GOLD OUTLOOK TO Q1 2020: PRICES LIKELY TO RISE AS RATE CYCLE HAS COME TO AN END

April 2019

Since our last gold outlook published in January 2019, much has changed. The Federal Reserve (Fed) has changed its guidance for future policy settings for 2019 via its so-called "dot-plots", erasing the two 2019 rate increases that it had guided the market to expect back in December 2018. The US Government shutdown is also over, and importantly we also now have clarity on market positioning in the gold futures market through the Commodity Futures Trading Commission. Positioning has recovered strongly since the depressed levels we saw in Q4 2018. Ten-year Treasury yields have fallen substantially, marking pessimism about long-term growth in the US as the impulse from tax cuts in 2018 have faded. With all these changes, gold had shot up sharply in February 2019 to US$1350/oz, from US$1280/oz at the end of 2018. However, we ended Q1 2019 back down to US$1290/oz as a risk-on sentiment has pushed gold into the background once again. It feels like a Déjà vu moment. We have trodden on the same path multiple times in the past year. Just before the equity market wobbles of February 2018 and December 2018, gold prices were weak. But market volatility had reminded investors of the defensive traits of gold. A clear difference more presently is that speculative positioning in gold futures is nowhere near as pessimistic as it was in in Q4 2018, indicating that many investors maintain faith in the metal. Also flows in to gold Exchange Traded Funds have largely stuck, indicating that investors are unwilling to profit-take on short-term gains and are holding for defensive/event risk motivations.

UPSIDE FOR GOLD AT THE END OF THE RATE CYCLE

We update our forecasts to Q1 2020 using the framework we outlined in ***"Gold: How we value the precious metal"***. The shadow of weak gold prices today, leads to a relatively conservative forecast of US$1385/oz for end of the forecast period (from US$1290/oz at the time of writing). We believe the balance of risks is to the upside as the world's monetary institutions have likely reached the end their tightening cycles. With such little headroom for rate cuts, should central banks be faced with another economic shock, we are likely to see them resort to the more creative end of their tool-boxes when the time comes. Given the adverse distributive effects of quantitative easing - which appear to favour a repricing of financial assets, helping "Wall Street", rather than "Main Street" - we suspect central banks will be under pressure to redevise tools when they come to loosening policy next time. Such experiments are likely to be gold-price positive. Gold tends to be a beneficiary in times of uncertainty.

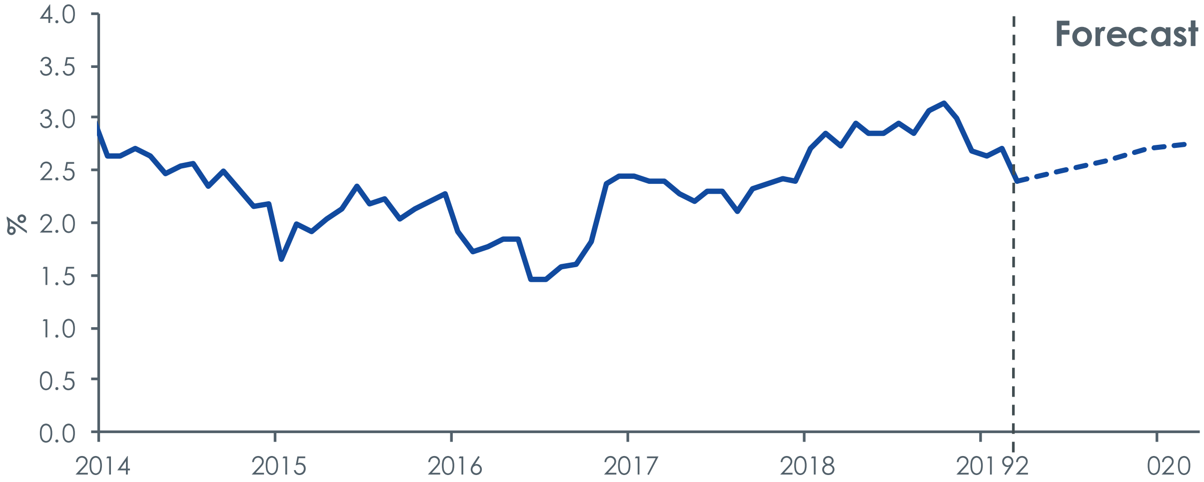
GOLD PRICE FORECAST

Source: WisdomTree Model Forecasts, Bloomberg Historical Data, data available as of close 31 March 2019. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

