Investment Strategy Update

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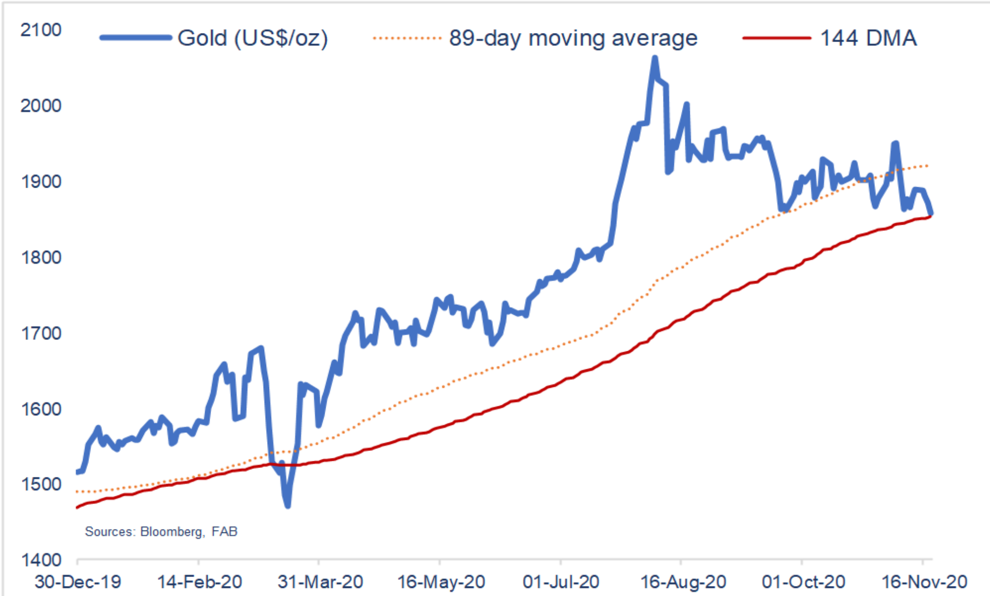
Gold faces a test as investors pile into risky assets



♦ Gold prices have dropped 1.68% so far this month as investors shunned the safest assets to buy riskier ones.

♦ Gold ETFs have reduced their holdings by 1.46 million ounces since the end of October as retail investors pulled some money out of them .

♦ Falling prices have brought gold close to a technical resistance, at about US$1,850/oz, which, if breached, could signal further weakness.

♦ While gold prices could stumble on these short-term headwinds, the yellow metal continues to be a good store of value and could benefit from a weaker dollar in the future.

♦ The FAB AAC remains overweight in EM and IG bonds and gold, and slightly underweight in global equities.

Gold has been an outstanding investment so far in 2020. After years of lagging other asset classes, the yellow metal has risen 22.8% this year-to-date. It was 36% higher for the year at its peak, on 6 August.

Since then, however, the haven asset has given back some of its gains. First, pressure on the Turkish lira forced the central bank of the country to sell US$4.76 billion of its foreign exchange reserves, which were mostly in the form of gold, since the end of July. This seems to have helped push gold prices lower in the past three months.

In the last couple of weeks, however, gold prices have dropped even as the lira regained its footing. This time, the sellers seem to be retail investors, who have been buying gold exchange-traded funds.

The gold holdings of these ETFs has dropped by 1.46 million ounces since the beginning of the month. These vehicles had racked up a record 111.24 million ounces of gold as of 15 October and now hold 109.38 million ounces.

The move has come at the same time as the news about a potential vaccine began to look more promising. This suggests that many investors were using the yellow metal and its ETFs as the equivalent of a cash account, waiting for the uncertainty to dissipate to reallocate it to higher-yielding asset classes, such as equities.

With US$17.01 trillion of bonds offering negative yields in the world, many investors are naturally compelled to hold gold instead of investment-grade notes, which may have been the default option in the past. Simply keeping cash is also risky, given the potential for an inflationary spike in the future, after record amounts of fiscal and monetary stimulus have been injected into the world's financial system.

Gold prices are testing the 144 -day moving average, a key support for technical analysts

These elements, along with a weakening US dollar, are likely to maintain the allure of gold. However, for now, what seems like a rotation into riskier assets is pushing the yellow metal's prices against a key support level, which could presage more weakness if broken. Some technical analysts say that if gold prices drop below US$1,850 for a few sessions it could move significantly lower from there.

If that happens, it may provide a good opportunity for investors to add some gold to their portfolios, in case they do not already have too much of it. Regardless of the direction it takes in the short-term, gold should always be part of a diversified portfolio, especially since it can serve as a hedge against volatility, and there may be interesting times ahead.

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