AGE's Gold Commentary

AGE Gold Commentary is our regular report analyzing trends in precious metals and rare coins. We monitor domestic and international markets and extrapolate from our 30 years in metals to place current events into a hard asset perspective. View archives.

2/20/2020: Gold's bull market gathers strength

Source:

Gold's new bull market is gathering speed and strength. After gaining 19% in 2019 for its best year since 2010, the metal has risen another 6% so far in 2020, surging above the psychologically-important $1,600 threshold for the first time since April 2013. And we think this is just the beginning.

The fundamental drivers behind gold's impressive start to 2020 are much the same as its epic rise last year. Slowing growth at home and abroad, lingering uncertainty over trade policies, and aggressive monetary easing from central banks have increased the risks to investors in global stock and currency markets.

As a result, yields are plummeting again as investors worldwide shift toward the safety of sovereign bonds and gold. As we said in December, these important fundamentals should persist and even accelerate in 2020.

Coronavirus risks

And now a powerful new wildcard has entered the deck, one that could drive gold substantially higher: the coronavirus, or COVID-19. Emerging from mainland China in late December, the mysterious SARS-like virus has infected more than 75,000 people in 30 countries and killed more than 2,000.

While the infection rate is apparently slowing, the course of the epidemic is far from certain. The World Health Organization has declared a global health emergency.

Major factories have closed in China, Japan, South Korea, and elsewhere because of the illness, disrupting global supply chains. Apple, one of the largest US companies with production in China, warned shareholders it will fail to meet Q2 sales forecasts because of the coronavirus. And this is likely just the start. Similar warnings from other global firms are sure to follow.

Investors are rightly concerned COVID-19 will damage a fragile global economy. Goldman Sachs warned clients this week that its impact on earnings may well be underestimated in currently overvalued stock prices.

Fragile global growth

Global growth, already falling before the outbreak, is expected to take a substantial hit. Oxford Economics cut its global growth forecast to 2.3%—potentially the slowest pace for the world economy since 2009.

Japan, the world's third largest economy, was already heading for recession after GDP tumbled 6.3% in Q4 of 2019. Germany, the fourth largest, has been hammered by falling trade, shrinking industrial output, and soft consumer demand. These downtrends are expected to accelerate because of COVID-19.

China, the world's second largest economy, is now projected to grow at just 5.2%, down from 6% in 2019, which was already the slowest in 30 years. 2020 growth in the eurozone is forecast at 1.1% and the UK just 1%.

Growth in the U.S. is not much better. Despite recent trade deals with China, Canada, and Mexico, our GDP is projected to grow around 2% in 2020, below last year's 2.3% and substantially below 2.8% growth in 2018. And this forecast was made before the coronavirus created additional headwinds.

