



Gold versus bitcoin

Which asset is the better investment?

Jordan Elisio

Few asset classes have generated more buzz in the last decade than bitcoin.

Marketed as ‘digital gold’, built using potentially revolutionary blockchain technology, and created by a (purported) man of mystery in Satoshi Nakamoto who launched it in the aftermath of the Global Financial Crisis, the world’s best-known cryptocurrency has risen from obscurity to front-page finance news.

This is no surprise given bitcoin’s spectacular price growth, which saw it trade above USD 65,000 at one point in 2021 (see Figure 1).

There were also a range of notable developments for bitcoin in 2021, including news that Tesla added it to its balance sheet in February of that year. El Salvador also announced it had adopted bitcoin as legal tender, though in practice this means it is encouraging merchants to accept, and citizens to save it, rather than denominating state liabilities in bitcoin.

Market access also improved, with the first-ever exchange-traded funds (ETFs) launched in North America, encouraging investors that they could now access bitcoin via regulated investment products.

Given this growth has coincided with a steady though not spectacular period for gold, some analysts claim bitcoin is replacing the precious metal, both as a safe-haven asset and as a form of money itself.

While the enthusiasm for bitcoin is understandable, it is far too

early to claim it will replace gold, with the precious metal likely to remain the safer bet for investors wanting to protect and grow their portfolio in the years ahead.

This paper explains why and, in the course of the discussion, covers a range of topics, including:

Figure 1. Gold and bitcoin prices in USD: January 2019 to January 2022



Source: Coinmetrics, Yahoo finance, World Gold Council

- why it is overly simplistic to call bitcoin a Ponzi scheme
- why the market for gold, and possibly bitcoin may grow going forward
- key characteristics and the investment case for gold and bitcoin
- six unanswered questions about bitcoin for investors to consider.

Why bitcoin is not a Ponzi scheme

We think it is overly simplistic to label bitcoin a Ponzi scheme.

First, it is worth remembering that there are two parts to bitcoin. There is the bitcoin network, and then there is the actual bitcoins themselves.

Note: Some users capitalise bitcoin when referring to the technology, network and protocols; and lower case for bitcoin as a currency. For consistency, this paper has adopted the latter usage in all instances.

Bitcoin operates as a payment pipeline, allowing users to transfer value, that is, bitcoins, between each other.

While this transfer feature is used sparingly and may appear to be of little use to readers (or the author of this paper), not everyone sees the world the same way.

For a growing number of people, there is indeed value in a network that facilitates the transfer of a tradable asset without the oversight of a central bank, regulated financial institution, or government.

Second, most bitcoin proponents are not pretending potential buyers will earn an income stream simply by owning it. They are open about the fact bitcoin's success relies on perpetual price growth.

One may be sceptical of such claims (we certainly are), and one can still hold a view that bitcoin will ultimately collapse, but that does not make it a Ponzi scheme.

Why the market can grow in the years ahead

Several factors could support higher levels of investment in alternative stores of wealth like gold, and possibly bitcoin, going forward.

The first is the very low market share of investable assets they currently comprise. In September 2020, Bridgewater published a paper titled *Some Perspective on Gold in the New Paradigm*. It noted gold's market share of global assets was close to 3%. This is way below the highs seen in the 1940s (10%) and the end of the 1970s (7%).

Gold is also coming off one of its worst 10-year periods of relative performance compared to US equities in nearly five decades (see Figure 2).

Markets tend to 'mean revert' over time, which could favour gold in the decade ahead.

Furthering this argument is the fact financial markets themselves are stretched by historical standards. The S&P 500 ended 2021 with a cyclically adjusted price earnings ratio of almost 40, one of the highest readings ever recorded. Fixed income markets were also expensive, with real yields on 10-year US Treasury bonds ending last year at -1.04%.

Given this environment, it is no surprise the outlook for traditional diversified strategies going forward is clouded, with AQR's Q1 2022 capital market assumptions noting that "the expected real return of a 60/40 portfolio remains around 2%, less than half its long-term average of nearly 5%".

