LV **Longview Economics**

Investments. Trades. Macro.

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Increase Gold Exposure in Strategic Portfolios

Summary & Conclusion

- Much of the 'frothiness' in gold prices, evident in December last year, has unwound (i.e. with gold consolidating its gains/trending sideways in recent months).
- The risk reward therefore favours starting to increase gold exposure in strategic portfolios for four key reasons. In particular: (i) our gold 'market timing model' has unwound its SELL signal; (ii) gold put protection is high; (iii) Fed cuts are likely to be 'priced back' into the rates market later this year; and (iv) key actors continue to hoard physical gold (at least for now).
- Risks are multiple and include the possible negative gold price impact from tighter liquidity (which we expect to materialise Q2 this year). Reflecting that risk we favour increasing gold weightings at current levels, and on weakness/if forthcoming.

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Important disclosures are included at the end of this report

Increase Gold Exposure in Strategic Portfolios

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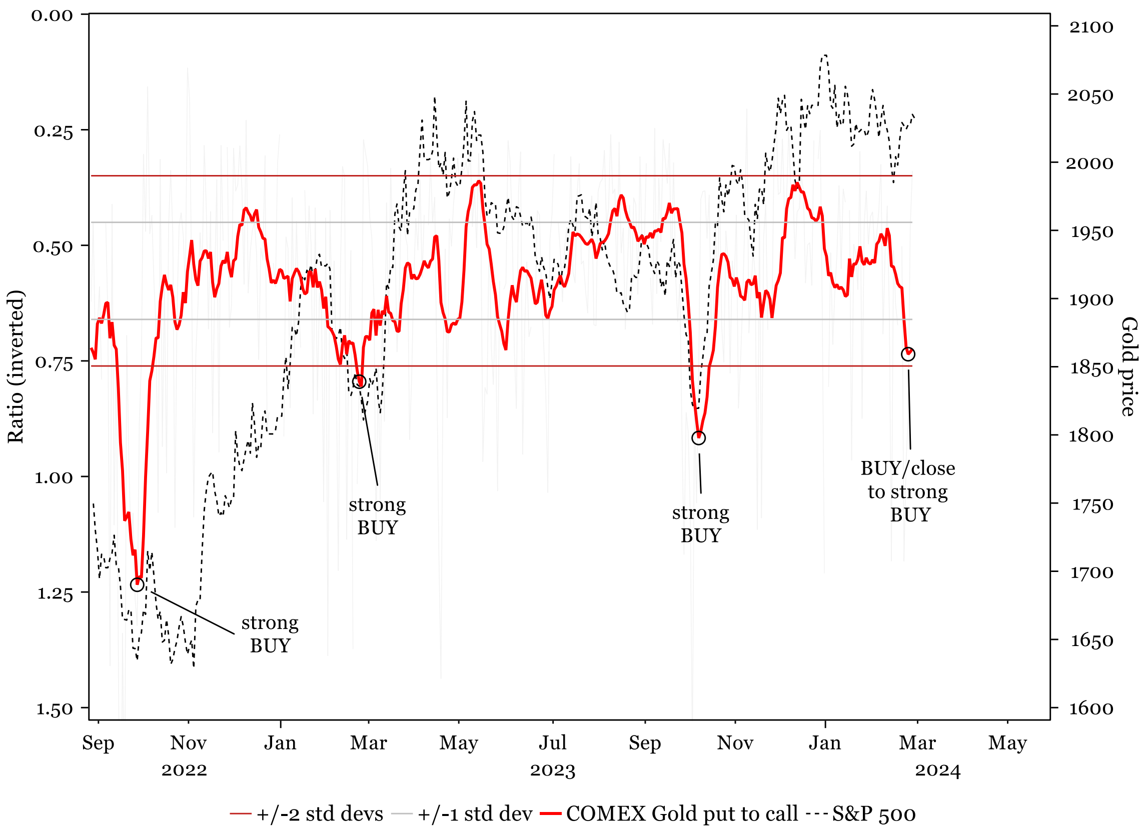
Summary & Conclusion

Having reduced gold exposure in December, we recommend *starting* to rebuild gold positions (i.e. move towards NEUTRAL weightings) in our strategic portfolio.

By early December, downside risks to gold were relatively high. The price was up 18% from its October low; net long positioning was crowded; sentiment was bullish; our technical (price based) models were on SELL (fig 8); and, reflecting all of that, our 'market timing model' had turned SELL (and has been timely in picking key turning points in the gold price in recent months, see fig 3).

