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H.B. 348 Specie Legal Tender Amendments

WHY UTAH SHOULD INVEST UP TO 10% OF ITS RAINY DAY FUNDS IN GOLD

Gold can play an important role in diversifying long-term investment portfolios, like the State's Rainy Day Funds (RDFs). Inflation and government securities—due to accumulated federal borrowing—represent potentially more important risks today. The RDFs are heavily invested in government securities (~80% in the Public Treasurers' Investment Fund (PTIF)). These have long been considered risk-free or near risk-free assets. However, the creditworthiness of the federal government is not what it once was, particularly as interest payments balloon (Fitch last year joined S&P Global's move 12 years ago in downgrading U.S. government debt).

While gold can benefit long-term investments, physical gold is not ideal for short-term portfolios like those governed by the Money Management Act, including the PTIF, for two primary reasons:

1) Moderate liquidity profile: Physical gold is a less liquid asset. Logistics lengthen the time before gold could be exchanged into dollars. However, demand remains robust globally from different buyer types (jewelry, coins, bars, bullion).

2) Volatility: Gold is volatile relative to the dollar in the short term but tends to perform well during recessions.

RDFs are unique investment pools. They are long-term in nature with a need for liquidity on short notice, more likely during times of financial stress. This precludes equity and illiquid investments like private assets. RDFs are currently invested in the PTIF, which meets the liquidity needs. All securities in the PTIF have counterparty risk (the risk of not being paid back). There are few assets that can play a complementary role to the PTIF in the RDFs. Physical gold is one such investment. Because of the unique nature of RDFs, this bill only addresses those funds, not the Money Management Act broadly.

REASONS TO CONSIDER A LIMITED ALLOCATION TO GOLD:

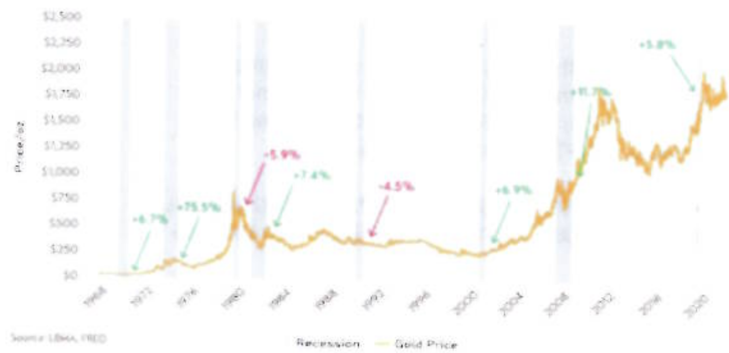
1) No counterparty risk: Physical gold held in secure custody is one of the few financial assets with no counterparty risk (risk of not being paid back).

2) Market disruption hedge: Gold has generally performed well during recessions when RDFs are more likely needed.[1]

3) The Bank for International Settlements (BIS) which oversees global financial regulations upgraded banking standards that recently went into effect reclassifying physical gold as the highest form of reserve asset. Central banks around the world are accumulating physical gold. US treasuries may not always be the safest asset.[2]

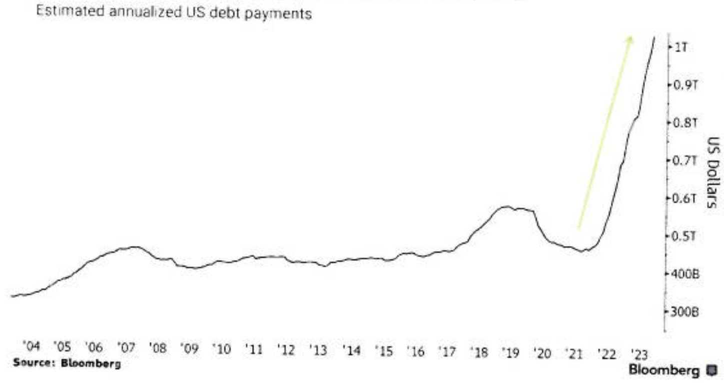
4) Precious metals tend to do well when people are concerned about losing real value from cash and government bonds, that is, when inflation expectations outpace nominal yields. This scenario could be sparked by government borrowing necessary to refinance debt at higher yields resulting in higher interest costs that leads to more borrowing to cover the higher costs.[3]

GOLD DURING RECESSIONS



COST OF US DEBT PILE SURGES

Estimated annualized US debt payments



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[1] Chart: https://www.forbes.com/sites/cme-group/2023/06/02/how-does-gold-perform-with-inflation-stagflation-and-recession/?sh=53d9c95bf324,accessed February 13, 2024.
[2] Basil Committee on Banking Supervision, "The Basil Framework," Bank of International Settlements. Page 246.
[3] Chart: https://sponsored.bloomberg.com/article/investing-in-gold-is-gold-still-a-good-inflation-hedge-in-a-recession-, accessed February 13, 2024.

GOLD TENDS TO PERFORM WELL DURING RECESSIONS

Not many assets perform well when a withdrawal is needed from the RDF. Yields on securities like those held in the PTIF tend to fall, as do equity markets and other risky assets. Gold is one of the few assets that move countercyclically when hard economic times emerge.

Physical Gold	Short-term Government Securities
⬇ Less liquid market	⬆ Highly liquid market
⬇ Volatility relative to dollar	⬇ May not keep up with inflation expectations
⬆ Considered risk-free asset	⬆ Considered risk-free asset
⬆ **No counterparty risk**	⬇ **Counterparty risk**
⬆ Central banks increased buying	
⬆ **Tends to perform well in economic stress**	⬇ Yields typically fall during recessions

In the case of an economic crisis, having access to physical gold could be important. We would have access to the asset, not just the value of the asset. Liquidity, while historically lower, would likely only temporarily slow down the ability to convert to dollars. Additionally, because this is only a portion of the State's RDFs, the risk from illiquidity is muted.

GOLD DIVERSIFIES PORTFOLIO RISK

Gold prices are uncorrelated with 3-month T-bills, the proxy used for the PTIF. From October 2019-March 2021 (capturing the COVID-19 market disruption), daily price changes between gold and 3-month T-bills correlated 0.03, nearly 0. The chart to the right shows the rolling 3-month correlations over that period.

THE REMAINDER OF THE STATE'S RAINY DAY FUNDS WOULD BE INVESTED IN THE PTIF

Up to 10% of the RDFs invested in precious metals would be exempt from the Money Management Act. The remainder of the RDFs would be invested in the highly liquid PTIF, as is current practice.

INVESTING 10% OF RAINY DAY FUNDS IN GOLD WILL NOT MATERIALLY AFFECT STATE'S BOND RATING

The State's municipal advisor has determined that investing up to 15% of the State's RDFs in gold could reduce liquidity ratios.

However, the municipal advisor does not believe this will have a material impact on the State's bond ratings, all else equal.

OTHER STATES ARE CONSIDERING GOLD

Other States working on gold bills include Arizona, Arkansas, Alabama, Florida, Indiana, Iowa, Missouri, Oklahoma, South Dakota, Tennessee, Texas, and Wisconsin.

The work performed by other states would be considered during a precious metals study.

ROLLING CORRELATION

GREAT FINANCIAL CRISIS CASE STUDY