On top of this, there is the continued decline in trust in central authorities. The Pew Research Centre, various Gallup polls and the Edelman Trust Barometer all highlight declining faith in government, which has been exacerbated by the response to the COVID-19 pandemic.



The quote

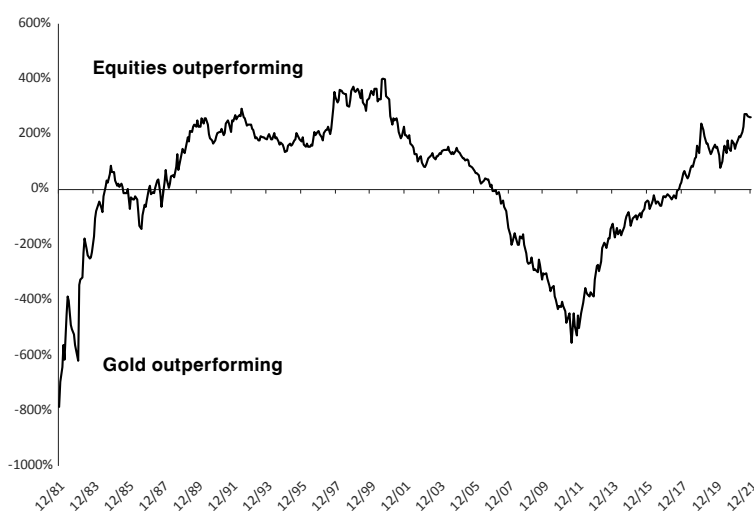
Coupled with the one of the most significant inflation spikes in decades and a developed world fiscal outlook that shows no credible path towards balanced budgets, the potential for alternative stores of wealth to blossom is clear.



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Figure 2. Rolling 10-year performance difference (%): S&P 500 price index versus gold price



Source: The Perth Mint, World Gold Council, Standard & Poor's

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Key characteristics to consider

Market size

At the end of 2021, there were just over 205,000 tonnes of physical gold held by investors, households, central banks and industrial users around the world, worth almost USD 12 trillion.

By contrast, the market value of bitcoin, even after its tremendous price rally, was just USD 877 billion. The size of these markets and the ratio between them since 2016 is shown in Table 1.

While the ratio shows the gold market is 14 times larger than bit-

Table 1. Size of gold and bitcoin markets: 2016 to 2021

Year	Bitcoin market size (USD billion)	Gold market size (USD trillion)	Ratio
2016	15.6	6.9	443
2017	233.5	7.9	34
2018	64.4	8.0	124
2019	130.0	9.6	74
2020	539.4	12.2	23
2021	876.9	11.9	14

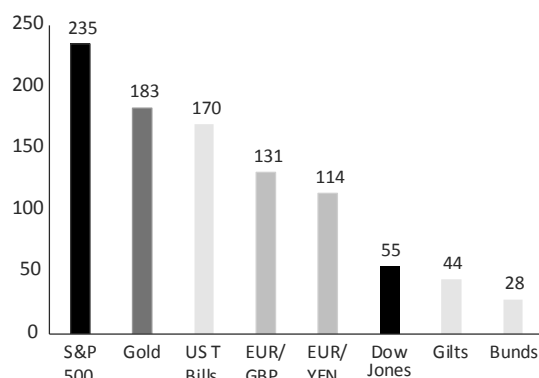
Source: The Perth Mint, World Gold Council, Coinmetrics

coin today, it was 124 times larger just three years ago. Given gold's much-lower relative volatility (see 'Volatility and drawdowns' section), investors can have great confidence that gold's multi-trillion-dollar market size will endure.

Liquidity

Daily turnover in the gold market averages more than USD 180 billion, which is more than most fixed income and equity markets (see Figure 3).

Figure 3. Average daily trading volumes (USD billion) for major assets: 2010 to 2020



Source: World Gold Council

Gold's high liquidity is beneficial to investors and helps explain why it is one of the most efficient asset classes to trade, witnessed through spreads for gold ETFs that are far lower than most other asset classes available through ETF structures.

Liquidity in the bitcoin market, despite increasing last year as the price rallied, averaged less than USD two billion per day in 2020. Total liquidity in bitcoin most of its roughly 12-year life has been comfortably less than one billion per day.

