DOLLAR DEPRECIATION AND ULTRA-LOW TREASURY YIELDS PROVIDE GOLD AND SILVER A BASE TO CONTINUE WITH STRONG GAINS

Nitesh Shah – Head of Commodities and Macroeconomic Research, WisdomTree Europe
12 Aug 2020

In July 2020, gold has had its best monthly performance since January 2012, i.e. since the depth of the European Sovereign Bond crisis. Gold is now trading at an all-time high. Gold and silver have outperformed all major asset classes this year. Silver, in particular, outperformed gold by approximately 20% year-to-date in its recent rally.

For the month of July:

- Gold: 11.1%
- Silver: 34.8%

For 2020 through 06 Aug:

- Gold: 35.4%
- Silver: 54.8%

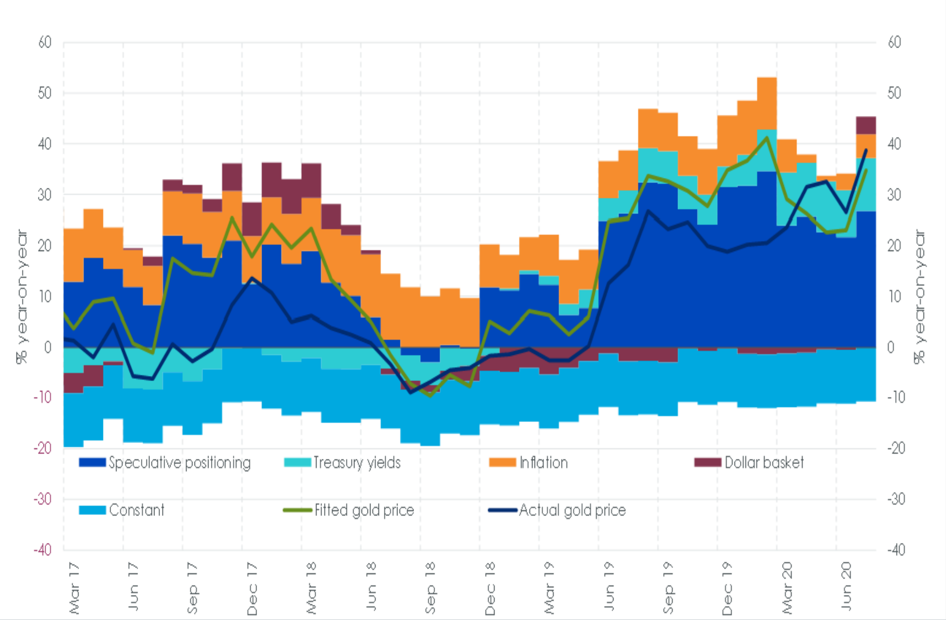
Even though we published our gold and silver forecasts in July 2020, recent market events coupled with strongly positive returns lead us to think it could help investors to see some updates.

Our gold model framework is explained in "Gold: how we value the precious metal". The model produces a yearly percentage growth rate, which we can apply to current prices to project where gold prices could head in a year's time. Now that we have a July 2020 gold price, we can project July 2021 gold prices. Moreover, we can factor in changes to economic assumptions that are warranted under these turbulent times.

Gold is not in a bubble

But firstly, let's take stock of what the model says about the most recent price rise (figure 1). Knowing where Treasury yields, the US Dollar and speculative positioning were in July 2020, the model indicates that prices should have risen 35% y-o-y (year-on-year) in July 2020. They in fact rose 39% y-o-y, just a fraction above. That indicated gold movement has been in line with its fundamentals and we can therefore rule out any bubble in gold prices. Interestingly, the US Dollar contributed to gold's rise in July. We have not seen that for over a year. The US Dollar has depreciated about 10% since March 2020. The fall in 10-year Treasury yields – which are now at an all-time low – also contributed to gold's gains. The strength in gold speculative futures positioning remained a key contributor to price gains.

