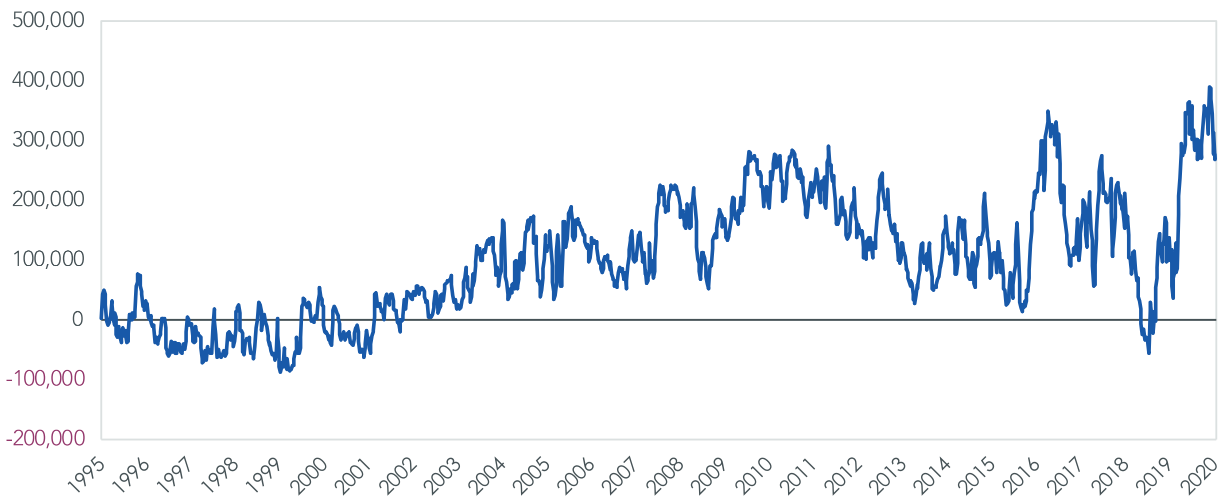
GOLD OUTLOOK FOR Q1 2021: INTO UNCHARTERED TERRITORY

April 2020

In Q1 2020, asset markets were whipsawed. Demand destruction from the sudden stop in global activity as countries deal with the COVID19 pandemic led to abrupt declines in cyclical asset prices from equities to credit to base metals and oil. There appeared nowhere to take cover. Even gold was not initially immune to the selling pressure. But that was for a very specific reason: the large equity drawdowns gave rise to a thirst for liquidity. Steep declines in risk assets led to investors selling gold to generate funds to meet margin calls. That was testament to gold's role as a liquid asset. Now that central banks have injected unprecedented amounts of liquidity into the system and opened up large swap lines, the selling pressure on gold appears to have assuaged and at the time of writing, gold price is rising and has surpassed levels last reached in December 2012.

Sentiment towards gold had risen to unprecedented levels in February 2020 and has not eased much since then. The COVID19 crisis has made many investors anxious about the performance of risk assets and equally many investors are anxious about the longer-term implications of the policy stimulus offered to alleviate the crisis. Gold is often a port of call in times of anxiety and that has been clearly been reflected in the gold futures market positioning. As we continue on a policy path that has never been trodden on in the past, we expect sentiment towards gold to remain strong.

FIGURE 1: NET SPECULATIVE POSITIONING IN GOLD FUTURES



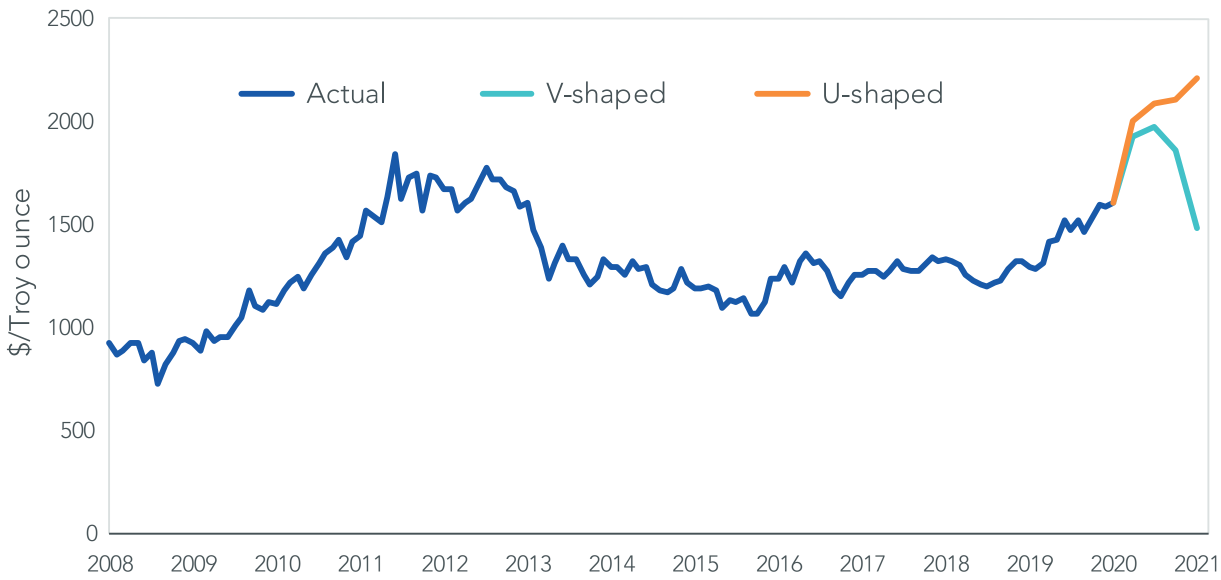
Source: WisdomTree, Bloomberg. Data as available 14 April 2020. ***Historical performance is not an indication of future performance and any investments may go down in value.***

