3/18/2021: Gold hit by surge in yields

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Greetings!

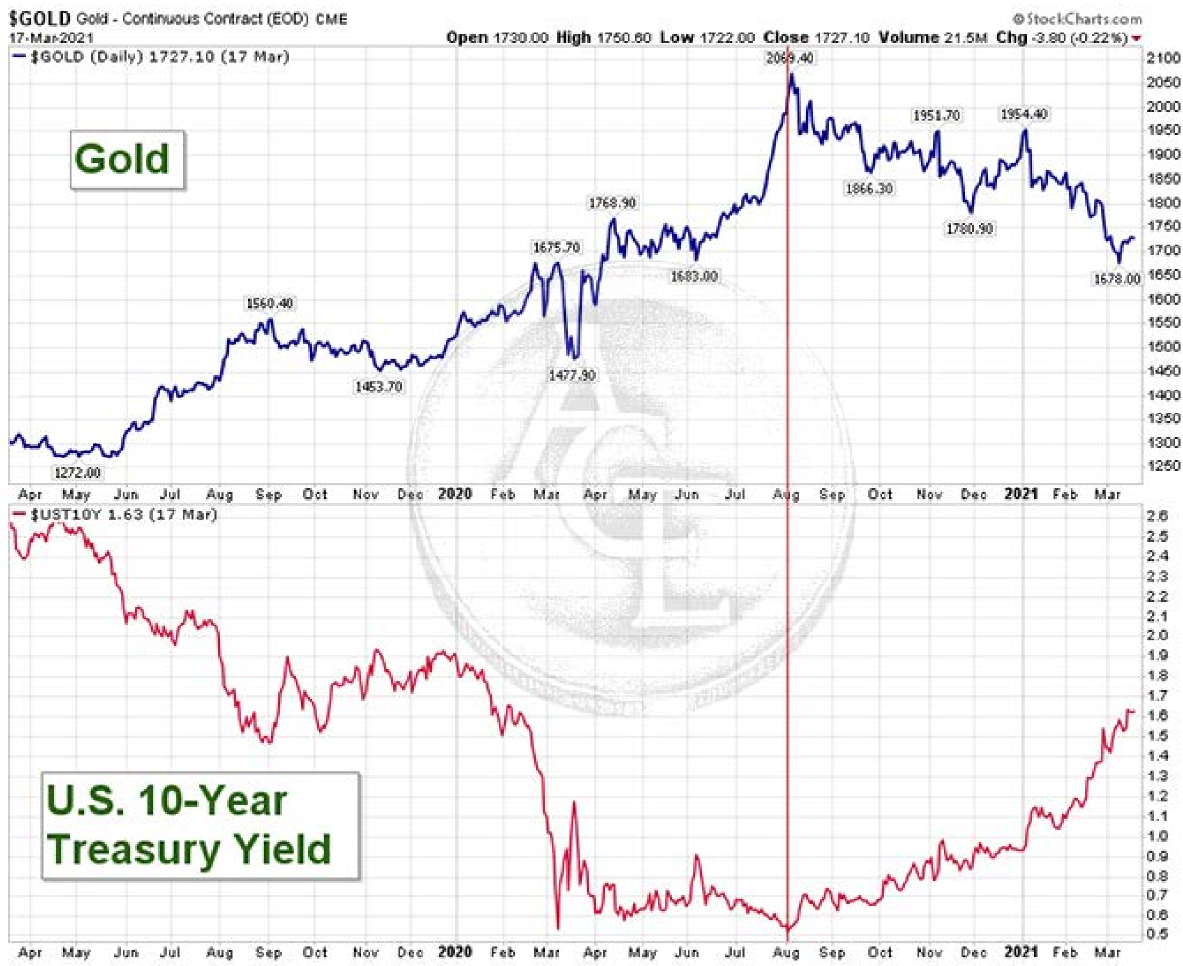
The US economy is poised to record a strong first quarter. Risk sentiment is unusually high as vaccines roll out and more parts of the country reopen after Covid-19 closures. Prices for commodities have surged in the last six months, fueling inflation concerns, and equities have pushed to new record highs.

