12/8/2020: Gold shines again in 2020

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Season's greetings!

In a year of unprecedented tragedy, gold has again been a shining light for investors. After rising nearly 19% in 2019, the metal is on track to gain more than 20% in 2020, making it among the best-performing asset in most portfolios.

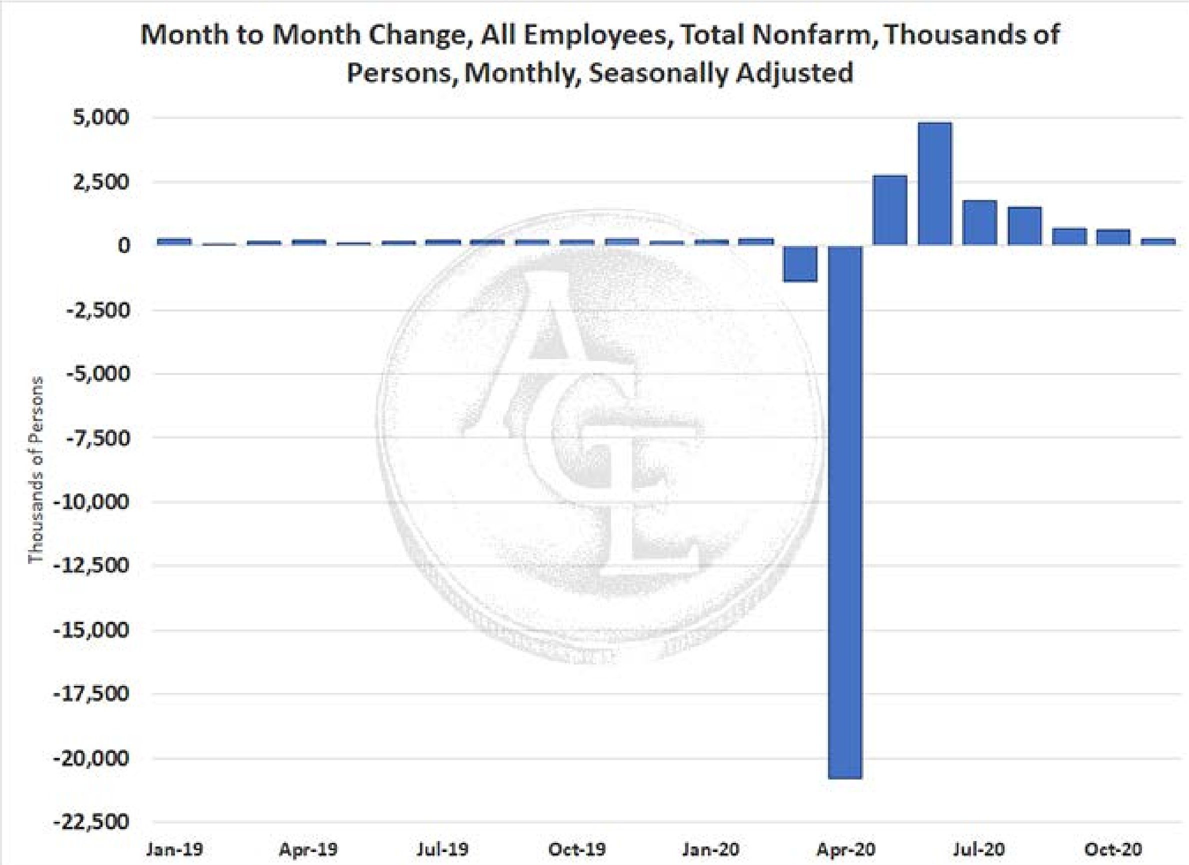
We think 2021 promises to be just as strong. The fundamental drivers that propelled gold to all-time highs this year--negative real interest rates, soaring debt ratios in major economies, unprecedented monetary easing and fiscal stimulus--are very much in place and likely to increase next year and beyond.

The economic damage the world has suffered due to COVID-19 will take years to repair, even if the virus is brought under control in coming months. Gold's traditional role as portfolio insurance against economic uncertainty, currency devaluation, and long-term inflation has seldom been more necessary.

As we said in our October Commentary, gold is gathering for the next leg up in this powerful bull market. The trend is your friend and gold's upward trajectory remains intact, despite the recent price correction. We expect it to move above its all-time high of $2,069 and probably into a trading range of $2,200 to $2,500 within the next six to twelve months, as we outline below.

