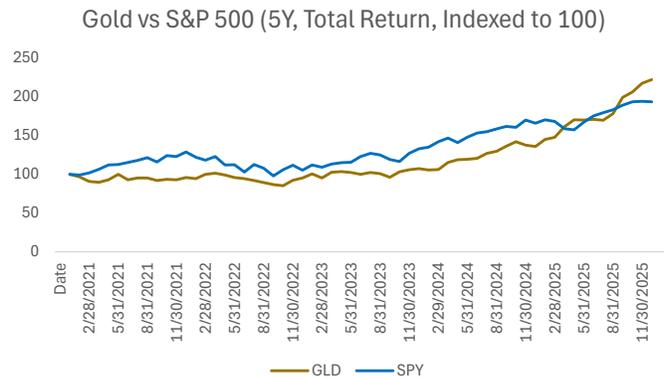


Gold (XAU/USD)	
<b>Prices &amp; Rates</b>	
Gold Price (COMEX, Front Month):	\$ 4,927.00
10Y Real Yield (FRED: DFII10):	1.90%
Fed Policy Rate (FRED: EFRR):	3.64%
<b>Demand &amp; Reserves</b>	
CB Net Buying (WGC, FY 2024 in tonnes):	1089.4
EM Share of CB Gold Reserves:	19.78%
<b>Macro Regime</b>	
U.S. Debt / GDP (FRED: GFDEGDQ188S):	121.00%
Global FX Reserves (USD Share, IMF COFER):	56.92%
<b>Relative Performance</b>	
Gold vs. S&P 500 (5Y, total return):	28.48%
<i>December 31, 2020 - December 31, 2025</i>	



## Executive Summary

We maintain a **Strategic Overweight** stance on gold as the global macro regime continues to shift away from the conditions that characterized the prior decade. This view is informed from a regime-based allocation perspective rather than a near-term price forecast. Elevated sovereign debt burdens, persistent fiscal imbalances, and rising geopolitical fragmentation have materially altered the distribution of future monetary and financial outcomes. In this environment, gold has evolved from being primarily a cyclical hedge into a structural reserve asset. This distinction matters. Support for this statement is provided by sustained official-sector demand and diminishing reliance on traditional reserve currencies. Over the past five years, gold has outperformed the S&P 500 by about **28.5%** on a total return basis, reinforcing its capacity to compound and preserve real value through periods of macroeconomic stress.

We view this outperformance as the result of durable and slow-moving forces rather than short-term market dislocation. Central banks – particularly in emerging markets – have become consistent buyers of gold as they seek to diversify reserves and reduce exposure to geopolitical and financial risks. While gold is not immune to volatility, its lack of counterparty risk, independence from financial systems, and historically low correlation to risk assets support a sustained allocation above long-run neutral levels. For that reason, we think gold should remain a strategic holding, not a tactical trade.

## Central Bank Demand & Reserve Dynamics

Over the past decade, the role of gold within the global monetary system has undergone a meaningful shift. While gold has historically been viewed as a cyclical hedge against inflation or currency debasement, recent dynamics suggest a subtle restructuring of gold as a reserve asset. Data from the **World Gold Council (WGC)** indicates that official-sector purchases are no longer episodic but instead reflect a sustained reallocation within global reserve management.

- 1. Scale and Persistence of Official Sector Buying** – Central bank gold purchases have reached levels not seen in decades, both in absolute terms and total demand. According to the WGC, global central banks have recorded **official-sector gold demand exceeding 1,000 tonnes annually** in recent years – a level that in our view is hard to reconcile with a purely cyclical interpretation of gold.

The demand is notable for three reasons:

- a. **Magnitude** - Annual net purchases are large relative to new mine supply, providing a meaningful structural bid to the market.
- b. **Persistence** - Buying has remained elevated across varying macro conditions, including periods of rising real rates.
- c. **Official Nature** – Unlike speculative flows, CB demand is typically long horizon and insensitive to short-term price fluctuations.

