KGI CHINA DEVELOPMENT FINANCIAL

# Gold

## Gold: Hedge against incoming Dollar flood

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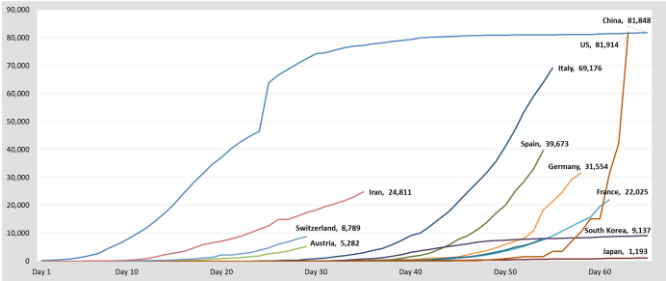
- Over the past weeks, the COVID-19 pandemic has stressed global financial markets, resulting in gold being a victim of the indiscriminate sell-offs.
- However, gold regained lost ground, boosted by the tailwinds of quantitative easing, zero interest rates, and dollar strength, similar to the last gold bull run following the global financial crisis (GFC) in 2008.
- We raise our 12 months gold target price to an all-time high of US$1,900/oz.

**Fears of Armageddon.** As of 26-March, the total global infected cases of COVID-19 has increased to more than 460,000. China, South Korea, and Japan, the early centres of the outbreak, have largely contained the spread within about one and a half months. Meanwhile, Europe and the US, where the outbreak started in early March, are still undergoing the rapid rise of infected cases and are only expected to reach the inflection point in about two weeks. The scale of spread of COVID-19 has never been seen in history, simultaneously resulting in frozen economic activities (lockdown of cities, shutdown of borders, halt of public transports, and suspension of entertainment venues). As a result, OECD revised down global GPD growth in 2020 from 2.9% in last November to 2.4% in early March. Governments and central banks reacted rapidly, announcing a series of stimulus, but financial markets regarded these as panic moves.

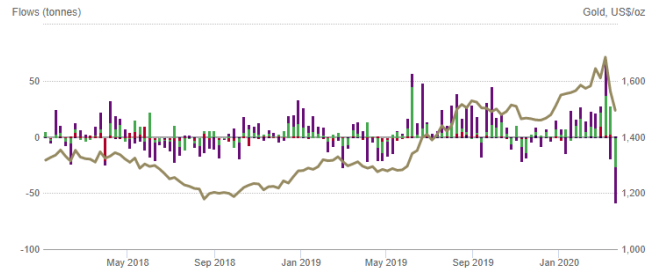
**Figure 1: Infected cases by major epicenter**




*Data updated as of 26-March*
*Source: WHO, KGI Research*

In the third week of March, gold was another victim of the global indiscriminate selling alongside other major asset classes. According to the World Gold Council, North America and Europe are the two main camps, liquidating gold holdings by 31.5 tonnes and 25.9 tonnes respectively. The net outflows in terms of AUM (US$) dropped by 2.1% WoW. The sell-off almost wiped out the gains in the first week of March when moderately pessimistic market sentiment was favourable for gold.

**Figure 2: Weekly global gold ETF flows**




*Source: WGC*

**Tailwinds for gold similar to post GFC era.** Those investing in gold must hold a long-term view. The accumulation of AUM on gold allocation since 2016 remains intact. Recall that the last bull-run of gold (from March 2009 to August 2011) was built on several foundations: 1) Quantitative easing for the first time in history, 2) Zero interest rate environment, 3) Confidence in the US dollar (dollar strength). The recent market crash and the foreseeable economic downturn has forced the Fed to take unprecedented aggressive measures.

Compared to the GFC era, the Fed has expanded its asset purchase program to include corporate debt this time around. The implication for gold is that the financial system is going to be flooded with dollars. As more dollars are printed, the higher the price of gold should be. Meanwhile, zero interest rates are expected to be prolonged given that the economic recovery relies more heavily on consumption, which takes longer to recover compared to production. The low growth and low yield environment makes gold more attractive.

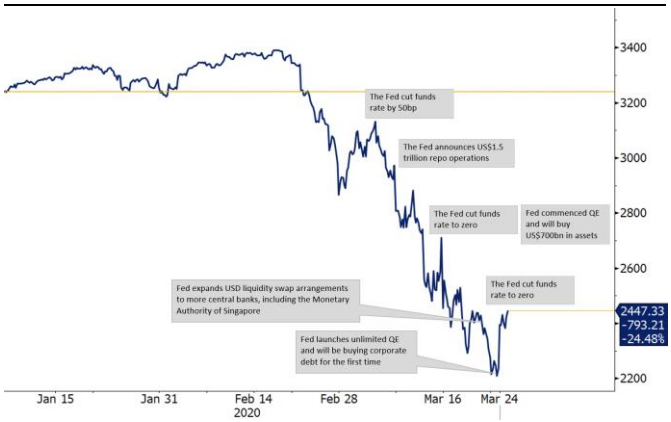
The recent liquidity drain was due to the outflow of holdings in financial assets. Holding cash during a recession is a consensus, the consequence of which is a strong dollar. But the hoarding of cash will likely not be sustainable given the "unlimited" dollar supply and will lead to asset price inflation, which will lure money back into financial markets.