Jobs, jobs, jobs

Employment remains the most important driver of the US recovery, just like after the global financial crisis of 2008 and 2009. As you can see in the chart below, monthly job creation has been waning since the initial rebound in late spring. The November non-farm payrolls report of 245,000 jobs added was 60% lower than the September/October average, representing the smallest increase since May.



Through November, the US economy suffered a net loss of over 9 million jobs this year, which is 17% more than during the global financial crisis. It took more than four years, until the summer of 2014, for those jobs to come back. It will probably require a similar period, until 2024 or 2025, to regain the losses from this crisis.

Of course, job recovery will have no real chance until COVID-19 is brought under control. The recent developments in vaccines are extremely promising but distribution will take time. The next few months are going to be grim, based on the current rates of infection and hospitalization. It is therefore reasonable to assume that any significant recovery in the labor market--and hence in the economy as a whole--is unlikely until summer at the earliest.

In the meantime, global economies will subsist on monetary easing and fiscal stimulus, which means exploding debts and deficits at home and abroad. And that's good for gold.

Exploding debt and deficits

The US budget deficit hit an all-time high $3.1 trillion in 2020, double the previous record set during the financial crisis in 2008. Driven by $3.5 trillion in COVID stimulus, this gap represents more than 15% of total GDP, the sum of all goods and services produced by the county. This is the highest level since 1945, when the US was borrowing heavily for World War II.

Another coronavirus relief package of just under $1 trillion is being negotiated now, and it will probably not be the last. So, the deficit in 2021 will likely be close to 2020, perhaps more. If so, it would push our total national debt well over $30 trillion.

If these numbers hold, we will have added $6 trillion to our national debt over the span of two years. It took 212 years, from 1792 to 2004, for the debt to reach the first $6 trillion. Now the government is poised to add another $6 trillion in just 24 months.

With interest rates near zero, payments on this enormous debt are manageable relative to size of the US economy. The Achilles heel, however, is that around 60% is funded with Treasury notes of shorter duration, 2 to 10 years, which are sensitive to interest rates. If we move into a more inflationary environment, these notes will roll over at higher rates of interest that dramatically increase the cost of servicing the debt.

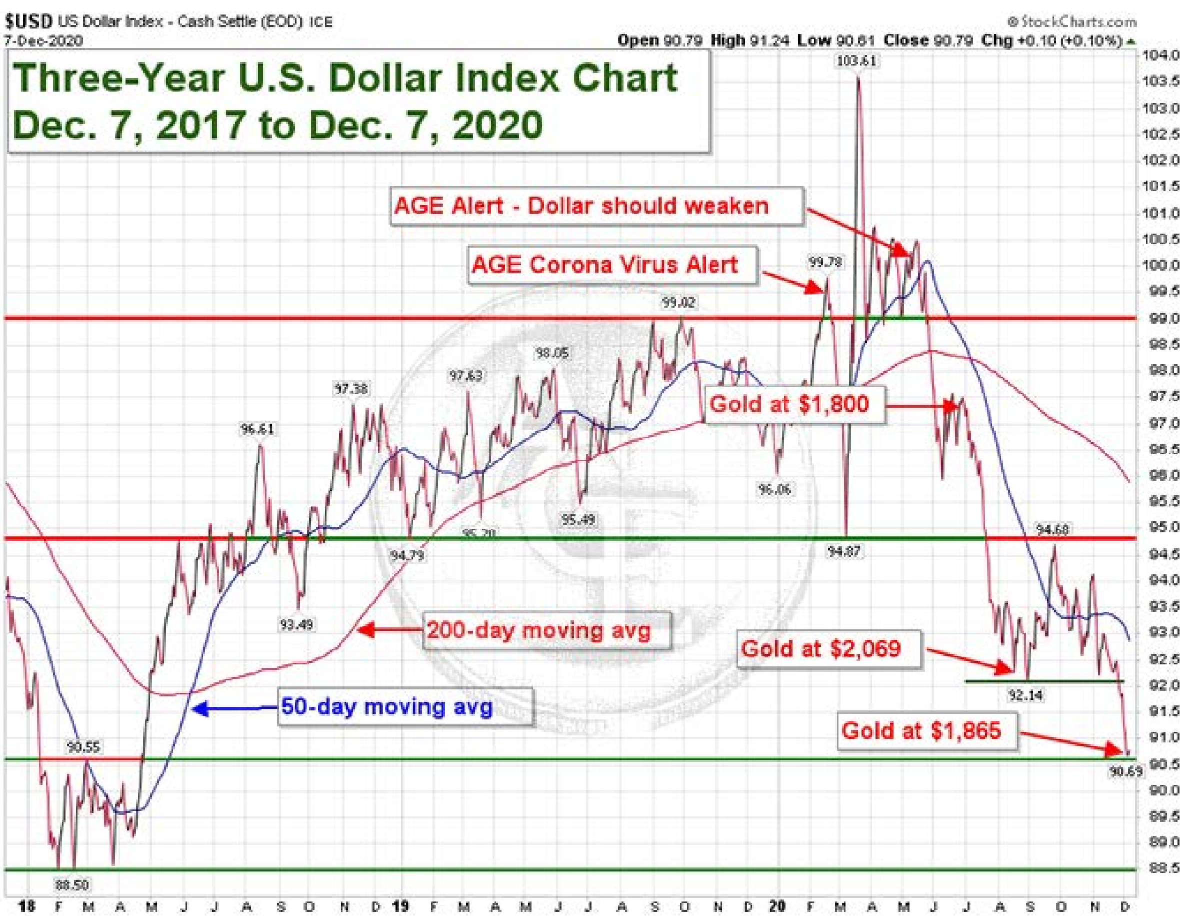
Reducing the burden of our exorbitant debt is a good reason for the Federal Reserve to hold interest rates lower for longer. Low or negative real rates are good for gold because they remove the opportunity cost for holding the metal instead of bonds as a safe-haven asset. And low yields also limit the bond market's ability to act as a hedge against corrections in the equities market, making gold relatively more attractive as a portfolio counterbalance.