Added to that models' backdrop, and supporting the gold price rally from October to December, expectations for Fed rate cuts had increased (i.e. to relatively ambitious levels, see fig 4).

Fig 1: Gold put to call ratio (10 day smoothed) vs. gold price (USD/oz)



Source: Longview Economics, Macrobond

Since December, and given that backdrop, gold price action has been impressive. That is, the price has consolidated its gains, and found support at around $2,000/oz (fig 2).

Fig 2: Gold price futures (USD/oz), with 50 & 200 day moving averages

Source: Longview Economics, Macrobond

Of note, and as the price has trended sideways, signs of frothiness and complacency have unwound. **The risk reward therefore favours starting to increase gold price exposure** in strategic portfolios for four key reasons. In particular:

- **i.** Our gold 'market timing model' has unwound its SELL signal (point 1);
- **ii.** Gold put protection is high (point 2);
- **iii.** Fed cuts are likely to be 'priced back' into the rates market (point 3); and
- **iv.** Key actors continue to hoard physical gold, for now (point 4).

We therefore favour *starting* to re-build gold weightings in the portfolio, with an additional 1pp. allocation (up from 2pp.), and a corresponding 1pp. reduction in cash (tables 1 & 1a). See **'Key Points'** below for full analysis.

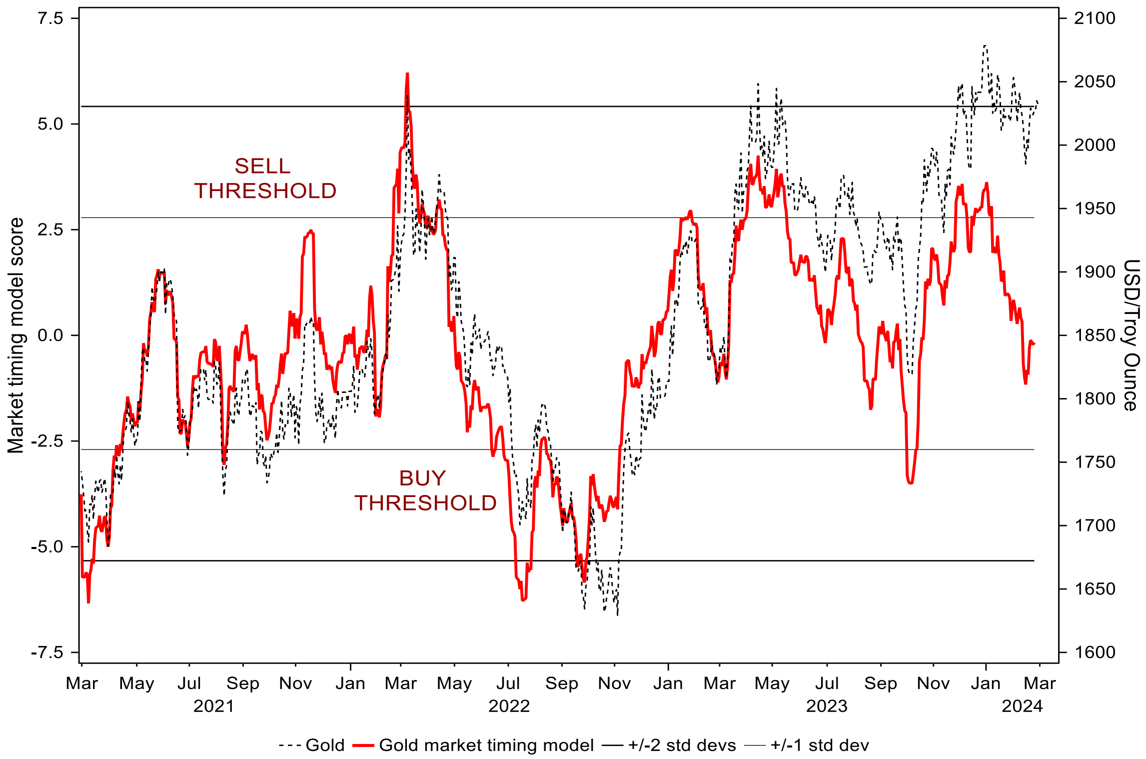
Risks to increasing LONG positions are multiple and include the possible negative gold price impact from tighter liquidity (which we expect to materialise Q2 this year, see **'Key Risks'** below for detail). Reflecting that risk, and given the potential for some gold models to move lower (and generate stronger BUY signals), we'd anticipate adding to the position on weakness/if forthcoming.