Scenarios using WisdomTree's framework

Where will gold go for the rest of this year? As the length and amplitude of the COVID19 shock on the global economy are simply unknown, it is particularly difficult t o f orecast a ny a sset p rice m ovements. H owever, u sing o ur m odel framework, explained in "Gold: how we value the precious metal", we provide some example scenarios.

There are almost an infinite number of scenarios we can paint. In the last few weeks, Treasury yields have moved in a very wide range (from as low as 0.54% on 9 March 2020 to 1.19% on 18 March 2020). That whole range is lower than when we started the crisis. Similarly, the USD Dollar basket has moved from a low of 95 on 9 March 2020 to 103 on 20 March 2020. Pinning down the right path for all the explanatory variables in the model is more difficult today than it has ever been, given the volatility in asset markets. It is likely that we will see several parameters go to levels we have never seen before. But we make an attempt with two main scenarios: a "v-shaped" economic recovery and a "u-shaped" economic recovery. Prior crises indicate we are more likely to head into a u-shaped economic recovery, but we would like to illustrate and contrast the two.

FIGURE 2: GOLD PRICE FORCASTS



Source: WisdomTree Model Forecasts, Bloomberg Historical Data, data available as of close 9 April 2020. ***Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties***

V-shaped economic recovery

In the v-shaped economic recovery forecast, we assume the effects of COVID19 on the economy are largely transitory i.e. when social distancing practices stop and global commerce starts again, activity resumes and the policy easing applied in the first two-quarters of the forecast horizon can be reversed in the latter two quarters. There is less downward pressure on Treasury yields initially and in the second half of the forecast horizon, yields rise. Speculative positioning in gold futures progressively falls from an elevated starting point, as the market anxiety diminishes. Inflation in Q2 2020 starts at 2.2% reflecting the fact that destroyed supply chains push prices up as hard as destroyed demand pushes down prices. Over the forecast period inflation comes down as businesses resume operations supply chains restore but demand is weakened somewhat by tightening policy. We are making a strong assumption that monetary and fiscal authorities are able to withdraw stimulus sufficient enough to remove inflationary risks. That will require very tight political discipline.

Our currency assumption in the scenario is for the Dollar basket to be flat at 97. That reflects most central banks across the world moving policy in a similar direction to the Federal Reserve of US (Fed). In this scenario, while gold rises sharply initially, it more than gives back all its gains by the end of the period.

FIGURE 3: V-SHAPED ECONOMIC RECOVERY

	V-shaped economic recovery			
	Q2 2020	**Q3 2020**	**Q4 2020**	**Q1 2021**
Fed policy forecast	Easing	Easing	Tightening	Tightening
Inflation forecast	2.2%	2.1%	2.1%	2.0%
Nominal 10-year yields forecast	0.70%	0.70%	1.00%	1.50%
US$ exchange rate forecast (DXY)	97	97	97	97
Speculative positioning forecast	340k	300k	200k	120k
Gold price forecast	US$1920/oz	US$1965/oz	US$1860/oz	US$1480/oz

Source: WisdomTree, data available as of close 9 April 2020. ***Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties***

U-shaped economic recovery

In the u-shaped economic recovery forecast, we assume the global economy struggles to recover from COVID19. Facilities provided by central banks and fiscal authorities are heavily utilised and expanded. We could thus see continued policy easing. Downward pressure on Treasury yields increases with policy easing. Speculative positioning in gold futures rises to levels we have come close to but never reached in the past and remains elevated through the forecast horizon. That reflects market anxiety about the state of the world and the future consequences of unprecedented policy action. We start with an inflation forecast that is higher than in the V-shaped economic recovery, reflecting deeper damage to supply chains pushing prices higher. But weakness in demand takes price inflation down to similar levels by the end of the forecast horizon. In this scenario inflation expectations for future years (beyond Q1 2020) are likely to build up as the market casts doubts on the ability for policy stimulus withdrawal. That could lend further support to gold but falls outside of our model framework. In the u-shaped scenario, we expect that with higher haven demand for gold, we are likely to see higher demand for the US Dollar. Therefore, we assume the US Dollar basket remains at the relatively elevated level of 100 we are at the time of writing (9 April 2020) for the forecast horizon. In this scenario, gold rises above US$2000/oz – marking an all-time high – at the beginning of the forecast horizon and then continues to rise, ending Q1 2021 at US$2000/oz.