Naturally, the world is watching the US debt and deficits closely. As of September, over $7 trillion in US Treasuries were held by foreign countries, with Japan and China leading the way. If we lose the trust of these creditors and they sell Treasuries to buy the sovereign debt of other nations, the dollar will weaken, perhaps dramatically, against the currencies of those nations. Again, good for gold. A weaker dollar makes the metal less expensive in other currencies, bidding up demand in the global market.

Latest charts

US Dollar Index

The dollar is currently trading at the lowest level in 30 months, down around 6% this year, under pressure from the pandemic. With the US falling behind other developed nations in containing the spread, the economic fallout--along with the ensuing monetary easing, stimulus spending, and budget deficits--has taken their toll on the buck, and this downtrend is likely to continue in 2021.



As you can see in the chart, the dollar fell to a cyclical low of 88.50 in early 2018, when economic expansion in the US was trailing Europe and Asia. In 2019 and early 2020, as US growth accelerated, the dollar rebounded. Then came COVID in March, lockdowns, and volatility through the spring.

Now, after rebounding sharply over the summer, our economy has weakened once again relative to our peers, and this weakness is reflected in the dollar once more.

The inverse relationship of the dollar to gold has largely tracked these fluctuations. In early July, when the dollar index was at 96.50, gold was at $1,800 per ounce. Gold's subsequent surge to its all-time high of $2,069 in August was enabled by the dollar's retreat from 96.50 to a cyclical low 92.14. The buck's subsequent rebound to the short-term high of 94.68 in late September was the catalyst for gold breaking support at $1,925 and correcting down to $1,866.

The dollar and gold both remained range-bound from early October until late November, when the dollar broke support at 92.14 and tumbled all the way to the next support level of 90.50.

We do not see how the dollar can enjoy meaningful support until the pandemic is contained, which could be many months from now. Indeed, the dollar could easily fall further over the next few months, perhaps to the lowest support level on this chart at 88.50, if Europe and Asia control the virus and rebound more quickly than we do, lifting their currencies at the dollar's expense.

Gold

Gold remained in a relatively normal corrective phase into early November, when price volatility abruptly increased right after the presidential election. In the first couple of sessions, gold surged from $1,900 to the short-term high of $1,966, mainly on the expectation that an incoming Biden administration would push for a much bigger stimulus package. Additional stimulus is considered bullish for gold in its traditional role as a hedge against inflation and currency devaluation.

