Global Precious Metals Comment

Are gold's macro relationships broken?

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Global

Joni Teves
Strategist
joni.teves@ubs.com
+65-6495 6851

Gold, real rates and the dollar - "on a break" or "broken up?"

Gold appears to be distancing itself from its longstanding relationships with key macro variables such as US real rates and the US dollar. Prices have reached new highs and continue to trade not far from the peak despite real rates rising from the trough in early Q1 and the US dollar rallying 3% so far this year. Investors and market participants are currently struggling to fully explain gold's behaviour (Figure 1 and Figure 2). Are these relationships forever broken? We don't think so. With the US dollar, gold has a history of ignoring its strength during periods when investors are attracted to the yellow metal for safe haven and diversification purposes. Meanwhile, we think the outlook for real rates continues to be an important driver for the bullish outlook on gold. Although Fed easing has been repriced considerably in the past few months, the market still expects the Fed to hold a dovish stance. And as long as the Fed stays dovish, there is now growing risk of even larger declines in real rates should inflation surprise on the upside.

The case for having gold as a diversifier is strong

Gold's role as a portfolio diversifier and hedge against uncertainty adds to its strength and resilience. The persistence of geopolitical risks is one factor. So is the potential for higher volatility and macro uncertainty given many elections scheduled this year, particularly the US elections in November (Figure 3). Diversification also continues to be a driver for official sector gold buying, which we think remains strong this year and is also contributing to the dilution of gold's macro relationships (Figure 4 and Figure 5).

Gold is in uncharted territory - investors may want to tread lightly for now

After making new highs last week and staging only a modest pullback so far, the gold market is in uncharted territory. The bid tone into a long weekend across many markets likely reflects gold's role as a hedge amid geopolitical tensions. More generally, we think one aspect that has helped gold's upward momentum is that investor positioning came from a low base and broadly remains lean. That said, short-term players such as CTAs are now max long gold, which could mean further quick moves higher will become more of a struggle in the near term unless there is a major upside catalyst. Although we expect the market to maintain its bullish bias and see gold making new highs later, we think some caution is warranted for now. We expect price action in gold to be guided by US economic data releases in the short run.

Gold, real rates and the dollar – "on a break" or "broken up"?

Gold's behaviour relative to US real rates and the dollar continue to puzzle investors.

Gold appears to be distancing itself from its longstanding relationships with key macro variables such as US real rates and the US dollar. Prices have reached new highs and continue to trade not far from the peak despite real rates rising from the trough in early Q1 and the US dollar rallying 3% so far this year (Figure 1 and Figure 2). Basic models using real rates and the US dollar as the two main factors would suggest that the historical negative relationship with real rates has turned positive and that gold is trading with $200-$300 premium to its "fair value". To be fair, the recent all-time high in gold did occur shortly after US 10y real rates had fallen over 20bp and the dollar had retraced from its YTD-peak. However, this still does not change the reality that investors and market participants are currently struggling to fully explain gold's behaviour this year.

We think the outlook for real rates remain an important driver for bullish gold views.

Are these relationships forever broken? We don't think so. With the US dollar, gold has a history of ignoring its strength during periods when investors are attracted to the yellow metal for safe haven and diversification purposes. We argue that there is an element of this occurring this time around given the backdrop of persistent geopolitical tensions and the prospect of higher macro volatility, especially in the second half of 2024. With respect to gold's correlation with real rates, we don't think the intuitive link has actually broken down. In fact, we think the outlook on real rates continues to guide the view on gold and is a key factor in the market's bullish bias. Although Fed easing has been repriced considerably in the past few months, the market still expects the Fed to hold a dovish stance even when inflation is proving stickier and economic data is holding up better. This still implies falling real rates, which are conducive for higher gold prices. And as long as the Fed stays dovish, there is now growing risk of even larger declines in real rates should inflation surprise on the upside.

Gold's role as a portfolio diversifier and hedge against uncertainty adds to its resilience.

Moreover, there is generally a strong case for having gold in the portfolio right now. The persistence of geopolitical risks is one factor. So is the potential for higher volatility and macro uncertainty given many elections scheduled this year, particularly the US elections in November. Gold's historical behaviour suggests there should be little difference on its price path regardless of the outcome of the US Presidential elections, but the overall uncertainty around fiscal as well monetary policies are likely making investors nervous and in search of a diversifier like gold (Figure 3).

Official sector gold purchases also help dilute its macro relationships.

