StoneX Strategy

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10 April 2024

Gold & Gold Miners: Taking Profits and Monitoring Investment Demand

In the past couple of years, higher interest rates have generally dampened private sector institutional investor appetite for gold, evidenced by declining ETF gold holdings. In our analysis, the recent rise in the gold price has been largely driven by increasingly important geopolitical factors. Geopolitics, including efforts to diversify FX reserves away from the dollar, have informed official sector (central banks, sovereign wealth funds, etc.) attitudes towards gold.

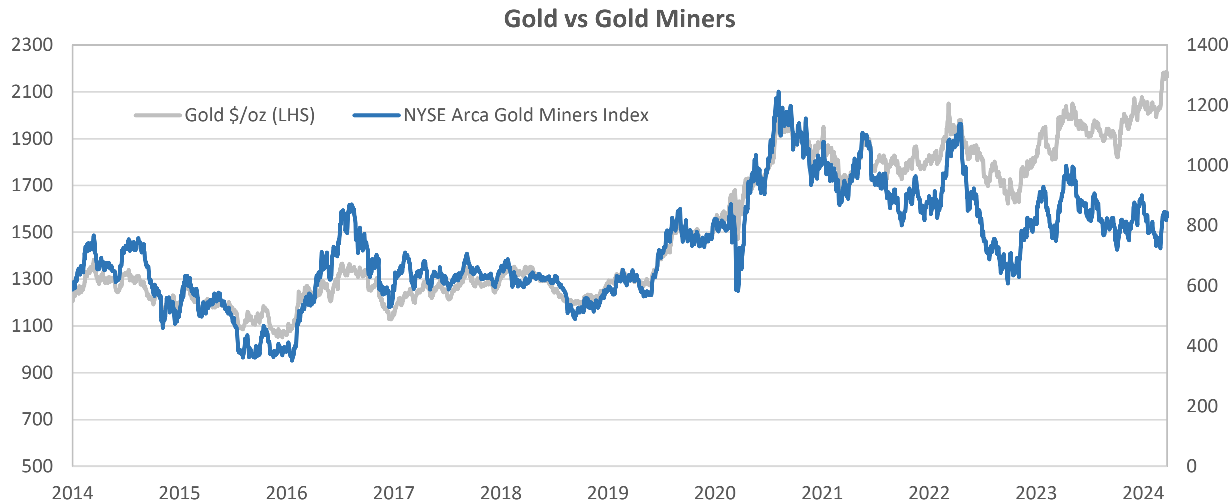
Strong official sector net purchases, while providing vital physical demand in the market, also send an important psychological message to other market participants—the desire to hedge risk.

For context, in 2010, net official flows were $2.8 billion, and in 2023, they were $64.5 billion—a CAGR of 27%. The official sector, which had for many years been a net seller of gold, turned net purchaser in 2009 in the wake of the Global Financial Crisis and has been a net buyer ever since.

Official sector demand has helped drive gold prices to new all-time highs. Meanwhile, the gold miners index remains well below all-time highs, primarily due to profit margin pressures and lack of investor interest in the asset class. The recent move in gold and gold miners looks near term extended as of April 9th. We are tactically closing our gold long from Jan 30th after a +15% move that has exceeded our year end price target. Given the potential trend exhaustion, we would recommend taking profits on gold and gold miners at current levels and waiting for a more attractive entry point.

