GOLD ON TRACK TO REACH NEW HIGHS

GOLD OUTLOOK TO Q2 2021

July 2020

Gold is the only major commodity to post year-to-date gains in the first half of 2020. The COVID-19 crisis has ripped apart the playbook for 2020. The International Monetary Fund, for example, started the year off expecting 3.3% GDP growth[1]. That has been revised down to -4.9%[2]. Cyclical assets experienced sharp drawdowns while defensive assets such as gold and US Treasuries have prospered. However, in recent months cyclical assets have staged a comeback as if these markets are expecting a V-shaped economic recovery. Unfortunately, the hard-economic data does not support such a swift economic recovery. The S&P 500 equity index may be shy of reaching its all-time high, but has kissed the level it started the year, earlier in June before retreating. The more tech-heavy Nasdaq Composite has reached all-time highs while less tech-concentrated and global indices such as MSCI ACWI have not done as well, but still represent what one could call a V-shaped recovery. Industrial metals and oil are also staging quite a vigorous recovery albeit somewhat behind equities. Could the risk-on rally be gold's undoing? Or will gold continue to remain in favour?

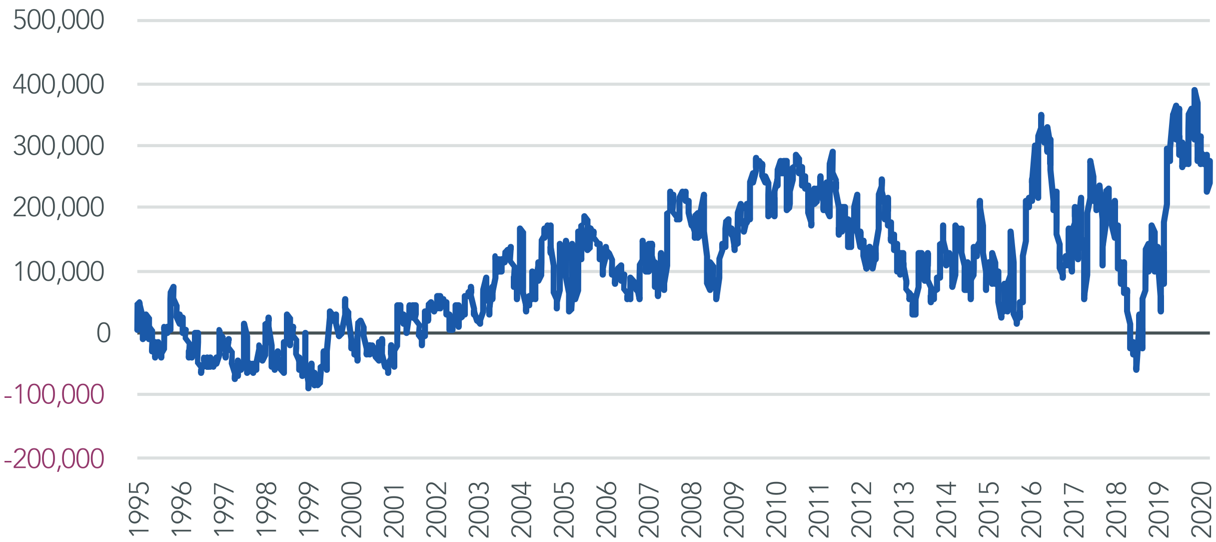
FIGURE 1: GOLD REMAINS AN OUTPERFORMER

Source: WisdomTree, Bloomberg. Data as available 25 June 2020.

All data rebased to 1 on 01/01/2020 ***You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.***

Judging by positioning in gold futures markets, sentiment towards gold has come off its all-time highs (figure 2).

