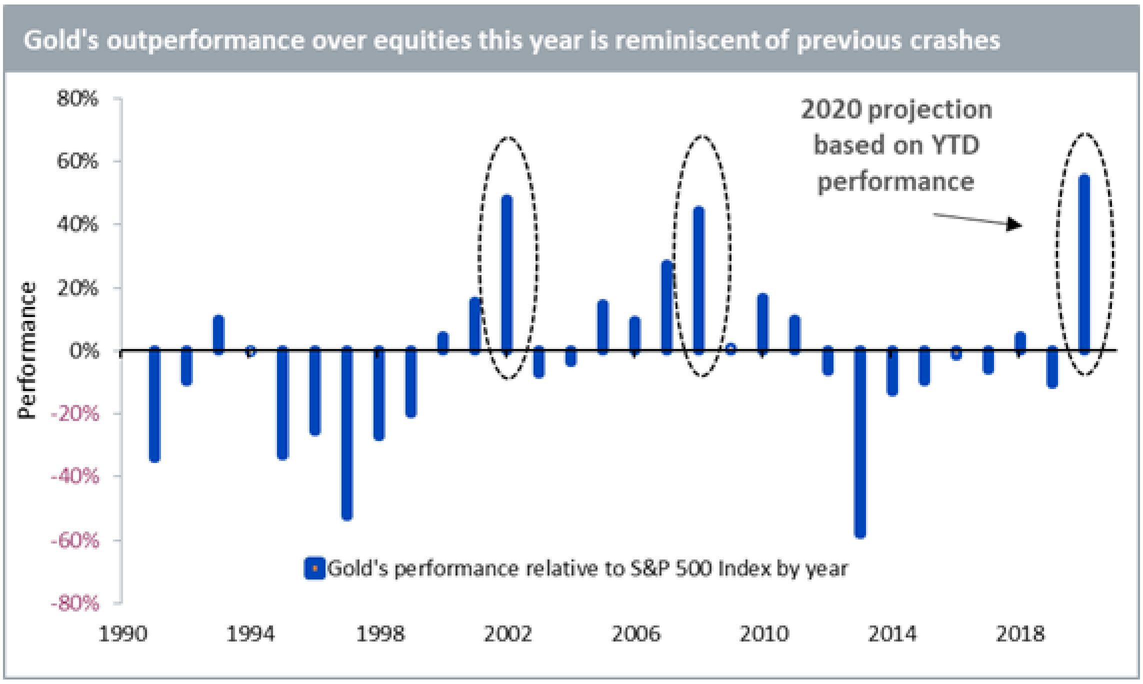
A moment in markets – gold is the new put option…again

Gold has outshined the S&P 500 Index by 28% this year[1]. Despite the risks, the S&P 500 Index – much like most other equity indices – has bounced back strongly from the doldrums in March this year. If investors were rushing towards options to protect their equity exposures from a potential downturn, this would be evident in an elevated reading of the VIX[2]. Instead, we see the VIX continuing to ease and inching towards 2019 levels – when the world was a very different place.

What we do see, however, is gold emerging as a put option – and not for the first time. Following previous meltdowns in equity markets – notably the dotcom crash and the global financial crisis – gold strongly outperformed equities (see figure below). As equities recover, they – in a manner that seems counterintuitive – move in the same direction as gold. They have indeed done so since March this year.



Source: WisdomTree, Bloomberg. Data as on 27 July 2020. 2020 bar is the annualised figure of the outperformance up to 27 July 2020. **Historical performance is not an indication of future performance and any investments may go down in value.**

Let's 'put' the risks together

Investors with equity exposure would be keen to hedge against the following risks:

1. **Earnings:** A combination of actual and estimated S&P 500 second quarter earnings show a 44% year-over-year decline. If actual results are in line with estimates, Q2 2020 net profit

[1] As on 27 July 2020.

[2] VIX stands for the CBOE Volatility Index

margins would be the lowest since Q4 2009[3]. Given the rally in equities in Q2, weakness in earnings may disappoint Wall Street.

2. **Infections:** The continuous rise in daily new cases of Covid-19 infections around the world may take its toll on markets, if investors realise that hopes of an imminent vaccine may be premature.
3. **Economic data:** Second quarter gross domestic product data for the US and Europe may serve as a reality check. A bounce back in Purchasing Managers Indices, which markets have drawn a lot of comfort from, points only to a month-to-month improvement, and not a holistic recovery in the economy.
4. **Geopolitics:** Equity markets have largely brushed aside rising tensions between the US and China. Had Covid-19 not taken centre stage this year, investors may have been more inclined to give heed to the matter. Until the pandemic, the most dominant issue tormenting markets since 2018 had been trade wars.

Can equities and gold continue to move in tandem?

Aside from frequent, but short-lived wobbles, equities have generally rallied since March on the back of significant monetary stimulus from central banks. This stimulus is unlikely to be withdrawn in the next few months. But equally, the risks noted above are not likely to disappear either. This creates a scenario where both equities and gold could continue to push upwards. Investors may keep adding equity exposure but look to mitigate their downside risk with what appears to be the new put option – gold.

[3] According to FactSet, as of 20 July 2020