How Much Gold Should I Own in My Portfolio?

June 26, 2023

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Key Takeaways

- Sprott recommends investors allocate 10-15% of their diversified portfolio to gold and gold-related equities.
- Physical gold is viewed as a strategic allocation, while gold-related equities can be a useful tactical allocation. We believe that gold and gold-related equities should constitute 10% and 0-5% of a portfolio, respectively.
- Physical gold has the potential to provide solid returns and diversification. Gold's robust liquidity and historic resilience make it a valued asset during times of economic stress. Because of this, we suggest that gold is a fixed income alternative and should hold a permanent place in all investment portfolios.
- Gold-related equities can offer leverage via the gold price and potential growth from new discoveries or production, which has the ability to lead to increasing dividends. As these equities can be highly cyclical, we believe that they should be purchased when undervalued and sold when in high demand and overpriced. We view these equities as highly attractive currently.

Breaking it Down

The question we most frequently encounter from investors is, "How much gold exposure should I have in my portfolio?" The exact percentage of physical gold and gold equities in an investment portfolio depends on several factors including an investor's risk tolerance, investment objectives, time horizon, income requirements and overall financial situation.

As a general recommendation, we suggest investing 10-15% of a diversified portfolio in gold and gold-related equities as follows:

- 10% should be allocated to physical gold, typically the more conservative option in a gold allocation. Physical gold provides a store of value and a hedge against systemic risks.
- 0-5% should be allocated to gold-related equities. This is generally considered the more aggressive option in a gold allocation, aiming to offer leverage to gold prices and the potential for high returns, albeit with increased risk levels.

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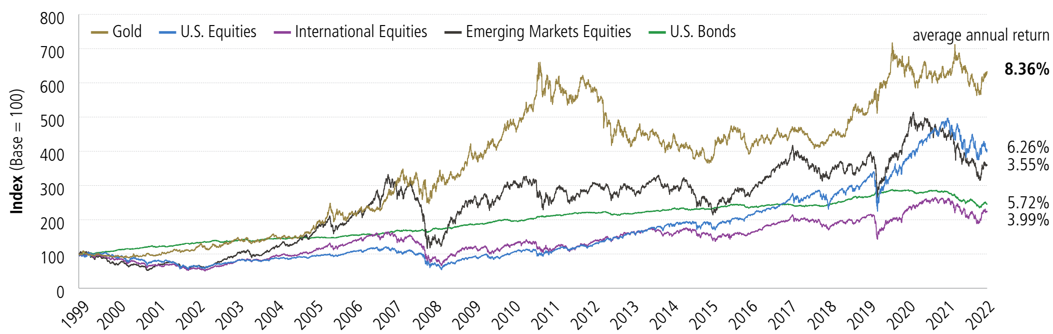
How Much Physical Gold and Why?

Sprott advocates for a permanent strategic 10% position in physical gold for most investors' portfolios due to the following reasons:

1. Historic Gold Returns

Since the U.S. abandoned the gold standard in 1971, gold's price, measured in U.S. dollars, has seen an annual growth rate of 7.7% (as of 12/31/2022). Notably, gold has outperformed many significant asset classes since the start of this century.

Figure 1. Gold Has Outperformed Other Asset Classes (1999-2022)

