Market Insight

Gold Outlook to Q3 2024: Galvanized by geopolitics

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WisdomTree.eu
+44 (0) 207 448 4330

As we go to publish this outlook, gold has clearly been given a lift from geopolitical stress. The war between Israel and Gaza has driven many to search for safe-haven assets and gold is a top contender.

However, in the weeks leading to this publication, gold was getting flanked by the twin headwinds of an appreciating US Dollar and a bond sell-off. Gold held relatively well against such pressures but began to wilt, with the 50-day moving average (DMA) price falling below the 200-dma toward the end of September. That is what technical analysts call a “death-cross”. However, despite its ominous name, that technical marker often signifies a new base. And true to that, gold has rebounded significantly, despite those bond and currency headwinds intensifying.

While we don’t know how prolonged or severe the war will be, destabilisation in the Middle East serves as a reminder that geopolitical, financial or economic stress can flare up at any moment and the best time to have an ‘insurance asset’ is before the event takes place. Gold is thus a valuable strategic asset.

While institutional demand for the metal has been muted for months, retail demand, especially in China and Turkey, is very strong. Central banks have also been very active in the gold markets this year and we don’t expect that trend to subside. Although demand in those pockets maybe seems like a reaction to localised concerns, we believe that globally, institutional investors are likely to be increasingly concerned about global risks – geopolitical and financial – and seek more hedging tools.

We acknowledge that the fight for institutional investor attention is going be difficult when defensive assets like US Treasuries are proving a yield (to maturity) of over 5% on the 2-year and close to 5% on the 10-year, compared to the zero-yielding asset that is gold. However, gold has proven to be a very effective hedge against financial, geopolitical, and inflationary risks. While many thought that inflationary risks were under control a few weeks ago, a resurge in energy prices has led many to question that assumption (and once again should support the demand for hedging instruments).

Geopolitics and gold

Gold is also viewed as a ‘safe-haven’ asset, meaning that during periods of economic uncertainty or heightened geopolitical risk, investors have historically turned to the precious metal for protection, pushing its price up. As such, gold can act like a form of portfolio insurance and help provide downside protection during market turmoil. Our analysis shows that when the Geopolitical Risk (GPR Index) has risen 1 standard deviation above its historic average (indicating heightened geopolitical tension), gold has risen 9% year-on-year (y-o-y) on average, while the S&P 500 Equity Index has fallen 8.6% y-o-y in those months[1]. Figure 1 shows how gold has performed after a range of key financial and geopolitical events.

1. Based on annual growth data from January 1986 to September 2023. Gold based on spot prices from Bloomberg, S&P 500 data from Bloomberg and Geopolitical Risk (GPR Index) from https://www.matteoiacoviello.com/gpr.htm

Figure 1: Gold's performance after financial and geopolitical events

	Event date	Gold Price Change 1 year forward	World Equities Price Change 1 year forward	Relative gold outperformance
Greece government deficit announcement	20/10/2009	26.5%	4.4%	22.1%
Global financial crisis	15/09/2008	31.6%	-12.7%	44.3%
9/11 terrorist attack	11/09/2001	16.9%	-15.1%	32.0%
Dotcom bubble	11/03/2000	-6.0%	-17.5%	11.5%
Desert Storm (First Gulf War)	02/08/1990	-3.5%	-2.9%	-0.5%
Junk bond crash	13/10/1989	6.9%	-16.0%	22.9%
Black Monday	19/10/1987	-11.6%	-0.7%	-10.8%
Nixon's resignation	09/08/1974	14.9%	4.4%	10.5%
Yom Kippur War	06/10/1973	47.4%	-42.0%	89.4%

Source: Bloomberg, WisdomTree. January 1971 to October 2023. Gold is based on Bloomberg spot prices and Equities are based on the S&P 500 Index. **Historical performance is not an indication of future performance and any investments may go down in value.**