Key Points

1. **Our gold 'market timing model' is back at relatively low levels**, having been on SELL in December (fig 3). While the model has not yet reached its BUY threshold, the gold price has rallied from around these model signal levels, in the past 12 months (e.g. in March 2023).

   There are three inputs into this indicator, including: **(i)** net speculative futures positioning; **(ii)** our technical gold price scoring system; and **(iii)** a measured gold sentiment index (published by CONSENSUS Inc). In aggregate, those inputs suggest that frothiness and complacency in the gold market, evident at the end of last year, have largely unwound. As fig 3 shows, this model has a good track record in picking key turning points in the gold price. As such, and while it may move lower/turn BUY, it supports the case for starting to increase gold exposure.

Fig 3: Gold Market timing model vs. Gold price (US$/oz)



Source: Longview Economics, Macrobond

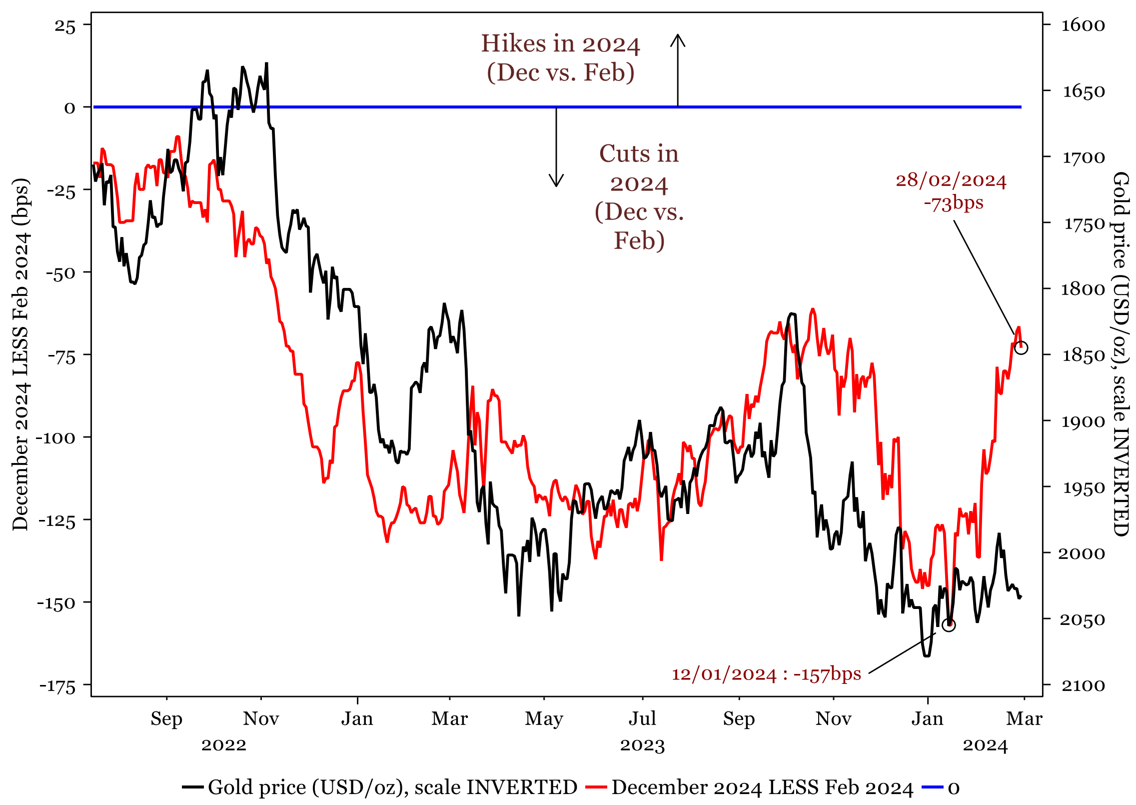
2. **Downside put protection in gold is high**. That is, despite 'range bound' trading in gold in recent months (fig 2), fear levels are relatively elevated (i.e. with a large volume of outstanding gold puts in portfolios, relative to calls). Our gold put to call ratio, therefore, is back on BUY, and close to strong BUY (see fig 1). Signals from this model, while not perfect, are typically useful at key turning points.