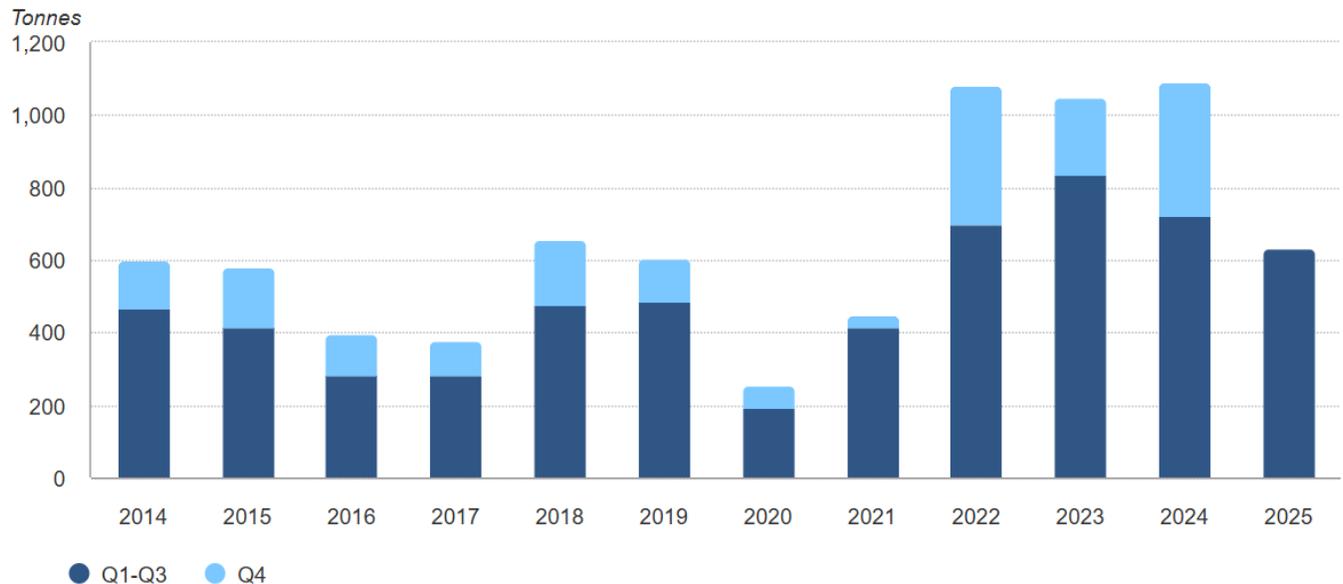


Chart 1: Global central bank gold demand (annual, tonnes)

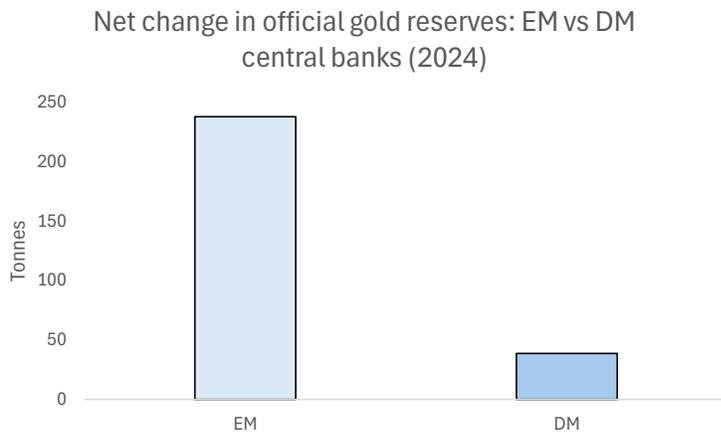
*Official-sector demand has remained persistently elevated since 2022, with annual purchases exceeding 1,000 tonnes—well above historical norms.*

Source: World Gold Council

2. **Emerging Markets as the Marginal Buyer** – The composition of CB demand has shifted significantly toward **emerging market reserve managers**, reflecting both economic and geopolitical considerations. WGC data show that EM central banks now account for a growing share of global gold reserves, reversing decades of under-allocation.

No single factor underpins this trend, as we see it reflects a combination of incentives facing reserve managers.

- a. **Reserve diversification** – EMs typically hold a higher proportion of reserves in foreign currencies, making diversification benefits more pronounced
- b. **Reduced reliance on USD** – Concerns around currency concentration and sanction risk have increased the appeal of neutral reserve assets
- c. **Domestic credibility considerations** – Gold holdings can increase balance-sheet credibility for central banks operating in less stable financial systems.



Net additions to official gold reserves in 2024 were overwhelmingly driven by EM central banks, which accounted for approximately 86% of net accumulation.

Source: World Gold Council; author calculations.

### Key Takeaways:

Net additions to official gold reserves in 2024 were overwhelmingly driven by EM central banks. EM institutions accounted for about 86% of net accumulation, underscoring the role of gold as a reserve diversification tool rather than a tactical response to short-term macro conditions.