FIGURE 2: NET SPECULATIVE POSITIONING IN GOLD FUTURES



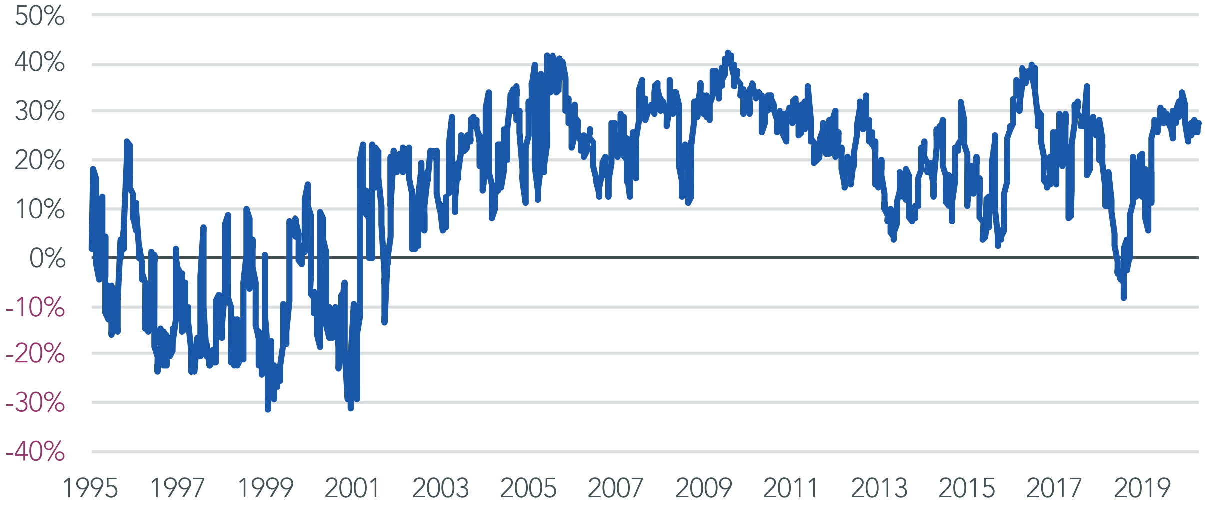
Source: WisdomTree, Bloomberg. Data as available 25 June 2020. ***You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.***

However, adjusting this series for open interest in all gold futures (by taking net speculative positioning as a percentage of open interest), as in Figure 3, we can see that the series did not touch the highs that were seen in 2009 this year. In February 2020 open interest in gold futures were also high, and so this adjusted series was a little lower than the raw net positioning data. Equally the decline in net speculative positioning in gold futures since then was also at a time when open interest was declining. We attribute the decline in open interest to the dislocations in the gold futures market that the COVID-19 crisis has brought about. Investor sentiment toward gold may not have fallen as much as indicated by the raw speculative positioning data (Figure 2) and indeed flows into gold exchange traded products also paint a more bullish picture. Gold in exchange traded products globally has risen to an all-time high of 102 million troy ounces, up from 83 million troy ounces at the beginning of the year.

[1] IMF: World Economic Outlook Update, January 2020: Tentative Stabilization, Sluggish Recovery?

[2] IMF: World Economic Outlook Update, June 2020: A Crisis Like No Other, An Uncertain Recovery

FIGURE 3: NET SPECULATIVE POSITIONING AS A PERCENTAGE OF OPEN INTEREST



Source: WisdomTree, Bloomberg. Data as available 25 June 2020.

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

We believe the global economy will deliver a U-shaped recovery. Our view is that the failure of the economy to perform a V-shaped recovery while various assets are bouncing strongly indicates that asset bubbles are remerging. Although in this crisis, fiscal and monetary authorities have tried to direct more of the stimulus to "Main Street" in addition to "Wall Street", we have seen an outsized performance in risk assets. A potential fall-out from a bubble could be gold price positive. In our "Investment Outlook 2020" we posed the question "With monetary policy space limited…… could fiscal become the new monetary?". While we may have underestimated the capacity of central banks to keep expanding, we were right in that we are inching closer to a form of Modern Monetary Theory, where central banks are amassing a larger share of government debt to allow fiscal institutions to keep spending. As the dust settles, there will be question marks as to the sustainability of this path. Indeed, in the sovereign debt crisis of 2011 gold reached its all-time high as the metal was highly sought after as a hedge to the rising Euro area debt problem.

