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Diversification remains golden

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As gold has failed to stay above USD 3,400/oz for the third time in quick succession, investors might see this as a signal to position for downside. We think investors should instead think of gold as a portfolio diversifier and as a hedge against spikes in risk. In addition to holding an adequate allocation to gold, investors could increase their indirect exposure to gold via gold miner bonds. The EUR continues to be the biggest beneficiary of the loss of confidence in the USD, and European quality stocks appear attractive currently.

The outbreak of hostilities between Israel and Iran took the price of gold to another all-time high of USD 3,432/oz and closer to the all-time intraday high of USD 3,500/oz. But it has failed to stay above USD 3,400/oz. In the two instances in the last three months that gold rose above USD 3,400/oz, it retreated below that level the very next session and fell 4% in two sessions and 7.3% in eight sessions. Should investors be concerned about the gold price's apparent fragility at these levels?

Investors though might benefit from thinking about gold from the perspective of portfolio diversification, rather than as a discrete trade that hinges on the price level. It should be noted that the gold price failed on multiple occasions to break above USD 2,100/oz till as recently February 2024, after which it rose sharply—by over 60% in 15 months, as the demand profile for gold evolved. Two recent surveys, conducted by the European Central Bank (ECB) and the World Gold Council (WGC) and YouGov, show that while many of the traditional reasons for gold demand remain in play, new drivers have emerged and likely account for the surge in demand over the last 15 months or so.

The WGC-YouGov survey showed that interest rates, inflation, and geographical instability remain the top three considerations that influence central bank decisions on how much gold to hold in reserves (93%, 81%, and 77%, respectively). Trade conflicts/tariffs were seen as the next most significant reason (59%), followed by unexpected shocks (49%). The current geostrategic environment leaves all these factors supportive of gold, albeit to different degrees. The Trump administration's unpredictable policy-making contributes to the erosion of confidence and that might remain a key

driver in the near term. Investors should be mindful of the factors that point to a sustained move out of the USD, and that gold is likely to be key to this.

Remain long gold as an avenue for diversification and as a hedge. With regard to the geopolitical instability and unexpected shocks, a 5% allocation to gold in balanced USD-denominated portfolios is recommended. This would entail being long gold, and our upside target for gold remains USD 3,800/oz. We expect central bank and ETF demand to remain robust going forward. Gold also serves as a liquid, politically neutral store of value in lieu of the USD.

Gold miner bonds benefiting from higher gold prices. An alternative avenue for investors to gain exposure to gold is via credit issued by select gold miners, which is offering yields of around 6%. Gold miners constitute a key export sector that is well positioned amid the ongoing tariff-related uncertainty because of higher gold prices. Gold miners have also shown improvement on the operational issues that had disappointed investors. Healthy free cash flow generation has enabled the companies to decrease their net leverage and further strengthen their balance sheets. We expect M&A activity to continue in a lower-risk fashion, which should help preserve the health of their financial metrics.

EUR and quality European stocks as alternate diversification options. We expect the EUR—as the most liquid alternative to the USD—to be a key beneficiary of the erosion of confidence in US policy-making. We expect EURUSD to climb steadily toward 1.20 by June 2026. Investors should also consider using the current market volatility to buy European quality stocks, which are well suited to portfolio diversification and increasing exposure to European equities. In terms of valuations, we also think this is a good time to target European quality stocks, with their P/E valuation premium having fallen over the last 18 months to slightly below its 10-year average.

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