
# Stick to Gold Bullion during Market Drawdowns

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Historically, gold bullion has performed well during periods of stock market turbulence. For example, during the 2008 Great Recession, gold rose over 20% while the S&P 500 fell 57% from its 2007 peak to its March 2009 bottom. Over the course of the prior major market decline, the dot-com bubble implosion of 2000 to 2002, gold rose 12.3% while the S&P 500 fell 49.1%.

The performance of gold miners during turbulent times is a different story. Through 1990 to the end of 2017, gold bullion and the Philadelphia Gold and Silver Index (PHLX G/S), the longest-running index of precious metal miners, had a correlation of 0.60 (much stronger than the 0.15 observed between silver and the PHLX G/S over the same time period). As Table 1 shows, a similar correlation was seen during each of the last five significant market drawdowns, but returns during these periods diverged significantly. On average, over these periods, gold bullion returned 10.4%, whereas the PHLX G/S fell 8.2%.

Table 1. S&P 500 peak-to-trough returns during the last five significant market drawdowns

| Period (Market Peak – Trough) | S&P 500 Return | PHLX G/S Return | Gold Return | PHLX G/S - Gold Correlation |
|---|---|---|---|---|
| Early 1990s Recession ('90) | -19.9% | -11.8% | 7.3% | 0.77 |
| Asian Financial Crisis ('98) | -19.2% | 18.6% | 1.8% | 0.80 |
| Dot-com Bubble ('00 – '02) | -49.1% | 3.0% | 12.3% | 0.58 |
| Great Recession ('07 – '09) | -56.8% | -33.4% | 24.5% | 0.58 |
| European Financial Crisis ('11) | -19.4% | -17.7% | 6.4% | 0.60 |
| Average | -32.9% | -8.2% | 10.4% | 0.67 |

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The relationship between the S&P 500, gold bullion, and the PHLX G/S during each of these periods is illustrated in Charts 1 through 5. During the Great Recession and Asian Financial Crisis, the PHLX G/S max drawdowns were greater than the S&P 500.

We offer two possible explanations for the performance divergence observed over these periods. First, investors, driven by panic and fear, enter "sell everything" mode. Even though bullion is rising, mining stocks are sold. Second, mining companies typically require significant capital and often need access to debt and equity financing to fund day-to-day activities, capital expenditures, and exploration. During market downturns, the ability of these mining companies to fund operations is hampered as lending and capital markets activity grinds to a halt.

While we see most markets as fully valued, we do not currently see any of the precursors that typically forewarn of a recession or material market drawdown. But it's better to fully explore risk management options before, not during, periods of market turmoil. The key takeaway from our research is that bullion itself may be a more reliable performer during market declines.

Chart 1. Early 1990s Recession ('90)

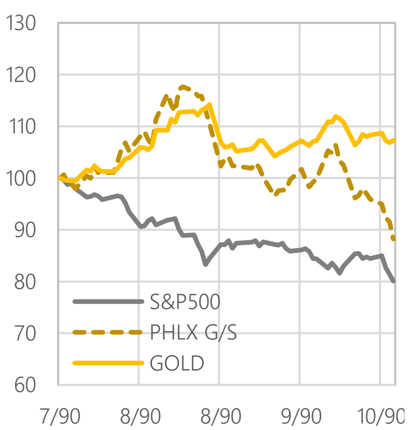



Chart 2. Asian Financial Crisis ('98)

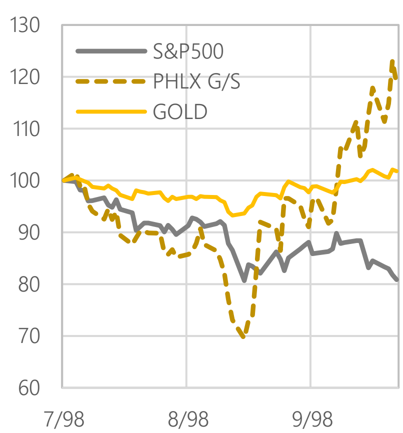



Chart 3. Dot-com Bubble ('00 – '02)

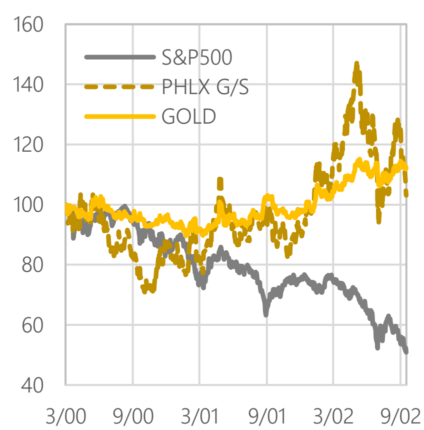



Chart 4. Great Recession ('07 – '09)

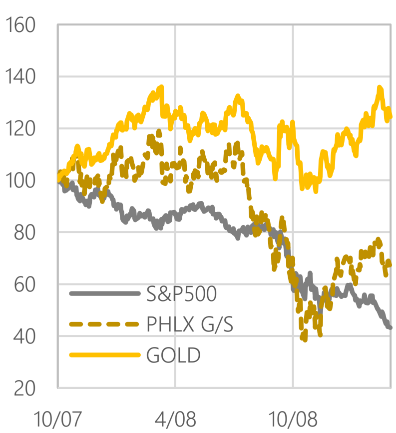
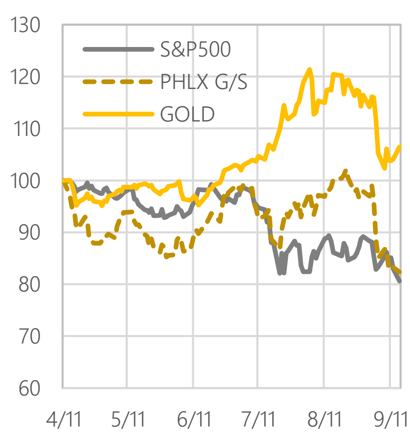



Chart 5. European Financial Crisis ('11)




Sources: FactSet, Trapeze Asset Management Inc.

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