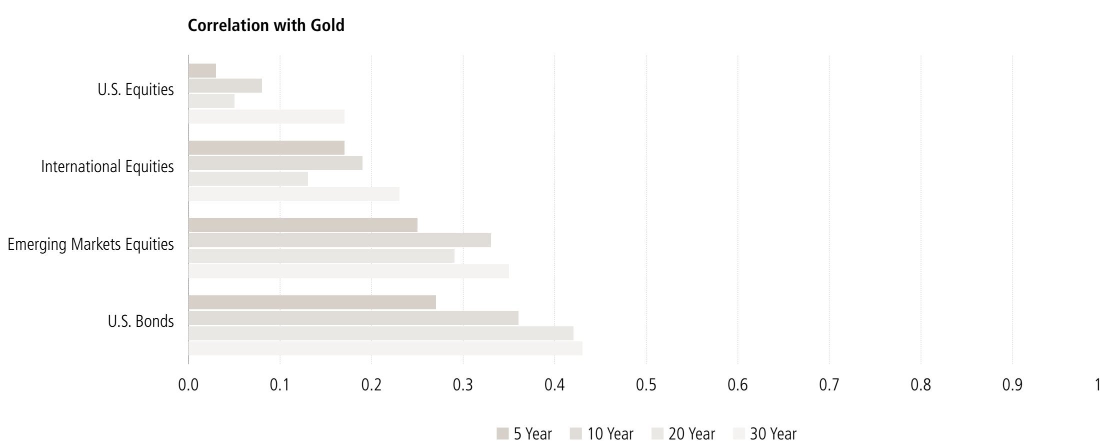


Source: Bloomberg. Measures period from 12/31/1999-12/31/2022. Gold is measured by GOLDS Comdty Spot Price; U.S. Equities are measured by the S&P 500 Total Return Index; International Equities are measured by the MSCI EAFE Index; Emerging Markets Equities are measured by the MSCI Emerging Markets Index; and U.S. Bonds are measured by the Bloomberg U.S. Aggregate Bond Index. You cannot invest directly in an index. Included for illustrative purposes only. **Past performance is no guarantee of future results.**

2. Diversification

Gold's addition to a portfolio offers diversification, a key principle of effective investment management. Gold often behaves independently from stocks and bonds, sometimes exhibiting a negative correlation. This implies that gold's value might increase when stocks and bonds lose value.

Figure 2. Gold Has Low Correlation* to Other Asset Classes



*A correlation of 1.00 indicates perfect correlation. Numbers below 1 indicate that the asset class is not fully correlated and will not move in tandem with gold. The lower the number, the lower the correlation.

Source: Bloomberg. Measures 30-year period from 12/31/1992 to 12/31/2022. Gold is measured by GOLDS Comdty Spot Price; U.S. Equities are measured by the S&P 500 Total Return Index; International Equities are measured by the MSCI EAFE Index; Emerging Markets Equities are measured by the MSCI Emerging Markets Index; and U.S. Bonds are measured by the Bloomberg U.S. Aggregate Bond Index. You cannot invest directly in an index. Included for illustrative purposes only. **Past performance is no guarantee of future results.** Asset allocation or diversification does not guarantee investment returns and does not eliminate the risk of loss.

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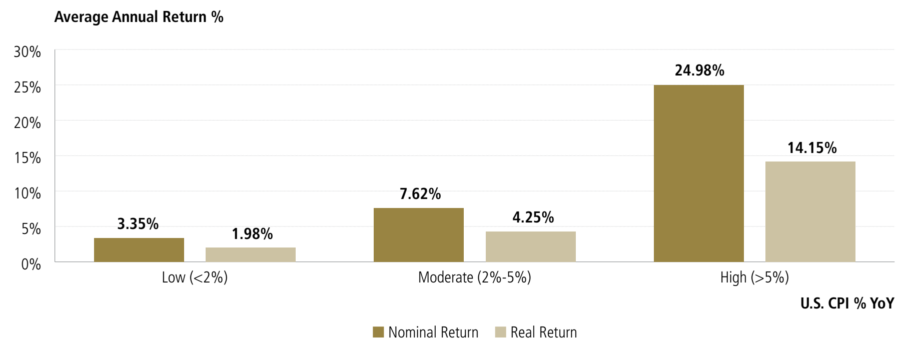
3. Store of Value

For thousands of years, gold has been recognized as a store of value, a belief that continues today. As a physical commodity, gold has intrinsic value, unlike paper money or digital assets. Gold is traditionally viewed as an inflation hedge, maintaining its value or even appreciating during times of inflation, when currency value tends to decline. In periods of economic turbulence or geopolitical uncertainty, many investors turn to gold as a "safe haven" asset. For investors in countries with volatile or weak currencies, gold provides a way to address currency devaluation.

Figure 3. Gold Historically Rallies in Periods of High Inflation

Gold Nominal and Real Returns in U.S. Dollars as a Function of Annual Inflation*



*As of 12/31/2022. Based on y-o-y changes in U.S. dollars for gold: LBMA Gold Price PM and inflation: U.S. CPI since January 1971.