Rising indebtedness and inflationary pressures may only present a real threat more than a year out into the future and so maybe beyond the 1-year forecast horizon of this outlook, but investors will anticipate these potential issues and so we believe that demand for gold will remain elevated as investors seek hedges to the burgeoning debt issues.

We are also in a Presidential election year in the US. In the 2016 election year, positioning in gold futures roared to a fresh high in the run-up to a tightly fought election. When Trump won, markets priced in business-friendly growth policies and positioning in gold fell and so did gold prices. Today the polls seem to indicate Biden is leading Trump by a very large margin[3]. Obviously, it is very early days and the ability of polls to predict election outcomes leaves something to desire. Also, the dynamics are very different today. In the past election, Obama's two terms were over and the Democratic nominee was unknown at this stage in the cycle. But at this time in the past election cycle Hillary and Trump were neck-to-neck[4]. Further uncertainties are generated as we don't know whether whoever wins the

[3] See Trump vs Biden: who is leading the 2020 US election polls? https://ig.ft.com/us-election-2020/

[4] See US election poll tracker: Who is ahead - Clinton or Trump? https://www.bbc.co.uk/news/election-us-2016-37450661

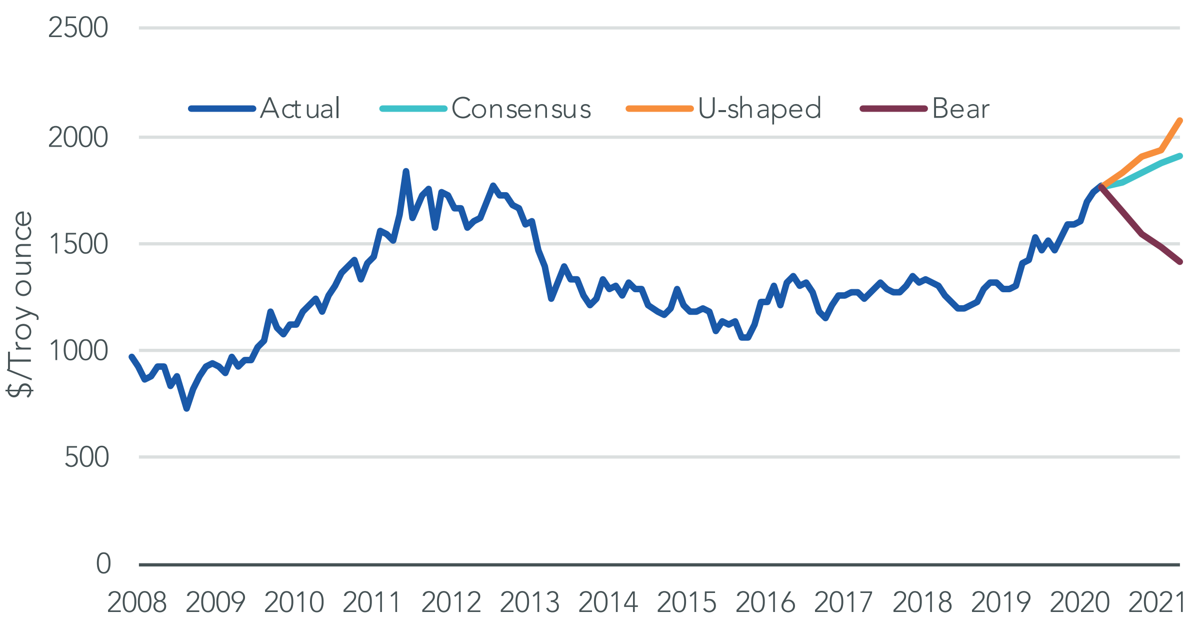
Presidency will have the support of the House and Senate and therefore their ability to push policy through. At the time of writing, we are seeing trade frictions between the US and other countries like China re-emerge. The path of these discussions could go in different ways under a Trump or a Biden Presidency. Whatever happens in this election, we believe that investors will seek hedges as we approach a period which has often been turbulent for asset markets.