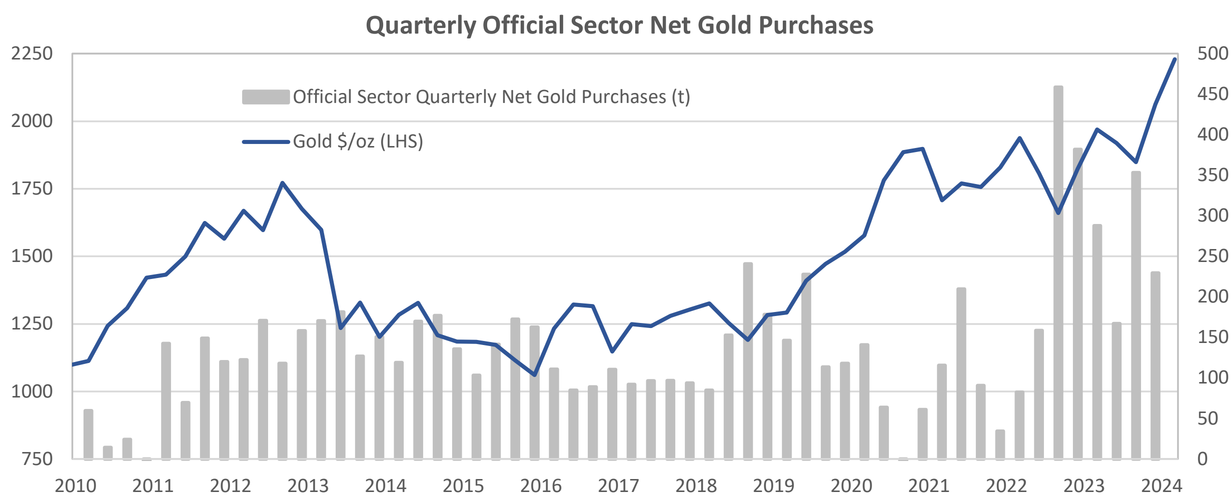
	Spot	End- 2024 Forecast
USG10Y	4.13	3.75
USG30Y	4.38	4.20
DXY	103.60	100.00
EUR	1.08	1.12
JPY	147.82	142.00
SPX	4875	5000
Gold	2018	2180
Copper	8563	8900
WTI Crude	77.46	82.00

Source: StoneX, Bloomberg (as of 1/25/2024)



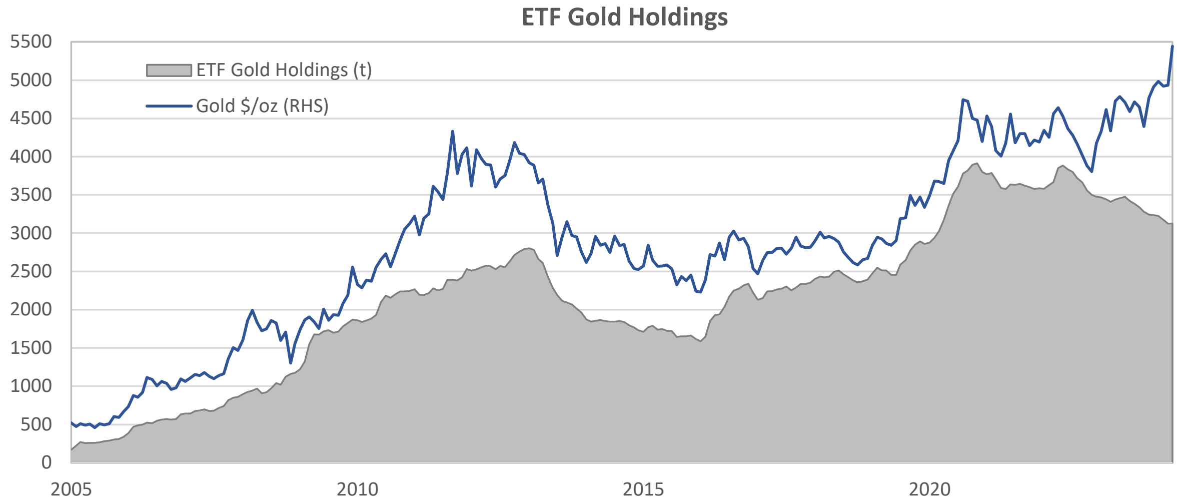
Source: StoneX, Bloomberg

Official demand for gold increased dramatically following the 2022 imposition of international sanctions on Russia, specifically the SWIFT ban and asset freeze (note that many major gold purchasers recently have been in Asia and Eastern Europe). Also, in a break with their tradition of neutrality, even Switzerland participated in the Western sanctions on Russia, making the Swiss franc less of a safe haven. Increasingly, many central banks are diversifying away from sovereign currencies into gold.