But almost immediately thereafter, Pfizer/BioNTech announced a COVID-19 vaccine that was 90% effective in Phase 3 trials, knocking gold $100 lower as risk appetite skyrocketed on hopes for an end to the pandemic. But even with this whipsaw price movement up and down, gold remained primarily within the blue trend lines for the next two weeks, as you can see below.

Thanksgiving week brought more volatility. On the Friday after the holiday, when trading volumes are notoriously thin, gold was bullied down to short-term low of $1,780 as trading algorithms triggered stop-loss orders.

This technical sell-off was quickly bought back up on the following Monday. Then the rebound accelerated days later, driving gold above $1,860, as a new fiscal stimulus package of around $900 billion found bi-partisan support in Congress.

Given the dollar's new cyclical low and the fundamentals outlined above, gold really should be $1,950 or higher right now, rather than $1,860 or lower. And if the metal's recent history of year-end trading cycles is any guide, it soon will be.

Year-end trading cycles

For the past five years, gold has traded at a short-term cyclical low at or near the end of the year, only to move sharply higher at onset of the New Year. Why? In part, it has to do with how hedge funds and other large speculators square their year-end books.

Because gold has been in an uptrend since 2016, the market is rife with big money managers trading futures contracts. Many traders take long positions, buying futures contracts early in the year, which they then sell late in the year to lock-in annual profits before closing their books. These liquidations tend to depress the price.

In addition, lower trading volumes during the late-year holidays are also at play, making gold susceptible to being bullied lower by computer algorithms.

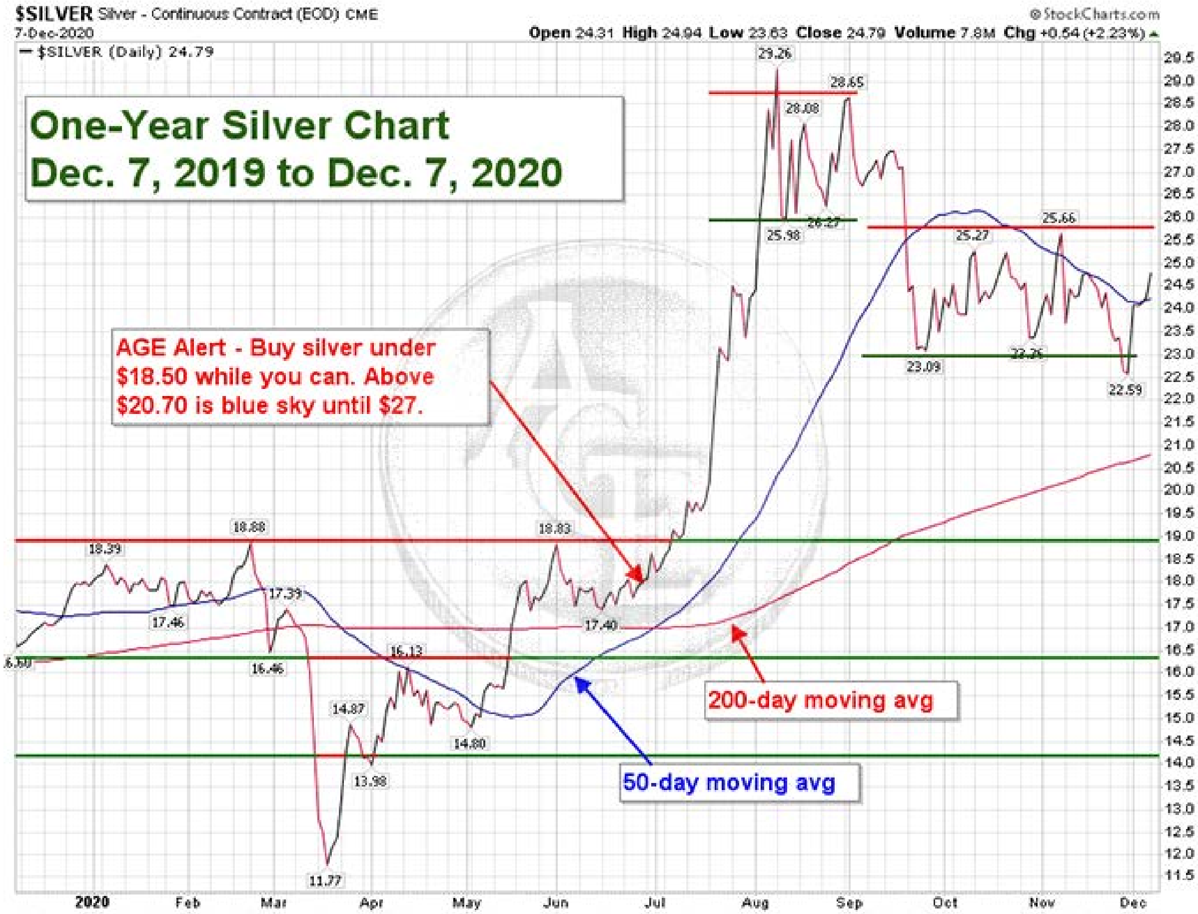
Once the New Year begins, however, the cycle reverses. New contracts are bought by traders. But more important, the festival seasons begin in China and India, the biggest gold consuming nations in the world. Gold purchases and gifts are considered auspicious during these times, driving heavy demand for physical gold in January and February. All of this contributes to gold's pattern of falling and then rising as the year turns over.

