



EQUITY

The Glistening Project: Why Some Investors Are Looking Again at Gold

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For some investors, increasing exposure to gold has been a knee-jerk reaction to bouts of heightened financial market volatility. Franklin Equity Group's Steve Land says there's more to gold than that. And he explains why he's positive about both the prospects for gold and for gold equities.

The return of volatility to global financial markets in October has prompted a resurgence of interest in gold after a quiet summer.

Gold declined for six straight months through September, the longest consecutive monthly downtrend since 1997. After spending much of September and early October in a very narrow trading range, gold prices finally picked up following the equity market wobble in mid-October.

Although we do not make specific predictions on the price of gold, we believe there are some interesting potential catalysts for gold in the current market environment. And in an environment of rising prices, we see significant opportunity in companies that mine gold.

The Golden Role

Gold plays many roles: as jewelry, as a financial asset, and in applications in the medical and dentistry fields. It even has industrial uses in high-end electronics.

Jewelry demand remained solid with a 6% year-on-year (YoY) growth rate during the third quarter of 2018, according to the World Gold Council, with a strong global economic backdrop and 10% improvement from China and India lending support.¹

According to our analysis, improving economic activity and positive wealth generation (aided by positive global stock market performance) should offer broadening support for jewelry sales as the jewelry market remains the largest segment of demand for gold.

Gold's role as a financial instrument is mainly as a diversification tool² given the precious metal's history of low correlation³ with other financial assets and its long history as a store of value.

Interest in gold as a financial asset has declined the past two years as strong stock market returns with limited volatility provided little reason for most investors to look for diversification. But, there are signs that demand for the asset is growing, notably among central banks.

According to the World Gold Council, global central bank gold purchases were up around 17% YoY for the first three quarters of 2018.⁴ Central bank purchases in the third quarter were at the highest levels since the fourth quarter of 2015. Russia led the way with purchases and its third-quarter increase of 92.2 tons was the largest on record, bringing the country's gold reserves to more than 2,000 tons for the first time.

The Central Bank of Hungary announced in October that it had increased its gold holdings 10-fold.⁵ That news followed purchases by Poland's central bank in July, August and September.

Macroeconomic Influences on the Price of Gold

Although we think uncertainty from rising global trade tensions should be positive for the price of gold, the strong US dollar has been a headwind. A strong dollar generally makes gold more expensive in many of the international markets with the most price-sensitive demand, such as China and India. This relationship gives gold an inverse correlation to the US dollar, so any US dollar weakness should be supportive for gold.

The low unemployment rate in the United States, combined with the stimulative effects of the US tax-policy changes and the impact of escalating trade tensions with newly implemented tariffs coming into full effect, have increased the dialogue about the potential for inflationary pressures to return.

This environment holds the potential to be supportive of higher precious metals prices and related equities. As inflation rises, the money supply tends to grow, but the supply of new gold being extracted from gold mines is relatively stagnant and slow to respond.

In an inflationary environment, gold prices should tend to move higher, maintaining value in real terms.

Outlook for Gold-Mining Equities

Shares of gold mining companies have fallen significantly from their 2011 highs. We believe their valuations now reflect expectations that gold prices will likely remain subdued into the future.

Current gold prices are close to marginal cost, which represents the level required for many gold mining companies to remain in business over the long term. So, even a relatively small rise in the price of gold can have a dramatic impact on a company's expected cash flow.

While we think companies in this space offer significant upside potential if gold prices rise, we also believe many firms in the sector are well-positioned to survive a further downturn in prices.

Most mining companies have maintained a focus on improving the cost structure of their operations, debt repayment and asset rationalization, which we believe should result in improved performance potential going forward.

Hence, we continue to see attractive opportunities in gold- and precious-metals-focused equities.

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What Are the Risks?

Franklin Gold and Precious Metals Fund

All investments involve risks, including possible loss of principal. Also, the fund concentrates in the precious metals sector which involves fluctuations in the price of gold and other precious metals and increased susceptibility to adverse economic and regulatory developments affecting the sector. In addition, the fund is subject to the risks of currency fluctuation and political uncertainty associated with foreign investing. Investments in developing markets involve heightened risks related to the same factors, in addition to those associated with their relatively small size and lesser liquidity. The fund may also invest in smaller companies, which can be particularly sensitive to changing economic conditions, and their prospects for growth are less certain than those of larger, more established companies. Investing in a non-diversified fund involves the risk of greater price fluctuation than a more diversified portfolio. These and other risks are described more fully in the fund's [prospectus](#).

Investors should carefully consider a fund's investment goals, risks, sales charges and expenses before investing. Download a [prospectus](#), which contains this and other information. Please carefully read a prospectus before you invest or send money.

[1.](#) Source: World Gold Council.

[2.](#) Diversification does not guarantee profit or protect against risk of loss.

[3.](#) Correlation measures the degree to which two investments move in tandem. Correlation will range between 1 (perfect positive correlation where two items have historically moved in the same direction) and -1 (perfect negative correlation, where two items have historically moved in opposite directions).

[4.](#) Source: World Gold Council, "Gold Demand Trends Q3 2018," November 1, 2018.

[5.](#) Source: Magyar Nemzeti Bank, "HUNGARY'S GOLD RESERVES INCREASE TENFOLD, REACHING HISTORICAL LEVELS," October 2018.