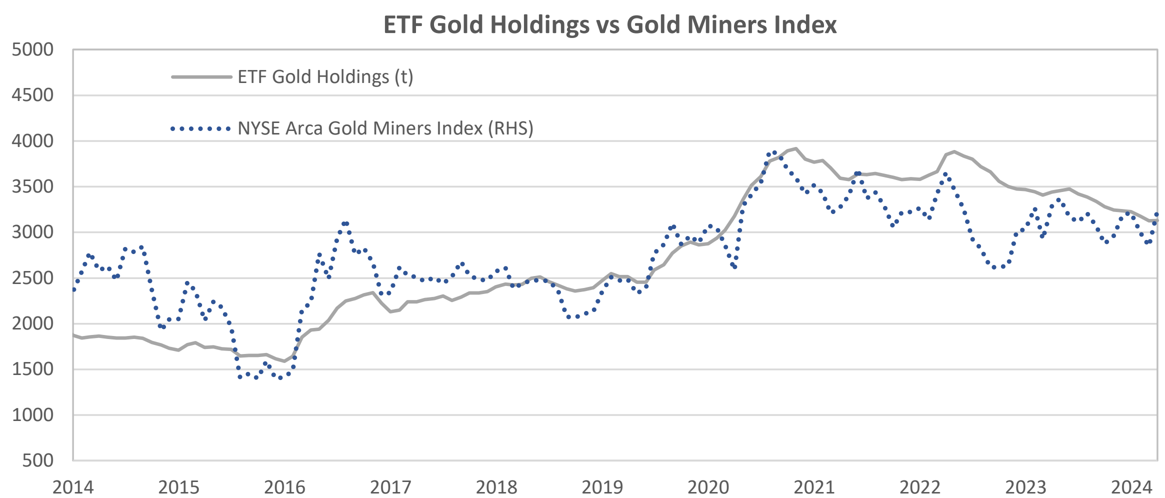
Source: StoneX, Bloomberg, World Gold Council

In contrast, ETF investors have reduced gold allocations. Rising interest rates have induced yield chasing and increased the cost of carry for physical investment, overpowering the risk mitigation allure of gold for some investors. Total ETF gold holdings (measured in metric tonnes) have declined by 20% since the peak level in late 2020. Currently, total ETF gold holdings stand at 3,130t, equivalent to ten months of global mine production, and just 10% above the late 2012 holdings level.



Source: StoneX, Bloomberg, World Gold Council

Low investor allocations leave plenty of room for re-accumulation of gold positions over the medium-term, which is bullish from a contrarian perspective. Indeed, we are already starting to see some ETF buying. In the near term, renewed investor demand would be a catalyst for the miners. As the chart below illustrates, the gold miners index tends to follow the level of ETF gold holdings (a proxy for investor interest in the asset class). Without investor demand, it is hard for the miners to participate in the gold bull market; not only for price-related reasons but because of the necessary contagion of bullish sentiment. Central banks buy gold not for profit motive but for FX reserve diversification and risk management. Moreover, they buy gold, not gold mining stocks. **As such, the bid for gold has not translated into a bid for the equities.**



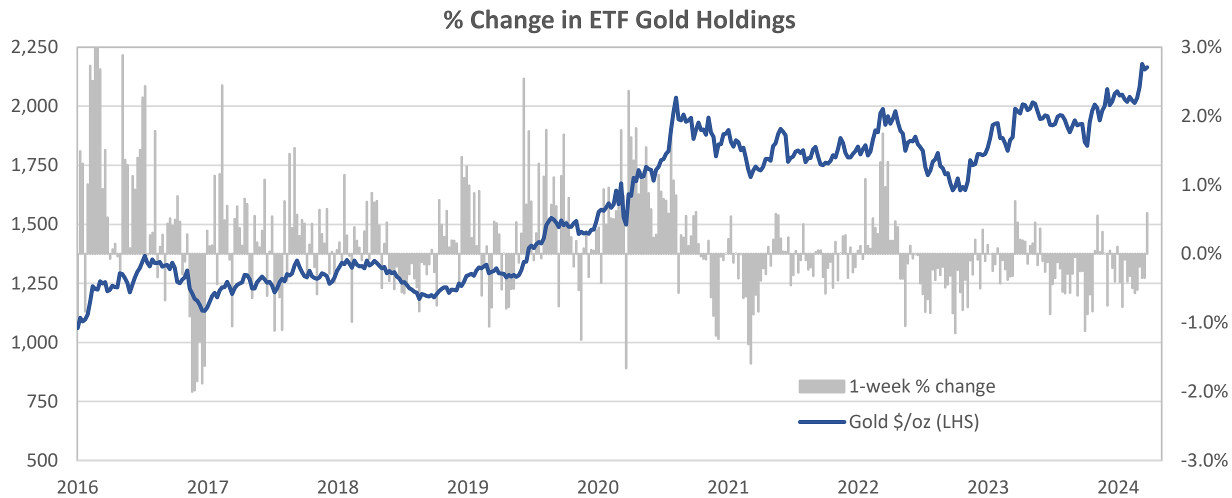
Source: StoneX, Bloomberg, World Gold Council