Source: World Gold Council. Data as of 12/31/2022. Included for illustrative purposes only. **Past performance is no guarantee of future results.**

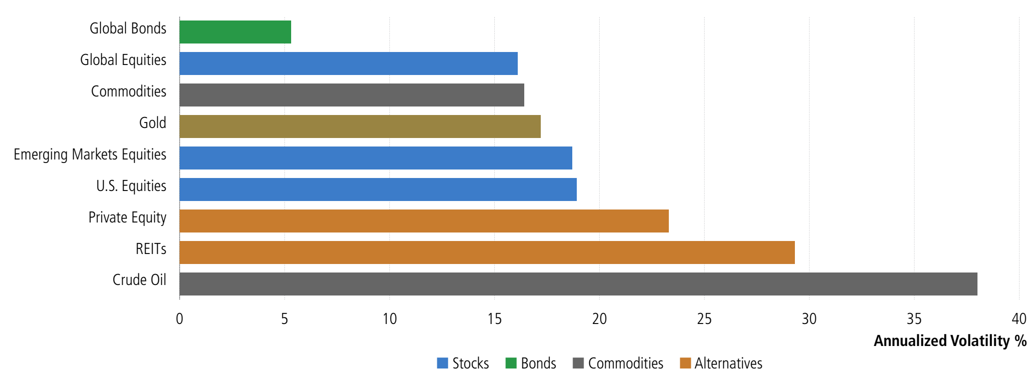
4. Liquidity

Gold is a highly liquid asset, which can be easily bought and sold. This characteristic is especially beneficial in periods of financial stress, when quick and efficient transactions may be essential. Gold's high liquidity also ensures its value is maintained with minimal transaction costs.

Figure 4. Gold Has Historically Demonstrated Less Volatility

Gold has been less volatile than many equity indices, alternatives and commodities because of its scale, liquidity and diverse sources of demand.

Average Daily Volatility of Several Major Assets Since 2002*



*Annualized volatility is computed based on daily returns in U.S. dollars between 12/31/2002 and 12/31/2022.

Source: World Gold Council. Data as of 12/31/2022. Global Bonds are measured by the Bloomberg Global Aggregate Bond Index; Global Equities are measured by the MSCI Daily Gross World Index; Commodities are measured by the Bloomberg Commodity Index; Gold is measured by the LBMA Gold Price PM; Emerging Markets Equities are measured by MSCI Daily Gross EM; U.S. Equities are measured by the MSCI USA Index; Private Equities are measured by the S&P Listed Private Equity Index; REITs are measured by the FTSE Nareit Equity REITs Index USD; and Oil is measured by the Bloomberg WTI Crude Oil. You cannot invest directly in an index. Included for illustrative purposes only. **Past performance is no guarantee of future results.**

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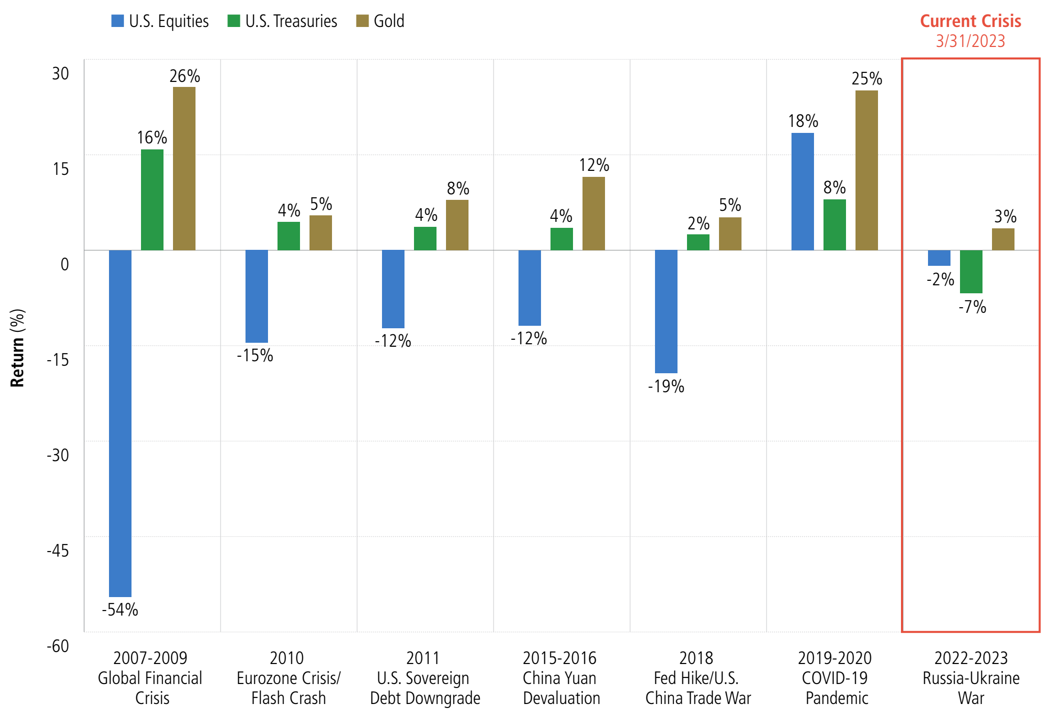
5. Increasing Demand for Alternative Safe Havens

