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The Federal Reserve's decisive 50-basis-point cut last week added to enthusiasm for the precious metal by lowering the opportunity cost of holding the non-yielding asset. (UBS)

Why gold's hedging properties remain attractive

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The price of gold reached a new all-time high on Monday at USD 2,630 an ounce. The precious metal has now gained more than 27% since the start of 2024, putting it on track for its best annual performance in 14 years.

While record high prices may dissuade some investors, we see several reasons the rally still has room to run:

More Fed easing is coming. The Federal Reserve's decisive 50-basis-point cut last week added to enthusiasm for the precious metal, by lowering the opportunity cost of holding the non-yielding asset. This is just the start of the Fed's easing cycle, and we expect an additional 50 basis points of further easing in the remainder of 2024, followed by an additional 100 basis points in 2025. As returns on cash are eroded by this lower interest rate environment, more investor funds may end up redirected into assets like gold.

Geopolitical tensions are worsening. Conflicts in both the Middle East and Ukraine-Russia remain no closer to resolution, bolstering the case for gold as a portfolio geopolitical hedge. Israel's military on Monday carried out new strikes on southern Lebanon, following exchanges of fire between the Israeli Defense Force and Hezbollah on Sunday. Iran's Revolutionary Guards are reportedly banning the use of all communication devices after Hezbollah pagers and walkie-talkies detonated across Lebanon last week. Ukraine on Saturday said it struck two Russian munition depots ahead of President Zelenskiy's address to the UN Security Council in New York next week.

Demand from investors and cental banks remains strong. Central bank buying has helped fuel the move higher in gold in recent years. Official buying now accounts for roughly a quarter of total gold demand, roughly double its level before 2022. Now, as Fed rate cuts finally materialize, demand from investors via exchange-traded funds (ETFs) looks set to gather pace too. According to the official gold ETF data published by the World Gold Council, inflows into gold ETFs continued in August for a fourth consecutive month. Total holdings have rebounded to nearly 3,182 metric tons, the highest since the start of the year, narrowing the year-to-date loss to 44 metric tons.

We remain Most Preferred on gold in our global strategy, with a target of USD 2,700/oz by mid-2025. Despite the rally, we believe gold's hedging properties remain attractive. Alongside physical gold, investor may consider exposure through structured strategies, ETFs, or via gold miner equities. Investors unaccustomed to the volatility of individual commodities may also consider exposure via an actively managed strategy that seeks to deliver alpha over comparable passive indices.

Main contributors: Solita Marcelli, Mark Haefele, Giovanni Staunovo, Dominic Schnider, Jon Gordon, Vincent Heaney

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