3. **There's a growing risk that (more) Fed cuts will be 'priced back' into the rates market, underpinning strength in the gold price.**

As fig 4 shows, the gold price has correlated reasonably well with Fed policy expectations. As such, and while there have been 'other factors' driving gold prices in the past 24 months (see point 4 below), the outlook for Fed rates is still relevant (i.e. as one of the three key 'traditional drivers'[1] of gold price direction).

In that respect, the rates market has dramatically priced out cuts in recent months, principally on growing concerns about sticky US inflation (as well as better than expected macro data). That repricing has been a headwind for gold (albeit gold price action has been relatively resilient, see fig 4, probably because of central bank buying, see point 4).

Fig 4: Gold price (US$/oz, scale INVERTED) vs. 2024 Fed rate pricing (bps)



Source: Longview Economics, Macrobond

[1] Those drivers are 10y TIPS yields, the US dollar, and Fed rate expectations.

Concerns, though, about sticky inflation are largely 'priced in' while, in the medium term, the US macro backdrop is a disinflationary one. That is, when assessed across a range of inflation theories and approaches, the most likely outcome is that US CPI continues to fall over coming quarters.

Added to which, risks to the US economy are skewed to the downside. Recently, US macro data has been better than expected (as per the Citi economic surprise index). That has no doubt contributed to the repricing of rates this year (fig 4). As fig 5 shows, disappointing macro data is usually associated with gold price strength (and vice versa – NB the gold price scale in this chart is inverted).

Fig 5: US Citi Econ Surprise Index vs. gold price (US$/oz), scale INVERTED

Source: Longview Economics, Macrobond

Over the next 6 – 9 months, though, the risk is that **US macro data surprises to the downside**. Of note, many of the leading indicators of the US labour market are pointing to a marked deceleration in job growth. That includes, for example, (i) the pick up in part time workers for economic reasons; (ii) the fall in 'temporary help' in the service sector; and (iii) the downtrend in the 'jobs plentiful less hard to get' index, amongst others highlighted.

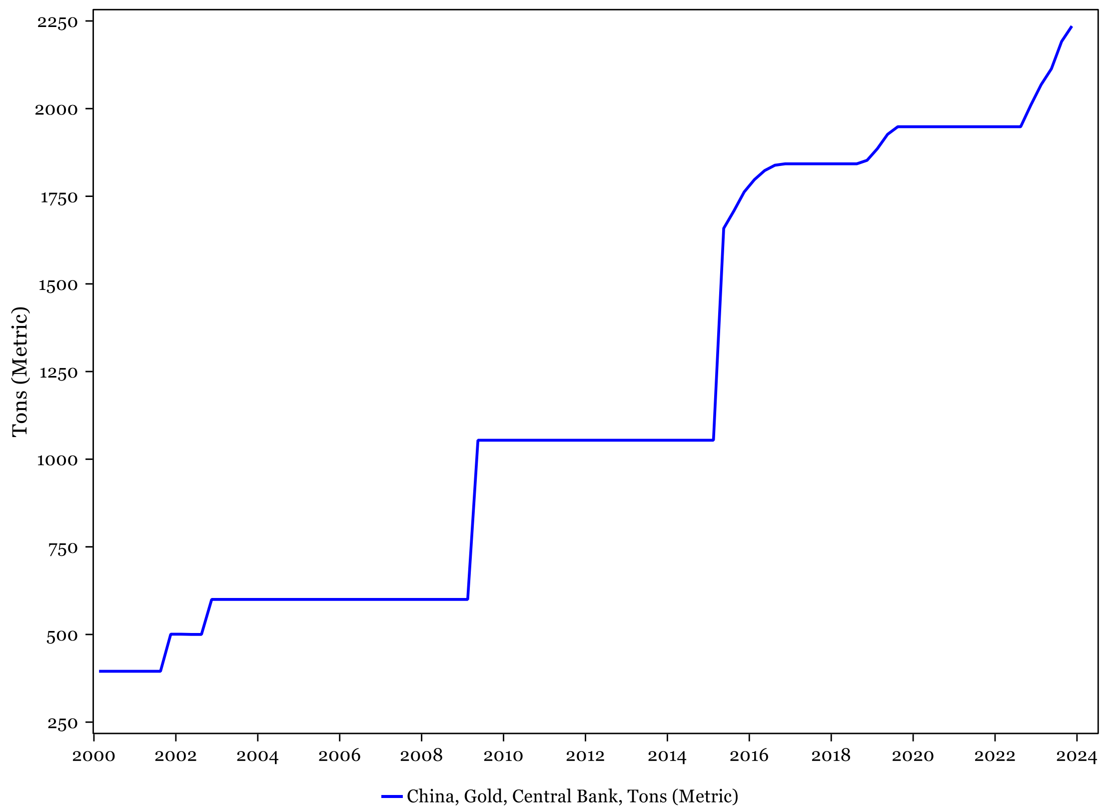
That combination, of softer inflation and decelerating economic growth (and, in particular, softer than expected macro data) should result in a re-pricing of rate expectations **and a stronger gold price**.