This asymmetry highlights the structural nature of official-sector demand and reinforces gold's role as a neutral reserve asset in an increasingly fragmented financial system.

- 3. Implications for the Gold Market** - The rise of central banks as dominant marginal buyers has important implications for gold's long-term dynamics. Official-sector demand is typically less price-elastic than private investment flows, contributing to greater downside support during periods of market weakness. In turn, the strategic nature of reserve allocations suggests that this demand is unlikely to quickly reverse in response to cyclical macro developments. As a result, gold pricing increasingly reflects **structural allocation decisions** rather than purely speculative positioning. This shift in demand dynamics provides the foundation for gold's performance across recent market regimes and sets the stage for the macro constraints explored in the following section.

## Macro Regime: Debt, Real Rates, and Fiscal Constraints

While official-sector demand has become a key structural driver of gold accumulation, the macro environment in which these decisions are being made is equally important. Elevated public debt levels and persistent fiscal imbalances have materially constrained the range of feasible monetary policy outcomes, altering the long-run relationship between interest rates, inflation, and real asset performance. In this context, gold's opportunity cost has been structurally capped, even during periods of cyclical tightening.

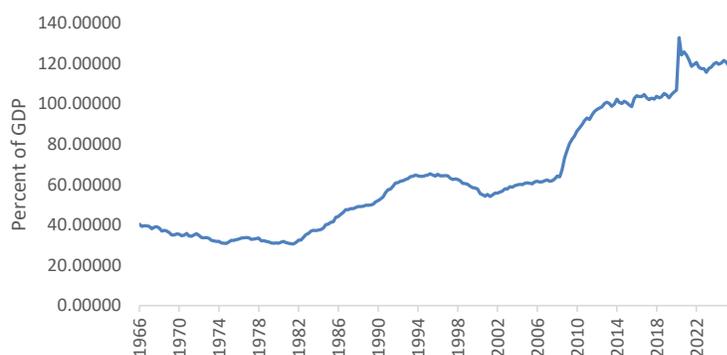
### Elevated Debt Levels and Fiscal Dominance

Public debt levels across major economies have risen sharply over the past decade and remain elevated relative to historical norms. In the US, the federal debt level now exceeds **120%** of GDP, according to data from the Federal Reserve Economic Data (FRED), with similar dynamics evident across other developed markets.

From our perspective, high debt levels matter for gold for two reasons:

- 1. Policy flexibility is constrained** – Sustained periods of high real interest rates materially increase debt servicing costs, raising political and fiscal pressures to limit restrictive policy.
- 2. Monetary policy becomes asymmetric** – Central banks can tighten temporarily but face strong incentives to ease during periods of economic stress.

Federal Debt: Total Public Debt as Percent of Gross Domestic Product



U.S. Federal Debt as a Percentage of GDP  
Source: FRED (GFDEGDQ188S)

These dynamics increase the likelihood that future policy responses rely more heavily on **financial repression or greater tolerance for inflation**, rather than sustained real-rate normalization. As debt servicing costs rise with higher real yields, policymakers face increasing incentives to prioritize economic and financial stability over prolonged monetary restraint.

Overtime, this shifts the adjustment burden away from real interest rates and towards mechanisms that erode the value of liabilities, reinforcing the appeal of assets that preserve purchasing power.

### Real Interest Rates and the Opportunity Cost of Gold

Gold has historically exhibited an inverse relationship with real interest rates, as rising real yields increase the opportunity cost of holding non-yielding assets. However, the current regime differs from prior tightening cycles. While real rates have risen episodically, their durability has been limited, reflecting both fiscal constraints and the sensitivity of financial conditions to higher rates.

Data from FRED show that **10-year real yields** have remained volatile and episodic rather than persistently elevated, even amid aggressive nominal rate increases.

The more important implications are:

1. **Temporary real-rate spikes do not invalidate gold's role** – Short-lived increases in real yields have not led to sustained gold underperformance.
2. **The distribution of future real rates has shifted lower** – Structural forces limit how long real rates can be maintained.
3. **Gold no longer requires deeply negative real yields to perform** – In a high-debt regime, stability matters more than outright real-rate suppression.