Figure 1: The impact of each variable: attribution of fitted results vs. actual price



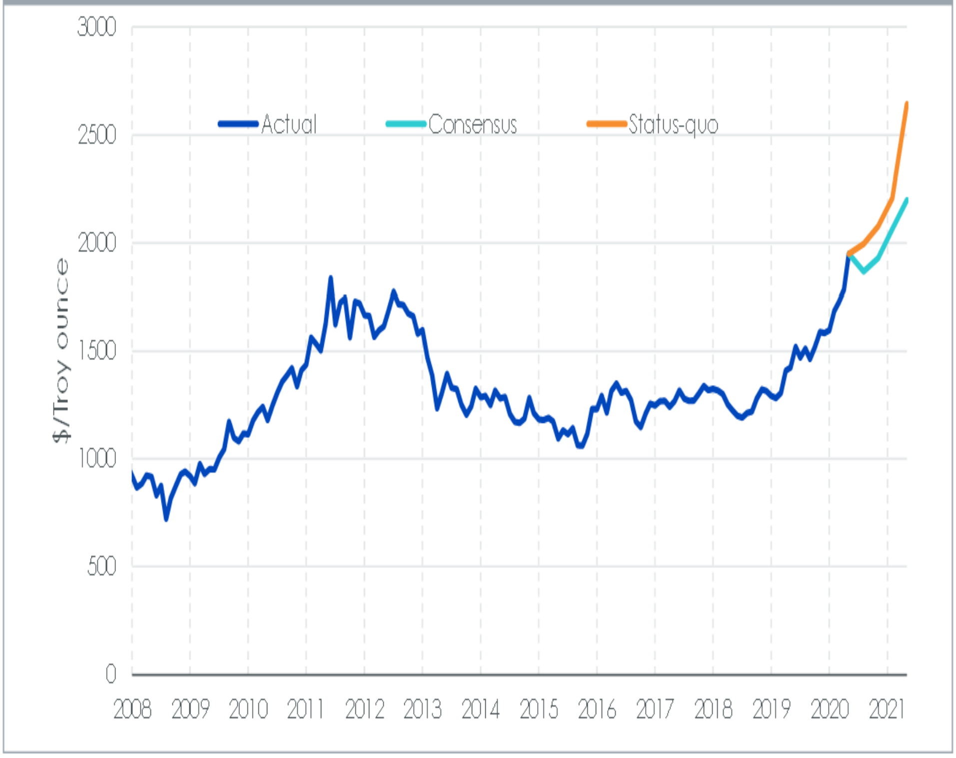
Source: Bloomberg, WisdomTree price model, data as of 30 July 2020. July 2020 inflation assumed to be 1%. The fitted gold price is the price the model would have forecast. The constant does not have economic meaning but is used in econometric modeling to capture other terms. It can be thought of as how much gold prices would change if all other variables are set to zero (although that would be unrealistic).

Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.

Gold forecasts to July 2021

As presented in our webinar on August 4th 2020[1], we update our forecasts (figure 2) to reflect some minor changes in consensus forecasts for economic variables (consensus scenario[2]), but more importantly, what would happen if the US Dollar Basket and US Treasury yields remain as low as they have been since the end of July 2020 (status quo scenario[3])? Both are reasonable assumptions to make given the uncertainty that rising COVID-19 cases are posing on economic outcomes – driving greater demand for Treasuries and building in greater dovish expectations for the Federal Reserve.

Figure 2: Gold price forecasts



Source: WisdomTree Model Forecasts, Bloomberg Historical Data, data available as of close 30 July 2020.

Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties

Our consensus scenario points to gold rising to $2200/oz by July 2021. The Status-quo scenario, indicates gold could rise to $2640/oz by July 2021 if Treasury yields and the US Dollar Basket remain as low as they are today for the whole year. The latter scenario indicates there is still a further 30% upside for gold.

Silver forecasts to July 2021

In Silver Outlook: A Phoenix Rising From The Ashes, we discussed how the gold price forecast is an important input to our silver view. What if instead of taking the 'U-shaped economic recovery scenario' presented in Gold Outlook: On Track to Reach New Highs to feed our silver view, we take the Status-quo scenario presented above and update forecasts to July 2021 for silver[4]?

