

Why the gold price rally may continue

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We often write about the different market developments that can impact the returns of gold within investor portfolios. The primary factors that we consider are:

- Policy of the US Federal Reserve (Fed)
- Consumer Price Index (CPI) measures of inflation
- Behaviour of the US Dollar
- Levels of interest rates—particularly the US 10-Year Treasury Note
- Gold futures speculative positioning

While we believe that these are among the most important factors that explain movements in the gold price, we couldn't say that they are the sole determinants as to why the price moves. Technical factors, such as the ratios of gold to US equities, gold to US government bonds, and gold to the US Dollar are also certainly worth considering. Below, we look at these ratios and explore the implications for the gold price.

Gold technicals: the gold price to US equities ratio

Since the end of 2009, there have been two dominant trends within the relationship between the price of gold and US equities, as shown through the performance of the S&P 500.

- From 31 December 2009 to 22 August 2011, the price of gold appreciated by nearly 40% annualised while the S&P 500 only gained about 1% per year
- From 22 August 2011 to 8 February 2019, the S&P 500 gained about 14% per year, while the price of gold lost nearly 5% per year¹

At the risk of stating the obvious, US equities have been the star performers at the expense of most other asset classes since 2011, gold included. But we'd note that in Figure 1, which shows the ratio of the gold price to the S&P 500, we see a falling wedge pattern. The performance of US equities was strong enough recently to push the line—designed such that it declines when US equities are outperforming gold—outside the lower boundary of the falling wedge. This move was short-lived, and technicians have noted that when moves like this fail to establish a trend, the reverse move may occur quite quickly. This suggests that gold could potentially outperform US equities in the near term.

Figure 1: The relationship between gold and US equities may be changing

Source: Bloomberg, with period from 31 December 2009 to 8 February 2019. Concept for chart from blog post by JC Parets on 6 February 2019.

Historical performance is not an indication of future performance and any investments may go down in value. You cannot invest directly in an index.

Gold technicals: the gold price to long-maturity US government bonds ratio

One of the big debates among investors today is in relation to where US interest rates—particularly long-term US interest rates—may go to from current levels. From the early 1980s to the present, the trend has clearly been down, leading to massive price appreciation for bond investors. Now, however, with interest rates near historic lows, many hypothesise that the next 10 or 20 years could look very different to the last 30 to 40 years.

In Figure 2, we show the ratio of longer-dated US government bond cumulative returns against the price of gold, using the ICE US Treasury 20+ Year Index as a measure of the returns from US government bonds. The chart shows:

- From 2004 to 2011, the price of gold outperformed longer-maturity US government bonds, resulting in an upward trend in the ratio
- From 2011 to about 2014, longer-maturity US government bonds outperformed gold, resulting in a downward trend in the ratio
- From 2014 onwards, we have observed a strong multi-year basing process, and it looks like the price of gold is again starting to outperform long-maturity US government bonds

While this ratio cannot guarantee that the price of gold will outperform longer-maturity US government bonds going forward, we think that the ratio is an interesting way to consider a longer-term historical context and relationship between the two assets.

Figure 2: Gold may be poised to outperform US government bonds

Source: Bloomberg, with period from 31 December 2004 to 8 February 2019. Concept for chart from blog post by JC Parets on 6 February 2019.

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Gold technicals: major trends in the relationship between the US Dollar and the gold price

Gold (and many other commodities) is priced in US Dollars, leading to a natural tendency of the price of gold to rise as the value of the US Dollar falls. Figure 3 indicates that since the late 1960s, the US Dollar has had four regimes of significant depreciation. It is clear that the price of gold responded during these periods by moving significantly higher.

On the right-hand side of Figure 3, we indicate that a pattern has developed recently that looks similar to patterns that we have seen in the past prior to a big US Dollar move down and a subsequent upward

move in the price of gold. While this pattern is by no means a guarantee of future performance, we do believe that analysing the long-term relationship between the US Dollar and gold is helpful in stepping outside the minute-by-minute, hour-by-hour, and day-by-day short-term analysis that the world has become accustomed to.

Figure 3: The US Dollar versus gold price relationship since the late 1960s

Source: Bloomberg. Periods of the US dollar are defined as Sept. 1969 to June 1973 (Period 1), June 1976 to June 1980 (Period 2), December 1984 to December 1987 (Period 3) and June 2001 to March 2008 (Period 4). Periods of the gold price are December 1969 to December 1974 (Period 1), Sept. 1976 to Sept. 1980 (Period 2), December 1984 to December 1987 (Period 3) and March 2001 to Sept. 2012 (Period 4). Concept for chart from blog post by JC Parets on 6 February 2019.

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Conclusion: the price of gold may appreciate further

We have written recently that, based on our forecast and internal models as of 31 December 2018, gold's price could reach \$1,370 per troy ounce by 31 December 2019. This forecast was based primarily on fundamental factors, rather than technical factors. However, analysing the three charts above, we believe that gold's further appreciation could also be supported from a technical perspective.

1 Bloomberg, WisdomTree.

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