Cost to invest

The Perth Mint Gold (ASX:PMGOLD) gold ETF charges a management fee of 0.15% p.a. The average fee of the largest gold ETFs is just 0.23%.

The largest bitcoin investment vehicle charges 2% p.a., while the first bitcoin ETF listed in the US in 2021 charges 0.95% p.a. When assessing regulated investment vehicles, gold is the lower cost asset.

Volatility and drawdowns

Since the end of 2010, the annualised volatility of bitcoin has been approximately 200%. This compares to just 16% for gold and 13% for the S&P 500.

Major drawdowns are also a feature of bitcoin, and not just in its early days, with two corrections of more than 50% in 2021 (see Table 2).

Gold can suffer drawdowns too, having fallen 42% in the cyclical bear market that ended in late 2015.

Table 2. Bitcoin drawdowns corrections: 2010 to 2022

Time period	Bitcoin USD price (high)	Bitcoin USD price (low)	Bitcoin price decline (%)
Sep to Oct 2010	0.17	0.01	-94
November 2010	0.50	0.14	-72
Feb 2011 to April 2011	1.10	0.56	-49
May 2011	8.45	5.58	-34
June to November 2011	32	2	-94
April to July 2013	266	63	-76
Nov 2013 to Jan 2015	1,166	170	-85
March 2017	1,326	892	-33
June to July 2017	3,025	1,837	-39
September 2017	5,014	2,951	-41
November 2017	7,879	5,507	-30
Dec 17 to Dec 18	19,783	3,122	-84
January 2021	41,962	28,845	-31
Apr to June 2021	64,802	29,031	-55
Nov 21 to Jan 22*	68,991	33,327	-52

Source: The Perth Mint, CoinDesk, @CharlieBilello

*drawdown ongoing at time of publication.

These drawdowns though are typically far less frequent and of a far smaller magnitude relative to those displayed by bitcoin.

Governance and regulation

Gold trades in a well-regulated market, with the majority of the more

than USD 180 billion in daily turnover either taking place in over-the-counter trade, or on regulated futures market exchanges.

Some of the largest commercial and central banks in the world, including the Bank of England, play active roles as market makers and custodians.

By contrast, many cryptocurrency exchanges operate out of regulation 'lite' jurisdictions, with question marks over the integrity of some of the data they report. For example, in 2019 Bitwise Asset Management suggested up to 95% of reported trading volume in cryptocurrency markets was fake.

There are also question marks regarding so-called 'stablecoins', which are used to conduct a significant portion of bitcoin trading. These coins are often marketed as being fungible with actual US dollars, or as 'dollar-like' assets, though many observers are sceptical about these claims.

The concerns regarding stablecoins have intensified recently with a number of lawsuits involving stablecoin issuers, and the levying of multi-million-dollar fines against some of them.

Indeed, concerns regarding cryptocurrency market integrity help explain why the Securities and Exchange Commission (SEC) still will not allow a spot-based bitcoin ETF in the US, with the SEC noting the bitcoin market remains too prone to market manipulation.

Environmental, social and governance (ESG)

While energy is required to mine, transport, refine and manufacture physical gold products, the precious metal is 100% recyclable. Since 2010, 28% of the annual gold supply has been recycled.

Gold can also reduce an investment portfolio's carbon footprint. According to a 2021 report *Gold and climate change: decarbonising investment portfolios* produced by the World Gold Council and climate risk analytics consultancy Urgentum, a 70% equities 30% bond portfolio that reallocated 10% of its assets to gold would see its emissions intensity fall by 7%.

The bitcoin network uses vast amounts of energy, with the Cambridge Bitcoin Electricity Consumption index stating it consumes 125.51 terawatt hours p.a. If it were a country, bitcoin would be number 27 for electricity consumption. A 2021 article on CoinDesk, 'How much energy does bitcoin use?' suggested each transaction on the bitcoin network uses close to 1,720 kilowatt hours, equivalent to 59 days of power for the average US household.

Ultimately, people's views on ESG as it pertains to bitcoin is likely driven by their view on bitcoin as an investment. If one thinks it will skyrocket, and is helping build a better, fairer monetary system, then the energy usage is no doubt justified.