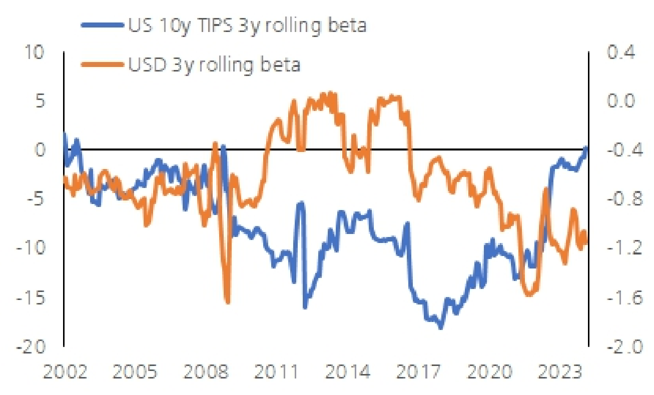
The official sector also remains a dominant feature in the market and is likely additionally diluting gold's macro relationships. Available data so far shows about 39 tonnes of net purchases from central banks in January, most of which came from China, Turkey and India (Figure 4). As data trickles in over the coming weeks and months, we would not be surprised to see strong buying from the official sector as a whole. Although our base case is to see a slowdown in the pace of purchases this year, we acknowledge there are upside risks to our view, as geopolitical tensions and sanctions risks linger (Figure 5).

Investors may want to tread lightly for now

With gold in uncharted territory, investors may want to tread lightly in the near term. US data releases will be key.

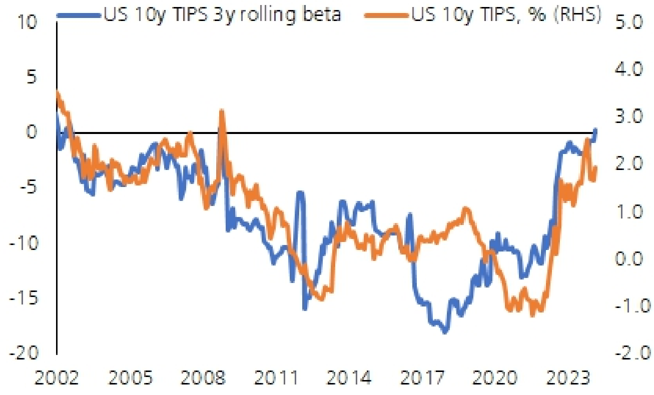
After making new highs last week and staging only a modest pullback so far, the gold market is in uncharted territory. We think one of the aspects that has really helped gold's upward momentum is that investor positioning came from a very low base and generally remains lean. Total speculative positions on Comex as well as money managers' net positions were only a little over half of respective all-time highs shortly before gold's initial rally through $2200. Open interest is down this week, suggesting that a combination of short-covering and some profit-taking at the highs have taken place since then. Short-term players such as CTAs are now max long gold, though, which could mean that further quick moves higher will become more of a struggle in the near term, unless there is a major upside catalyst. Although we expect the market to maintain its overall bullish bias and see gold making new highs later, we think some caution is warranted for now. A period of consolidation will ultimately be healthy for the market. In the short run, we expect price action in gold to be guided by US economic data releases.

Figure 1: Gold's negative relationship with real rates is "on a break", but not "broken up"