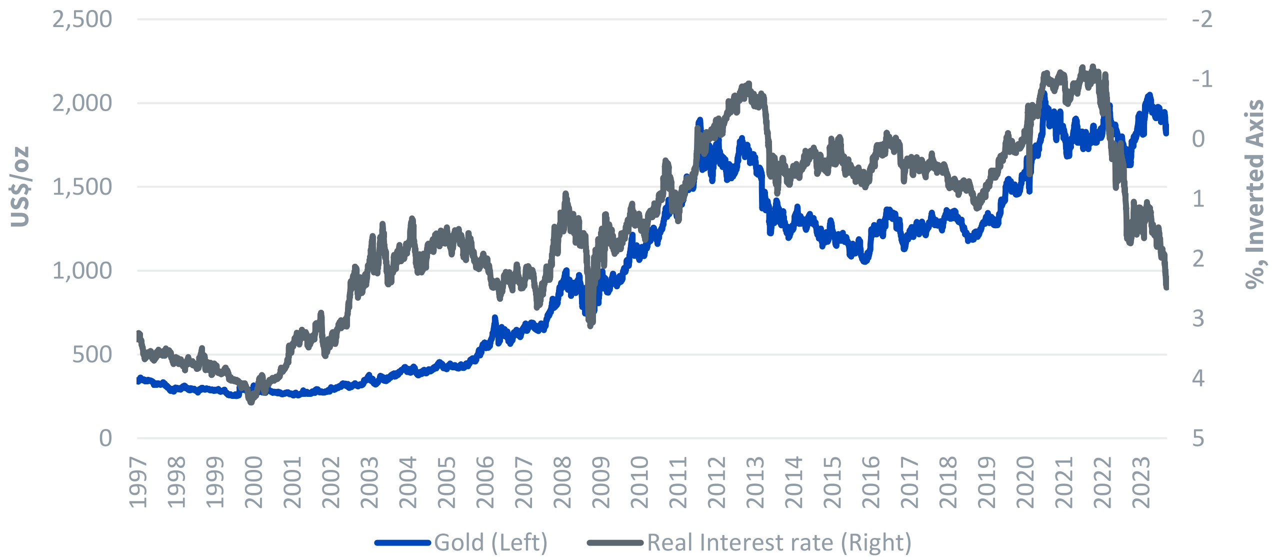
We stress that we don't know how long or severe the current turbulence in the Middle East will be, but historically gold has served as a valuable hedging tool.

Bond markets and gold

Markets are expecting Federal Reserve (Fed) policy interest rates to be 'higher for longer'. In contrast to most rate cycles, when cuts start to come into play shortly after the last hike, bond markets are expecting a long pause at the top. That has driven 10-year nominal Treasury yields to the highest level since 2007 and real yields to their highest since 2008.

Gold, however, is holding its own, with the yellow metal continuing to defy the historic real yield-gold relationships.

Figure 2: Gold vs. real rates (Treasury inflation-protected securities yield)



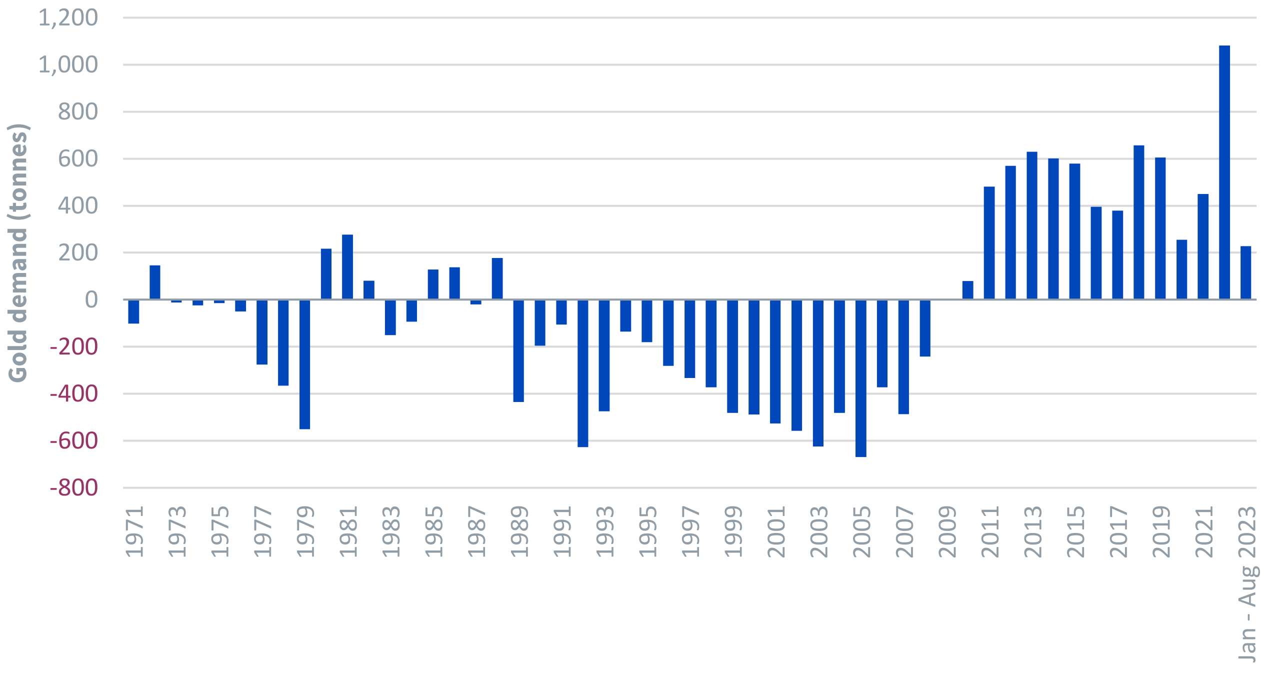
Source: Bloomberg, WisdomTree. 30/01/1997 – 24/10/2023. **Historical performance is not an indication of future performance and any investments may go down in value.**

