WHAT'S HOT: GOLD GETS A SAFE-HAVEN BID AS BANKS SHAKE CONFIDENCE

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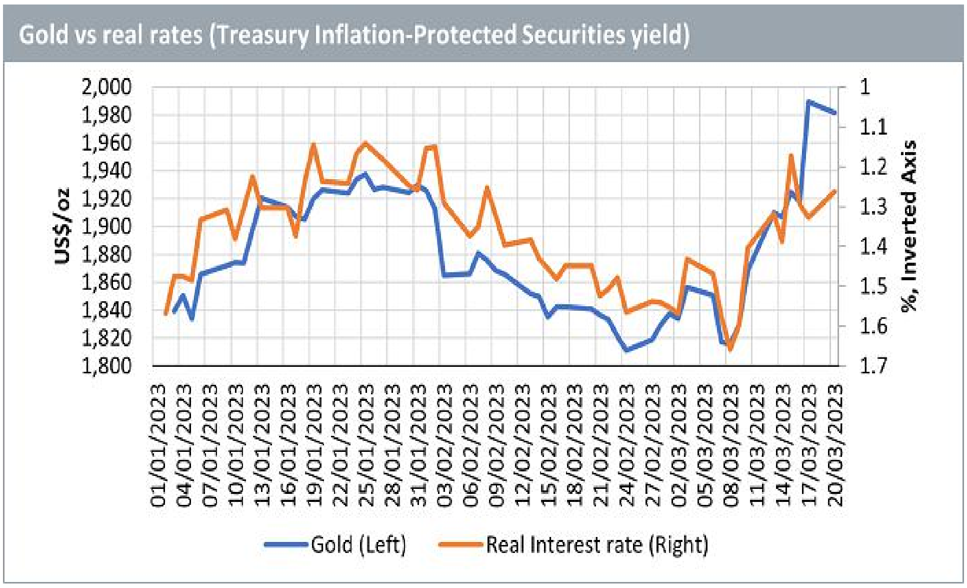
Investors turn to gold amid SVB collapse

Financial markets were sent into a tailspin on the news of Silicon Valley Bank (SVB) imploding. Despite the decisive moves by the Federal Deposit Insurance Corporation (FDIC)[1] and the Federal Reserve (Fed)[2], market confidence has been shaken and we have witnessed a flight to safety. Demand for government bonds have risen sharply, driving the yields on 10-year US Treasuries down from 4.0% on 9/3/2023 to 3.4% (17/03/2023). In tandem, gold prices have risen 8.7% over the same time period. The speed of gold's moves indicates that the flight to safety has not been obstructed by any broad-based liquidity issues. Very often in the initial phases of financial market stress, investors sell gold to raise cash to meet margin calls on futures positions in other assets or for other liquidity needs. The current crisis appears different in that there are no visible signs of panic gold selling and that could be indicative that the stress in certain parts of the banking sector are idiosyncratic. Nevertheless, investors have been reminded that unexpected events occur with greater frequency than they hoped and have sought to rebuild defensive positions that will help to hedge against further turbulence.



Source: Bloomberg, WisdomTree. From 1 Jan 2023 to 20th March 2023.

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Credit Suisse concerns add to investors desire for defensive hedges

The Credit Suisse debacle that unfolded quickly on the heels of SVB highlights that when confidence is shaken in one part of the banking sector it can easily spread. All banks, deposit takers, brokers and lending institutions with weak metrics are under the microscope. A liquidity life-line offered by the Swiss National Bank on 16/03/2023 had only allayed markets fears for a short time, before the Swiss regulator felt the need to orchestrate a takeover by UBS to save the 166 year old institution (which was agreed on Sunday 19 March). In the process, however, US$17bn worth of Credit Suisse bonds (primarily AT1s) have been wiped out. This has further driven investors to seek safe haven assets as they reexamine the riskiness of their assets.

Gold pauses to interpret the news

On the morning of Monday 20th March 2023 gold hit an intraday high of US$2009/oz just before 8am UK time, up considerably from Thursday 16th March 2023 close of US$1920/oz, marking the highest value since March 8th 2022 (i.e. when the Ukraine war was unfolding). However, by 11.30am, all of the gains since Friday 17th March were given back and at the time of writing, (11.30am) gold was hovering at US$1983.

Either tightening or loosening monetary policy could be interpreted as a policy mistake. Gold is there as a hedge.

The European Central Bank (ECB) raised interest rates by 50 basis points on 16/03/2023, marking a bold move given the fragile state of market confidence. However, blended with dovish commentary, markets are expecting less rate rises in the future and believe the 50 bps hike was delivered only because the ECB felt like it had pre-committed and any smaller hike would signal conditions are worse than what the market has priced in. The Euro appreciated against the dollar and the Dollar basket depreciated, providing further support for gold in Dollar terms.

While the jury is out on whether the Federal Reserve will pivot its monetary policy early (note the Federal Open Committee meeting is on 21st and 22nd March), investors are seeking to protect themselves with hard assets. If the Fed doesn't soften its hawkish stance, it risks transforming a bank liquidity issue into a recession as risk appetite and confidence has been shaken. If the Fed does act either by terminating quantitative tightening or prematurely ending the hike cycle, the central bank's monetary largess will linger for longer. Either way, gold is likely to benefit. Gold tends to do well in recessions and is seen as the antithesis to central bank created fiat currencies.

Gold gains are well supported

We therefore expect gold to hold onto the past week's gains in this time of turbulence. The key short-term risk for gold at this stage is not market confidence recovering quickly, but a broader market meltdown that could drive gold selling to raise liquidity for meeting other obligations (such as margin calls). In that scenario, gold is likely to recover in time as other investors will buy the metal to shore up their defensive hedges.

Sources

[1] The FDIC provided more than its usual $250,000 insurance on deposits.

[2] The Fed created a new liquidity tool - Bank Term Funding Program (BTFP) - offering loans of up to one year in length to banks, savings associations, credit unions, and other eligible depository institutions pledging U.S. Treasuries, agency debt and mortgage-backed securities, and other qualifying assets as collateral.

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