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.

5/18/2020: Deja vu all over again!

Source:

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In two short months, the COVID-19 pandemic has resulted in the deepest US economic contraction and loss of jobs since the 1930s. Congress and the Federal Reserve, following the playbook from the 2009 global financial crisis, have responded with unprecedented monetary easing and fiscal stimulus. Policies like these—but smaller in scope—propelled gold to an all-time high of $1,911 in 2011. Today, it looks like déjà vu all over again, only this time on steroids.

Vanishing jobs, falling GDP

The coronavirus catastrophe for the labor market is hard to overstate. More than 36 million people have lost jobs since late March, causing the unemployment rate to skyrocket above 20%. One worker in five has filed for first-time unemployment benefits but more than 30% have yet to receive the first check. More jobs have been lost the last two months than were created in the ten years following the 2008 financial crisis.

While some of these losses are temporary, many will be permanent. Small businesses, for example, account for nearly half of all employment in the US. Many simply do not have the financial reserves to withstand a protracted shutdown, or even an extended slowdown. Faced with the hard choice between preserving their accumulated assets (life savings) or trying to reopen, many small business owners will simply opt to shutter for good.

As go jobs, so goes spending and GDP. Retail sales plummeted by 16.4% in April, the most on record by a huge margin. With consumer spending comprising around 70% of the economy, real GDP is projected to contract by more than 46% in the second quarter, according to the Atlanta Fed. Most analysts, including the IMF, forecast annual US GDP to decline by around 6% in 2020, the most since 1946.

It is difficult to imagine a scenario in which consumer spending will rebound sharply as society reopens, especially with lingering COVID fears keeping people out of restaurants, theaters, stadiums, and stores. Keep in mind, it took the travel industry over two-years to fully recover from the 9/11 attacks. Sadly, today's disruption is far more widespread, and the ripples will likely be felt for years to come.

Debt and deficits

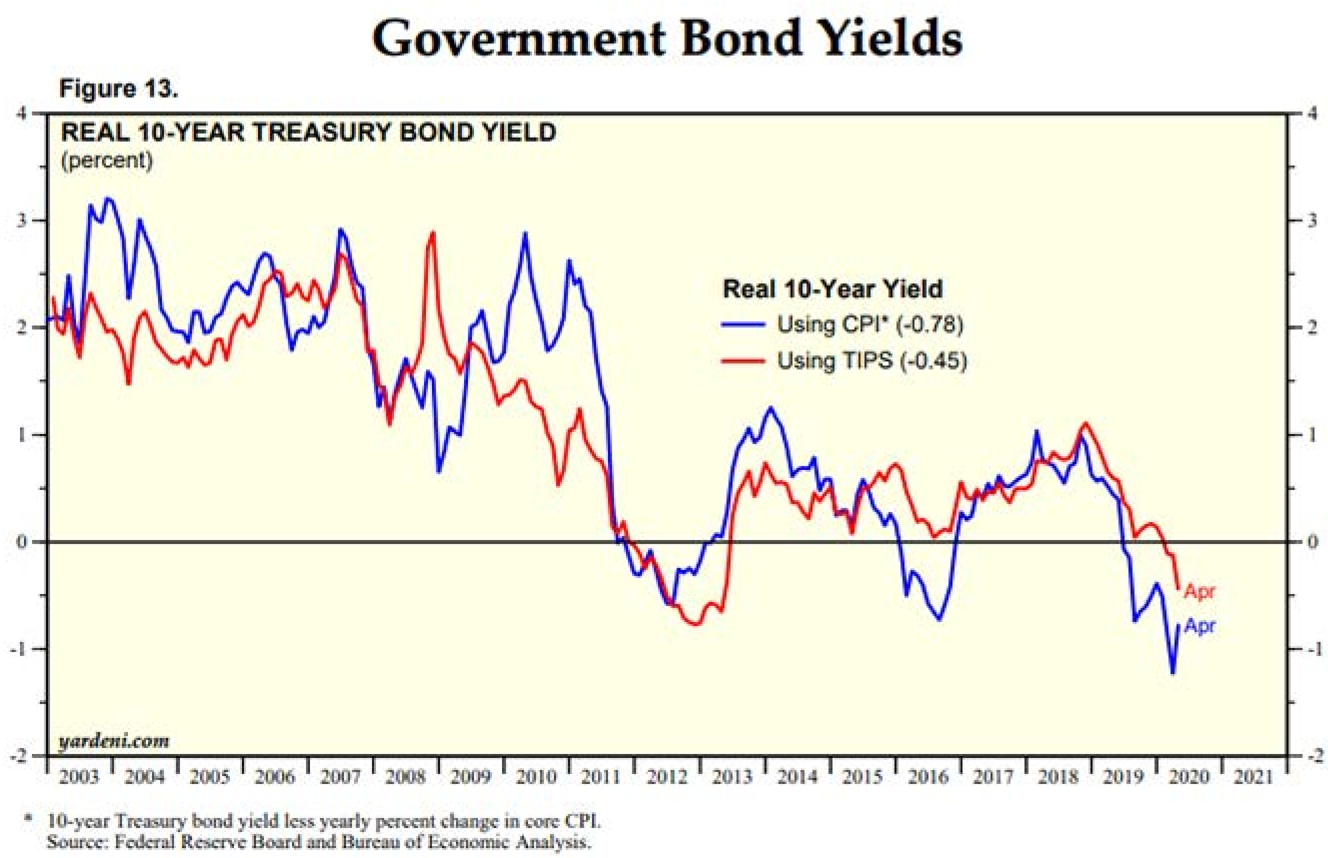
To prevent another Great Depression, the government and the Fed are taking unprecedented measures, all of which are ultimately bearish for the dollar and bullish for gold.