If you see bitcoin as a speculative trading vehicle, with little real-world application, then it is arguably the most energy-intensive form of gambling on the planet.

The investment case

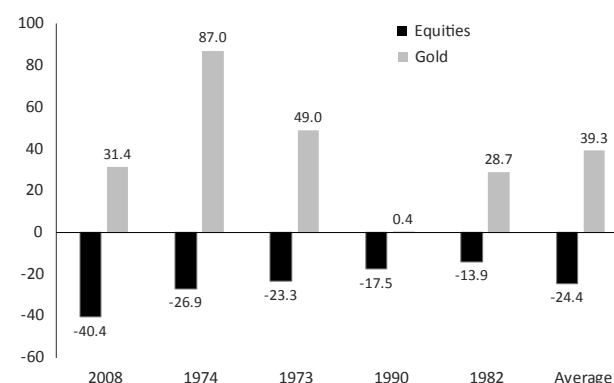
Gold has delivered strong long-term returns, rising approximately 9% p.a. since the 1970s. It is positively correlated to rising equity markets and has a history of outperformance in low real-interest-rate environments.

Gold is also well known as a safe-haven asset, typically providing protection when its needed most. Even those who do not invest in gold acknowledge that over the long run it has held its value, and that in periods of market stress, when equities are falling and/or inflation is rising, gold tends to perform well.

Market data over the past 50 years validates these beliefs, with gold on average rising by more than 15% in years that inflation has been 3% or higher, while multiple studies have found gold is on average the best-performing asset when equities suffer sharp pullbacks.

Figure 4 highlights this clearly, with gold proving particularly effective for local investors, given equity 'risk-off' periods often coincide with pullbacks in the Australian dollar.

Figure 4. Australian equity and AUD gold price returns (%) during worst equity corrections: 1970 to 2021



Source: The Perth Mint, World Gold Council, Reuters

Bitcoin does not have this history.

From an inflation perspective, the bitcoin price was essentially flat over 2021, even as US inflation rose from less than 2% to more than 7%. In the 10 years leading into 2021, which covers the majority of its lifespan, US inflation averaged less than 2% p.a. Given this, there is no evidence bitcoin offers inflation protection yet.

Bitcoin is even less convincing as an equity market hedge. It has not only fallen in all of the significant S&P 500 pullbacks since 2015, it has underperformed to the downside (see Table 3).

Table 3. Equity market corrections and bitcoin price moves: 2011 to 2022

Start date	End date	S&P 500 price fall (%)	Bitcoin price fall (%)
3/11/2015	11/02/2016	-13.3	-5.8
26/01/2018	8/02/2018	-10.2	-25.5
20/09/2018	24/12/2018	-19.8	-37.8
19/02/2020	23/03/2020	-33.9	-32.7
3/01/2022	27/01/2022	-10.0	-20.0
Average return		-17.4	-24.4

Source: The Perth Mint, Standard and Poor's, Coinmetrics

This problem shows no sign of abating and indeed may be getting worse, with the correlation of bitcoin and US equity markets rising to more than 50% in 2021.

This is not to disparage bitcoin as an investment, but it does illustrate that in terms of its price behaviour, and the benefit it can bring to a portfolio, it has not proved itself to be a safe haven like gold has.

The one thing bitcoin has proved capable of is spectacular perfor-

mance, with a price increase since 2010 that not only dwarfs what gold has delivered over the same timeframe, but every other mainstream asset class too.

Six unanswered questions about bitcoin

While bitcoin's performance is undeniable, there are several questions about it that remain unanswered. Some of these are explored in the following discussion, comparing it with gold where relevant.

Decentralisation

The argument that bitcoin is decentralised and that no government can control or stop it, is a core selling point used in its promotion.

There are three elements to this worth considering.

- Is decentralisation a good thing?
- Is bitcoin really decentralised?
- How does it compare to gold on this basis?

As to whether decentralisation is a good thing, consider the drawbacks. What happens if someone's bitcoin wallet is hacked, they forget their password, or accidentally send bitcoins to the wrong address for payment? There are no safeguards in place.