In past editions of our Gold Outlook, we have commented on bond yield curve inversions (10-year yields below 2-year yields) and their predictive power of recessions. Gold tends to perform strongly in recessions. The lag between an inversion and a recession can be long and usually more than a year. We are at least 15 months into the current inversion, and we are not yet in a recession. However, markets are jittery and expressing anxiety about what is to come. In recent weeks, the yield curve has become less inverted. However, that shouldn't be interpreted as a positive sign for the economy. Firstly, historically we have seen yield curve inversion usually unwind around the time a recession starts. Secondly in the past, most dis-inversions have occurred as a result of shorter yields (2-year yields) declining, in an event called "bull-steepening". Right now, we are seeing the dis-inversion due to longer yields (10-year yields) rising. This "bear steepening" from an inverted curve is not very common. The very few past examples don't offer us good insights into what that means for the economy or gold.

Central banks' demand for gold

After hitting an all-time high in 2022, central bank demand for gold has maintained strong momentum. Figure 3 shows annual official sector gold buying since 1971 and cumulative purchases in the first eight months of 2023. Between March and May 2023, Turkey's central bank was selling gold into the domestic public markets to satisfy strong bar, coin and jewellery demand following a temporary partial ban on gold bullion imports. That ban was put in place to soften the economic blow from the earthquake in February 2023. Since the import ban's reversal, the Turkish central bank has resumed a strong buying programme and we have seen three consecutive months of buying (June – August 2023 purchases of 43 tonnes). However, because of the sales, cumulative Turkish official sector flows were negative (January – August 2023 sales of 70.5 tonnes). We suspect Turkey will be very active in replenishing its reserves. The People's Bank of China has reported 10 consecutive months of gold purchases, amounting to 217 tonnes, over November 2022 – August 2023. Prior to this period, China had not reported any purchases since 2019.

