Investment Strategy

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ADCB
ASSET MANAGEMENT LIMITED

Gold – neutral in the short-term, and bullish in medium/long-term

- **Gold prices rallied between November 2022 and May 2023 but fell subsequently as concerns of the US hard-landing abated.**
- **The supply-demand outlook is not favourable in the near-term – with not much upside in demand for jewellery and from central banks.**
- **Upside risks to our short-term neutral outlook emerge from a potential recession or an escalation in geopolitical tensions; a stronger USD or further higher real rates are the downside risks.**
- **On the 6–12-month horizon we are more bullish on gold prices. Further beyond the medium-term too, gold acts as a hedge against recession and geopolitical risks, in our view.**

Performance

Gold hit a record high of USD2,072/toz in May after rising c26% since November 2022, as concerns about the US regional banking crisis, US debt ceiling issues, and a potential recession dominated. Subsequently, gold prices came under pressure in recent months (down 8% since their peak in May) as the US growth remained resilient. Even in major economies other than the US, recession probabilities have fallen since the start of the year. This has in turn caused a move higher in real rates with which gold is negatively correlated. Also, the USD strength did not help gold prices much.

Supply-demand dynamic

- From a supply perspective…
  - Mine output is rising and is expected to rise further this year and the next.
  - Recycling rates are also on the rise.
- On the demand side…
  - Although the prices have fallen, they are high enough to curtail jewellery demand (accounting for 47% of the overall demand) in price-sensitive markets and in China where the economic growth has been disappointing.
  - Investment demand (24% of overall demand) was high at the start of the year but fell as risks abated over recent months.
  - Central bank demand (23% of the overall demand) is easing from stellar 2022 levels but remains high as geopolitical risks and portfolio diversification needs remain compelling reasons supporting official sector gold accumulation.
  - Industrial demand for gold (6% of the overall demand) remains muted as demand for electronics cooled on consumer rebalancing away from goods to services.

Outlook for gold prices

- **Short-term (3-6 months):** After having been bullish on gold since November last year, we cut our positions (by taking profits) in both gold and gold miner equities in June this year (see our Tactical Asset Allocation: Fooled by bearishness, June 19 2023). We maintain a neutral outlook on the commodity in the short-term. The short-term outlook hinges on the developed world central banks' monetary policy. Here, while we see rate cuts coming, we see them happening only in late H1'24 or early H2'24. To that extent, the primary support for gold prices is unlikely to materialize in the short-term horizon. Yet, we see limited downside given the recent price weakness. Upside risks to our neutral view come in the form of a US/global recession, and an escalation in geopolitical tensions. A stronger USD or further higher real rates are the downside risks.
- **Medium-term (6-12 months):** This time horizon coincides with a potential rate cut (our base-case) from the US Fed which should trigger a gold price rally. Should these rate cuts follow a recession (not our base-case), the gold price rally could be stronger.
- **Long-term (over 1 year):** Further beyond the medium-term, gold acts as a hedge against recession and geopolitical risks. Especially in a deglobalized multi-polar world, gold could act as the international store of value.

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Gold in multi-asset portfolios

Sizing gold positions is very important. Having too little exposure means insufficient cover against risks and having too much exposure means high opportunity costs (equities tend to outperform gold through the cycle). In this regard, a recent research paper ("*The Golden Rule of Investing*", Pim van Vliet and Harald Lohre, June 23 2023) showed that adding 10% gold to a 50/50 equity-bond portfolio delivered optimal risk-return mix on a 1-year time frame.

Exhibit 1: Adding gold to a 50/50 equity-bond portfolio, 1975-2022

1-year horizon	0	5	10	15	20	25	30	35	40	45	50
Real return	6.1%	6.0%	5.9%	5.8%	5.6%	5.5%	5.3%	5.1%	4.9%	4.7%	4.5%
Downside volatility	3.9%	3.7%	**3.7%**	3.7%	3.7%	3.8%	4.0%	4.2%	4.5%	4.9%	5.2%
Sortino ratio	1.56	1.61	**1.61**	1.57	1.50	1.42	1.32	1.21	1.09	0.97	0.85
Loss probability	26.6%	24.3%	**22.4%**	22.6%	22.6%	22.0%	23.8%	26.8%	27.5%	29.7%	32.1%
Expected loss	-1.6%	-1.4%	-1.3%	**-1.3%**	-1.3%	-1.4%	-1.4%	-1.6%	-1.7%	-1.9%	-2.2%
Minimum return	-24.8%	-24.2%	-23.6%	-23.0%	**-22.4%**	-22.7%	-24.3%	-25.8%	-27.4%	-29.0%	-30.5%

Source: "The Golden Rule of Investing", Pim van Vliet and Harald Lohre, June 23 2023

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