4. **Gold prices, for now, remain supported by geopolitical tensions,** with strong appetite amongst investors/central banks to hoard physical gold. That includes buying from family offices, ultra-high net worth individuals or state actors, many of which are 'price-insensitive' buyers.

   In other words, and while the 'usual' drivers of gold price direction are still relevant (and examined in point 3 above), 'unusual' factors have also played a role in the past 24 months, and bear watching closely.

   Naturally, it's difficult to prove (i) why investors have taken more physical delivery of gold, and/or (ii) how much longer that type of buying will support the gold price. Of note, though, the Chinese central bank continues to build its gold holdings (which have risen by 287 tons in the past two years, and are trending up, see fig 6) while Chinese retail interest also appears robust, as suggested by the (still) high premium of Chinese gold price (relative to the US price, – see fig 9).

Fig 6: Chinese central bank (PBoC) physical gold holdings (metric tons)



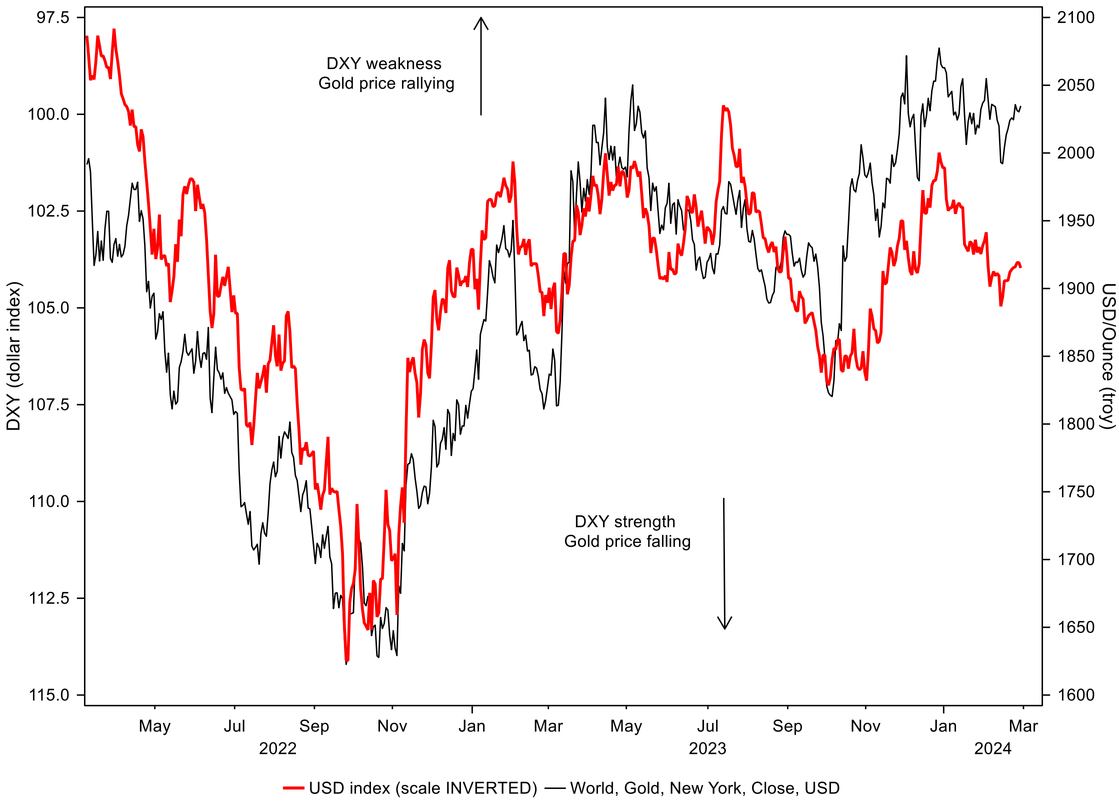
Source: Longview Economics, Macrobond

Key Risks

Risks to increasing LONG gold exposure are multiple. Most notably, the Fed's RRP facility is likely to be mostly, if not fully, drained by Q2 this year. A key 'one-off' source of financial market liquidity will therefore be exhausted, which will likely create a challenging time for risk assets.