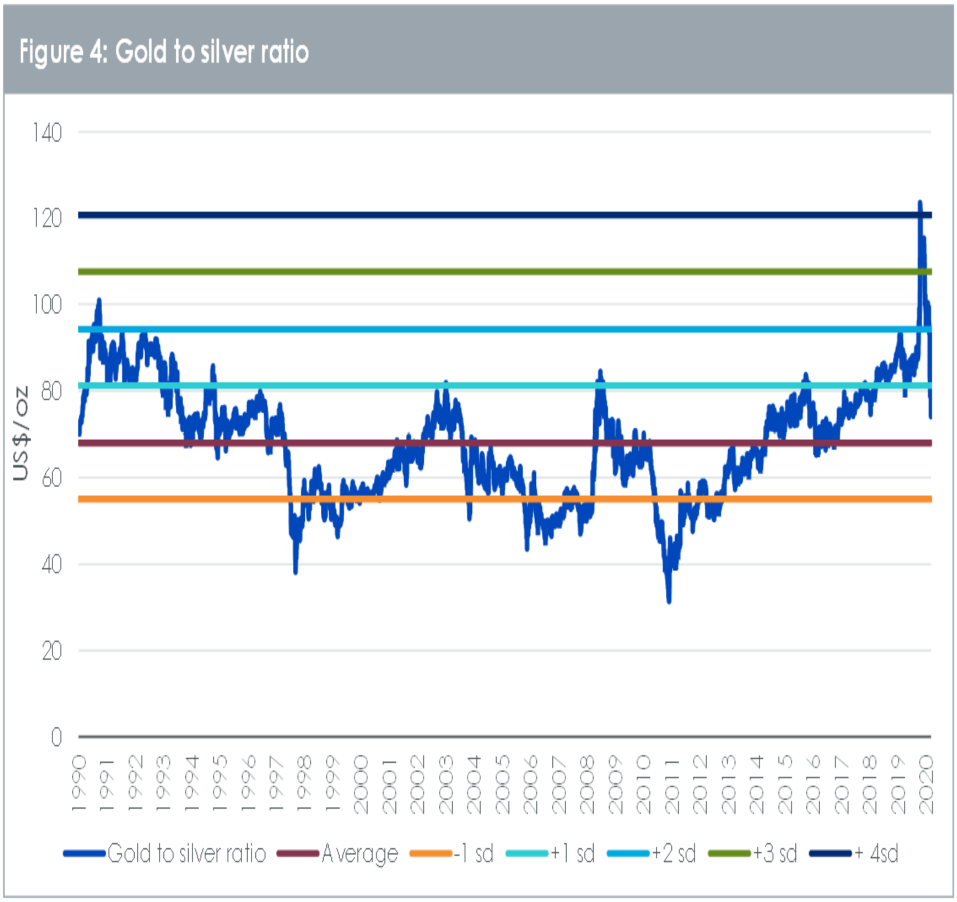
Source: WisdomTree Model Forecasts, Bloomberg Historical Data, data available as of close 30 July 2020.

Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties

Silver could rise substantially to US$36/oz (figure 3). That represents more than 25% upside from today's levels. At the time of writing the slides for our recent webinar (31st July 2020)[5], that would have been over a 50% gain, but silver has moved so rapidly in a week.

Relative price of gold and silver

The gold to silver price ratio had been elevated since 2019 and peaked out in March 2020 at 123, close to 4 standard deviations above the average since 1990 (figure 4). With silver's recent catch-up rally, the ratio has fallen to 74. The forecasts presented above in the Status-quo scenario, indicate the gold to silver price ratio will remain around this range, which is fractionally above the long-term average of 68 since 1990. We do not think that the ratio will fall much below that level given potential headwinds that silver could face if economic conditions deteriorate (the fear of which is keeping Treasury yields low and gold speculative positioning high).



Source: WisdomTree, Bloomberg. 1/6/1990 – 30/07/2020. sd = standard deviation

Historical performance is not an indication of future performance and any investments may go down in value

Gold and silver have moved decisively in recent weeks but remain in line with their respective fundamentals. It is remarkable that such rapid price appreciation can occur without necessitating bubble-like conditions. If current conditions of low yields and weak Dollar remain, i.e. yields do not have to fall further or Dollar does not need to depreciate further, gold and silver could continue their rally with investor sentiment towards the metals remaining robust.

Sources

1 "Precious metals on the podium but poised to go further still"

2 In the consensus scenario, we maintain the assumption that speculative positioning remains flat at 250k net long just as we had in the consensus view presented in Gold Outlook to Q2 2021: On Track to Reach New Highs

3 Just as in the 'U-shaped economic recovery scenario' presented in Gold Outlook to Q2 2021: On Track to Reach New Highs, we assume that that speculative positioning in gold futures will rise to 350k net long by Q1 2021, but we assume it will stay at that level to July 2021.

4 Other assumptions remain the same as we have them in Silver Outlook to Q2 2021: A Phoenix Rising From The Ashes

5 "Precious metals on the podium but poised to go further still" which went live on 4th August 2020, but slides were drafted on 31st July 2020

View the online version of this article here.

Important Information

Marketing communications issued in the European Economic Area ("EEA"): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as "WisdomTree" (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. The information contained in this document is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

The application of regulations and tax laws can often lead to a number of different interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.