Lastly, at the time of writing, we are seeing COVID-19 cases spike in areas of the world that have eased lockdown conditions, including the US, China and parts of Europe. If we have to go back to lockdown conditions we could see the risk-rally dented and gold regain favour as a safe-haven asset.

SCENARIOS USING WISDOMTREE'S FRAMEWORK

Using our model framework, explained in "Gold: how we value the precious metal", we provide some scenarios for gold prices until Q2 2021.

FIGURE 4: GOLD PRICE FORECASTS



Source: WisdomTree Model Forecasts, Bloomberg Historical Data, data available as of close 25 June 2020.

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In the figure, we show 3 distinct forecasts:

- Consensus - based on consensus forecasts for all the macroeconomic inputs and an assumption that investor sentiment towards gold remains flat at where it is today
- U-Shaped – WisdomTree's base case, which is characterised by a U-shaped economic recovery
- Bear – A V-shaped economic recovery with very little inflation

CONSENSUS

The consensus compiled by Bloomberg[5] looks for a tightening of monetary policy by the Federal Reserve (Fed) toward the end of our forecast horizon, with the average of those polled by Bloomberg looking for a 5 basis point increase in the upper-end of the Fed Fund target range[6]. with Q2 2021 Fed Fund rates rising to 0.3% from 0.25%. That is likely to see Treasury yields rise presenting a headwind for gold. Consensus expectations are for inflation to remain sub-1% until the end of Q1 2021 and then rise substantially to 1.8% as the base effect of ultra-low energy prices in 2020 pushes up to the year-on-year calculation. In this scenario, we keep positioning in the gold futures market flat at 250k net long.

Our model indicates we get to a gold price of $1900/oz at the end of the forecast horizon, taking gold back to the all-time high reached in May 2011.

CONSENSUS

	Q3 2020	Q4 2020	Q1 2021	Q2 2021
Fed policy forecast	Flat	Flat	Flat	Tighten
Inflation forecast	0.5%	0.6%	0.8%	1.8%
Nominal 10-year yields forecast	0.8%	0.9%	1.0%	1.1%
US$ exchange rate forecast (DXY)	97.7	97	96.6	97.7
Speculative positioning forecast	250k	250k	250k	250k
Gold price forecast	US$1780/oz	US$1830/oz	US$1870/oz	US$1900/oz

Source: WisdomTree, data available as of close 25 June 2020.

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5 Bloomberg survey conducted in June 2020

6 The upper end of the target is currently 25 basis points (bps). The Fed normally moves targets in 25 bps increments. The survey is a mean average across 74 contributors, resulting in a non-25 bps movement. So even though the Fed may not move in 5 bps increments, the survey is indicative of whether the respondents on average believe there is rate tightening or losing.

U-SHAPED ECONOMIC RECOVERY

We believe we are in a U-shaped economic recovery. This is broadly in line with the IMF's latest forecast revision. The IMF believes the global economy will contract 4.9% this year. Although they expect a 5.4% recovery in 2021, that will leave the 2021 GDP some 6.1% below pre-crisis projections. Continued economic stimulus will be required to prop up the economy. That will continue to distort various asset markets and leave then vulnerable to sharp corrections. A continued easing bias by the Federal Reserve will keep downward pressure on the US Treasury yields.

We expect positioning in gold futures to rise once again. As we indicated in the introduction, the disconnect from the equity markets and the economy could drive investors to seek defensive hedges. Rising indebtedness, a Presidential election year, and spikes in COVID-19 cases could also drive more investors to defensive positions.