With this growing optimism, investors have started rotating away from safe havens, causing US Treasury yields to rise and gold to pull back. While we anticipated this type of shift, it is happening more quickly than we imagined. In this Gold Commentary, we will explain ramifications of this economic transition for gold and silver.

Treasury yields surge

The most significant driver for gold since 2019 has been the yield on US Treasurys. Yields began to decline from cyclical peaks in 2018, fell steadily in 2019, and then plummeted with the onset of Covid-19 in early 2020. The trend reached its apex last August when the resurgent pandemic drove yields to cyclical bottoms and gold to a peak at $2,069.

As a rule, gold tends to move inversely to yields, rising when they fall and falling when they rise. Because gold provides no yield itself, falling yields decrease the opportunity cost for holding gold instead of bonds as a safe-haven asset.



You can see the correlation between gold and the benchmark 10-year Treasury yield on the two-year chart above. Since last August (the vertical red line), the inverse relationship between yields (lower half of the chart, in red) and the gold price (upper half of the chart, in blue) is almost perfectly symmetrical.

Following the announcement of breakthroughs in Covid vaccines in mid-November, yields started grinding higher and gold lower. Then in February, as vaccines became widely available and economic data improved, this countertrend abruptly accelerated. Exuberant investors dumped bonds in one of the biggest selloffs in years, causing yields to spike dramatically higher, roiling stock markets and pressuring precious metals.

The 10-year Treasury yield spiked up by 50 basis points, from 1.1% to 1.64%, in February. Similarly, the 30-year yield recently peaked at 2.40%, also climbing over 50 basis points. These are huge increases in a short period.

Today, the 10-year and 30-year yields are around where they were in January 2020, just before Covid-19 reared its ugly head. While they could rise further, another sharp surge like we saw in February is doubtful. Rather, a gradual grind higher like we saw last fall is more likely.

Inflationary pressure rising

After plummeting to cyclical lows last spring, prices for some of the most basic commodities have rebounded to new cyclical highs over the last three to four months. Oil is back to pre-Covid prices at over $60 per barrel, copper is 50% higher than a year ago, and lumber prices are more than double their pre-Covid levels. Food prices are rising as well, with staples like corn and soybeans jumping 50% since last fall. And transportation costs have risen due to a shortage of truck drivers and shipping containers, adding a surcharge to many items.

In other words, with the recovery underway, demand for goods and services is rising faster than they can be delivered, so premiums are being paid. And with the passage of the new $1.9 trillion stimulus bill, the pool of available money to buy these goods and services is about to increase dramatically, to almost $3 trillion when you add in household savings.

All of this adds up to a substantial rebound in consumer and wholesale inflation. Analysts are now estimating the Consumer Price Index will hit an annual rate of 2.9% in Q2 of 2021, easing down to 2.5% in Q3 2021, before easing further towards 2.2% as we move into 2022.

For gold, rising inflation has been a mixed blessing. On the one hand, it is lifting Treasury yields, which have pressured the metal, as we discussed above, by increasing opportunity costs for holding it. But in the longer term, rising inflation should prove supportive of gold.

First, gold's traditional role as an inflation hedge and long-term store of value means that it will become increasingly attractive among many investors looking to preserve spending power. Second, as yields rise in response to inflation, credit markets tighten for consumers and businesses, which can accelerate the rotation out of overvalued equities. Gold is likely to pick up a substantial amount of that investment money as investor seek safety from falling stock markets.

Fed staying dovish

Much of the recent rise in Treasury yields and the dollar, and therefore much of the recent pressure on gold, has been driven by speculation that inflation and economic growth will force the Fed to increase interest rates sooner than planned. The March meeting of the FOMC was expected to be the moment of truth, when an accelerated schedule for monetary tightening would be signaled.