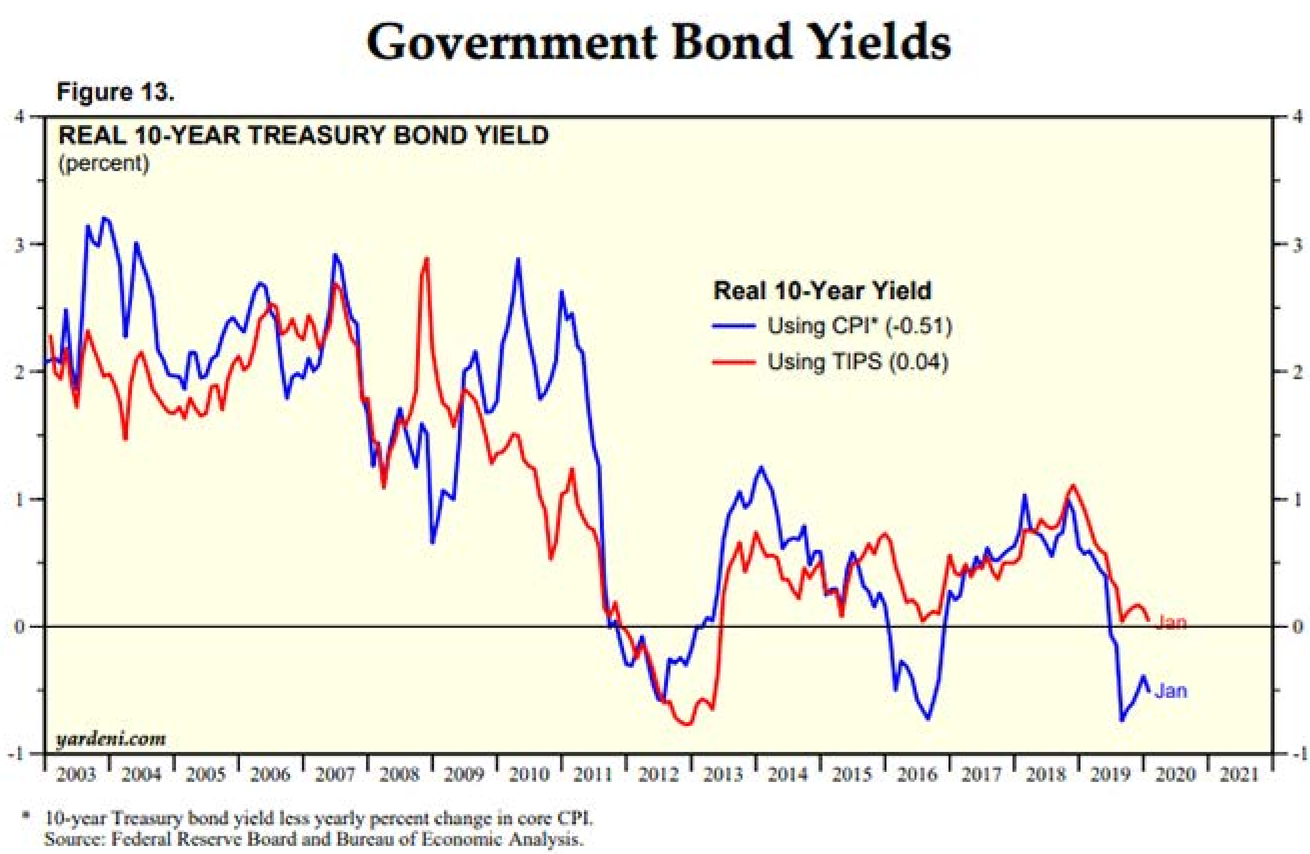
Negative real rates and QE

Both gold and silver technically entered a secular bull market last summer, rising sharply in response to slowing global growth and plummeting bond yields. Gold loves cheaper money.

Because it does not offer a yield, gold has difficulty competing against other assets that do. When real yields turn negative—that is, fall below the rate of inflation—gold becomes much more attractive as a vehicle for preserving wealth and purchasing power.

Between the fall of 2018 and last summer, the 10-year U.S. treasury yield plummeted from over 3% to 1.5%, falling below the inflation rate of 2%, and yielding a real rate of return of negative 0.5%. This plunge came with the global economic slowdown, which triggered deeper easing by central banks in Europe, China, and Japan. The Fed followed suit by cutting interest rates three times.

Gold and silver charged higher in response, breaking out into their technical bull markets. Now concerns about global economic weakness are back to the forefront, triggered by the coronavirus. Bond yields are falling again, and gold and silver are again marching higher.