FIGURE 4: U-SHAPED ECONOMIC RECOVERY

	U-shaped economic recovery			
	Q2 2020	Q3 2020	Q4 2020	Q1 2021
Fed policy forecast	Easing	Easing	Easing	Easing
Inflation forecast	2.5%	2.5%	2.0%	2.0%
Nominal 10-year yields forecast	0.50%	0.25%	0.20%	0.15%
US$ exchange rate forecast (DXY)	100	100	100	100
Speculative positioning forecast	400k	350k	350k	350k
Gold price forecast	US$2000/oz	US$2090/oz	US$2100/oz	US$2200/oz

Source: WisdomTree, data available as of close 9 April 2020. ***Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties***

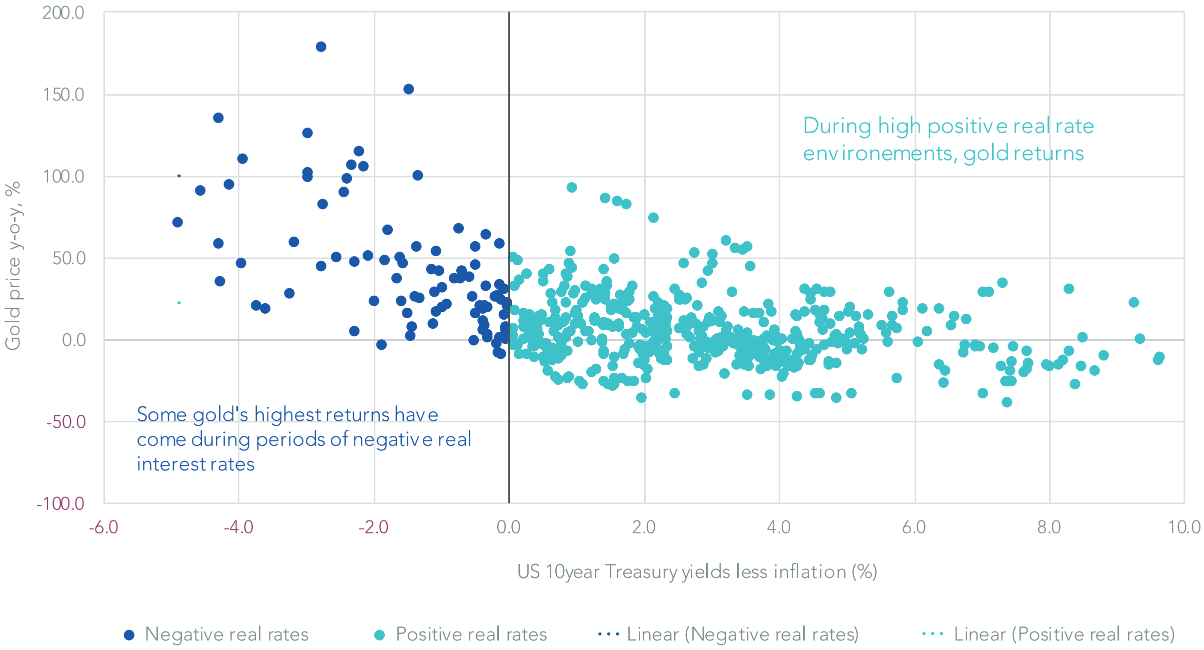
Heading out of sample

These are only two of an infinite number of scenarios one can design. We will continue to write about and project gold prices using the tools we present here as the macroeconomic environment evolves in this crisis. At this point in time, we believe the chances of a v-shaped economic recovery are lower than a u-shaped economic recovery. Deep shocks tend to have persistent economic effects, that we believe are difficult to reverse in just two quarters. That's at least our learning from the Great Financial Crisis that started in 2008. We acknowledge we are making a strong assumption that in the v-shaped economic recovery policy stimulus can be removed and policy makers execute this without large inflationary implications. Experiences from the Great Depression in the 1930s are harder to apply today, given the different role that gold played in the monetary system then and now. Our u-shaped recovery does take a number of variables such as speculative positioning in gold futures and Treasury yields outside of the observations our model was calibrated on. So, gold could behave differently at these levels.