As to whether or not bitcoin is decentralised, consider that, as per its creation story, it was designed by one person. That one person decided the total amount of coins that could ever be mined, and the rate at which they would be supplied into the market.

Ownership today is incredibly concentrated, with estimates suggesting anywhere between 70–90% of all bitcoins are held by just 2% of owners.

Finally, the bitcoin network is ultimately just one ledger, with every account balance and transaction that ever occurred publicly viewable. Should something happen to corrupt that ledger (admittedly it would be a 'black swan' event), the entire network could be rendered worthless.

Is that really decentralised?

Gold by contrast is held by every major central bank or national treasury on behalf of their respective citizens and is owned directly by households and investors the world over.

Gold is also mined, refined, traded and stored in multiple locations. Therefore, while there is a risk a particular country could pass a law that is unfavourable to gold investors, or that gold stored in a specific vault could be stolen, there is no one single point of failure in the gold market.

Supply

As gold is never truly consumed, its total supply is stable, having grown by an average of 1.82% p.a. since 2010 (see Table 4).

Based on current production, it will take until 2080 for the total gold supply to double.

This stable (not fixed) supply profile is a permanent and effectively unalterable feature of the gold market. Thousands of years of history, combined with the laws of nature, gives investors confidence it will not change going forward.

Bitcoin has been designed so that only 21 million coins can ever be issued.

While it is understandable that in an era of limitless fiat currency creation, investors are attracted to assets with a fixed supply, there are two points worth considering.

First, while bitcoin is theoretically limited to 21 million coins, it is a piece of software. There are disincentives to change the supply, but it can be done.

Table 4. Above-ground gold stocks and annual percentage change

Year	Total gold supply (tonnes)	Annual increase (%)
2010	168,246	
2011	171,145	1.72
2012	174,057	1.70
2013	177,196	1.80
2014	180,563	1.90
2015	183,942	1.87
2016	187,495	1.93
2017	191,048	1.89
2018	194,688	1.91
2019	198,293	1.85
2020	201,722	1.73
2021	205,238	1.74
Average		1.82

Source: World Gold Council

Second, is a fixed supply a desirable feature for a currency?

To help answer this, it is worth considering why we have money in the first place? Essentially, it is to facilitate trade and allow for economic specialisation. As populations and output grow, the idea we would want a fixed money supply is no more logical than saying we should have a fixed quantity of coffee or a cap on the number of cars that can be manufactured.

As US satirist, social commentator and literary critic H. L. Menck-en once said: *"For every complex problem, there is an answer that is clear, simple, and wrong."*

Use cases

Gold has multiple, enduring sources of demand, being used for four primary purposes, namely:

- in jewellery, where it is a display and store of wealth
- in portfolios, where it is used as an investment/speculation/store of wealth
- in industry, including electronics, medicine, dentistry and aerospace
- as a monetary reserve for central banks.

The ownership proportions are shown in Table 5.

Bitcoin only has two potential demand sources, that is:

- as an investment/speculation/store of wealth.
- as a mechanism to make payments across a 24/7 unregulated monetary pipeline.

Most bitcoin advocates acknowledge the former is by far the pri-

Table 5. Breakdown of gold ownership: End 2021

Gold market ownership	Tonnes held	Share of total gold holdings (%)
Jewellery	94,464	46
Private investors	45,456	22
Central banks	34,592	17
Industrial/other	30,726	15
Total	205,238	100

Source: World Gold Council

many reason people purchase it today. Academic literature supports this view, with a 2021 National Bureau of Economic Research paper, *Blockchain analysis of the bitcoin market*, finding that “90% of transaction volume on the Bitcoin blockchain is not tied to economically meaningful activities ...” In other words, the overwhelming majority of bitcoin network activity is supporting speculation and trading.

Network effects

Network effects are the phenomenon by which something (for instance, a social media platform or a search engine) becomes exponentially more valuable to each user as the userbase expands. Table 6 illustrates the phenomenon.

Table 6. Network effects: Telecommunications

# people with a telephone	# potential conversations
1	0
2	1
3	3
4	6
5	10
10	45
100	4,950

Source: Created by author

Bitcoin advocates often refer to this concept, arguing that as the number of people who use bitcoin grows, so too must its price.