### Inflation Risk, Policy Trade-offs, and Asset Preservation

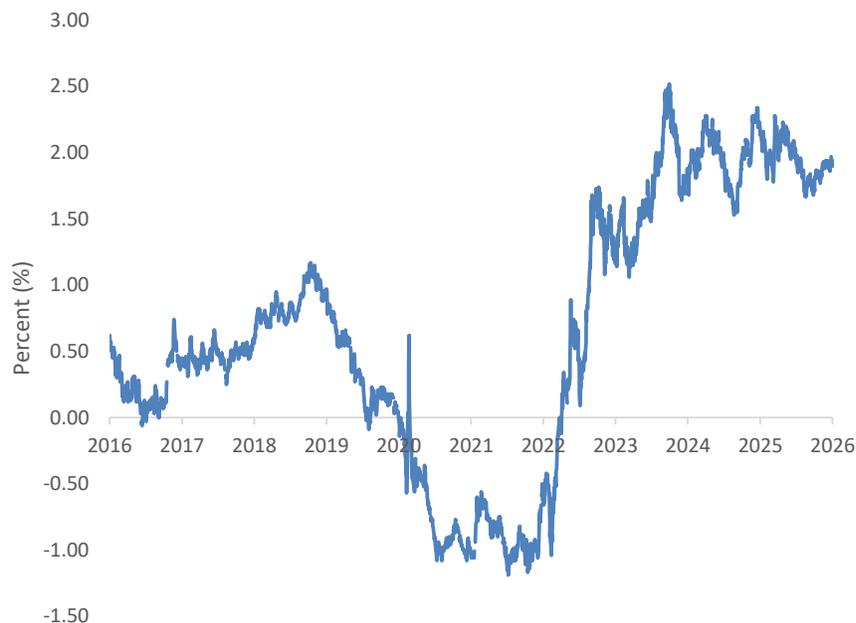
Persistent fiscal deficits and elevated debt levels increase the probability that future macro adjustments occur through **inflation tolerance rather than outright austerity**. While this does not imply near-term runaway inflation, it does suggest that policymakers face a narrower set of trade-offs than in prior decades.

In environments such as this:

1. **Financial assets are more exposed to policy volatility**
2. **Currency purchasing power becomes a secondary policy objective**
3. **Real assets with no counterparty risk gain strategic relevance**

Gold's independence from financial systems and lack of reliance on issuer credibility make it uniquely positioned in this regime.

## US 10-Year Real Yield



*Real yields have risen episodically but remain volatile, reflecting constraints on sustained real-rate normalization.  
Source: FRED (DFII10)*

### Implications for Gold's Strategic Role

When put together, elevated debt levels, constrained policy flexibility, and episodic real-rate volatility reduce the long-term opportunity cost of holding gold. Unlike prior cycles where real-rate normalization has functioned as a structural headwind, we believe the current regime suggests a more **bounded downside** for gold during tightening phases and a stronger response during periods of policy easing or fiscal stress.

This macro backdrop reinforces the case for gold as a **strategic allocation** rather than a cyclical hedge tied to inflation expectations or rate forecasts.

*These macro constraints provide the economic foundation for the official-sector behavior discussed in the previous section and set the stage for the geopolitical considerations examined next.*

## Geopolitical Fragmentation and Financial System Risk

Beyond macroeconomic constraints, the global financial system becomes increasingly shaped by geopolitical considerations that influence cross-border capital flows and reserve management. The use of economic and financial tools as instruments of foreign policy have altered the risk calculus for sovereign reserve holders, particularly in emerging markets. In an environment such as this, gold's proposition extends beyond inflation hedging to encompass **financial neutrality and system independence**.

### Weaponization of Financial Infrastructure

Over the past decade, reserve assets, settlement claims, and global payment systems have become more deeply integrated into geopolitical strategy. Reserve freezes, sanctions, and settlement restrictions have made this risk tangible for reserve managers.

This introduces a new dimension of risk:

1. **Counter party exposure** - Sovereign reserves held in foreign currencies or securities are ultimately claims on issuing jurisdictions.
2. **Settlement and access risk** - Payment systems and custodial arrangements can be restricted during periods of political tension.
3. **Legal and jurisdictional risk** - Assets held abroad may be subject to legal constraints outside the control of the holder.

Gold then exists outside of these frameworks, as physical gold bullion holdings are not contingent on access to payment systems, legal jurisdictions, or foreign issuers.

### **Reserve Fragmentation and the Search for Neutral Assets**

As geopolitical alignment becomes more fragmented, reserve portfolios are increasingly optimized not just for yield or liquidity, but for resilience under stress. This has driven a reassessment of reserve composition, particularly among EM central banks who face higher exposure to geopolitical spillovers.