Figure 3: Central bank gold demand

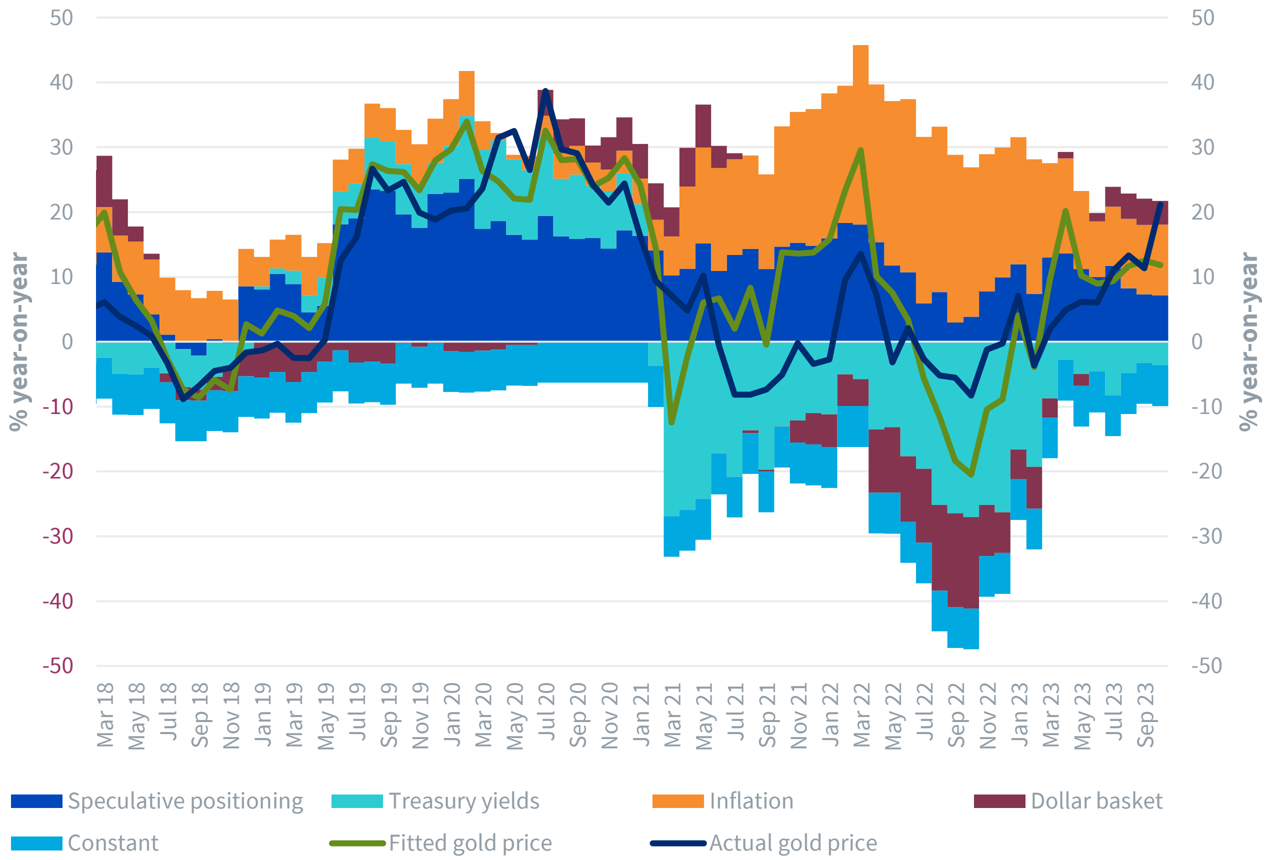


Source: WisdomTree, World Gold Council, Metal Focus, GFMS. January 1971 to August 2023. **Historical performance is not an indication of future performance and any investments may go down in value.**

Gold look-back

If we look to WisdomTree's quantitative gold model[2] to see what has been driving gold prices recently, we can see that despite the bond sell-off, positive inflation and the US Dollar remaining weaker than a year ago (although appreciating in recent months) have both helped gold. With perfect hindsight, such as knowing all the macro inputs for September 2023, the model had accurately pinned down gold prices in that month. However, as of 20 October 2023, we are seeing gold prices look stronger than what our model would predict. We have assumed inflation in October of 3.7% and used spot prices for gold, US Treasuries and the US Dollar Index (DXY) as of 20 October and the last available futures positioning data (17 October). We believe most of the discrepancy is driven by relatively low futures positioning data. Normally in such periods of geopolitical uncertainty we would expect gold positioning to be higher, yet the latest reading shows positioning at the long-term average of 111k[3]. Indeed, there are multiple signs of physical market strength, but institutional demand is lacking. Maybe it's the allure of positive bond yields distorting institutional investor interest in gold. Also, the data on positioning is only available on a weekly basis and lagged by several days, so may not reflect actual positioning at the time of the price reading.

Figure 4: The impact of each variable: attribution of fitted results vs. actual price



Source: Bloomberg, WisdomTree price model, data as of 20 October 2023. The fitted gold price is the price the model would have forecast. The constant does not have economic meaning but is used in econometric modeling to capture other terms. It can be thought of as how much gold prices would change if all other variables were set to zero (although that would be unrealistic). **Historical performance is not an indication of future performance and any investments may go down in value.**

2. See our model described in [Gold: how we value the precious metal]

3. The latest net speculative positioning data as of 17 October 2023, was 111k net long, which coincides with the long-term average since 1995.