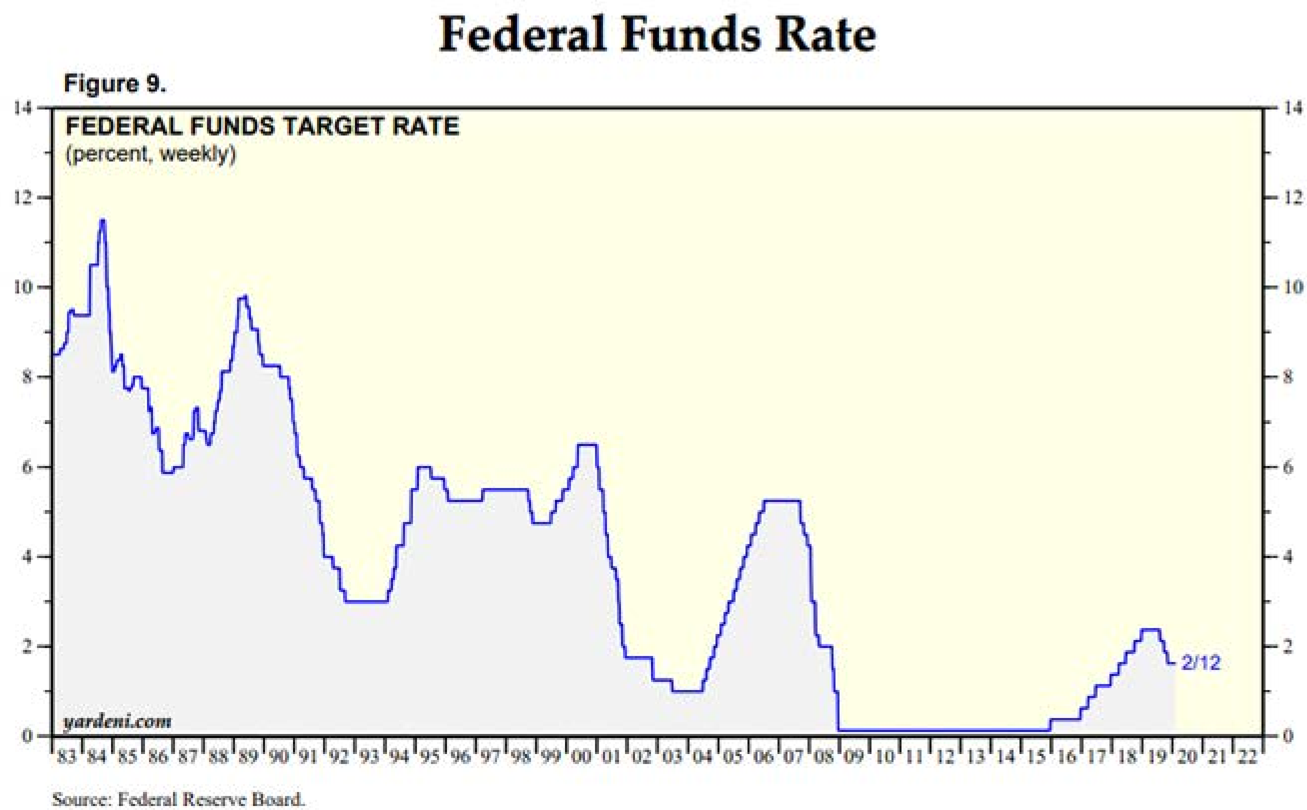


In recent testimony before Congress, Fed Chairman Jerome Powell said quantitative easing (QE) will be the central bank's main line of defense in the next economic downturn. Essentially printing money, QE was used extensively after the global financial crisis in 2009, flooding the economy with cheap cash in three successive waves.

Between 2009 and 2011 gold virtually doubled in price from under $1,000 to over $1,900 as the printing presses were turned on full throttle and the Fed dropped rates to zero.

In each of the past the past three recessions, the Fed has responded by slashing rates by at least 5% to stimulate growth. From 1990 to 1992, rates were cut from 8% to 3%; from 2000 to 2003, from 6.5% to 1%; and from 2006 to 2008, the Fed slashed its fund rate from 5.25% all the way to 0%, where it remained until 2016.

After hiking rates back to 2.5% over the next three years, the Fed reversed course last summer amidst the trade war with China, lowering rates to the current 1.75%.



With its benchmark rate at 1.75%, the Fed has very little room to cut. This means the central bank can no longer use its main method of fighting recession—cutting rates by 5%—unless it goes deeply into the negative, something the U.S. has never done.

No wonder Chairman Powell is so committed to using of QE again to stimulate the economy in the event of further contraction. He simply doesn't have much choice. And as recent history has shown us, that's good for gold.

