Is it time to take profits in gold?

Momentum may have carried gold too far. Since the market turbulence ended in March, the gold price has been making new highs and breached $2,000/oz. However, other safe havens have not moved as far. The 10-year US Treasury yield has only just moved to a new low and the yen has not strengthened beyond its level in March. In addition, the economic recovery that has taken place following the easing of lockdowns is not enough to justify the current level of stock markets in the US or Germany. Another bout of market volatility could see gold sell off again, as happened in March.

Dollar weakness could reverse and then gold would struggle. The dollar has been weakening against the euro for some time and this has helped gold’s rise. However, speculative futures contracts long the euro, and therefore short the dollar, have just reached a record level. Previous extremes have occurred around turning points. This suggests that the dollar’s weakness could soon reverse and that would be a headwind for gold.

Central bank monetary policy is not inflationary. The ECB has been matching the Fed euro for dollar in expanding its balance sheet, with both now over $7 trillion. When gold reached its previous record high in 2011, the Fed was in the middle of QE2 (Quantitative Easing 2), having expanded its balance sheet from $900 billion in 2008 to $2.9 trillion in 2011. Meanwhile, the Eurozone was dealing with the Greek debt crisis. However, inflation has not increased. US core CPI (excluding changes in energy and food prices) has been less than 2.5% since 2008, as has the EU’s Harmonised Index of Consumer Prices (HICP). Inflation is showing up in financial asset prices, not CPI.

Bond yields near historical lows demonstrate more concern about deflation than fear of inflation. Real interest rates are negative which tends to boost gold. However, the Fed has said it will not move to negative interest rates, and should inflation turn into deflation then the real interest rate will rise which would also be a headwind for gold. Buying gold at these levels offers much less of a margin of safety.
The silver price continued its ascent last week and hit a seven-year high of $29/oz. The price has now rallied by over 140% since an intra-day low in March, with over 34% of gains in July alone, representing one of the best months on record for silver. The gold:silver ratio remains at 73, as gold and silver moved in tandem last week. As well as strong retail investor demand, silver's price rally is likely being supported by a rebound in industrial activity, which means a sustainable rise above its current price relies on this demand being maintained (and the avoidance of a second wave of lockdowns).

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The gold price pushed through $2,000/oz last week, as it continues to be supported by low interest rates and a weakening US dollar. The price has rallied 35% in the year to date, including 11% in July alone. Such a steep rally suggests a downward correction in the near term is likely (if only partially).
Does a rising palladium price signal a temporary squeeze? The palladium price rallied again last week (+7%) to close to $2,250/oz, hinting at tightness in the market. Refined metal output is expected to have been at its lowest between May and June, resulting in a tighter market moving into the second half of the year. Despite the three-week lockdown in South Africa, refineries remained operational and continued to process stocks, thus maintaining some degree of supply. Now those stocks have been drawn down and recycling volumes are low, a potential recovery in autocatalyst demand later in the year could coincide with limited supply. Refined output in the second half of the year is currently forecast to be around 20% lower than demand, although this deficit could be reduced if vehicle sales fail to rebound as quickly as anticipated.

 Delayed 5G uptake will curb iridium electrical demand this year. Slowing smartphone sales, particularly those on the new 5G network, are likely to limit potential upside for iridium demand this year. Iridium crucibles are used to help produce surface acoustic wave (SAW) filters for various electronic devices, and improvements in smartphone functionality are increasing the number of SAW filters used per device. The widespread rollout of 5G networks and 5G-enabled smartphones was expected to stimulate smartphone sales (and iridium crucible demand) in 2020. However, the effect of Covid-19 on consumer spending means global smartphone shipments are estimated to fall by 15-17% this year (source: International Data Corporation). Consumer sentiment is expected to remain subdued throughout the year as countries grapple with the economic repercussions of the pandemic. Electrical applications such as crucibles and hard-disk drives are the largest market for iridium, accounting for 30% of total consumption last year (~70 koz).

After several attempts, rhodium broke through $9,000/oz last week and is now trading above $10,000/oz. The move was triggered by a recovery in automotive demand and reduced availability of refined metal owing to Covid-19. It seems that the fundamentals for ruthenium and iridium are already priced in, as prices remained unchanged for another week.
Silver price

The silver price broke through $29/oz last week for the first time since 2013 in a stellar rally which saw it outperform gold again.

China jewellery sales

Jewellery demand sank by more than 40% at the start of the year, and was still down by more than 20% year-on-year in the first six months of 2020.

2020 3E PGM supply* vs. 2019

Impact of Covid-19

Mine ramp-up

Higher recycling supply in Q2

* includes recycling

Iridium demand 2019

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