Gold outlook using WisdomTree's forecast model

Using the same model, we can produce gold forecasts consistent with several macroeconomic scenarios (Figure 5).

Consensus

Our consensus scenario takes the Bloomberg Survey of Professional Economists' average views on inflation, US Dollar and Treasury yield forecasts. Consensus is looking for inflation to continue declining (although remaining above central bank targets), the dollar to depreciate, and bond yields to fall from one of the most elevated levels seen since 2007.

Without a consensus forecast on gold sentiment, we reduce speculative positioning to a conservative 75k, which is below the long-term average of 111k since 1995. The risk is clearly to the upside this year if a recession or financial dislocation materialises, or geopolitical tensions escalate. Gold is a highly sought-after asset in times of economic, financial and geopolitical stress, and these triggers could drive sentiment towards the metal even higher.

In the consensus case scenario, gold reaches US$2,090/oz by Q3 2024, piercing through previous all-time nominal highs (US$2,061/oz on 7 August 2020). However, in real terms this does not reach an all-time high, which was reached in January 1980. In fact, it would be 40% below that level. And in real terms it is still 17% below the 2020 high.

Bull case

In this scenario the Federal Reserve reacts to the recession warning signs and pivots away from its higher for longer mantra. If the US central bank signals it will begin monetary expansion in 2024 by end of 2023, bond yields will be falling and assuming it moves before the European Central Bank and other major central banks, we could see the US Dollar depreciate at a faster rate. If recession does materialise, we expect inflation will fall below target levels. Assuming that the recession fears that the Fed is responding to are real, we expect positioning in gold futures to remain elevated.

In this scenario, gold could reach US$2,300/oz. That would be 12% higher than the all-time nominal high reached in August 2020, and about 7% below that in real terms. However, it would be 33% below the all-time real high reached in 1980.

Bear case

In the bear case we maintain an inflation scenario in line with consensus but keep bond yields significantly higher for longer. Bond yields have surprised to the upside this year and this scenario is a thought experiment on what happens to gold if they remain elevated. Although we acknowledge that such a scenario increases recession risk and therefore could be gold-positive, drawing more investors to the yellow metal as a hedge, for the sake of building a negative scenario, we cut speculative positioning in gold futures down to 50k.

In this scenario, gold could reach US$1,670/oz, retracing prices back to November 2022 levels.

Figure 5: Gold price forecasts

Source: WisdomTree Model Forecasts, Bloomberg Historical Data, data available as of close September 2023. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

	Consensus			
	Q4 2023	Q1 2024	Q2 2024	Q3 2024
Inflation forecast	3.4%	3.1%	2.9%	2.6%
Nominal 10-year yields forecast	4.50%	4.33%	4.10%	3.90%
US$ exchange rate forecast (DXY)	104.5	103.1	101.3	100.0
Speculative positioning forecast	75,000	75,000	75,000	75,000
Gold price forecast	US$1,920/oz	US$2,050/oz	US$2,060/oz	US$2,090/oz

Source: WisdomTree. Bloomberg Survey of Professional Economists. October 2023. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

	Bull			
	Q4 2023	Q1 2024	Q2 2024	Q3 2024
Inflation forecast	2.0%	2.0%	1.0%	1.0%
Nominal 10-year yields forecast	3.60%	3.40%	3.20%	3.00%
US$ exchange rate forecast (DXY)	100	98	96	94
Speculative positioning forecast	200,000	200,000	200,000	200,000
Gold price forecast	US$2,120/oz	US$2,190/oz	US$2,255/oz	US$2,300/oz

Source: WisdomTree. October 2023. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

	Bear			
	Q4 2023	Q1 2024	Q2 2024	Q3 2024
Inflation forecast	3.4%	3.1%	2.9%	2.6%
Nominal 10-year yields forecast	5.00%	5.00%	5.00%	5.00%
US$ exchange rate forecast (DXY)	106	107	108	110
Speculative positioning forecast	50,000	50,000	50,000	50,000
Gold price forecast	US$1,825/oz	US$1,760/oz	US$1,700/oz	US$1,670/oz

Source: WisdomTree, October 2023. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

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