



Fundamentals Flash

12 July 2018

Short-term global headwinds present long-term investment opportunities in **GOLD**

Global financial markets kick-started 2018 with much enthusiasm – where the synchronised and broad-based expansion seen from the year before seemingly showed further room to run. But like all rallies, the tranquil conditions ended quite abruptly as escalating trade tensions between the United States (“US”) and China took centre stage and imbued uncertainty into markets.

In the wake of rising volatility, various indicators have pointed towards a slowdown in global growth for the year. Emerging markets in particular endured a broad weakness as a result of a growing divergence in policy stance between the rate-hiking US Federal Reserve and most other central banks in the region. Currencies, including those in Asia, have also shown cracks against the recent strengthening-bias of the USD.

So how have *gold* prices fared thus far?

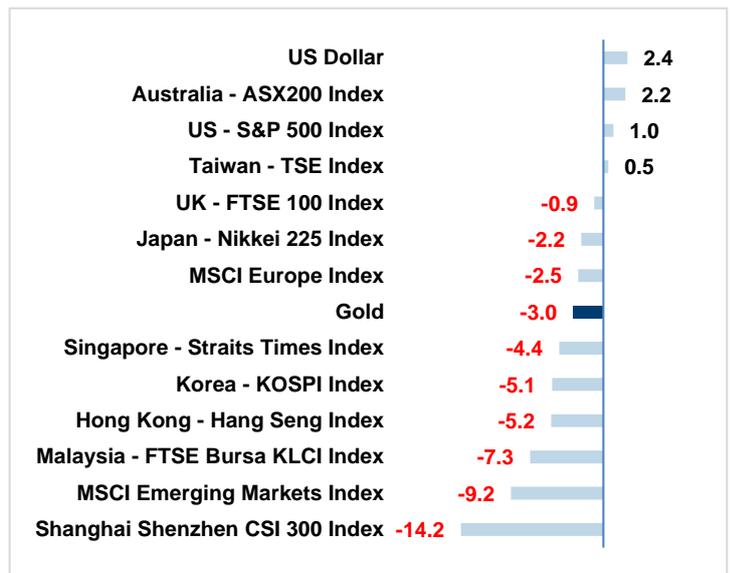
Well, considering the current trying environment, many would expect gold prices to swell given its safe haven attributes. But on the contrary, the US greenback – amid its recent strength – has stolen the limelight as the preferred “shelter” in this dire period; and this has dampened the performance of gold given the inverse relationship between the two assets as shown in Figure 1.

Figure 1: Gold Price Movement vs DXY (USD) Index



Source: Bloomberg as at 2 July 2018.

Figure 2: Performance Comparison in USD terms (%)



Source: Bloomberg as at 27 June 2018.

But in spite of the softer outing, gold has remained true to its “long-term wealth preservation” attribute, and still held up relatively better as compared to other regional indices this year, as portrayed in Figure 2.



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Better times ahead for Gold?

With demand and supply for the royal metal holding steady, the largest factor that is currently affecting gold prices is the recent surge in USD.

Nonetheless, current indicators are suggesting that the greenback is seemingly approaching its peak and trading into “overbought” territory. Moreover, longer term risks still looms for the said currency as the US budget deficit is estimated to surpass US\$1 trillion by 2020 following recent tax cuts and spending increases by the Trump administration – which many believe could cap further upside for the USD in the medium term.

In the midst of a weakening global growth outlook and heating trade tensions, we expect market volatility to heighten in 2H2018 which could further dampen the performance of both the equity and bond space. And given gold’s low correlation with most asset classes during times of market turbulence, we could potentially witness a shift in fund flows toward the royal metal in the foreseeable future.



Gold in demand!

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- Gold remains widely used as a store of wealth and jewelleries alike, especially in regions such as China and India; where demand for the yellow metal continues to grow.

Purchases by Central Banks

- Central banks have been net purchasers of gold in the past 5 years.
- Russia, Turkey and Kazakhstan, have collectively contributed to almost 50% of the said purchases – as these central banks move toward reducing their holdings of US debts.

Gold for the long-term

While recent headwinds have asserted downward pressure on the performance of gold, we think that the current price correction presents an opportune entry for investors seeking for long term diversification, or a hedge to combat economic stress.



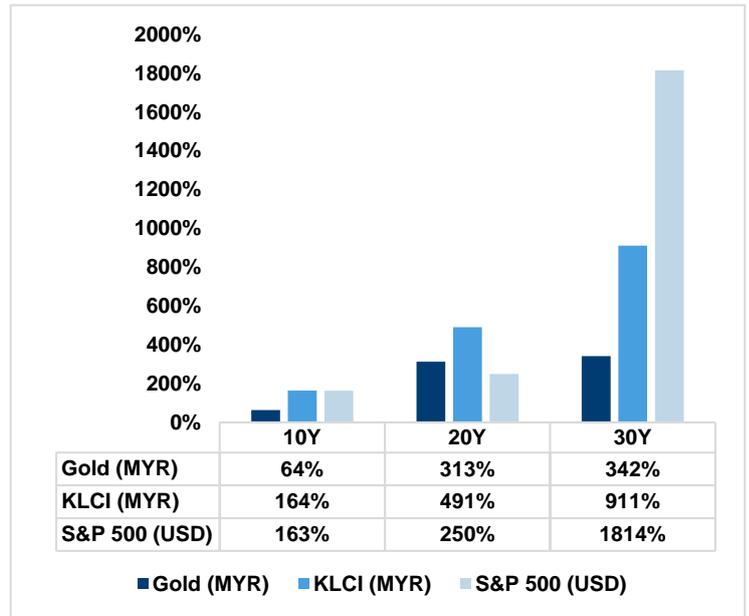
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Bear in mind, gold’s low correlation – with the likes of stocks – does not only work for investors during periods of turmoil. Due to its dual nature as luxury good and an investment, gold’s long term price trend is supported by income growth. Hence when stocks rally strongly, the wealth effect could increase their correlation to gold – benefitting its performance in the process! As evident in Figure 3, gold has been delivering positive returns over the longer term; even comparable to equities in some instances.

After all is said and done, the royal metal’s status as a natural hedge and long term store of wealth is undeniable – which makes the case as to why it should be an essential component of any diversified portfolio.

Figure 3: Long-term Returns of Gold, KLCI, and S&P 500



Source: Bloomberg as at 2 July 2018.

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