The demand for gold in emerging markets is increasing alongside rising wealth, a trend that may likely to enhance gold prices. At the same time, we are witnessing a general decline in trust towards governments, exacerbated by escalating geopolitical tensions and swelling budget deficits that have culminated in high debt-to-GDP ratios. Significantly, gold, when held in allocated physical form, carries no obligation to any entity and is free of credit risk.

During geopolitical and economic crises, gold has provided a safe haven investment compared to more traditional asset classes, like stocks and bonds. During the seven crisis periods since 2007 (Figure 5), on average gold bullion has returned 12.02% compared to -13.78% for the S&P 500 Total Return Index and 4.45% for U.S. Treasuries (as of 3/31/2023).

Figure 5. Gold Has Been a Safe Haven During Economic and Political Instability

Performance of Gold Bullion vs. S&P 500 Total Return Index and U.S. Treasuries in "Crisis" Periods* (2007-March 31, 2023)



*The beginning and ending periods selected are our best estimate of the highest impact periods of each crisis and does not necessarily indicate the exact beginning or ending of the specific crisis event. Data as of 3/31/2023.

Source: Sprott Asset Management, Bloomberg. Dates used: Global Financial Crisis: 10/11/2007-3/6/2009; Eurozone Crisis: 4/20/2010-7/1/2010; U.S. Sovereign Debt Downgrade: 7/25/2011-8/9/2011; China Yuan Devaluation: 8/18/2015-2/11/2016; Fed Rate Hike & China Trade War: 9/20/2018-12/24/2018; COVID-19 Pandemic: 12/31/2019-12/31/2020; Russia-Ukraine War & Banking Crisis: 2/24/2022-3/31/2023. S&P 500 TR Index is measured by the SPXTR; U.S. Treasuries are measured by Bloomberg Barclays US Treasury Total Return Unhedged USD (LUATTRUU); and Gold Bullion is measured by spot gold (Bloomberg GOLDS Comdty). You cannot invest directly in an index. Included for illustrative purposes only. **Past performance is no guarantee of future results.**

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How Much in Gold-Related Equities and Why?

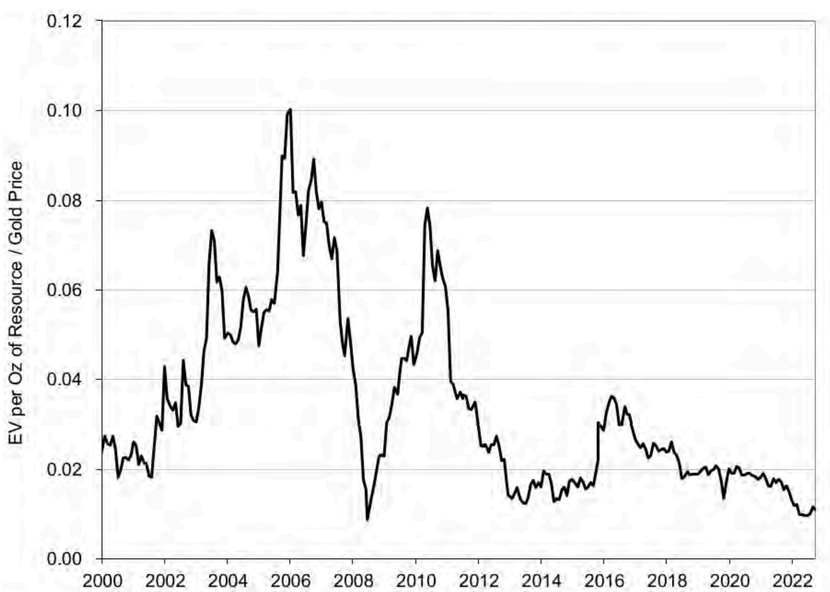
Gold-related equities should occupy a tactical 5% position in investors' portfolios when conditions are favorable. Like other cyclical industries, we believe it is prudent to capitalize on the cycles and mispricing of gold equities.