Congress has already committed to $3 trillion in stimulus spending, with as much as $3 trillion more on the way. As a result, the annual US budget deficit will quadruple to almost $4 trillion in 2020, pushing our national debt from $23 trillion to $27 trillion. This astronomical number is greater than the combined debt of all other countries in the world. No other nation in history has ever accumulated this much debt.

To finance this enormous debt the government will have little choice but to inflate its way out by devaluing the dollar. At the same time, the rising US debt-to-GDP ratio could easily discourage foreign investment and accelerate trends away from the dollar as the world's reserve currency. A weaker dollar, of course, supports gold and other commodities priced in it for global trade by making them less expensive in other currencies.

Negative real interest rates

Meanwhile, the Fed has slashed interest rates to near zero while pledging unlimited quantitative easing and a variety of new facilities to increase liquidity. All these policies flood the markets with cheap dollars to promote spending and lending, effectively diluting the dollar's purchasing power and increasing the risk of long-term inflation.



With interest rates near zero, real yields (after inflation) on 10-year Treasurys have turned negative. If nominal yields are 0.6% and inflation around 1.6%, the real rate of return (after inflation) is -1%.

Negative real yields are bullish for gold because the metal offers no yield itself. When real yields are positive, gold is at a disadvantage for attracting safe-haven monies because of the opportunity cost for holding it instead of Treasurys. But when real yields are negative, that opportunity cost disappears.

In addition, gold typically gains in value when inflation rises. Regular Treasurys, on the other hand, lose value when investors sell them at a discount to buy higher-yielding bonds to keep up with inflation.

Truly, gold's fundamentals for future gains have seldom been so strong.