Instead, the Fed laid waste to those bets by explicitly reiterating its pledge to keep interest rates near zero through 2023, irrespective of inflation. While acknowledging recent improvements and projecting faster growth of 6.5% this year, the central bank underscored full employment as its primary objective, not inflation. While hiring has picked up recent months, the US has still lost nearly 10 million jobs in the past year, and many of them are not coming back.

We have a very long way to go, and the Fed knows it. So quantitative easing will continue at $120 billion per month for as long as it takes. Interest rates will remain near zero for years to come. The cash spigot remains wide open, and that's good for gold.

Time will tell how far can market forces push Treasury yields higher before they encounter natural market resistance or central bank intervention. But as the Fed underscored in its March policy statement, the global economy has been deeply scarred by the pandemic and the US recovery still faces many headwinds. The central bank will do whatever is necessary for a full recovery.

Debt and the dollar

Our national debt has surpassed $28 trillion and the new $1.9 trillion stimulus package will swell it to almost $30 trillion this year--up from just $24 trillion in 2019. If not contained, this ever-expanding debt load will become a serious impediment to our economic health. Money that would normally go to things that help to grow our economy, like research and development or infrastructure investment, instead goes to debt service.

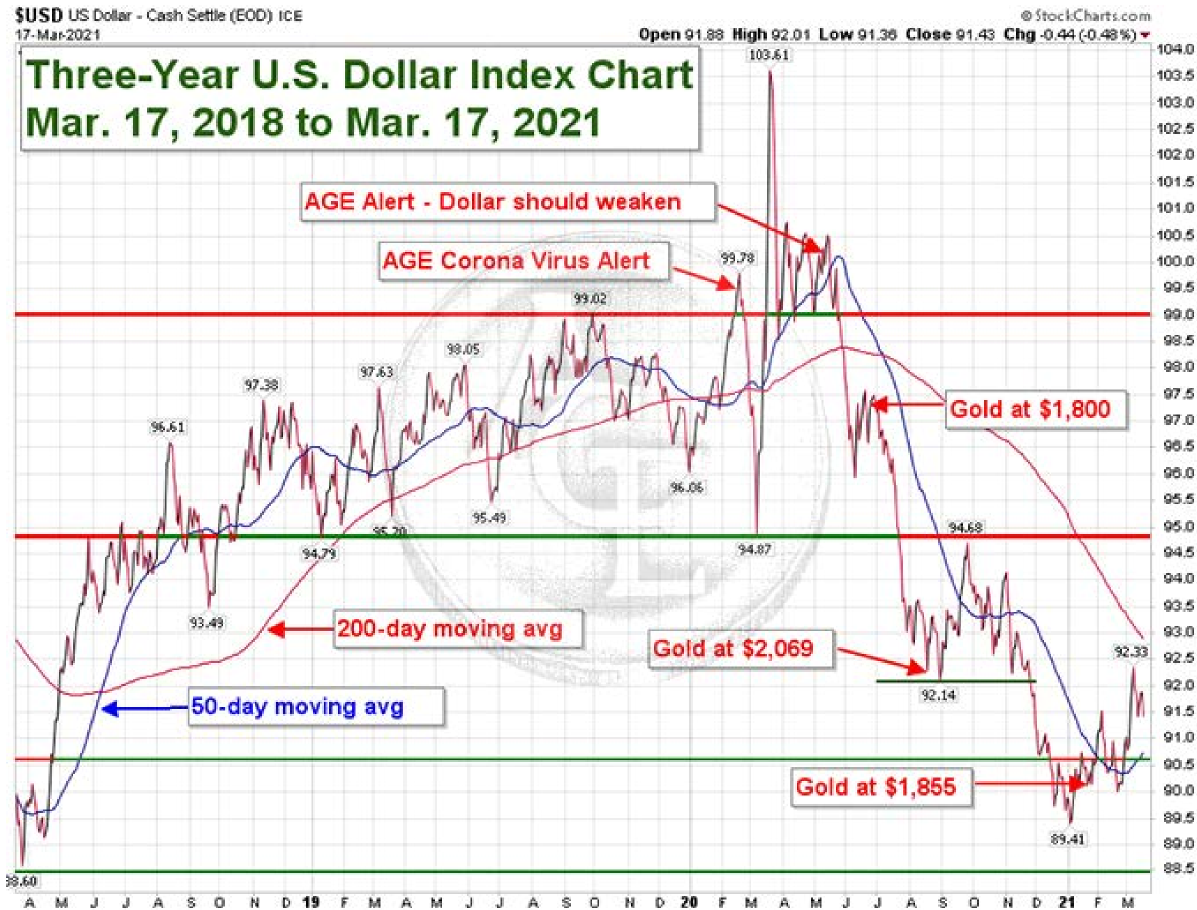
And rising debt also hurts the dollar. The dollar continues to underperform relative to the strength of the US economy and the recent surge in US Treasury yields. The ICE Dollar Index is just under 92, which is substantially lower a year ago, pre-Covid, when it was at 97. Based on the faster recovery of the US relative to Europe and much of Asia, we would expect dollar to be substantially higher.

