SM227 | 4.19.2025
Gold for the 21st Century | Episode 4
Don Casturo, Founding Partner & CIO, Quantix Commodities

We continue *Gold for the 21st Century* this week with Don Casturo, Founding Partner and Chief Investment Officer at Quantix Commodities. David Greely sits down with Don to discuss the role of gold in protecting investors' portfolios, the drivers of recent gold market performance, and how de-dollarization is changing the way gold trades relative to other assets.

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Announcer (18s):
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David Greely (01m 06s):
Welcome back to Gold for the 21st Century on SmarterMarkets. I am Dave Greely, Chief Economist at Abaxx Technologies. Our guest today is Don Casturo, Founding Partner and Chief Investment Officer at Quantix Commodities. We will be discussing the role of gold in protecting investors' portfolios, the drivers of recent gold market performance and how de-dollarization is changing the way gold trades relative to other assets. Hello Don. Welcome back to SmarterMarkets.

Don Casturo (01m 36s):
Thank you Dave. Great to be here.

David Greely (01m 38s):
Well it's great to have you here. You know, so far on this series we have been discussing the role of gold in the financial system and I'm glad to have you here with us to talk about the role of gold in investor portfolios. As people will remember, you're the chief investment officer of Quantix Commodities where you provide investors with commodity investment products designed to protect their portfolios from inflation and I was curious, how much interest are you seeing from investors in protecting their wealth from inflation and how has that been changing since you started Quantix I think that's about six years ago.

Don Casturo (02m 15s):
Yeah, it's been a bit of a rollercoaster over those six years. We were onto the theme of inflation becoming relevant and after years of basically irrelevance with how low inflation was for over a decade But we felt that we were at the end of the economic cycle where such output gaps were going to be decreasing and they were going to see some pressure on the commodity sector in particular that could lead to inflation and indeed coming out of the pandemic, that was definitely the case and there was quite a bit as you, as you're well aware of inflation fears, not only in actual CPI numbers, but inflation fears that were running rampant in 21 and 22. Those kind of came, were put on the back burner a little bit for the last couple years, but we are definitely seeing the reemergence of inflation spheres now. You can see it in consumer expectations of inflations being as high as they were even back then and we are hearing it amongst our investors that inflation definitely is a concern once again.

David Greely (03m 15s):
And I know your approach, you tend to distinguish different types or sources of inflation, whether it's, you said output gaps tightening and economic cycle pressure versus currency debasement. How are you thinking about that? In the current environment?

Don Casturo (03m 30s):
We aim to provide in commodity inflation protection on our broad basket sort of level. So I know this series is focused on gold in particular. Goldfield plays a very important role in our approach, but not the only role. I mean we, we are by no means precious only fund. We are a broad basket commodity fund and we feel the best form of inflation protection sort of incorporates the whole commodity spectrum because in my discussions with investors over the years and, and my belief personally is that there are different sources of inflation that matter to investors and that when investors are concerned about it and that comes through with conversations with them, many of them would say, should I buy oil or should buy gold? And it occurred to me like, wow, those things have completely different characteristics. How can investors think they are both appropriate as inflation vegs?

Don Casturo (04m 13s):
The reality is it's the different forms of inflation that they are worried about, which is why a, we think a, a dynamic re-weighting of a broader commodity basket is probably the most appropriate approach and that's what we have implemented with the way we've created our, our long only basket commodities. But basically the premise is if you're in an environment where inflation's being driven by a deficit in things people consume, you are going to want to own those consumable commodities because the only way to address that is to try to encourage more supply or less demand by raising the price of those consumables. If the thing that's driving inflation is general I store of value, I think everything's going to cost more a year from now and most commodities, certainly all the ones that we would trade in the liquid benchmarks are denominated in US dollars. So that's particularly the case if you think the dollar is gonna have less purchasing power, you want to look at the commodities that are a good store of value and that's where gold fits in. Now you mentioned the word debasement, that's how we, when we originally came up with this framework, we were describing this wave biding process to through the lens of scarcity versus debasement. We have sort of broadened the definition of debasement, how to include de-dollarization because I think that's more of where the driver of wanting to look at commodities, gold in particular as a store of value is coming from that than you know, rampant money printing so to speak, that it might be characterized just solely by the strict definition of debasement.