New gold records

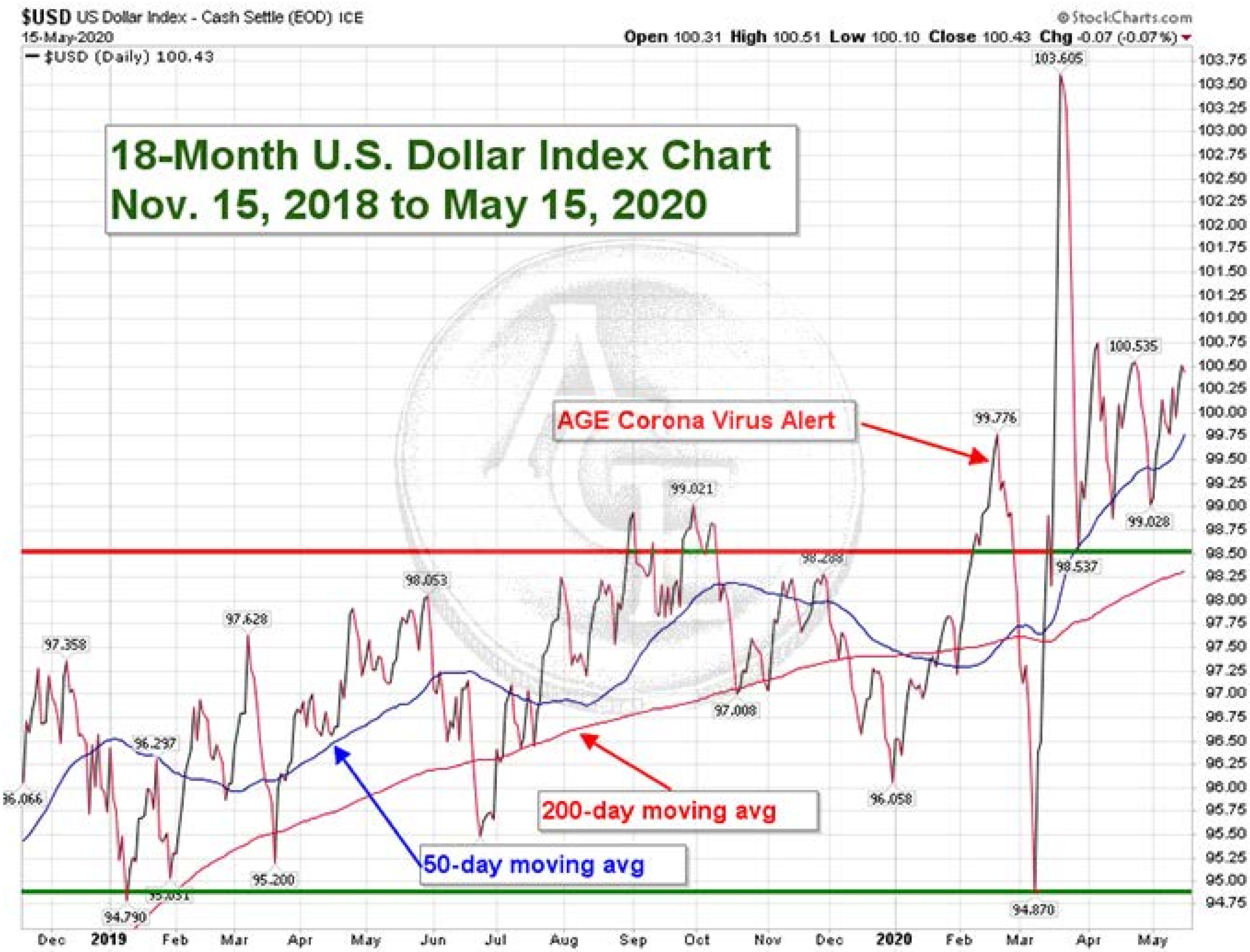
Between 2009 and 2011, gold doubled in value to reach its record high of $1,911 behind quantitative easing and negative real interest rates. It has yet to break out in the same way so far in this crisis, but we are confident that it will.

Indeed, gold has already set new record highs in almost every other major currency— euros, yen, rupees, rubles, and many more. Only the relative strength of the US dollar, itself a safe-haven asset during global crises, has kept gold from a new record here. We expect this to change soon as the Fed's monetary easing begins to rollout in earnest, pressuring the dollar.

The Bank of America recently upgraded its gold price forecast from $2,000 to $3,000 an ounce within 18 months, citing negative real interest rates and quantitative easing as the main drivers. As BOA said, "the Fed can't print gold."

US dollar

Looking at the 18-month US Dollar index chart, you can see the wild fluctuations in the dollar as the global impact of the coronavirus pandemic became apparent in late February and early March.



After bottoming in early March, noted by the green major support line at 94.7, the dollar skyrocketed to 103.65 as panicked selloffs in stock markets triggered flights to liquidity. Traders rushed to dump everything in sight for cash, including gold, one of the most liquid assets.

This extreme market action is eerily similar to what happened in late 2008 when the collapse of Lehman Bros signaled the start of the global financial crisis. That V-shaped selloff and recovery occurred over three months while this episode took only three weeks.

By 2010, the dollar lost as much as 17% as quantitative easing from the Federal Reserve exploded the money supply and increased the risk of long-term inflation. These measures also helped to buoy gold to record high values in 2011. The same playbook, but more so, is being used today, and likely with similar results.

Every week the consequences of the pandemic become more apparent, and the prospects for a quick, V-shaped recovery dim a little more. In 2009, our GDP shrank by 2.5%. In 2020, GDP is projected to decline by more than twice that amount.

In this environment, it is hard to see how the dollar can remain overvalued for long. The Fed has repeatedly pledged to use every tool in its box to prevent another Great Depression. But the Fed can only do so much, and all its tools are essentially variations on a theme: flooding the financial system with cheap cash. As we saw during the last crisis, that's ultimately bad for the dollar and great for gold.

Gold

Since breaking above $1,370 last summer, gold had been stair-stepping higher in increments of $100. Then, as you can see on the chart, the coronavirus hit, and volatility began.

In late February and early March, gold surged twice to meet resistance around $1,676. And both times, panicked rushes for cash because of selloffs in equities knocked it lower. The first time, gold found support around $1,560 before recovering. But the early March liquidation drove it below short-term support at $1,560 to a low of $1,477 before safe-haven demand returned it to the $1,575 to $1,675 trading range.