Let's take a look at the latest charts.

US Dollar Index

As you can see on the US Dollar index chart below, the dollar has been underperforming since last August compared to the rebound in US Treasury yields. Today, the dollar has moved back above

short-term resistance at 90.50 but not by much. It will find further resistance at 92.25 and then long-term resistance at just under 95. So, the buck has a long way to go to regain the strength it enjoyed in 2018 and 2019 above 95.



With a change from the conservative Trump to the liberal Biden administration, pro-business policies and lower taxes are likely to morph into higher taxes and increased regulation, reducing the allure of the dollar to foreign investors. And the enormous increases in monetary easing and deficit spending will further pressure the currency. So, we see the dollar continuing to underperform in the short term, and potentially resuming its downward trend in the long term.

Gold

Gold has been in a corrective phase since August, one that accelerated last month due to the surge in bond yields. In mid-February, it broke sharply below major support at $1,775, falling to the next long-term support level at $1,678 before rebounding cautiously over the past two weeks. Coinciding with the February drop was its crossing of the 50-day moving average under the 200-day moving average, often referred to as the death cross.

As we have seen before, when gold has broken both above and below the major blue trend lines on the chart during this corrective phase, it has proven to be an overreaction. Based on that history, gold appears to be oversold below $1,750.

With US economic optimism so high now, and the rise in bond yields showing little sign of abating, gold could see further declines. A substantial break below $1,678 puts the next lower major support level of $1,575 into play, where gold encountered upside resistance prior to the initial Covid-19 surge in the US.

What has characterized gold's corrective phase lower since last August, absent the three drops below the blue trend lines, is a rather orderly decline in a gradual, stair-stepping fashion. If gold does continue to correct lower, we would expect it to do so cautiously.

In the short-term gold will find short-term support at $1,680 and long-term support at $1,575. It will encounter upside resistance at $1,780, and again at $1,865.

As we weather this correction, we should keep in mind the positive factors supporting gold in the near and medium terms. First, the dollar remains relatively weak despite rising bond yields. Given the staggering amount of fiscal and monetary stimulus being pumped into the economy, a substantial rise in the buck is difficult to imagine, and that is encouraging for gold because it keeps the price low in other currencies, stimulating overseas demand.

Another beneficial factor, as we mentioned earlier, is that stocks do not like rising bond yields. Should yields rise further, investors could exit equities in droves. Gold is likely to respond like it did in the fall of 2018, when the Dow tumbled 10% and the metal jumped $150. And finally, with inflation expectations rising, gold will benefit as investors seek to retain purchasing power with gold. Remember, inflation was the primary driver of the 1970's bull market, when saw gold rocketed from $41 an ounce in 1971 to $850 in 1980.

We believe gold is oversold and undervalued at current levels. But the trend is your friend, as we've said before, and the trend for gold has been lower. The good news is, we are seeing a better buying opportunity than we imagined possible just a few months ago.

The world is transitioning from a contracting and deflationary economy to an expanding, inflationary one. It is quite possible that gold is reaching an inflection point higher now, especially considering the Fed's emphatic reaffirmation of its long-term commitment to easy money policies. Keep an eye on US treasury yields; they will be very telling.