David Greely (05m 44s):
And I would love to go into that de-dollarization piece a little bit, right because it's one of those things that people have talked about for decades and then you don't see it and you don't see it. But I think many people think this time might be different. Is that the sense of the conversation you are hearing?

Don Casturo (05m 58s):
Yeah, absolutely and I think the interesting things that have been happening in treasury markets sort of tell you that there is something to this de-dollarization thing that's more than just gold prices rally and central banks buying it a little bit more than they historically have for the last couple years. If it's a company not, not only by buying gold but you are actually even seeing signs of selling treasuries, the implications for gold could be enormous in that respect.

David Greely (06m 23s):
Yeah, and I wanted to ask you about that. Could you go a little bit more into that, what you are seeing with how gold is trading against other assets like treasuries or dollars? Is that changing relative to previous patterns?

Don Casturo (06m 35s):
Absolutely many gold market observers, banks have put out models historically you could fairly accurately with a high progression coefficient model, the price of gold off of real rates and obviously inversely correlated. The higher the real rates go, the lower gold are go and vice versa. Those models have suffered and don't really work well at all over the past several years basically since the Russian invasion of Ukraine. US response to that was to use the dollar as a weapon and not only when it was Russia concerned about that, but other essential banks seeing that the power the US may choose to employ his world's reserve currency by using the dollar as a weapon has sort of moved those central bank in the desire to move away from that and even when you saw real rates rising while the Fed was raising rates in the last episode, gold continued to rally and that historically would've been unusual but that is a very telling sign I think as to what a new input into the modeling of gold price needs to include, which is this desire to move out of dollar assets into something more neutral the country, less currency of gold.

David Greely (07m 41s):
And I know you have said you have a broad basket of commodities that you use to help provide inflation protection. How do you see gold's role in that and how much gold do you put in that portfolio?

Don Casturo (07m 53s):
Well a key feature of our process is this dynamic re-weighting, like I said AI, it's not a static weight that gold holds X amount overall time and we have some proprietary signals to try to identify what is the bigger driver, whether it is the scarcity, the debasement element and that actually takes the gold weight somewhere in our modeling somewhere between anywhere between five and as high as 50%. So it can have a, a very wide range depending on what, you know, what our signals are telling us, where we are.

David Greely (08m 24s):
Able to share where you are at now?

Don Casturo (08m 26s):
So we're closer to the higher end of that range. The majority of the signals are telling us it's a better environment for gold than the consumable commodities. Not at max, not at the max weight but towards the higher end.

David Greely (08m 38s):
Fair enough and I know you approach gold from more of a macro trading perspective, so I wanted to ask you, you know, how are you thinking about the way gold's been performing in the context of the broader macro environment?

Don Casturo (08m 52s):
So performing basically every other asset year to date, even over the past couple of years with phenomenal equity performance, gold has pretty much kept up. So I think every investor has to seriously consider at least some allocation, maybe not as high as our corn commodity basket has for it, but at least some allocation to gold makes sense on just relative performance basis.

David Greely (09m 17s):
It's pretty amazing to think given the strength and equities in recent years that gold's kept up. Have you seen that before in your career?

Don Casturo (09m 26s):
No, no, as I said, I think that's a very telling statement in terms of the global mindset of gold and how that has shifted.

David Greely (09m 35s):
When you look across the type of people, I don't know how much visibility you have into it, but do you feel like new and different types of investors or banks or central banks are participating more in the gold market than they used to?