Investors may wish to question this.

To explain why, assume 12 school friends from the late 1990s all reconnected via a social media platform (SMP) in 2021, with one friend joining each month.

While the first 11 friends get to share a few more jokes in year one, the twelfth friend gets the same utility upon joining, even though they connect last. Crucially, the experience of all the friends is improved by the twelfth friend joining, strengthening the network effect of the SMP.

Assume that upon joining the SMP, each friend also bought USD 10,000 of bitcoin, with prices increasing from USD 5,000 to USD 60,000 in a linear fashion each month.

Table 7 highlights how much bitcoin each friend owns, and how much value they would get from it if prices double after the twelfth friend purchases.

Considering that the primary use case for bitcoin is speculation, it is clear the 12 friends will not get the same utility from it in the way they do from their SMP accounts.

It is also worth noting that in many cases, technologies that develop genuine network effects do so because they offer better value for money as the userbase expands.

As illustrations, consider that in the US some studies suggest wireless telephone service charges have fallen more than 50% in the past 25 years. A 2020 Reserve Bank of Australia paper, *Quality change and inflation measurement*, also suggested the measured price of mobile phone handsets had fallen 18% since mid-2015.

It is much harder for something to build, let alone maintain a network effect, if the cost to each new user goes up. Yet, that is exactly the hypothesis the bullish case for bitcoin is built upon.

Table 7. Value of bitcoin investments for 12 friends: Hypothetical example

Friend	Bitcoin USD price at time of purchase	USD investment	Number of bitcoins bought	Current USD value	USD value if bitcoin doubles
# 1	5,000	10,000	2.00	120,000	240,000
# 2	10,000	10,000	1.00	60,000	120,000
# 3	15,000	10,000	0.67	40,000	80,000
# 4	20,000	10,000	0.50	30,000	60,000
# 5	25,000	10,000	0.40	24,000	48,000
# 6	30,000	10,000	0.33	20,000	40,000
# 7	35,000	10,000	0.29	17,143	34,286
# 8	40,000	10,000	0.25	15,000	30,000
# 9	45,000	10,000	0.22	13,333	26,667
# 10	50,000	10,000	0.20	12,000	24,000
# 11	55,000	10,000	0.18	10,909	21,818
# 12	60,000	10,000	0.17	10,000	20,000

Source: Created by author

The law of diminishing returns

Bitcoin bulls often claim it is history’s best-performing asset, noting it rose from 0.01 in 2010 to more than USD 65,000 per coin at one stage in 2021. That is a total return of more than 200% p.a.

The maths is not in dispute. There are, however, two points worth noting.

1. Bitcoin was essentially valueless on day one

Bitcoin ended 2010 trading at USD 0.30. In 2011, the price rose to USD 4.71, an almost 1,500% increase. That price increase added just USD 36 million to the value of the entire bitcoin network. It was so small, fewer than 50 self-managed superannuation fund trustees could have bought all of it back then.

This microscopic size of bitcoin in its early days creates a distortive effect when it comes to analysing returns.

The increase is real, but bitcoin was not large enough, nor accessible to anyone beyond a small niche of investors in its formative years, to draw any conclusions around expected performance based on growth exhibited to date.

2. The returns are (almost certainly) non-repeatable

Bitcoin had a market value of almost USD 900 billion by the end of 2021, finishing the year trading at USD 46,355. To double in 2022, it will need to trade above USD 90,000. Should this occur, bitcoin will end 2022 with a market value of USD 1.75 trillion.

Expressed differently, the value increase required to generate a 100% return today is 24,000 times more than the increase required in 2011, when bitcoin rose 1,471% (see Table 8 on next page).

Competition

There is no limit on the number of crypto assets. Estimates suggest there are more than 10,000 on issue. All are competing for market share and investor attention.

And while bitcoin remains the largest, its share of cryptocurrency markets has been falling for years. Figure 5 illustrates this, showing bitcoin’s market share as a percentage of:

- the entire crypto universe (down to 40% by the end of 2021)
- coins designed to compete as digital currencies (down to 64% by end of 2021).