We believe that inflation in the U-shaped recovery will be higher than that assumed by consensus. That is largely because supply chains are broken and so input prices for many good and services are rising. Furthermore, official measures of CPI inflation may fail to accurately reflect inflation in this COVID-19 crisis. Notably, the consumption basket that statistics are compiled on are based on 2019 consumption, but what people consume today has shifted greatly in this new environment. The lack of availability of certain products often means that people have to switch to consuming substitutes - for example, smaller packaged items – which are often more costly than the product they originally wanted but won't be reflected in official inflation statistics. Inflation distortions are likely to continue. The 2021 basket will be based on consumption in 2020, which once again won't be reflective of what people are likely to be consuming once a recovery is in motion. We factor this into what we believe is reflective of an inflation experience rather than what will be measured by official statistics. The way in which we have done that is to adjust upward inflation when we are using the pre-crisis consumer basket as a base and adjust downward when using the post-crisis crisis consumer basket as a base.

We believe the US Dollar will move back to the upper end of its trading range we have seen in the past 3 months. If there is haven demand for gold in this uncertain environment, there is likely to be haven demand for the US Dollar as well.

Our model indicates we could get to a gold price of $2070/oz at the end of the forecast horizon and we pierce the previous all-time reached in May 2011 by the end of this year.

U-SHAPED ECONOMIC RECOVERY

	Q3 2020	Q4 2020	Q1 2021	Q2 2021
Fed policy forecast	Loosening	Loosening	Loosening	Loosening
Inflation forecast	0.8%	0.8%	1.5%	1.7%
Nominal 10-year yields forecast	0.8%	0.8%	0.8%	0.8%
US$ exchange rate forecast (DXY)	99	99	99	99
Speculative positioning forecast	280k	300k	350k	300k
Gold price forecast	US$1820/oz	US$1900/oz	US$1930/oz	US$2070/oz

Source: WisdomTree, data available as of close 25 June 2020.

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BEAR-CASE SCENARIO

In this scenario, we explore what will happen if the Fed thinks that the era of extraordinary accommodation is no longer needed. The basis for this could be a 'V-shaped' economic recovery, in the context of COVID-19 cases subsiding continuously (maybe with a vaccine breakthrough), no repeat of the trade policy frictions that were brewing in 2018/2019 and possibly an awareness of the distortions in asset markets that continued loosening will entail. To be clear, the Fed has raised rates in prior election cycles, although tightening policy today will be more controversial.

Treasury yields would rise, and the US Dollar could appreciate if other central banks don't move with the same speed.

In the absence of major threats to the economy and indeed the economy catching up to cyclical asset markets, investor positioning in gold futures could decline.

Lastly, to add further headwinds to gold, the recovery is largely dis-inflationary. Efficient ways of working, new supply chain management and accelerated applications of the technology could drive down costs and keep a lid on prices.

Combining all this together would drive gold prices down to US$1415/oz, thus erasing gains we have seen since July 2019.

BEAR-CASE SCENARIO

	Q3 2020	Q4 2020	Q1 2021	Q2 2021
Fed policy forecast	Tighten	Tighten	Tighten	Tighten
Inflation forecast	0.5%	0.5%	0.5%	0.5%
Nominal 10-year yields forecast	1.5%	1.5%	1.5%	1.5%
US$ exchange rate forecast (DXY)	102	102	102	102
Speculative positioning forecast	120k	120k	120k	120k
Gold price forecast	US$1650/oz	US$1540/oz	US$1475/oz	US$1415/oz

Source: WisdomTree, data available as of close 25 June 2020.

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Whether we take economic inputs from consensus or our in-house view of a U-shaped economic recovery, gold is likely to head to an all-time high based on our model outputs. It will just get there faster if the Fed keeps easing (as in the U-shaped scenario). The pullback in positioning in gold futures could easily turn around as markets appreciate that we may not be out of the woods yet in this crisis.

In the bear case scenario, which we believe is least likely, gold could erase a year's worth of gains as the return to policy normalcy is swift (and doesn't entail and economic collapse).

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