Don Casturo (09m 49s):
One of the things that is on in our investors' minds that is a fear that they may have missed out like because gold is at all-time highs and the size of the daily rally seemed to be outsized of historic moves that it's a sign of a speculative bubble and one of the things I, I tell those investors seeing I think that they should be much more concerned about that if the buying was coming from the majority of the buying and the reason we were at this level was purely from the speculative community because that speculative community tends to be a little higher frequency is sensitive to pullbacks and maybe has risk metrics that force them to reconsider and rebalance their portfolios on a stop loss sort of basis but given that the primary buyer that has emerged and has changed the models for gold pricing that I alluded to earlier has been central banks, their modus operandi and trading dynamic is completely different as we've discussed in the past.

Don Casturo (10m 42s):
They invest in divest on decade long cycles and you know, we are in the very early innings of this central bank asset reallocation and if they were the primary buyers, if they wake up tomorrow and gold's down a hundred dollars for example, they are not gonna panic sell. I feel quite confident they're going to want to buy more in that scenario, which I think makes it a much more stable rally than something you might have seen in the past where commitment of traders is showing excessive gold length or the ETFs at all-time record highs. Neither of which are the case by the way either though. I will make one comment on that that I think is overlooked by a lot of people. Yes. ETF and managed money length from a contract or ounce basis is not even at all-time highs and you know it's above the 50 percentile on a dollar notional basis, it's at all-time highs. If you are looking at an ounces, it doesn't seem that stretched. But when gold prices are twice what they were the last time ETFs were this well owned, obviously that means there is a lot more dollar ownership.

David Greely (11m 49s):
Are you seeing a response in the physical market? Like are the physical buyers having to back off at these higher price levels? You said the central banks are still in?

Don Casturo (11m 59s):
Jewelry demand is off a bit. So when you say physical buyers, gold is not really consumed. I mean it's, you could argue jewelry isn't even consumption too because that can be resold and scrapped back into the market. Jewelry demand is off a bit and scaring some of those investors away, but it's overwhelmed by the amount of central bank buying that you are seeing and what I think is encouraging for the gold story though it does put introduce a little bit more a hundred dollars pullback risk is the fact that financial investors non-central bank like the public sector financial investors has actually started to come back into the ETF despite the fact that it's at all time highs like the price of the ETF.

David Greely (12m 39s):
Yeah and I was thinking when you think about investing in gold, how do you think about doing it through gold futures versus an ETF versus physical gold?

Don Casturo (12m 49s):
We tend to go for the easiest source of execution, which happens to be COMEX gold. Now that's an interesting question lately because of the introduction of tariffs, there has been a basis market for gold where gold was not actually trading at the same price globally. Normally it's, it's tight in a very tight range. It's totally fungible. Yes, the gold bars are a different size in some locations so you have to melt it down and resize it. But that's an easy process with the exception of the pandemic where those plants were closing down and you couldn't move it around. It's not difficult to make gold fungible globally, but tariffs have challenged that now too and the fact that there was some fear that there would be a tariff put on gold coming into the US which caused some dislocations between what I would say is the more easily traded COMEX contract and the more OTC gold locations globally.

Don Casturo (13m 40s):
So that's a consideration. You want to look at that. That has largely been priced out now because gold has been exempted outside of that we tend to just trade COMEX because it's the easiest. I think there are physical buyers out there. We are not a physical buyer. I have heard in the past people will do that because yeah that's real fear factor. Like I actually want to know the gold is in my own vault or my own safe somewhere if that's where the world is going. I am not even sure, you know, borrowing gold is going to be your top concern.

David Greely (14m 12s):
I wanted to ask you because you know at Quantix you also look to create alpha for investors in the gold market in the other commodity markets. Like are you seeing any interesting relative value traits in gold or other types of trading strategies that have become appealing in this environment?