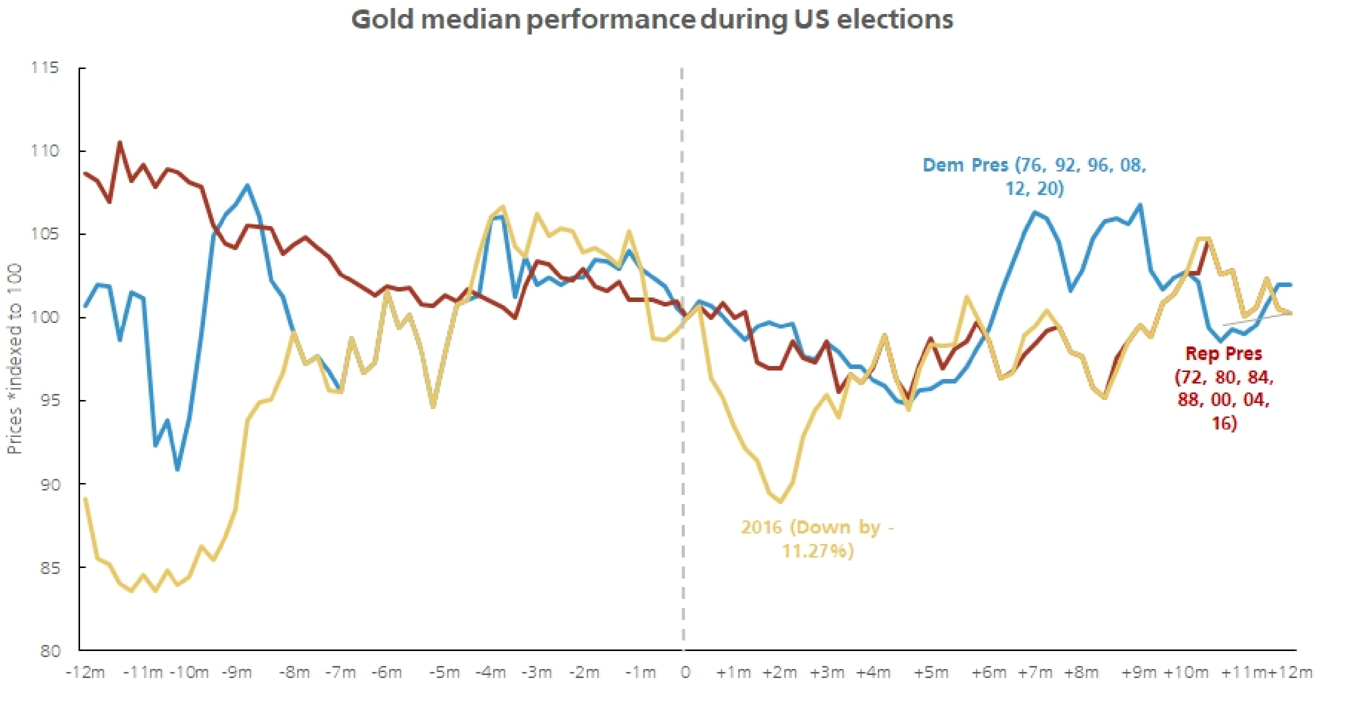
Source: Bloomberg, UBS. Note: Using US10y TIPS, DXY, VIX 3mma, Industrial Metals Index, and M2 as inputs; measured on monthly changes over a rolling 3y period

Figure 2: History shows that periods of higher real rates tend to coincide with lower/positive betas



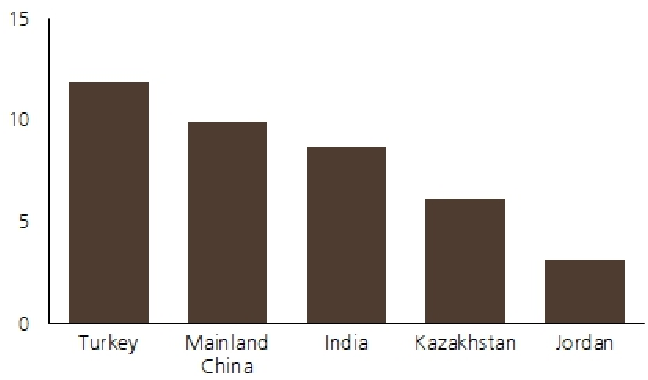
Source: Bloomberg, UBS. Note: Using US10y TIPS, DXY, VIX 3mma, Industrial Metals Index, and M2 as inputs; measured on monthly changes over a rolling 3y period

Figure 3: Gold's price path has been similar regardless of US Presidential elections outcome, but broader uncertainty make diversification into gold attractive



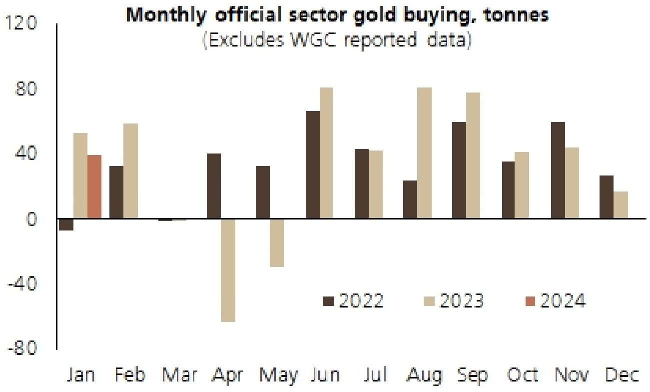
Source: Bloomberg, UBS.

Figure 4: Central banks continue to buy gold in 2024 (tonnes)



Source: IMF, WGC, UBS.

Figure 5: Preliminary data suggests a slower pace of buying, but there are upside risks



Source: IMF, WGC, UBS.

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