Often, in tightening liquidity environments (when risk aversion returns to markets), the dollar is strong (and gold prices come under pressure, see fig 7 below).

Fig 7: US dollar index (scale INVERTED) vs. gold price (US$/oz)



Source: Longview Economics, Macrobond

We would note, though, that gold's correlation with the dollar occasionally breaks down. It's possible, for example, that tighter liquidity (and risk aversion) in Q2 is associated with a rally in bonds and a pricing of more rate cuts from the Fed. In that scenario (and as fig 4 suggests), the gold price would likely rally (especially if US macro data was starting to soften/surprise to the downside, see fig 5).

On balance, therefore, our preferred strategy is to start building LONG gold positions at current prices, with the view to increasing the position size on weakness/if forthcoming.

Key charts & tables

Table 1: Benchmark & Recommendations[2]

RISKY Assets				SAFE Assets			
Asset	L'view B'mark (%)	Feb '24 weight'g (%)	OW/UW (pp)	Asset	L'view B'mark (%)	Feb '24 weight'g (%)	OW/ UW (pp)
DM Equities	25	25	-	Developed Sovereign Debt	25	28	+3
EM Equities	10	12	+2				
Commodities	5	7	+2	Cash	15	8	-7
HY & EM Corporate Debt	5	5	-	HG Corporate Debt	10	10	-
EM Sovereign	5	5	-				
Total RISKY	***50***	***54***	***+4***	**Total SAFE**	**50**	**46**	***-4***

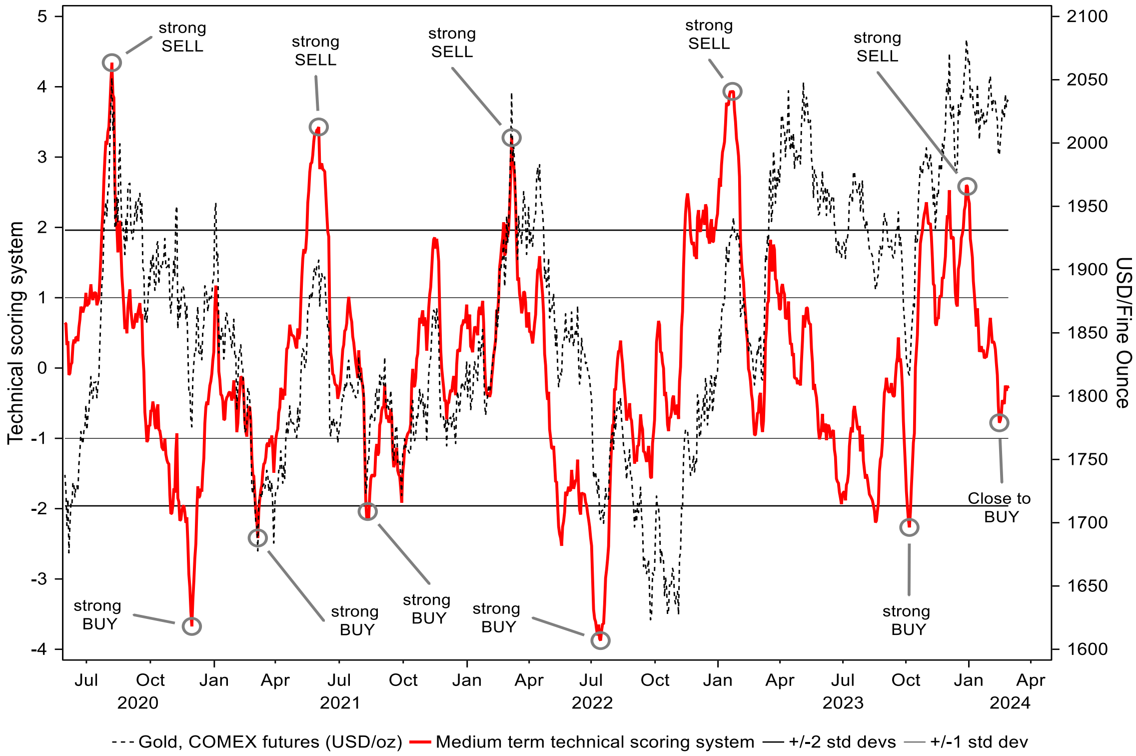
Source: Longview Economics
[2] Split of safe haven assets vs. risk assets (& vs. benchmarks)