Don Casturo (14m 30s):
Well one thing that's related to what I just talked about in terms of tariff factor is that because COMEX Gold was starting to trade at a premium with the idea that if there is a tariff charge attached to gold, it's going to be more expensive in the US than it is globally. Prior to that tariff ever being put in place, just the fear of the tariff was creating a differential between the COMEX price and London Gold while before there was any tariff in place, which is incentivizing massive amounts of gold to be sent to the US because it's like wow, I, there's no tariff yet I can buy it here, ship it there for less than a differential. So the future and just deliver in. And quite a lot of that actually had occurred over the last several months, which means COMEX gold inventories like those that are on the COMEX Exchange have exploded and that gold needs to be financed.

Don Casturo (15m 17s):
Somebody needs to be paying for the fact that that's just sitting in COMEX Vaults. Historically investment banks have done that but I think they have reached their capacity of doing it and now it's searching for other forms of financing and those other forms of financing are demanding a higher price in order to do that. So the Contango between spot gold and the second or third nearby future actually has a yield to it that's higher than treasury risk-free rate. So yeah, that's an interesting trade. Something we actually do for our investors. Excess collateral for the cash management and I think that's the sort of buyers that that dynamic has been forced to find. Like because investment banks typically do it are sort of full on that trade. So it's getting a little better yield for people like us.

David Greely (16m 04s):
And I am curious, how do you think that may play out given we have kind of got this large inventory of gold now in on COMEX that doesn't really need to be there?

Don Casturo (16m 14s):
I think eventually the world global inventories will renormalize because if you are not holding the physical gold, you don't want to be paying that larger carry, you might move it back, but for now we'll take the excess yield and you know, there's really, it's, it's a risk free trade. Like if it does move back and the spreads tighten, you don't lose any money having done that. You just get to mark to market the gain rather than having to carry it to expiration. I think eventually yes those spreads will come back to more normal dollar rates but dollar we will see how long that may take.

David Greely (16m 46s):
And I wanted to ask you kind of looking at the broader commodities, right? You have got an environment where gold's been going up and hitting new highs at the same time you've got crude oil and energy falling. How do you think about, you know, just the broader commodity landscape right now?

Don Casturo (17m 02s):
Longer term not just gold but other commodities have a better story than the rest of the 60 40 portfolio and you know, I think post the Rose Garden you saw panic selling in everything. Even gold was down $150, $200 from where it was trading in in the days leading up to the rose garden tariff speech. But you look at a day like today equity markets are off 3% and basically I am looking at my commodity screen, it's a sea of green, you know, I think, and it's not just gold, gold obviously is leading the charge up 3.5%, but even oil and agriculture and base metals are all up today because I think investors are becoming a little more, a bit more disciplined about where we might be leading with this. And, and I and what I think is supportive of the other commodities is not demand because I acknowledge that a trade war is not super bullish global growth and consumption. But the other thing that was a characteristic of the low inflation periods of and global free trade was global free flow of capital. And that capital was helping resupply commodities everywhere. It was just encouraging investment in commodity supply, which I think is going to be challenging and quite tougher to get going forward. So the supply side story for commodities I think is over the coming years is gonna be pretty interesting.

David Greely (18m 26s):
I wanted to get your wider perspective because obviously you have been deeply involved in commodities markets for a long time. Partner at Goldman Sachs around commodities there. Does this current market environment remind you of any other markets environments you have been in or is this a new thing?

Don Casturo (18m 43s):
Our former colleague Jeff Curry, who definitely was was keen to be talking about supply side, lack of reinvestment, revenge of the old economy type story. So my theme has been out there at various points during my commodity history. I think this time is a, it's a little bit different driver, it's the same theme but the driver of that theme, we haven't had the potential for this much deglobalization and lack of free trade, lack of free flow of international capital like in a century.

David Greely (19m 12s):
It's astounding it really is and how much do you think investors are recalibrating around that you know are they seeing this as like we need to make small changes or is this like a broader rethink of asset allocation of the whole thing?

Don Casturo (19m 31s):
So I think investors are still in the shock phase. Like the policy ping pong has been so exhausting for everybody that I am not sure enough investors have really thought this through to where the end game is yet for now they are like, I am exhausted, I am just moving to the sideline. Which in and of itself is bearish. Like being on the sideline means you are not putting capital to work. But I don't think they have actively thought about, okay I may never get to put capital work or I may never feel comfortable putting it to work and where that could actually lead markets. So, you know, I think the direction of travel still has a way to go on that basis.

