Gold, S&P and the Euro: Correlations Revisited

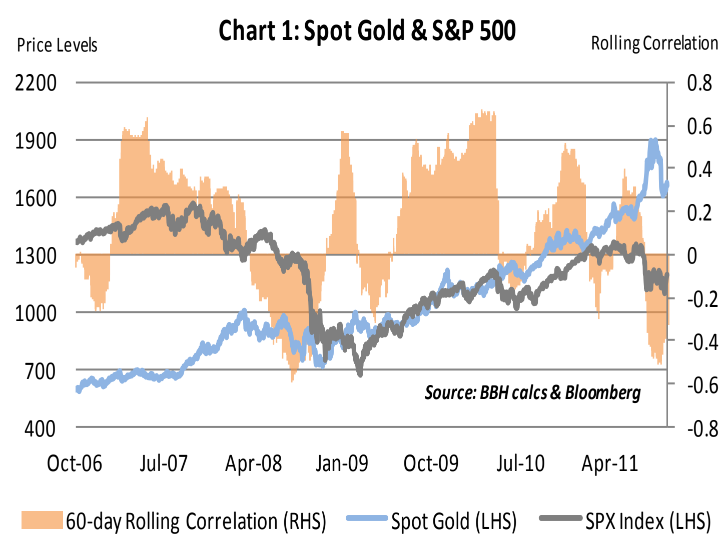
The elevated volatility levels have made for difficult times for many investors. To simplify the complexity, there is much reference to risk-on and risk-off. We look at the correlations (60-day rolling correlation of the percentage change) between gold, S&P and the euro and find a more nuanced and varied relationship than many intuitively assume.

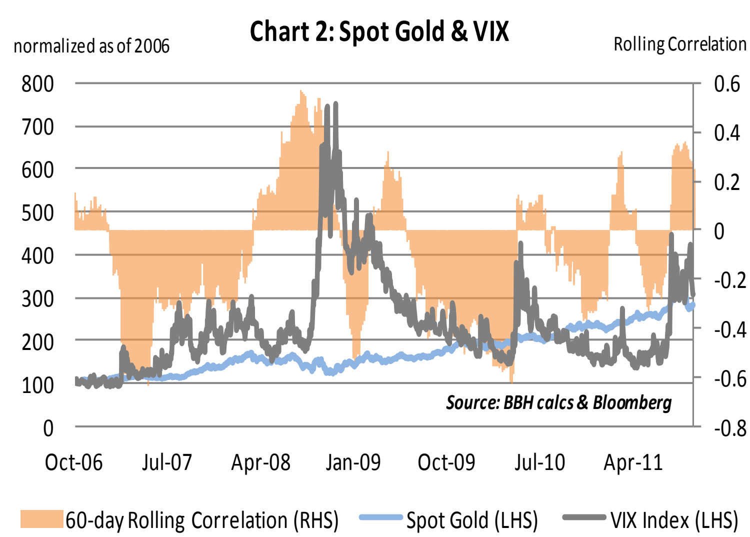
Gold and S&P

Gold is often portrayed and regarded as the ultimate safe haven. It offers, its advocates opine, a superior store of value, which is all the more important as central banks monetize debt and debase their paper money. The S&P 500 is the opposite. Rising US share prices is sign of investors taking on more risk. As the pendulum of market sentiment swings from risk-on to risk-off one would expect gold and the S&P 500 to move in opposite directions. We look here at 60 day rolling correlations conducted on the basis of percent change.

Yet since 2006, the gold and the S&P 500 have been mostly positively correlated (Chart 1). Indeed the highest correlation of the decade was recorded last May at about 0.66. Every year for the past five years, gold and the S&P 500 do spend a period inversely correlated. The two are inversely correlated now and have been since the start of August. This is the second period of inverse correlation this year, which is itself unusual. The first period was from mid-Feb through late April, reaching an extreme of about -0.25. This second period has been deeper and looks to last longer. In early Sept the correlation stood at -0.51 and now is near -.32.