Risk to the upside in negative real rate environment

In fact, our analysis shows that when real interest rates (i.e. nominal Treasury yields less inflation) are negative, as they are today, gold prices rise faster, than when they are positive. In the chart below we plot real rates (horizontal axis) against gold price returns (vertical axis). We look at the line of best fit when real rates are positive (light blue line) and when they are negative (dark blue line). The dark line has a steeper slope. Which indicates that for every basis point decrease in real rates when rates are negative, you get a higher gold price rise than when real rates are positive. Our model that the forecasts are based on however, treats all rates the same (regardless of whether they are positive or negative). So, the modelled forecasts for gold we have presented in this environment may be an underestimate. Thus it does feel like we are heading into uncharted territory.

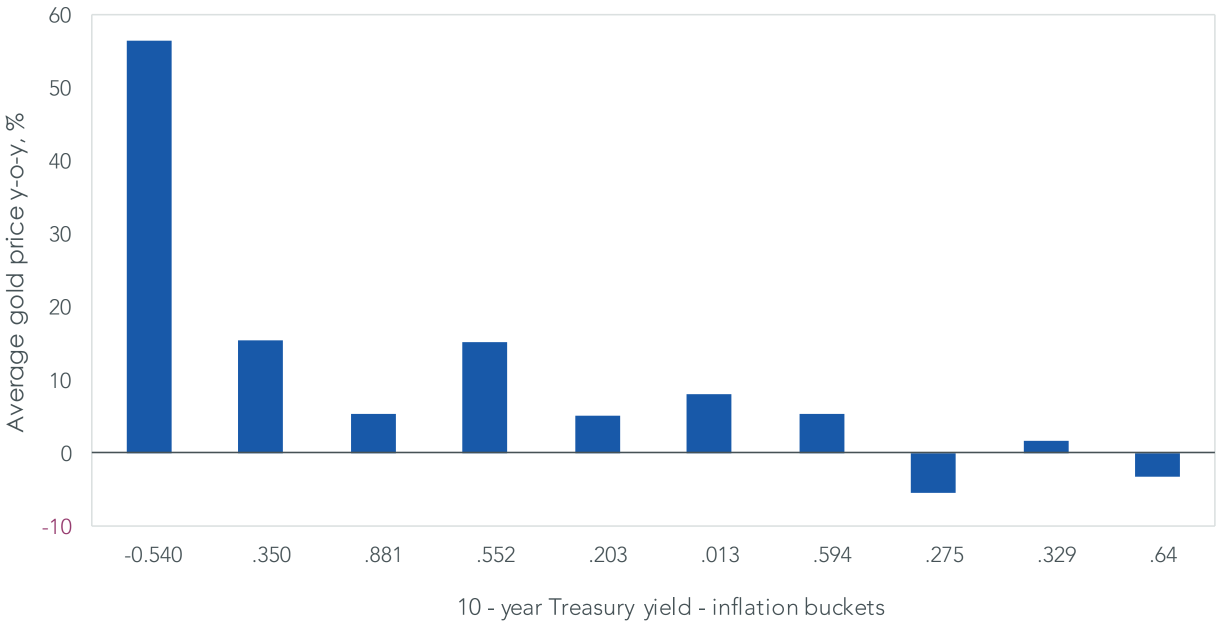
FIGURE 5: US 10-YEAR YIELD LESS INFLATION VS GOLD (1972-2020)



Source: WisdomTree, Bloomberg. Period: January 1972 to January 2020. Lines of best fit shown on chart are calculated via Excel function (labelled linear in key above). We use a separate line of best fit for the positive real yield observations and negative real yield observations. ***Historical performance is not an indication of future performance and any investments may go down in value.***

To illustrate the point, the current real rate based on nominal Treasury yields less inflation is -0.76 (14 April 2020). In the figure below we present the same data as in the above chart but show the average gold price change by real rate buckets, with roughly equal observations in each rate bucket (approx. 58 observations in each bucket). The chart highlights when we have seen real rates in a range this low (i.e. the first bucket in the histogram below), we have seen on average year-on-year gold price gains of 56%. So, if real rates remain this low for the forecast horizon, we could see substantially higher gold prices than in our model framework presented earlier (i.e. gold prices higher than US $2200/oz).

FIGURE 6: GOLD PERFORMANCE IN DIFFERENT REAL RATE ENVIRONMENTS



Source: WisdomTree, Bloomberg. Period: January 1972 to January 2020. ***Historical performance is not an indication of future performance and any investments may go down in value.***

Once again, possibly outside of the timeframe of this piece, inflation could rise in response to the unprecedented level of stimulus. Although our model framework is based on current inflation, if inflation expectations become unanchored, we could see gold prices rises in response. Indeed, higher inflation expectations can be self-fulfilling and so our inflation forecasts could be too low. This poses an upside risk to our gold price forecasts.

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