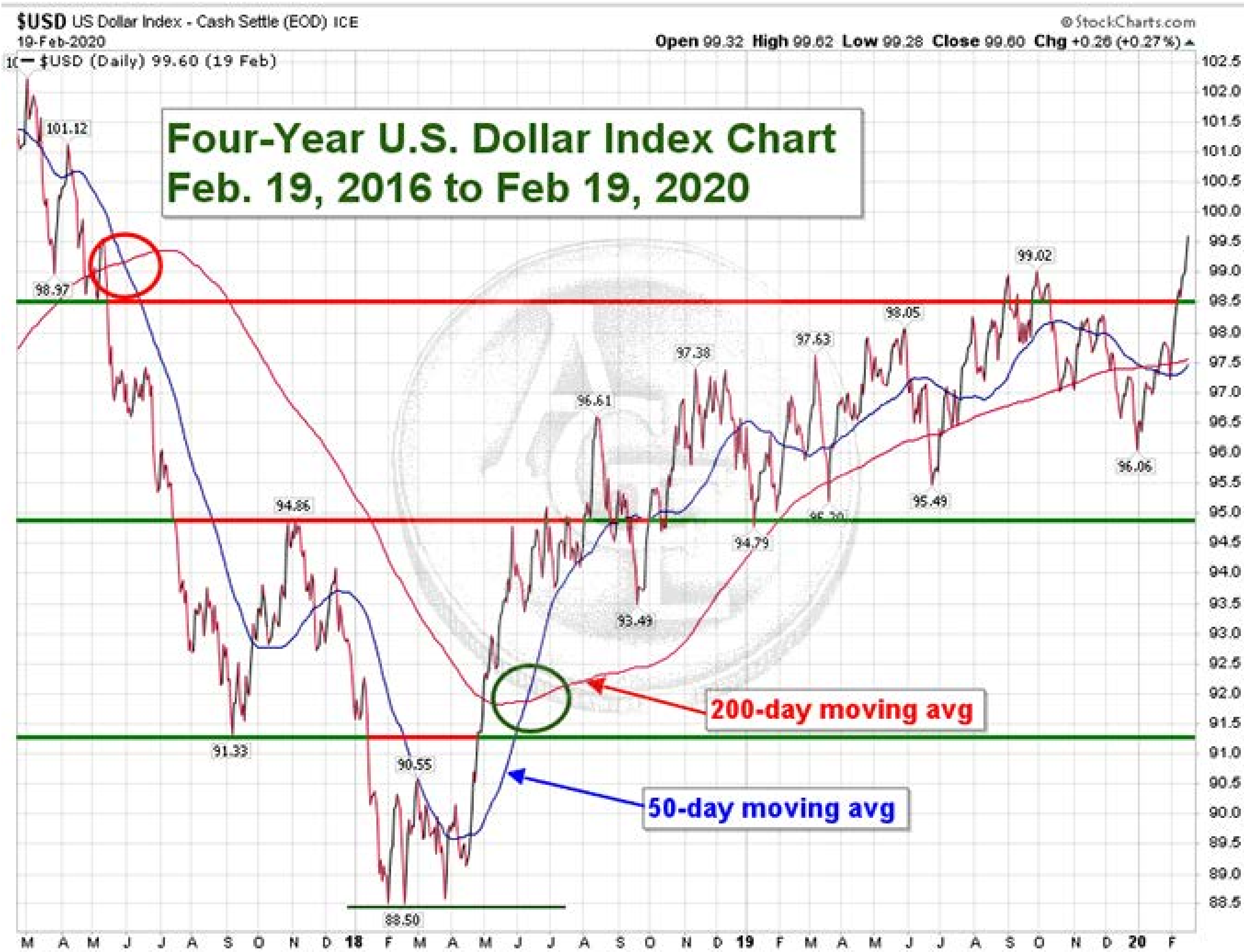
The latest charts

U.S. dollar

One of the beneficiaries of the 2019 global economic downturn has been the U.S. dollar. Not because the U.S. economy has been so strong but because other economies have been relatively weaker. For foreign money to enter our bond or stock markets, dollars must be bought first, buoying the buck higher than it might normally be.

As we have said many times, the price of gold and the dollar have an inverse relationship. When one is strong, the other is often weak. This is because gold is denominated in dollars for global trade, making its price in other currencies fluctuate relative to their strength against the dollar.

So, for gold to be rising so aggressively despite the dollar's strength is confirmation that underlying demand for the metal is extremely high. Given the risks we've been discussing, this should come as no surprise.



Beginning in 2014, when the U.S. economy led the global recovery, tremendous amounts of foreign capital from all over the world moved into the U.S., buoying the dollar.

Between 2017 and mid-2018, the world enjoyed the first real synchronous global economic expansion since the 2008 financial crisis. Foreigners therefore sold their dollars and bought pounds, euros, and yen, repatriating their money and weakening the dollar through 2017.

This tend reversed as the global economic expansion turned into a contraction in the second half of 2018, and then faltered further in 2019. The dollar strengthened during this time, as the chart shows.

Over the past month, the dollar has broken out above strong resistance at 98.5 on the index chart. This move coincides with the coronavirus outbreak and indicates flights to safety of foreign money into US Treasurys, which first required exchanging into dollars. Escalating demand for safe havens helps to explain why gold and the dollar are rising at the same time today.

