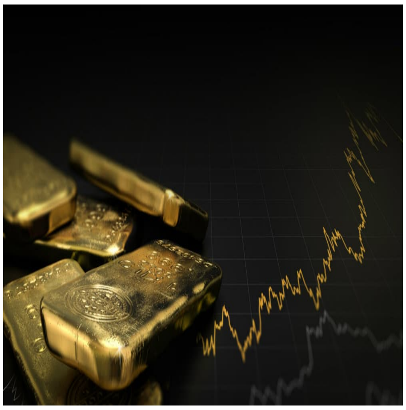

Relationship Between Gold and Oil Prices: Why There's a Big Disconnection in 2020

Description

There's an interesting relationship between gold and oil prices. According to *Market Realist*, which provides institutional-quality market research, more than 60% of the time, gold and crude oil have a direct relationship.

This means that when gold prices rise, crude oil prices also tend to rise, and vice versa.

Right now, there's a big disconnect between gold and oil prices. The gold price in U.S. dollars has appreciated 35% in the last 12 months against the WTI oil price falling by half.

Gold Price in U.S. Dollars data by YCharts. Long-term normalized price changes in gold and WTI oil.

To better understand why there's massive decoupling between gold and oil prices, let's first talk about the gold standard.

The gold standard

In human history, there were different forms of payments. One of them was using precious metals like gold and silver as a currency. However, it got to a point where it was too much of a hassle to carry metals around. So, paper money was eventually introduced for convenience.

Under a gold standard, paper money was worth a certain amount of gold, and it was backed by a country's gold reserves. Governments on these standards could not freely print money, because the money must be backed by the equivalent value in gold.

Britain, Canada, France, Germany, and the United States were examples of nations that used a gold standard sometime in their history.

No country uses a gold standard right now. Instead, we use fiat currency, which is more convenient but is not backed by a physical commodity (like gold) that has intrinsic value.

Why the gold price keeps rising

There have been unprecedented levels of money printing around the globe for reasons, such as economic stimulation. Moreover, inflation reduces our purchasing power over time. Therefore, $1 today is worth much less than, say, 20 years ago.

According to the Bank of Canada, the inflation rate (or decline in the value of money) has been 1.83% since 2000. So, a basket of goods and services that costs $100 in 2000 now costs $143.60, or 43.6% more.

The gold price tends to increase over time with inflation. However, the price of gold tends to rise more when there's high uncertainty in the economy.

The COVID-19 pandemic has infected more than 5.6 million people across 188 countries. And as businesses reopen progressively, there will be subsequent waves of the virus.

The upward trend in the gold price is still intact. Since money printing continues, we're not out of the woods with COVID-19, and high debt levels are weighing on the economies, the trend is likely to continue for some time.

What to invest in if you're bullish on gold

If you agree gold prices will head higher or you simply want gold exposure as a hedge in your diversified portfolio, consider buying some **Newmont** or **Franco-Nevada** shares. The stocks just dipped about 15% and 9%, respectively, from their highs. So, it's a good time to nibble.

Newmont expects to produce about six million ounces of gold this year with all-in sustaining costs of US$1,015 per ounce versus the gold price of US$1,755 per ounce. Management expects Q2 to be the lowest production and highest cost quarter of 2020, as the sites ramp up from care and maintenance. So, there could be another dip in the stock come August.

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