END OF RATE-CYCLE ALREADY PRICED INTO TREASURY YIELDS

US 10-year Treasury yields have already dropped from over 3.1% in October 2018 to 2.4% shortly after the most recent Federal Open Monetary Committee meeting (and is close to 2.5% at the time of writing). The shorter end of the Treasury yield curve did not fall as much, leading to an inversion the yield curve (between 3 months and 10 years). That indicates that the market is more concerned about long-term growth rather than simply pricing through a lower rate environment. Many commentators have concluded an economic recession is on the horizon due to the curve inversion. We note that following periods of inversion, recessions take longer than a year to materialise. Indeed, there is nothing to guarantee a recession. On the contrary, US manufacturing Institute for Supply Management (ISM) and global Purchasing Manager's Indices (PMIs) appear to display early signs of stabilising. We believe that yields could rise from 2.5% today to 2.75% in Q1 2020 as we move past the trough in growth. That places some negative pressure on gold.

NOMINAL US 10YR BOND YIELDS FORECAST

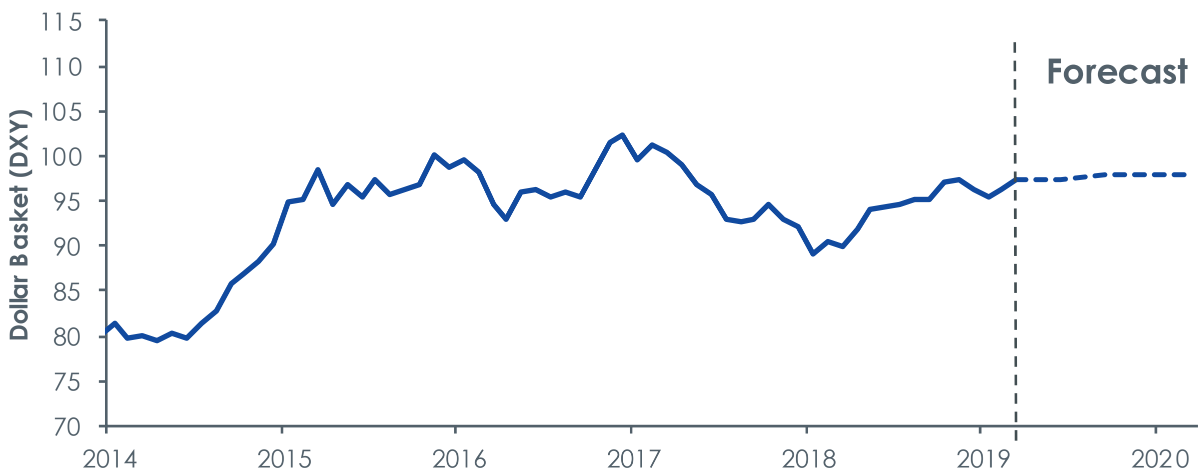


Source: Bloomberg, WisdomTree, data available as of close 31 March 2019. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

US DOLLAR APPRECIATION TO ABATE

Although Treasury yields fell following the Fed's recent meeting, the US Dollar appreciated. That indicates that the market believes that interest rate differentials between the US and other countries will remain wide, despite the US ending its rate cycle prematurely. While we believe that Europe, Japan and China are all subject to event risks, we doubt that the risks are any higher than in the US. Thus, we are doubtful that the US dollar will continue to appreciate substantially against its main trading partners.

US DOLLAR EXCHANGE RATE FORECAST



Source: Bloomberg, WisdomTree, data available as of close 31 March 2019. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

INFLATION TO RECOVER AT THE HEADLINE LEVEL

Although we are not expecting a strong demand-driven inflation pull, we note the recovery in energy prices which is likely to drive inflation up at the headline level, if not at the core level. We expect oil and other energy prices to continue to rise for most of the year as the Organization of Petroleum Exporting Countries keeps supply tight, despite US oil and gas production continuing to grow.