David Greely (20m 09s):
So I got to ask you, are there any interesting opportunities or dislocations you are seeing across commodity markets outside of the gold market?

Don Casturo (20m 18s):
And they have been using the phrase throwing the baby out with the bath water. As I said that after the rose guard and everything went red, there is probably some things that didn't need to go red gold is one of them, which just bounced back very hard. I think another interesting commodity actually, one that is even down today is natural gas. There is increased LNG that's trying to globalize that market, but largely it's still a geographically isolated market that should be relatively free from what, what's going on in the Terra 4. It was a well owned themed trade to be long backend NAC gas because LNG supply is increasing. I think that hitting the sell button forced a lot of that speculative length out of the nag gas curve but now we are prices that are quite frankly below incentivizing reproduction while we actually have a, a demand off taker and increased LNG, which has already been committed. I think nag looks interesting right now.

David Greely (21m 14s):
And I was curious because everybody follows, you know, the VIX as it went higher and higher and kind of understand what that means for equity markets. What does it mean when you get that level of VIX and anxiety? What does that mean for how commodities trade?

Don Casturo (21m 28s):
It's bullish long term because you start getting people thinking about a more diversified portfolio mix in some genuine diversification and desiring to get some uncorrelated assets in their portfolio. The immediate impact of it is similar to what we saw again after Trump's traffic speech was, you know, sell everything. But as we are getting more clarity about what should really be sold and what should not be sold and where am I gonna put dollars to work, I think it's already starting to show up that commodities are, are a beneficiary of a high vex.

David Greely (22m 00s):
And I wanted to ask you now that commodities and gold are getting a look from investors who may not have been giving it a look in a little while, what do you think an investor who is new to the commodity or you know, the commodity or gold space and is looking at it for the first time in a while, what do you think they need to know or what questions should they be asking?

Don Casturo (22m 20s):
I think they need to know less than they used to know which is a good thing because if you go back to like when we started our careers, you really had to have a futures trading account, which very few investors did to really get access to commodities. I mean, one of the things that has happened with the advent of ETFs, they have made many asset classes more accessible and in a safe way. I mean they, there is professional managers that know how to trade these future markets and know where, where the implications of trading futures markets are and not having to get caught taking physical delivery of anything. That manager can take care of that for you put in a wrapper that's more accessible to the general public. If you have an equity account, you can trade an ETF that can give you commodity exposure and I think that that's a good thing for investors to have it more accessible.

David Greely (23m 07s):
And last thing I wanted to ask you, going back in this podcast series, we have been talking about the role of gold in the 21st century and I am curious what do you think the role of gold should be in investors' portfolios and what do you think we need to do to make that point of view more mainstream than it's been?

Don Casturo (23m 28s):
Even relative to something like crypto, which gold gets compared to is it competing with crypto or not? I think the thing that is attractive about gold in general is just its longevity. It has been a form of value for thousands of years, far out dating any fiat currency and I think of this period where global trade dynamics are going such a violent and potential incredible disruption that the attractiveness of something that has been around that long should be pretty obvious to everyone and you know, that's how I would differentiate it from crypto. You could argue crypto is a country less currency too, but it does not have the longevity going for it that like that that should give investors comfort like, hey, however this ends up, gold is still gaining be around because it's been around forever. I can re-decide what I want to use my gold with at the other side of the tunnel. But right now, while I am in that tunnel and I don't know where it ends, gold seems like a pretty safe place to put your money.

David Greely (24m 30s):
Thanks again to Don Casturo, Founding Partner and Chief Investment Officer at Quantix Commodities. We hope you enjoyed the episode. We will be back next week with another episode of Gold for the 21st Century. We hope you will join us.

Announcer (24m 45s):
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