In the short-term we see support for gold at the 200-day moving average of $1,810 and again just below that at $1,780. Gold has recently surpassed upside resistance at $1,850, with the next upside resistance point at the 50-day moving average of $1,880. Resistance above $1,880 will be found at $1,925 and again at $1,975. Above that is the all-time high of $2,069.

With all these factors in mind, we expect gold to move decidedly higher in 2021, pushing above $2,069 and probably into a range between $2,200 and $2,500. As we said, none of the fundamentals that drove gold to record highs in 2020--negative real interest rates, surging US debt and deficits, and weakness in the dollar--are materially different today than they were in August.

Silver

Like gold, silver has been in a corrective phase that appears to be ending. Since hitting a cyclical high this summer at $29.26, silver retreated to short-term support at $23. While it did fall below support on the Friday after Thanksgiving, bullied by thin trade and algorithms, it rebounded by $1.50 on the following Monday. This sharp recovery encourages us to believe silver has strong support now at $23.



Silver is currently in a $23 to $25.65 trading range, as defined by the green support and red resistance lines on the chart. It is encountering short-term resistance at $24.75 after just punching over the 50-day moving average at $24.25, a bullish move. Above $24.75, silver will find resistance at $25.65 and again at $28.65. Major support at $23 has held since September, so we do not believe silver will drop below that level.

Silver lagged gold's run higher until this past August, when it played catch up with a vengeance. We expect to see another dramatic silver surge higher towards $35, like the August surge towards $30, accompanying gold's next big move, perhaps early next year. Gold will lead; silver, which has clearly shown it is "back in play" in 2020, will follow gold more responsively now.

For now, silver remains substantially undervalued relative to gold. While gold is trading near its all-time high, silver is trading at less than half of its all-time high. We highly recommend adding both gold and silver to your portfolios while the current year-end dip remains available. We would recommend a split of 60/40 or even a 70/30, with the bulk of funds going to silver.

Classic gold coins and bullion

We are happy to report that premiums on modern gold and silver bullion coins and bars are back to normal levels, with adequate supplies in the national and international markets. Mints around the world are now switching production from 2020 to 2021 dates. While some interruptions in delivery may occur over the next four or five weeks because of this changeover, they should be very brief.

Premiums for pre-1933 US gold coins, which expanded dramatically this year because of extreme demand for physical gold, have lessened over the last several months. Supplies have returned to the marketplace as higher prices and premiums have lured fresh coins out of European vaults.

As a result, some great values are available now. While the basal value of these coins has risen with the gold price, premiums for some of our favorites have slipped back below their long-term averages on the recent market correction. We like pre-1933 US gold coins because their scarcity provides leverage to the rising gold price during periods of high demand, as we saw dramatically this year.

For gold with muscle, we highly recommend the $20 Liberty MS63 and $20 Saint-Gaudens MS64 in the current market.

For investors who want greater profit opportunity through much greater scarcity, we highly recommend the $10 Liberty MS65 and $10 Indian MS65.

As 2020 draws to a close, we would like to take this opportunity to thank all of you for your business and support. It means the world to us. We sincerely appreciate your trust.

Our office will close the entire week of December 21 to 25.

We wish you all a happy and safe holiday season and a wonderful 2021!

Sincerely,

Dana Samuelson
President