return data from Dec 1990 to Dec 2015. It measures the degree to which the deviations of one variable from its mean are related to those of a different variable from its respective mean. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Stocks represented by S&P 500 Index; Bonds represented by Barclays US Aggregate Index; Commodities represented by Bloomberg Commodity Index. Index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income.

<sup>2</sup> Ibid.

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Diversification does not ensure a profit or guarantee against loss.

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#### Definitions

**Barclays U.S. Aggregate Bond Index** A benchmark that provides a measure of the performance of the U.S. dollar denominated investment grade bond market, which includes investment grade government bonds, investment grade corporate bonds, mortgage pass through securities, commercial mortgage backed securities and asset backed securities that are publicly for sale in the US.

**Bloomberg Commodity Index** A broadly diversified commodity price index distributed by Bloomberg Indexes that tracks 22 commodity futures and seven sectors. No one commodity can compose less than 2 percent or more than 15 percent of the index and no sector can represent more than 33 percent of the index.

**S&P 500 Index** A popular benchmark for U.S. large-cap equities that includes 500 companies from leading industries and captures about 80% of available market capitalization.

**Stagflation** An economic condition prevailing in the 1970s characterized by slow growth and relatively high unemployment as well as inflation leading to an overall decline in gross domestic product.

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