CONSUMER PRICE INDEX INFLATION FORECAST

Source: Bloomberg, WisdomTree, data available as of close 31 March 2019. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

SPECULATIVE POSITIONING IN A HOLDING PATTERN

Speculative positioning in gold futures have recovered strongly from depressed levels at the beginning of Q4 2018. However, in the absence of shocks and with cyclical assets performing well, gold positioning has not been able to gather further momentum. Indeed, we keep our forecasts for positioning in the metal only slightly higher than today's levels, at 120,000 contracts net long at the end of the forecast horizon. That reflects our neutral position – we don't have any specific shocks in mind that will drive gold demand higher – but that the same time we can name many risks investors will want to hedge against. Despite some cyclical indicators – such global Purchasing Managers Indices and US payrolls and durable goods orders looking like they have troughed, investor concerns about growing indebtedness, yield-curve inversions and the future of the EU (and a potential disruptive exit of the UK), investors are likely to maintain interest in defensive assets. The International Monetary Fund's Spring update on 14 April voiced some of these concerns which belie current optimism in cyclical assets.

ALTERNATIVE SCENARIOS

We have also developed alternative scenarios for gold as summarised below. In the bear case, the US Federal Reserve delivers the one rate increase in its dot-plot for 2020 in the first quarter despite inflation being tame. That drives bond yields higher and the US Dollar appreciates as interest rate differentials between the US and other countries widen. Speculative positioning in gold falls, reflecting a risk-on environment. In this bear case scenario, gold could fall to US$1195/oz.

In the bull case for gold, a rather dovish narrative from the Fed could poise the market in anticipation of looser monetary policy. Treasury yields are likely to decline, and the US Dollar could depreciate if the US is the only country expressing dovish concerns. In the bull case, we raise speculative positioning in gold futures to 200,000 contracts net long – which is around the levels reached this time last year. That could reflect investor concerns about the next round of monetary experimentation. In this bull case scenario, gold could rise to US$1557/oz.

Q3 2019	Base	Bear	Bull
Fed policy forecast	Rates on hold	1 rate increases	Rates on hold, dovish narrative around future policy course
Inflation forecast	2.4%	1.8%	2.5%
Nominal 10-year forecast	2.75%	3.20%	2.32%
US$ exchange rate forcast (DXY)	98	103	93
Speculative positioning forecast	120k	50k	200K
Gold price forecast	US$1385/oz	US$1195/oz	US$1557/oz

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

Given the volatility in speculative positioning in the past year, we offer some further sensitivity analysis around that variable and the US$ exchange rate. So for example, if we keep the base case scenario of the US Dollar basket at 98 at the end of the forecast horizon, but raise speculative positioning to 200,000 contracts net long as in the bull case scenario, we could end up with gold prices close to US$1460/oz.

Specualtive positioning	US EXCHANGE RATE (DXY) LEVEL								
	87	90	92	95	97	98	101	103	106
-50000	1301	1274	1255	1228	1210	1192	1164	1146	1119
-25000	1328	1300	1282	1255	1237	1218	1191	1173	1146
0	1354	1327	1309	1282	1263	1245	1218	1200	1172
25000	1381	1354	1336	1308	1290	1272	1244	1226	1199
50000	1408	1380	1362	1335	1317	1299	1271	1253	1226
75000	1435	1407	1389	1362	1343	1325	1298	1280	1252
100000	1461	1434	1416	1388	1370	1352	1325	1306	1279
125000	1488	1461	1442	1415	1397	1379	1351	1333	1306
150000	1515	1487	1469	1442	1424	1405	1378	1360	1332
175000	1541	1514	1496	1468	1450	1432	1405	1386	1359
200000	1568	1541	1522	1495	1477	1459	1431	1413	1386
225000	1595	1567	1549	1522	1504	1485	1458	1440	1413
250000	1621	1594	1576	1549	1530	1512	1485	1467	1439
275000	1648	1621	1603	1575	1557	1539	1511	1493	1466
300000	1675	1647	1629	1602	1584	1566	1538	1520	1493
325000	1702	1674	1656	1629	1610	1592	1565	1547	1519

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

Gold prices are likely to rise in the absence of further policy interest rate hikes. A recovery in sentiment toward the metal and slightly higher inflation are likely to be gold price positive. We expect gold prices to rise to around US$1385/oz by the end of Q1 2020. We believe the upside risks to gold prices are likely to be more pronounced that the downside after a prolonged bull run in cyclical assets.

Source for all data in this article: WisdomTree, Bloomberg as of 31 March 2019.

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