Gold plays a very important role in this context:

- It is **politically neutral**, carrying no sovereign issuer risk.
- It is **globally liquid**, with continuous markets.
- It is **independent of financial infrastructure**, reducing exposure to capital controls or sanctions.

These attributes help explain why reserve diversification has favored gold rather than alternative currencies or digital instruments, which remain embedded within existing financial structures.

### **Implications for Portfolio Construction**

For private investors, the same forces shaping official-sector behavior have implications for portfolio construction. Geopolitical fragmentation increases the probability of tail events that disrupt traditional correlations across asset classes. In such scenarios, assets that are independent of both policy regimes and financial intermediaries can provide meaningful diversification benefits.

Gold's performance during recent periods of heightened geopolitical stress underscores its role as a **portfolio stabilizer** rather than a directional macro trade. While gold does not eliminate volatility, it can mitigate drawdowns during periods when financial assets are exposed to policy-driven shocks.

### **Strategic Context**

Importantly, the relevance of geopolitics to gold demand does not require persistent escalation or crisis. We think it reflects a **structural repricing of risk** in a world where political considerations increasingly influence economic outcomes. Even in periods of relative calm, the option value of holding neutral reserve assets remains elevated.

*Taken together, official-sector behavior, macroeconomic constraints, and geopolitical fragmentation suggest that gold's role within portfolios is evolving. The following section considers the implications for asset allocation, as well as the key risks and counterarguments to a sustained strategic overweight.*

## **Portfolio Implications, Risks, and Counterarguments**

The case for a strategic overweight allocation of gold rests on structural forces rather than short-term forecasts. However, no asset is without trade-offs, and a sustained overweight must be evaluated in the context of opportunity cost, volatility, and alternative sources of diversification. This section outlines the key risks to the thesis and explains why they do not invalidate gold as a long-term portfolio holding.

## Portfolio Role and Implementation

Gold's primary function within a portfolio is to mitigate and diversify risk rather than growth maximization. Its value lies in its ability to perform differently from traditional financial assets during periods of macro stress, policy uncertainty, or geopolitical disruption.

From a portfolio perspective, gold offers:

1. **Low correlation to risk assets** during stress regimes
2. **Protection against policy-driven tail risks**
3. **Diversification benefits when traditional hedges weaken**

A strategic allocation to gold is therefore best viewed as a complement to equities and fixed income, rather than a substitute. Position sizing should reflect this role, with allocations calibrated to improve risk-adjusted returns rather than to express directional macro views.

## Key Risks and Counterarguments:

### Opportunity Cost

A key risk of gold is its lack of yield, particularly during periods when real interest rates rise. While higher yields can create short-term headwinds, the current macro regime limits the sustainability of prolonged real-rate normalization. As discussed previously, elevated debt levels and financial sensitivity constrain how restrictive policy can remain, reducing the long-run opportunity cost of holding gold.

### Equity Outperformance

Another counterargument is that equities, particularly in growth-driven environments, might outperform gold over extended periods. This may be true in isolation, however, gold's role is not to outperform equities in all environments but to **preserve purchasing power and dampen portfolio volatility** during periods when equity risk is asymmetric.

### Valuation and Mean Reversion

Following a superior performance, concerns around valuation and mean reversions are valid. Gold can experience extended periods of consolidation or drawdowns, particularly when macro risks appear to recede. We are less confident about gold's short-term path than its long-term potential.

### What Would Invalidate the Thesis

A disciplined investment framework requires clarity around conditions under which a strategic overweight would no longer be justified. Key developments that could weaken the case for gold include:

1. **Sustained real-rate normalization**
2. **Reversal of official-sector accumulation**
3. **Meaningful reduction in geopolitical and financial fragmentation**

Absent these developments, the structural forces supporting gold are likely to persist.

## Conclusion

Gold's relevance within portfolios is evolving alongside changes in the global macro and geopolitical landscape. Elevated public debt, constrained policy flexibility, and increasing fragmentation of the financial system have altered the distribution of risks faced by both sovereign reserve managers and private investors. In this context, gold functions less as an inflation hedge and more as an **asset for resilience and diversification**.

While gold is not immune to volatility or opportunity cost, the balance of risk supports maintaining an allocation above long-run neutral levels. As such, we believe gold remains well-positioned as a core strategic holding within a diversified portfolio.

This conclusion reflects our own assessment of how structural constraints, rather than cyclical forecasts, shape long-term asset behavior.

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