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Gold & Silver: How Long Will The Rally Last?

By Ian Williams, Chairman, Chief Executive, Charteris Treasury Portfolio Managers

Despite a recent strong rally, gold and precious metals fans were forced to keep their bubbly on ice in 2018. Even as multiple geopolitical challenges flared up during the year, and a mountain of debt piled up globally, the party failed to get into full swing.

Yet, the underlying prospects for gold and silver continue to look attractive, and both metals remain in a 20-year primary bull market that is likely to peak early in the next decade.

It is worth noting that since 2000, when the last tech bubble burst, gold has comfortably outperformed both equities and bonds, peaking at over \$1,900 in 2011. At the time of writing, physical gold has delivered an almost 350% gain over that period. US equities, as measured by the S&P 500 index, has returned approximately 150% including dividends, while the UK 30-year gilt has returned about 135%.

Although gold and silver failed to shine in 2018, a late surge narrowed the overall decline for the year to about 3% for gold and about 9.5% for silver. This compared with a 7% decline for US equities. Unlike gold and silver, Palladium was extremely successful last year, hitting a new all-time high as increasingly tough

vehicle emission standards continued to drive up demand worldwide.

Bulls of the sector have been encouraged by a recent rally, which began late last year and has continued into the New Year. The key to gold and silver's medium-term prospects depend largely on a sustained upturn in investment demand, which languished in the past two years as many investors favoured technology, growth and other momentum-driven sectors at the expense of investing in precious metals and mining company shares. As a result, the strong gains made by gold and silver assets in 2016, when the gold price jumped by about a third to around \$1,350, were eroded in the following two years amid dwindling interest from institutional or hedge fund investors, especially those based in North America.

In the wake of the stock market rout in the fourth quarter of last year – which saw almost two trillion dollars wiped off the value of major technology companies – investors are now once again re-evaluating the composition of their portfolios to gain more exposure to sectors that missed out on the boom times.

On the plus side, gold demand has been well supported by central banks for the past decade. They have been net buyers of gold since the beginning of the 2008 financial crisis. According to World Gold Council Figures, the amount of gold purchased by the central banks reached the highest level in almost three years for the quarter ending in September 2018. Banks bought almost 148 metric tons of gold during the quarter, implying growth of 22% year over year. Their appetite for gold appears to be getting bigger as a number of central banks from emerging countries, led by Russia, continue to diversify their assets by buying gold with the primary aim being to reduce exposure to the US dollar.

The obvious starting point for investors is to look for relative value among the many oversold and out of favour assets classes, some of which are showing up as incredibly cheap on historic valuations. At the top of this list is probably a collection of emerging market equities, including EM currencies. In addition, gold and silver assets are also showing extreme relative cheapness based on historical precedent. For example, while physical gold and silver have soared in value since 2000, gold and silver mining company shares have lagged by a huge margin, and were up by just a third in that period.

Growing uncertainty about the global economy and a possible weakening of the dollar due to an expected end to US interest rate hikes this year, also provide bullish conditions for gold and other precious metals to shine. Longer term, the dollar's role as the world's reserve currency is also likely to be challenged by China, who continues to chip away at the dollar's dominance by introducing a variety of measures and financial instruments (such as renminbi oil futures, exchangeable with gold) that bypass the US currency.

For silver, the prospects look even more bullish due to its industrial applications, such as in solar energy, as well as a long-term decline in new mine supply.

Encouragingly, gold and silver assets are already starting to display some relative strength as the US and other markets experience increased volatility. In December 2018 alone, the Nasdaq market fell by about 8%, while the average gold fund rose by about 8%. Although a single month's swing does not make a new trend, it does highlight the importance of having a balanced portfolio of non-correlated assets if the tech-led bull market in equities turns to bust.

So how do investors obtain greater balance in their portfolio? The answer is that gold and silver will move back into favour once investors are sure that the downward momentum of the last two years is finally over. As investors have run down their gold exposure to next to nothing, any rebalancing of global portfolios from a close to zero weighting, up to, say, 5% across the board, will have a dramatic impact on the price of not only the gold and silver metal price, but a much greater impact on the share prices of the gold & silver mining companies. Whether 5% of a portfolio is the correct exposure is open to debate but it looks increasingly obvious that a zero weighting for gold and silver assets is definitely the wrong number.

Ian Williams is chairman of Charters Treasury Portfolio Managers, a London based boutique fund management company. The firm's Charters Gold & Precious Metals Fund was ranked NO 1 UK fund from all sectors in 2016.



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