Gold

But the dollar's rise to a three-year high also suggests that it has been capping gold's impressive rise. For example, gold bottomed in November 2019 and then moved sharply higher from $1,460 to

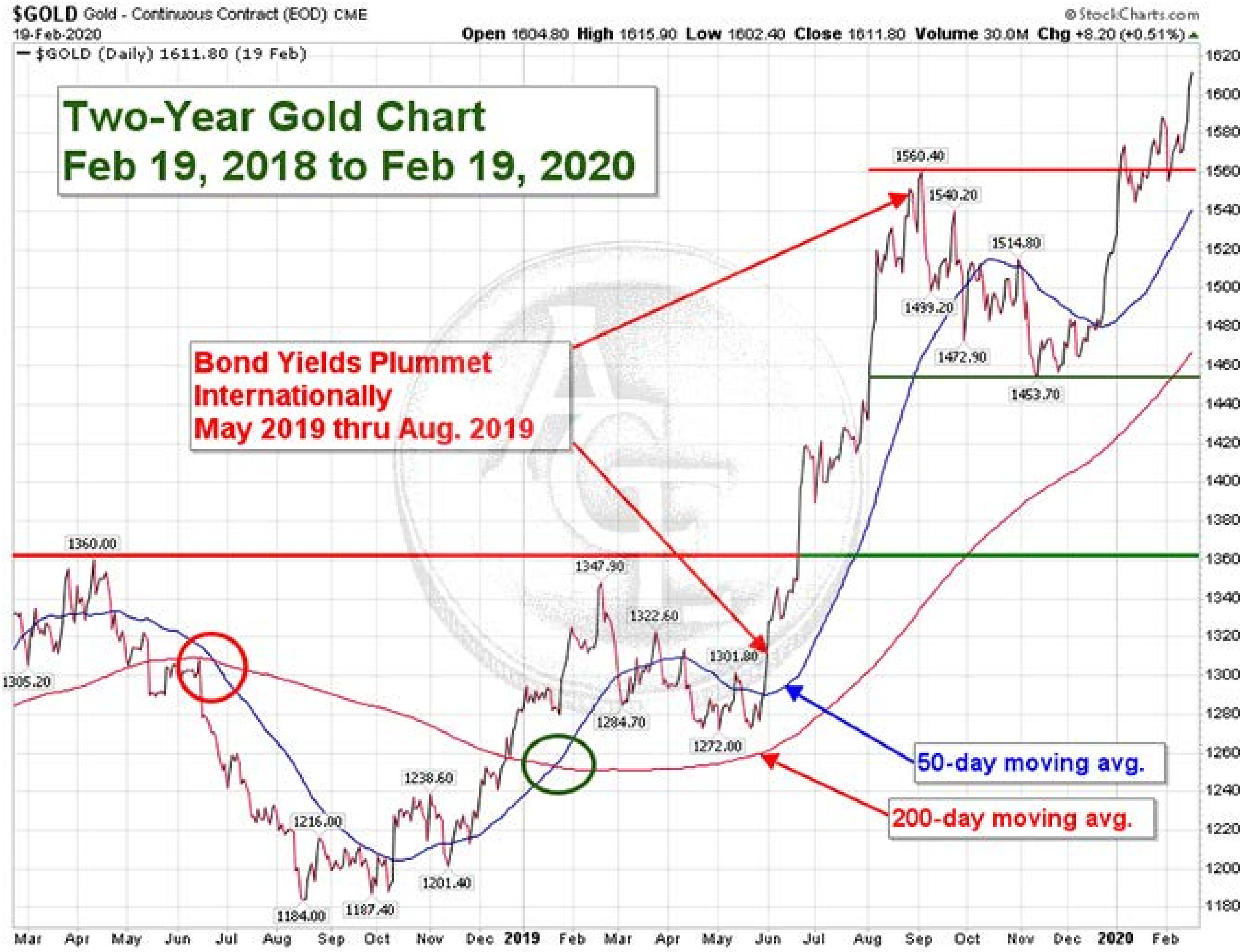
$1,550 in December. At the same time, the dollar weakened substantially from 98.25 to the 96.06, as we would ordinarily expect, given the inverse relationship between it and gold.

Today, with real bond yields already at or around negative, gold is not so reliant on yields falling further to make it an attractive alternative to bonds.

In other words, the artificial support lent to the dollar by foreign money flowing into Treasurys could dry up and gold would still be in strong demand as portfolio insurance against risk. The bottom line is that any weakness in the dollar will simply to add fuel to gold's bull-market fire, driving prices higher still.