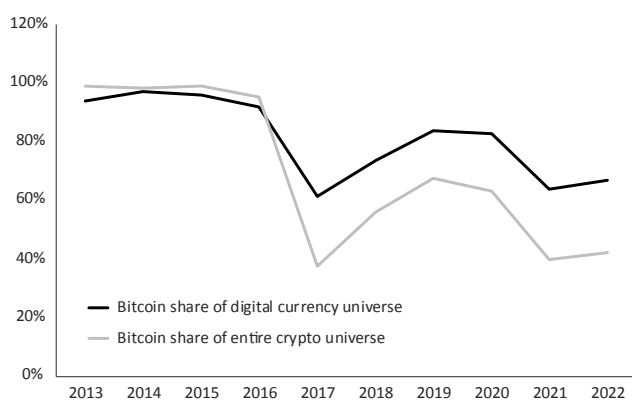
Table 8. Market value and percentage price growth for Bitcoin: 2011 versus 2022*

Year	Price (start)	Price (end)	Price gain	End year market cap (USD)	Market cap gain (USD)
2011	0.30	4.71	1471%	37,723,644	36,217,464
2022*	46,355	92,710	100%	1,753,713,176,509	876,856,588,254

Source: The Perth Mint, Coinmetrics

*Hypothetical only, noting market value would double with price slightly below USD 92,710, given additional bitcoin will be mined in 2022.

Figure 5. Bitcoin market share (%): 2013 to 2022



Source: The Perth Mint, Real Bitcoin Dominance Index, TradingView

The information in Figure 5 suggests the following:

- Crypto market investors are not convinced the primary use case for blockchain technology is the creation of assets trying to serve a monetary function. Other assets, most notably Ethereum, are proving increasingly popular.
- Even when narrowing in on those trying to provide a monetary function, it is not clear bitcoin will remain the dominant player, having lost market share since 2013.

This competition is unlikely to dissipate, especially given most people attracted to the crypto space are in it to make a fast (fiat) dollar.

After all, relative to bitcoin, other crypto assets are much smaller in size. They require a far smaller increase in market value to deliver the same percentage gains.

This is highlighted in Table 9, which shows the market value of bitcoin, as well as the average market value of the next 10 largest cryptocurrencies* and the average market value of those ranked from 6–10.

Those ranked 6–10 in particular are tiny, requiring less than one-fortieth of the market value increase bitcoin now needs to double in price.

Going back to our social media platform example, given the main objective is speculation, why would the twelfth friend buy bitcoin when they could purchase a much smaller crypto asset?

Table 9. Size of bitcoin and other cryptocurrency assets: End January 2022

Crypto asset	Size end Jan (USD billion)	Size compared to bitcoin (%)
Bitcoin	727	
Average—next 10 largest	57	7.8
Average—6–10	18	2.4

Source: Coinmarketcap.com

*excludes stablecoins

Conclusion

This paper has highlighted that when comparing gold to bitcoin, it is the precious metal has the clearer investment case, is easier to allocate to, and is more favourable when considering ESG. following is a summary of each factor.

Investment case

The role of gold, as a potential source of return, as a stabiliser in periods of equity market stress, and as protection during periods of high inflation, is well established.

While bitcoin has offered explosive price growth at times, this comes with substantial volatility, and regular significant drawdowns. Bitcoin has not demonstrated it is a safe haven.

Execution

Gold trades significant volumes in an established, well-regulated market. It can easily be incorporated into a portfolio, often at a lower cost than traditional assets.

While bitcoin market infrastructure has improved, cryptocurrencies remain plagued by allegations of fraud, and the material overstatement of liquidity. They are also likely to be subject to increased regulatory oversight.

ESG

Gold is a 100% recyclable asset, with studies highlighting allocations to gold can reduce a diversified investment strategy's carbon footprint.

Bitcoin remains incredibly energy intensive. Concerns regarding its impact on climate change and net-zero initiatives will potentially limit investment, especially from fiduciaries factoring ESG considerations into capital allocation decisions.

Given these factors, it is clear investors focusing on protecting and building wealth going forward are likely to be better served with an allocation to gold in a well-diversified portfolio. **FS**

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