Fundamental reasons also underlie recent underperformance. Historically, mining companies have offered leverage to the gold price such that when gold rises by x percent, the profit margin rises by a multiple of x. However, the past few years have been different. Many mining companies have allowed costs to rise along with the gold price, attributable potentially to complacent management. However, in some cases it is deliberate as certain miners have flexibility to move to lower grade ore areas in order to conserve mine life.

Higher gold prices have not necessarily translated into improved margins. Work by consultants “Metals Focus”, shows that since the end of 2020, the ratio of gold mining majors' EBITDA to the gold price has been falling, which to some extent reflects reduced production. Capital expenditure has been under pressure, and in some cases has not been enough to maintain production at current levels.

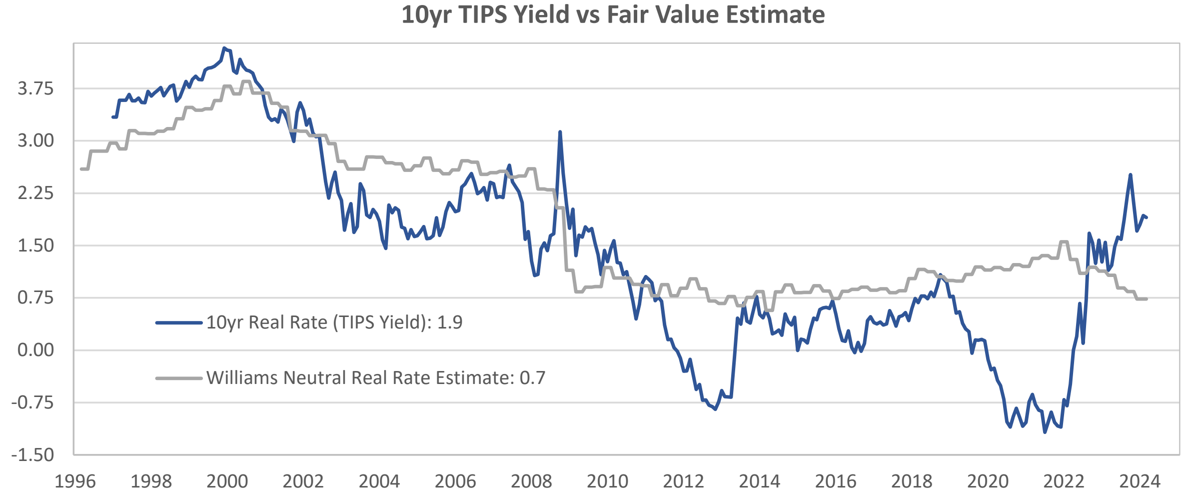
In addition, mining companies have faced profit margin pressure from labor shortages and input cost inflation. Input costs have risen faster than the gold price in the past few years, hurting the bottom line. If the recent breakout in the gold price continues and higher price levels persist, mining margins should improve.

An increase in investor demand for gold would theoretically bode well for the gold mining stocks. Constructively, the week ending 22nd March saw the biggest inflow to gold ETFs in more than a year. Gold ETF inflows would likely imply a growing belief among investors that higher gold prices are sustainable, which would in turn help support estimates of fair value for mining businesses. Specifically, a higher assumed long-term gold price should improve projections of profitability for mining companies.