Table 1a: Top level Strategic Recommended Asset Allocation (% weightings)

Asset Class	**NEW** % of total (Updated Feb '24)	**%** Breakdown	Change from last update	**OLD** % of total (updated Feb 24)
Equity:	**37**		-	**37**
- Developed		25	-	25
- Emerging		12	-	12
Corporate Debt:	**15**		-	**15**
- US High grade corporate		7	-	7
- EZ High grade corporate		3	-	3
- US High yield corporate		2	-	2
- EZ High yield corporate		2	-	2
- EM corporate debt		1	-	1
Commodities:	**7**		**+1**	**6**
- Gold		3	+1	2
- Silver		-	-	-
- Agricultural		-	-	-
- Base metals		1	-	1
- Energy		3	-	3
Sovereign debt:	**33**		-	**33**
- Developed		28	-	28
- Emerging		5	-	5
Cash	**8**	8	-1	**9**

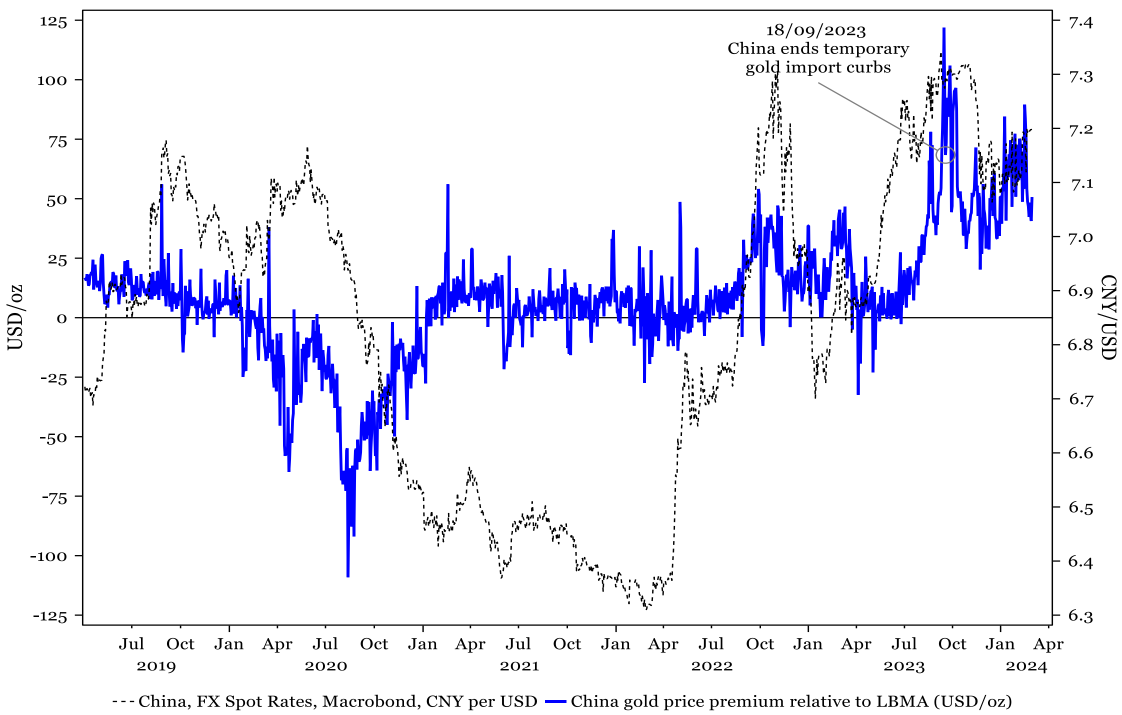
Source: Longview Economics

Fig 8: Gold medium term 'technical' scoring system vs. gold price (US$/oz)



Source: Longview Economics, Macrobond

Fig 9: China gold price LESS LBMA gold price (USD/oz)



Source: Longview Economics, Macrobond

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