Gold-related equities provide the following enhancements to physical gold:

1. Leverage

Gold mining companies provide leverage to gold prices. When gold prices rise, the profits of these companies may increase significantly, leading to larger gains for investors. Conversely, when gold prices fall, losses can be amplified. Typically, gold-related equities offer about twice the short- to medium-term return of gold prices, owing to their operational leverage. Various valuation metrics, such as the enterprise value per ounce of gold resource, can be used to understand gold equities' position in the cycle.

Figure 6. Enterprise Value per Ounce of Gold Resource Divided by Gold Price for North American Gold Developers (2000-2022)



Source: Scotiabank. Data as of 3/31/2023. Included for illustrative purposes only. **Past performance is no guarantee of future results.**

2. Growth Potential

The discovery of new gold reserves by a mining company can lead to considerable growth and noteworthy returns on investment, an advantage that physical gold does not possess. As illustrated in Figure 7, the life cycle of a gold mining company is outlined in three stages: 1) Discovery; 2) Development; and 3) Production. The most value-enhancing stages occur during discovery and the mining company's transition from development to production. These phases have the potential to offer significant value-addition opportunities that we consider favorable for investment. However, it is important to note that investing in gold equities also comes with risks. These include operational risks associated with the mining company, geopolitical risks if the mines are in unstable regions, and market risks related to the volatility of stock prices.

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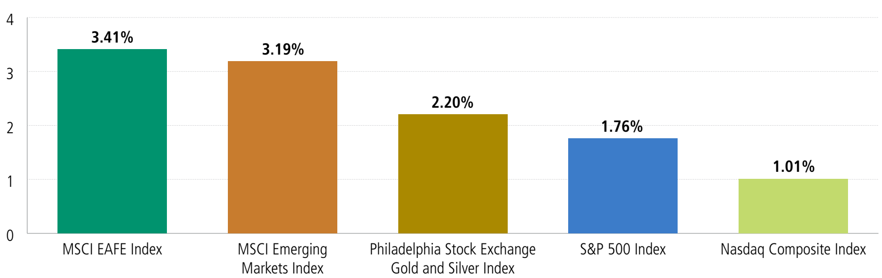
Figure 7. Life Cycle of a Gold Mining Company

Source: Sprott Asset Management. Included for illustrative purposes only. **Past performance is no guarantee of future results.**

3. Dividends

Contrary to physical gold, which does not yield any income merely through possession, gold-related equities have the potential to pay dividends. This serves as a source of income for investors.

Figure 8. Trailing 12-month Dividend Yield



Source: Bloomberg. Measures 12-month period from 7/01/2022 to 6/30/2023. International Equities are measured by the MSCI EAFE Index; Emerging Markets Equities are measured by the MSCI Emerging Markets Index; Gold-Related Equities are measured by the PHLX Gold/Silver Sector Index; U.S. Large-Cap Equities are measured by the S&P 500 Total Return Index; and U.S. Small-Cap Equities are measured by the Nasdaq Composite Index. Included for illustrative purposes only. **Past performance is no guarantee of future results.**

In Conclusion

We believe it is prudent for investors to include gold and gold-related equities in their portfolios for several reasons. Gold has historically shown a negative correlation with other assets during times of market stress, providing a valuable hedge against economic downturns and inflation. Gold can be viewed as a permanent fixed income alternative with zero credit risk. Moreover, gold-related equities, such as mining companies, offer the potential for leverage to the price of gold, giving investors the opportunity for possible significant gains. Overall, the diversification benefits, inflationary hedge, and potential for high returns may make gold and gold-related equities a compelling choice for any balanced investment portfolio. At present, the gold-related equities sector is particularly appealing due to its undervalued status and lack of popularity.

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