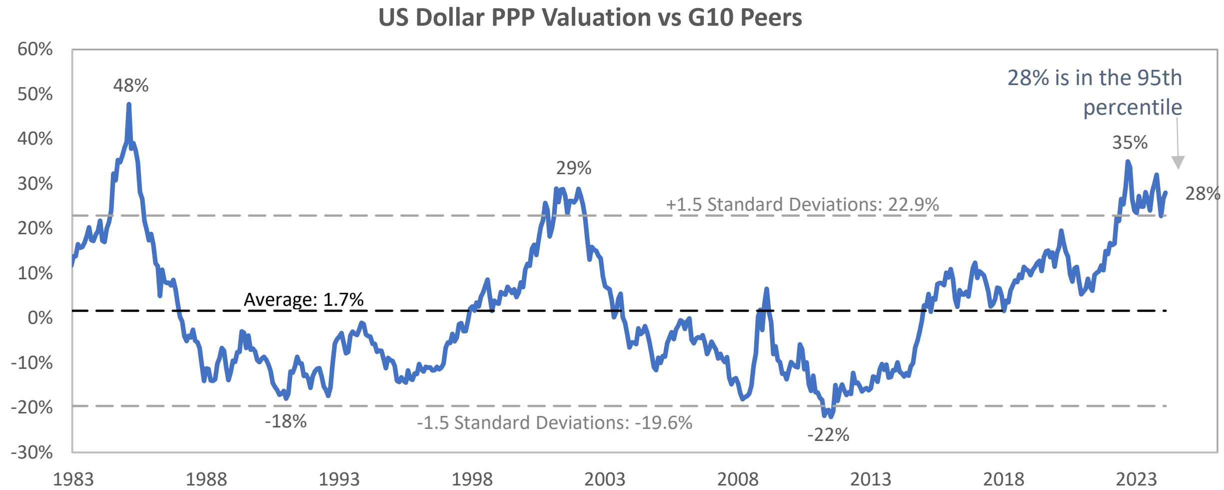
Source: StoneX, Bloomberg

Turning to macro, gold tends to follow the inverse of US real rates and the US dollar (all else equal). Our analysis suggests that both should be declining over the medium-term. 10yr real rates are above estimates of fair value and the US dollar is significantly overvalued from a purchasing power parity (PPP) perspective. According to the model developed by John Williams (NY Fed President), the neutral real rate is more than 100bps below the current 10yr TIPS yield. The bottom line is that real rates have room to fall, which would likely provide a tailwind to gold.



