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Narrative and Reality

Last week, the narrative served up by central banks once more derailed gold. After recently testing the $1,900 level, the metal temporarily dropped to around $1,730, before rebounding to the $1,780/$1,790 range. What caused the sell-off? Mostly, official statements that the recent increase in inflation will prove temporary and the belief that a rise in interest rates, and therefore the dollar, is imminent. What powered the rebound? Another sharp rise in producer prices, clocking in at a 7.8% year-over-year rate.

10 Year Gold Price History in US Dollars per Ounce

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I have no idea how long the illusion of 'temporary inflation' will hold, but the combination of price pressures on the wage and housing fronts, combined with a sharp rise in shipping rates and supply-chain challenges, suggests that dismissing the topic is foolish. As to the notion of rising interest rates, I think it'll be a year or longer before the Fed and other central banks can act.

What to do, given current realities? When it comes to gold, for reasons I'll explain below, I continue to advise a meaningful inclusion in an investment portfolio.

Which Gold Investment Is Right For Me?

Should you hold gold in the form of a mining shares, gold ETF's or certificates, or physical bullion? It's a question I'm being asked increasingly often. The answer is simple: it depends on how you relate to gold.

Are you disgusted with central bank recklessness and want to hold a currency that's held its value and offered protection against monetary and socio-political turmoil over centuries and millennia? Is the stabilization of your overall investment portfolio your main objective? Or do you view the yellow metal as an attractive speculation at the right point of the economic cycle or when chart patterns look attractive? And if so, how much leverage do you want to inject into your gold investments?

If protection against inflation and falling currency values is your priority, I highly recommend a holding of physical metal. Unlike an ETF, a gold certificate or a futures contract, actual gold is not someone else's liability and can, in the event of a systemic breakdown, be a highly desirable store of wealth. What are the chances of you needing physical gold to satisfy financial obligations, barter with, or pledge as collateral? In our part of the world, probably small, but if you look beyond the developed economies, the metal's appeal as an asset of last resort is broad-based. In countless jurisdictions, gold is not only seen as the only trusted currency, it's also respected for its high level of recognition and liquidity. In short, a physical holding of bullion represents the highest standard of gold investment.

If your intention is short-term in nature and having physical possession of, or access to, is not an objective, exchange traded funds like the SPDR Gold Trust (GLD on the New York Stock Exchange) or Sprott Physical Gold Trust (PHYS on the NYSE or on the Toronto Exchange) will do the job just fine.

The same is true if you merely want to inject gold into your portfolio mix as a performance stabilizer. Throughout the past thirty years, we've consistently been able to reduce overall portfolio volatility by holding between ten and fifteen percent of total assets in the metal—ten percent during times when inflation and currency volatility are subdued, fifteen percent when monetary policy is overly accommodative and price pressures intensify.

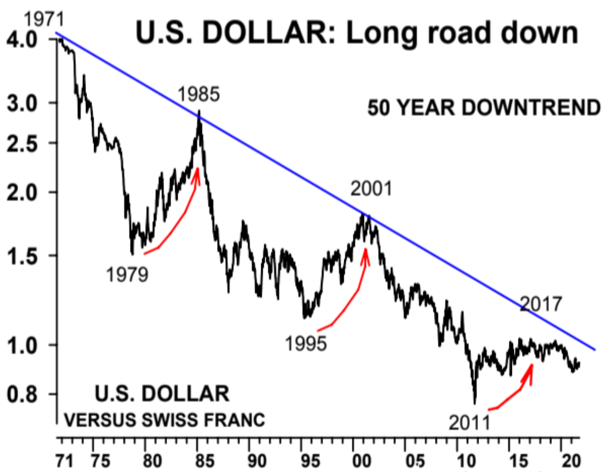
At times when gold's fundamental and technical profiles look especially compelling (like now), additional leverage can be gained through exposure to mining shares. During most of the past fifteen years we've avoided gold equities, except for royalty based companies such as Wheaton Precious Metals (WPM) and Franco Nevada (FNV). The simple reason: many major gold mining companies were poorly managed and, in addition, were seriously challenged by low bullion prices. That has, in some cases, dramatically changed. In the current pricing environment, major miners such as Barrick Gold (ABX) or Newmont Corporation (NEM) are not only capable of generating significant positive cash flow, but also feature solid management teams. Having said that, the additional leverage inherent in mining plays is not for everyone.

Where From Here?

Gold continues to look attractive, with a move to new highs sometime later this year or in 2022 eminently possible. Here is a brief compilation of relevant factors:

-The world's central banks remain trapped in a highly accommodative mode, while governments the world over are boosting their spending to levels that defy the imagination. One inevitable consequence of abundant liquidity and historically low interest rates is a gradual loss of faith in money.

-The narrative of an imminent 'tapering' of central bank support operations is unlikely to play out. Covid-related developments may push the advent of a more restrictive central bank policy far into 2022 or beyond.



-Numerous macro trends contribute to rising inflation, while the U.S. dollar appears trapped in a long-term downtrend (see chart at left, courtesy the Aden Forecast). That decline should continue and perhaps accelerate, as the dollar's pre-eminence as the world's reserve currency and U.S. dominance of international payments systems will be challenged, both by a changing world order and technology.

-Gold's supply/demand profile is stable; we cannot identify any near-term developments that would alter that.

-The yellow metal's technical position is compelling. Technicians point to the next episode of historical chart patterns, the "C-rise". Historically, C-rises last an average of seven months and push prices up an average of 33%.

-The gold price is in an uptrend in terms of other major currencies.

-The geopolitical situation remains tenuous. U.S. efforts to perpetuate a "rules-based international order" (i.e. one based on U.S. rules), no longer resonate with several of America's key traditional allies. Meanwhile, Washington's push to contain China as an economic and military rival and short-stop a China-Russia dominated Eurasian alliance is more than likely to fail and will almost certainly complicate international relations.

The bottom line: I have not seen a more favourable constellation for gold since I first started writing about the subject in the mid-1970s. Of course, financial markets and narratives are far more manipulated than they were then, which can both subdue and boost price movements in specific asset classes. I have no idea which it will be with gold, but continued tailwinds for the yellow metal appear assured.

Best regards,

Peter Cavelti