Silver

Silver has held up better than gold during the recent correction because of industrial demand. Along with platinum and palladium, silver has many applications in manufacturing--more than gold, which trades primarily as a currency of last resort and hedge against currency risk. As the global economy has reopened, demand for industrial commodities has risen.

Its underlying industrial demand has helped to cushion silver against the effects of higher bond yields. As you can see on the chart below, since surging last July to cyclical highs, silver has consolidated its gains and held up in price substantially better than gold. The Reddit buyers squeeze in early February helped to shine a spotlight on silver as well, causing an unexpected demand surge.

Silver is currently trading in a long-term range between $23 and $29.50, as indicated by the red and green support and resistance lines. This is the big picture view. Within this broad range we have the short-term support and resistance level at $26 that silver has been porpoising above and below. While market action has been choppy, a clearer uptrend has begun to emerge since the December $22.59 bottom, with higher lows holding during bouts of price weakness.

Silver's price action remains bullish above $23, and more so above $26. It will find short-term support at $24.50 and long-term support at $23, while encountering short-term resistance at $28 and long-term resistance at $29.50. A break above $29.50 puts the $30 to $35 trading range into play. The bias for silver is to the upside.

At the current gold-to-silver ratio of around 66-to-1, silver is valued fairly, relative to gold. We could see this ratio pushed lower towards 55-to-1 if silver does what we believe it will do, which is advance above $30 towards $35 over the coming months.

We recommend adding silver to your portfolio under $26 per ounce, and especially under $24.50, if that opportunity presents itself.

Physical gold & silver

Modern bullion

Modern bullion coins and bars from sovereign mints and private refineries continue to be in tight supply, with demand exceeding production capacity. Covid-19 has impaired production rates for over a year now. Demand has been strong the entire time, resulting in dealers bidding up premiums to restock merchandise.

Compounding this problem, the US Mint has decided to issue a new design this June on their popular 1-ounce Gold Eagles and Silver Eagles, the first design changes since 1986. Our best guess is that the Mint wants to clear the shelves of the old design before introducing the new. So, their allocations have been lower than normal while demand has been high. As a result, premiums for gold and silver eagles are as high as we have ever seen them.

Fortunately, alternatives exist. We have been aggressively stocking Canadian Maple Leafs, Austrian Philharmonics, South African Krugerrands, and Pamp Suisse and Valcambi bars at lower, more competitive pricing. In addition, we've done our best to make sure our premiums for everything we offer are among the lowest in the industry.

Please visit our Gold Bullion and Silver Bullion pages for current availability.

As these bullion products become available, we buy them immediately, but the logistics of getting them shipped to us in a timely manner are not always within our control. We never offer any bullion products we do not own, and our supply lines are among the most reliable and experienced in the industry. We appreciate your patience and understanding during these tighter than normal market conditions.

Pre-1933 US Gold Coins

Supplies of pre-1933 US gold coins remain smaller than normal but plentiful enough that we have not seen price shocks. At least not yet. Prices have come down somewhat during the recent correction in the gold price, creating some excellent values.

We recommend the larger $20 and $10 gold coins, which have remained very popular over the last year. Their fundamental scarcity means they can provide added leverage to the gold price during periods of peak demand. Plus, their status as collectibles means they are exempt from broker reporting requirements, making them more private and secure than bullion.

Currently, the best values in the market are in $20 Saint-Gaudens MS63 and $20 Liberty MS63. These large double eagles in choice uncirculated grade offer the best combination of scarcity, premium, and low price. And what's even better, we're offering special discounts on both coins while supplies last, so get them while you can!

I wish to close by thanking you for your patience and loyalty. Recent months have been challenging, with sudden supply squeezes and our week-long closure due to the record-breaking cold spell here in Austin. You are the reason we enjoy a thriving and vibrant business, and we dearly appreciate all of you.

Sincerely,

Dana Samuelson
President