**Figure 3: Global gold AUM**


*Source: WGC*

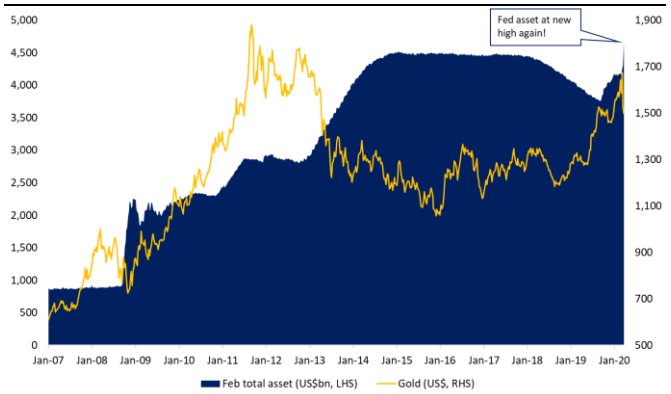
| Date | Monetary stimulus measures |
|---|---|
| 3 March | Fed cut rates by 50bp in its first emergency move since the global financial crisis in 2008. |
| 12 March | Fed injects US$1.5 trillion into short-term money markets, designed to ease pressure on the financial system. |
| 15 March | Fed cuts funds rate to zero and launches Quantitative Easing (QE). As part of the newly launched QE, the Fed will buy US$700 billion in assets over the coming months. |
| 17-20 March | Fed unleashes a jungle of funding facilities: Commercial Paper Funding Facility (CPFF), Primary Dealer Credit Facility (PDCF), Money Market Mutual Fund Liquidity Facility (MMLF), Primary Market Corporate Credit Facility (PMCCF), Secondary Market Corporate Credit Facility (CMCCF) and Term Asset-Backed Securities Loan Facility (TALF). |
| 23 March | Fed announces new extensive measures, including expanding its QE Programme to include the unprecedented purchase of corporate debt. The Fed will focus on buying investment grade debt issued by US companies and US-listed exchange traded funds (ETF) that provide exposure to US investment grade corporate bonds. Marks the start of unlimited QE. |

**Figure 4: US monetary stimulus amid S&P500 index crash**



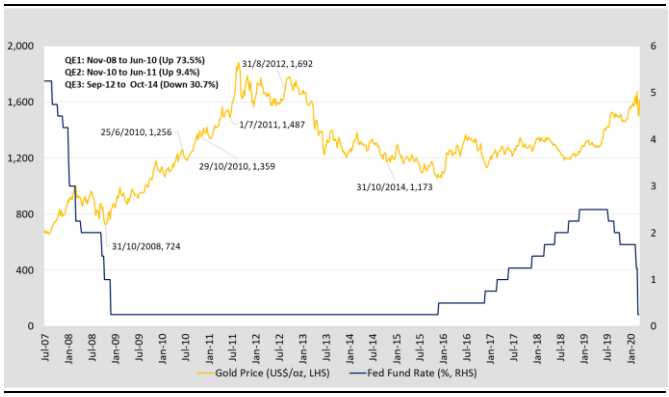

*Source: Bloomberg, KGI Research*

**Figure 5: Fed asset expansion and gold performance**




*Source: Bloomberg, KGI Research*

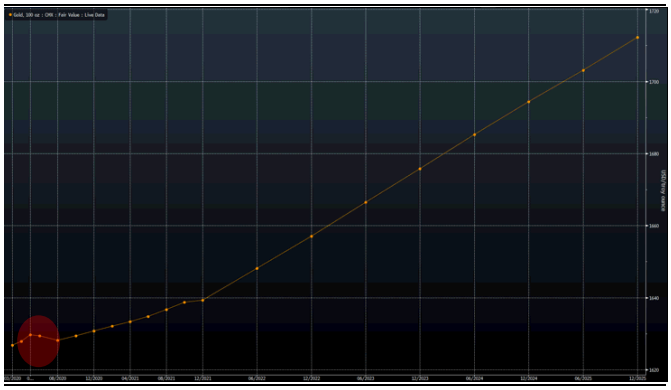
**Figure 6: Fed fund rate and gold performance**




*Source: Bloomberg, KGI Research*

**Strong demand in the near term.** Gold futures is currently in backwardation (Future prices with an expiration in May higher than in June and August), meaning that the demand for gold in the next two months is strong. This is largely due to the fact that the COVID-19 impact on the economy and corporate performance will surface more visibly during this period, and investors are hedging the shock (worse than expected) at this point. The dismal outlook and sentiment will leave more room for gold to rise.

**Figure 7: Gold futures curve**



*Source: Bloomberg, KGI Research*

**Trading strategy.** Gold price is currently trading above US$1,600/oz. The resistance level for gold is US$1,700/oz and US$1,800/oz on its way back to its historical high of US$1,900/oz. We raise our target price for gold to an all time high of US1,900/oz from our previous US$1,700/oz target. The support level is US$1,475/oz. **(See Figure 8)**

**Products recommended for trading gold:**

| |
|---|
| **ETF:** SPDR® Gold Shares **(GLD)** |
| **Mining ETF:** VanEck Vectors Gold Miners ETF **(GDX)**, VanEck Vectors Junior Gold Miners **(GDXJ)** |
| **Leveraged ETF:** Direxion Daily Gold Miners Index Bull 3X Shares **(NUGT)**, Direxion Daily Junior Gold Miners Index Bull 3X Shares **(JNUG)** |

**Figure 8: Fibonacci retracement on gold prices**


*Source: Bloomberg, KGI Research*

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|---|---|
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