Under the risk-on/risk-off rubric one might expect gold to be correlated with the S&P volatility – i.e., the VIX. Since the onset of the financial crisis, spot gold and the VIX have been mostly inversely correlated even though they have spent some time every year positively correlated (Chart 2). This year, in January and into February, the two were inversely correlated. Then they were positive correlated from early February to late April and then inversely correlated until early August. Since mid-August, the positive correlation has been fairly stable between 0.20-0.30. The inverse correlation between the S&P 500 and gold and the positive correlation between the VIX and gold currently seems reflective of the elevated nature of the crisis.

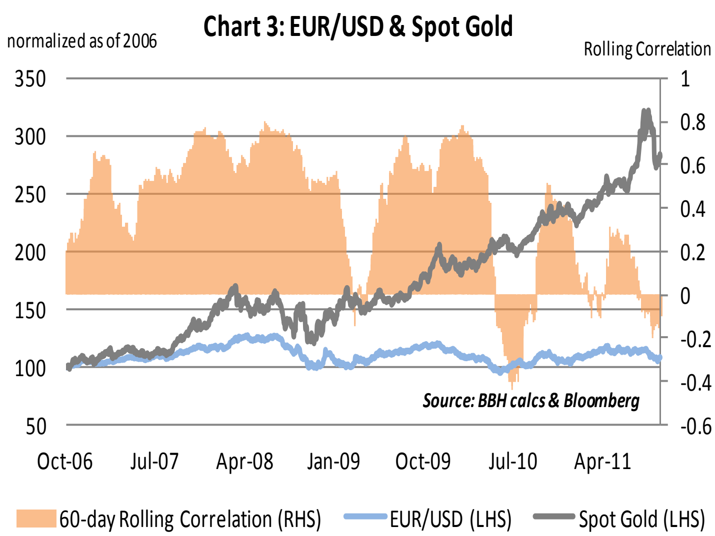


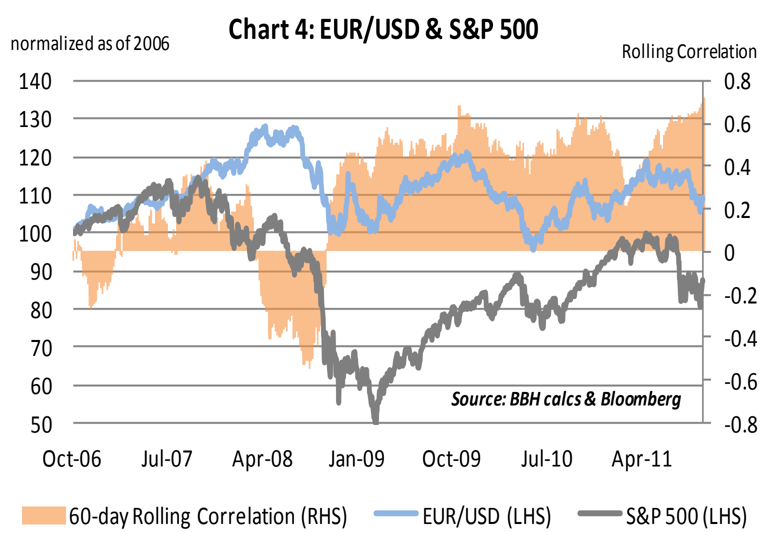


Euro, Gold and S&P

The euro tends to be correlated with gold prices (Chart 3). The 60-day rolling correlation was positive from 2003 until early 2009. The euro was inversely correlated with gold in March-April 2009 and then again from May through September 2010. This year from February through late April, the two were inversely correlated and more recently, since August, gold and the euro have tended move in opposite directions. When the two are positively correlated, ideas that both the yellow metal and the single currency are alternative to the US dollar make some intuitive sense.

The inverse correlation warns of a more nuanced relationship and would seem to underscore the fact that Europe is the eye of the current storm. From roughly 1995 through 2003, the euro (synthetic before 1999) and the S&P 500 were inversely correlated with few exceptions. Since 2004, the correlation has been mostly positive, with brief exceptions through 2007 (Chart 4). From March through September 2008 the euro and S&P were inversely correlated. However, since Lehman's demise, the rolling 60-day correlation has been positive and fairly stable between about 0.3 and 0.6. However, the correlation today is just below 0.72, which is the highest since at least 1992, when our data series began.





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