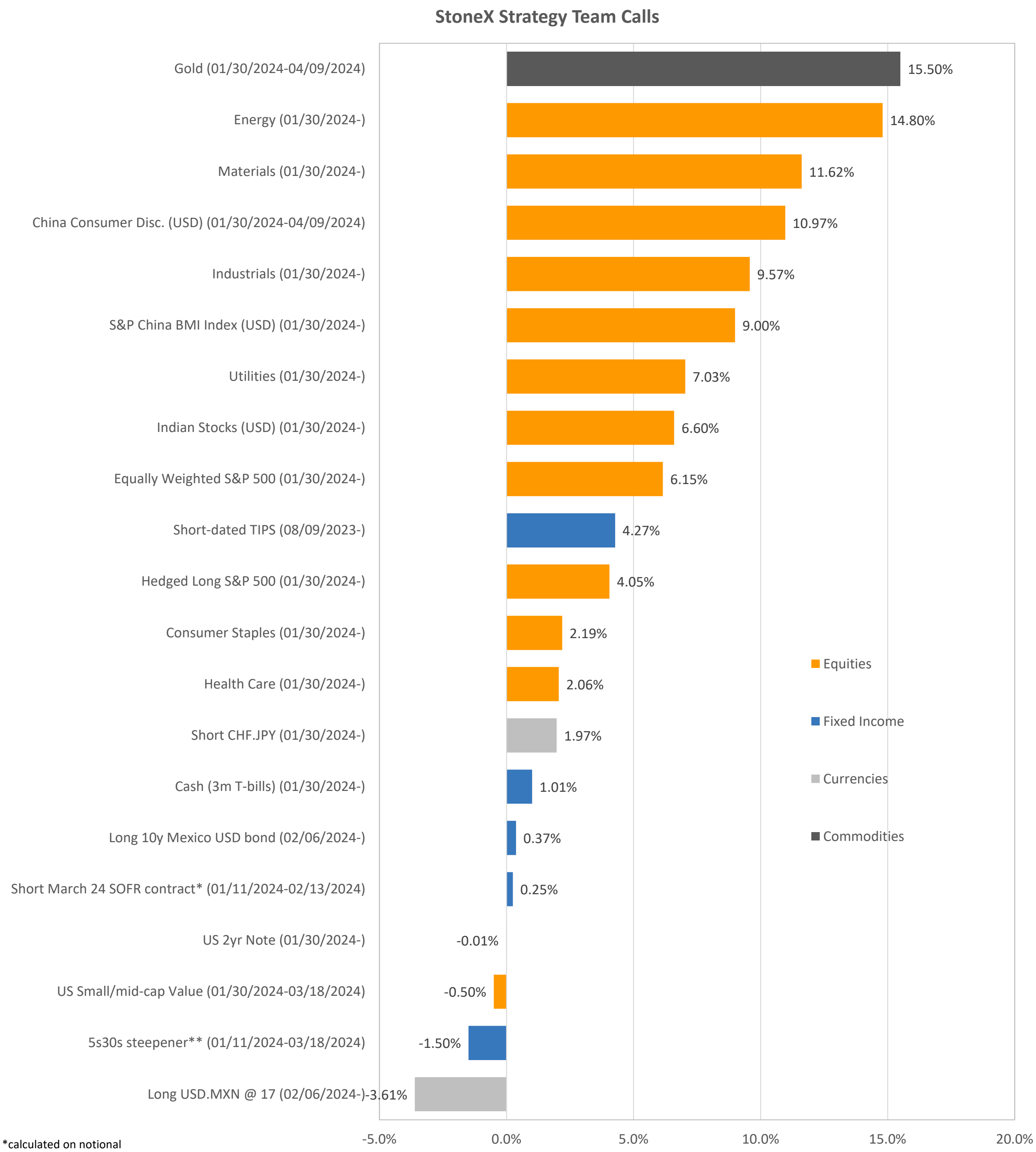
Source: StoneX, Bloomberg

On the US dollar, our analysis suggests that the dollar entered a secular bear market in late 2022. With a relative PPP overvaluation of 28% versus G10 peers, the dollar is likely to continue to decline in the decade ahead, further providing a tailwind to gold prices.



Source: StoneX, Bloomberg

Medium to longer term, we remain structurally positive on gold and gold miners but are looking for a tactical pullback in the near term and a more attractive re-entry point. We are taking profits on our long call gold from Jan 30th and also taking profits on our China equity longs from the same report.



*calculated on notional
** calculated on notional of 5yr note futures long leg

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Further Reading from StoneX Cross Asset Strategy

- Mar 18, 2024 StoneX: Fed Unlikely to Cut Much This Year as US Economy Grows Above Potential—Cross Asset Market Strategies
- Mar 14, 2024 StoneX Equity Strategy: This is Not 1999 (Yet)
- Mar 5, 2024 Around the Horn with StoneX Cross Asset Strategy Updated 2024 Outlook Presentation
- Feb 13, 2024 StoneX Equities Strategy: Stay Long and Hedge
- Feb 9, 2024 StoneX Strategy: Fade March Cut Probability Worked. On to Steepeners
- Jan 30, 2024 StoneX Strategy 2024 Outlook
- Jan 11, 2024 StoneX Rates Strategy: Fade the March Cut Probability
- Jan 8, 2024 Deciphering Mixed Signals: US Data Suggests to Prepare for Surprises
- Dec 12, 2023 StoneX Strategy: Rates Outlook
- Dec 19, 2023 Post Pivot Party - Stay Long but Buy Cheap Insurance
- Dec 7, 2023 StoneX Strategy: The Mexico Moment
- Nov 16, 2023 Market Strategies as the Tide Turns
- Sep 14, 2023 'No Landing' and 2% Core Inflation a Challenging and Historically Improbable Event
- Aug 3, 2023 Countercyclical Portfolio Policy: Chartpack
- Jul 18, 2023 StoneX Strategy: Countercyclical Portfolio Policy

StoneX Speaker Series and Livestreams

- Mar 5, 2024, 2024 Outlook: Economics and Market Strategies, Hosted by Kathryn Rooney Vera. Team of StoneX analysts updated views for 2024: global macro, equities, fixed income, commodities, FX, and cryptos.
- Nov 7, 2023, On Emerging Markets and Mexico: Banxico's Irene Espinosa, Van Eck's Natalia Gurushina, PhD, and Kathryn Rooney Vera Nov 7, 2023
- Oct 4, 2023, Apollo's Torsten Slok, Jon Hilsenrath (former WSJ)
- Aug 28, 2023 On Fed, inflation and US growth: Claudia Sahm, PhD, Rebecca Patterson, and Kathryn Rooney Vera
- Aug 10, 2023, Conference Board's Dana Peterson and Jonathan Smoke (Cox Automotive)
- Jul 26, 2023, Danielle DiMartino Booth (Quill) Intelligence

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