By April, though, gold stabilized and resumed its stair-stepping pattern, reaching a higher range between $1,675 and $1,775. With strong support at $1,675, it is encountering short-term upside resistance at $1,725 and will find stronger upside resistance at $1,775.

Based on its rise between 2009 and 2011, gold could easily rally 20% to 30% over the next 12 to 24 months, to between $2,050 and $2,200. At $2,200 it would be about 15% higher than its 2011 all-time high of $1,911. Remember, in many other currencies, gold is already about 15% higher today than in 2011. It is just a matter of time until it achieves a similar gain in dollars, in our opinion.

We highly encourage you add to your positions, especially on any price weakness. 2020 will prove to be a record-shattering year for worldwide economic decline. In this unprecedented environment gold will continue to shine as the ultimate currency of last resort.

Silver

Unlike gold, which has stair-stepped higher over the past few months, silver has stepped lower. The market turmoil in March was even more pronounced for silver, and it has yet to fully recover.

As many of you know, silver is typically more volatile than gold. Because it has more commercial applications, it trades as more of an industrial commodity, which makes it more susceptible to price-declines during an economic contraction. The good news is that silver is extremely undervalued in the current market.

Using 2009 to 2011 as our reference, silver lagged gold then as it is lagging now. But when silver finally did play catch up, it did so with a vengeance. We anticipate a similar pattern in this cycle.

In 2009, silver was pricing around 10% lower than before the Lehman Bros collapse. After a period of consolidation, it recovered all that 10% loss. Then as gold rallied in 2010 as a currency of last resort, silver followed, surging almost 150%.

Looking at the chart, you can silver stepping up (following gold) in mid-2019 from under $16.25, into the $16.25 to 18.40 trading range before the market turbulence hit in March 2020. As in 2009, silver looks oversold to us now at under $17.25.

As you can see in the gold-to-silver ratio chart below, silver is offering an unusually good buying opportunity right now. With the current ratio at 103 to 1, silver is undervalued relative to gold by approximately 20%. With gold at around $1,700 silver, should be at least $20 per ounce.

We highly encourage you to add to your silver positions while the opportunity exists at these prices. With gold leading, silver will follow, and it will move higher in larger percentage moves than gold.

Physical gold & silver

In March and April, our industry was overrun with five to ten times the normal volume of physical gold and silvery buyers. Dealer inventories were wiped out in a matter days and supply lines quickly became strained. These problems were exacerbated by temporary closures of several sovereign and private mints, including the US Mint and the Royal Canadian Mint.

Fortunately, were able to use our experience from 2009 to minimize the impact on our customers. Nonetheless, it was one of the most challenging environments in our 40 years in this market. I want to thank you all for your patience and your business.

In the heat of demand, premiums for all physical precious metals surged to the highest levels we have seen since 2009, when similar supply backlogs occurred. The market became extremely competitive; with more buyers than supplies, premiums rose.

Over the last two weeks, the markets somewhat normalized. We are happy to report that premiums are falling, but they are still higher than normal, especially for silver. For example, the US Mint has simply been unable to produce enough 1 oz Silver Eagles to satisfy demand, so they are still trading at higher premiums than usual.

The following bullion items are available at competitive market pricing and quick delivery.

Gold bullion

US Gold Eagles, BU

1 oz Canada Gold Maple Leafs

1 oz PAMP Fortuna gold bars

Silver bullion

1 oz US Silver Eagles, BU

1 oz Canada Silver Maple Leafs, BU

1 oz South Africa Silver Krugerrands, BU

Pre-1967 Canada Silver Dollars, BU

Pre-1933 US gold coins

While premiums for modern bullion coins are falling, premiums pre-1933 US gold coins are rising. Many of our favorite $20 and $10 gold coins have benefitted from the classic double-play of rising intrinsic value and rising premium value over the last two months—just as we told you they would.

Nonetheless, premiums for many coins remain below their 10-year averages. Prices are just beginning to rise in earnest, so it is still a buyer's market, but probably not for long.

We highly recommend $20 Saint-Gaudens in MS64 and $20 Saint-Gaudens in MS65 condition, $20 Liberty in MS63, and $20 Liberty in MS64 condition.

These are the best values for price, scarcity, and past performance today. If you want to own private physical gold that offers the potential for added leverage to the gold price, these classic pre-1933 US gold coins cannot be beat right now for overall value. Supplies are limited.

That's it for now. As always, thanks for your time!

Respectfully,

Dana Samuelson
President