The 15-year chart helps to put gold's recent breakout into perspective. With the move above major resistance at $1,550, gold is signaling it may be able to eventually challenge the 2011 all-time high of $1,900. Gold has already set new all-time highs in euros, pounds, rupees, yen, Canadian and Australian dollars, Mexican pesos, South African rands, and many more in 2020.

The dollar, for the reasons we discussed above, is one of the only currencies in which gold has yet reach a new record this year. But we think it's only a matter of time.



The two-year gold chart shows the strength of gold's breakout into a technical bull market last year. Normally, when a market moves so far so fast, we'd expect to see a substantial pullback—in this case, to the green short-term support line at $1,453. But the fundamentals driving this rally have been so solid that the correction has been shallow and brief.

Gold stair-stepped over short-term resistance at $1,560 and passed the psychological resistance level of $1,600 with relative ease. In the short-term, support will be at $1,560, $1,500, and $1,455. Upside resistance will be found in $25 increments at $1,625, $1,650 and $1,675, with stronger upside resistance at $1,700 and $1,750. Who would have thought that just a year ago, when gold was under $1,300, we would be discussing upside resistance at $1,700 today? Things can and do change quickly.

Looking forward, in the short term, we see the risk/reward ratio to be 2 to 1 with gold around $1,615 per ounce, with a downside risk of $50 and an upside reward of $100 an ounce. The trend is your friend and the trend for gold is decidedly upward!

Silver

Silver continues to be substantially undervalued relative to gold, with the current gold-to-silver ratio at just over 87:1. As we've said before, when the ratio is over 82:1, silver is extremely underpriced relative to gold. Silver will eventually catch up and the ratio will narrow towards its 25-year equilibrium of 65:1. This gold move over $1,600 may be the catalyst. Until then, silver is a terrific value.

Again, we are using a 15-year chart first to put the current market into perspective. In the bigger picture, silver is testing short-term upside resistance at $18.40. If silver moves over this level, which is likely, it will break towards major upside resistance at $20.75. Any push above $20.75 will most likely drive it into the $22.00 to $24.00 range.

Basis gold at $1,615, silver at $22 would put the gold-to-silver ratio at 72:1. Silver at $24 silver would put it at 66:1, where it would be fairly valued relative to gold.

The two-year silver chart is like the gold chart in that silver made a big move higher in 2019, corrected modestly lower, and is now challenging upside resistance—in this case, at $18.40. Above $18.40 silver will hit resistance at $19.55, and major upside resistance at $20.75. In the short term, support is at $17.50 and again at $16.80, but we doubt we will see silver under $17.50 any time soon.

If these short-term resistance levels are pierced, momentum trading could push silver much higher very quickly. At today's prices it is an excellent value, especially relative to gold.

Gold coins at low premiums

We continue to have a small supply of backdated 1-ounce U.S. Gold Eagles, BUavailable at a modest discount. The current 2020 coins are only available from the U.S. Mint at full premiums, making discounted backdates a much better value. For bulk bullion these are our top seller. All the backdates we offer are minty fresh.

Better still, premiums for many pre-1933 U.S. $20 and $10 gold coins remain at record lows. While the market allows, we have Almost Uncirculated $20 Saint-Gaudens AU and $20 Liberty AU gold double eagles at about the same premium as backdate 1-ounce U.S. gold eagles.

These vintage gold coins typically carry $50 to $100 premiums over modern 1-ounce gold bullion coins. Supplies are limited, however, and premiums could change without notice, so get 'em while you can.

The best values we have ever seen continue to be in Pre-1933 US $10 and $20 gold coins in higher grades. Premiums for these Mint State collectible coins remain at or near record lows. But available national supplies are tightening fast, which is a recipe for strong premium appreciation.

Our best value for volume buyers is $20 Saint-Gaudens in MS64 grade. For a mere $75 over the price of a modern 1-ounce U.S. Gold Eagle you can acquire an historic, 90+ year old coin in limited supply that has a previous market high of $2,300, $400 more than the all-time gold bullion high.

For the more speculative investor, we continue to love the gem-quality $10 Liberty in MS65 at current market pricing. With an extremely low survival rate of just 5,464 total coins, it is by far the scarcest of the four popular U.S. $10 and $20 gold coins in MS65 grade. It has a previous market high that is more than triple today's market price. Highly recommended!

That's all for now. As always, thanks for your time and business.

Sincerely,

Dana Samuelson
President