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Alternative Investments

Do Precious Metals Shine? An Investment Perspective

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Abstract

The investment role of precious metals in financial markets is investigated by analysis of daily data for gold, platinum, and silver from 1976 to 2004. All three precious metals have low correlations with stock index returns, which suggests that these metals may provide diversification within broad investment portfolios. Moreover, the data reveal that all three precious metals have some hedging capability, particularly during periods of "abnormal" stock market volatility. Financial portfolios that contain precious metals perform significantly better than standard equity portfolios.

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central investment role in many countries, but platinum is normally used for industrial purposes and plays only a small role in investment activity. So, we included platinum as a control metal for comparative purposes.

This study differs from previous research in the area in several important ways. First, we examined the properties of precious metals in a global context by examining their relationships to both the S&P 500 Index and the MSCI Europe/Australasia/Far East (EAFE) Index. Second, our study covers almost 30 years of precious metal price data and includes the bull run of the late 1970s, the bear period of the 1980s and 1990s, and the strong performance of precious metals in the early 2000s. Third, we used recent improvements in volatility modeling to examine the hedging properties of gold, silver, and platinum within a time-varying context. Finally, by comparing the investment properties of gold and silver with platinum, we were able to differentiate the unique investment characteristics of gold and silver from that of their industrial counterparts.

We found that all three precious metals have low correlations with the S&P 500 and EAFE, which suggests that they have the potential to provide diversification within broad-based investment portfolios. Moreover, and most importantly, all three precious metals have some hedging capability, particularly during periods of "abnormal" stock market volatility. The real benefits of holding precious metals come during periods of market uncertainty but not necessarily in market downturns. From a risk management standpoint, precious metals are possible alternatives to financial derivatives and are clearly of more importance in those countries where derivative markets in equities have not been established.

An examination of precious metals as part of a broad-based equity portfolio shows that their inclusion can be of great benefit. Including precious metals in a passive buy-and-hold strategy is more efficient than following the market. Furthermore, our results suggest that precious metals can be used as a hedge against market risk. Finally, our international analysis suggests that the benefits of holding precious metals are higher than is seen in the United States.

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