Gold, A Reflection Of The Times

Does the gold price mirror these uncertain times?

Neville Bergin

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Mining Explained

Preface to October 2019 Re-write

I was prompted to rewrite this article after updating my cap[ability statement for a potential client. My capability statement includes a list of publications for which I am the author or co-author. I decided to click on the link and reread the article I had written back in 2016 for Resource Global Network.

Whilst my forecast; I use the term loosely, of the gold price has weathered the passage of time, I felt that an update was warranted to reflect the changes over the past three years, the current state of the world and therefore what I saw as the likely prospects for the price of gold over the coming few years.

Whilst my thesis for the gold price is based on the level of uncertainty in the world; social, economic and political, I have found support for my views from chartists and the owner of the largest gold vault in Switzerland.

As I observe in the article, forecasting is a crowded field and this article represents my opinion and is a commentary on overall trend as I currently see it. I am but one of many pondering the future of the yellow metal, so do your own research and come to your own conclusions and where appropriate, seek professional advice.

Acknowledgements

I am indebted to Daryl Guppy for providing me with his most recent CNBC note on the gold price and for permission to include his chart from that note in this article.

http://www.guppytraders.com/

Similarly, I would like to thank goldprice.org for their permission to use their charts in the original article and this update.

https://goldprice.org/

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Golden Thread

During a career in mining spanning almost 40 years, I have spent around 18 years working in the gold sector, which I believe gives me a reasonable understanding of the industry. My engagement by Capricorn Metals (ASX: CMM) in 2016 as Project Manager for their Karlawinda Gold Project, refocused my interest in the yellow metal. Whilst my work for Capricorn came to an end, my involvement in the gold sector continues with Musgrave Minerals (ASX: MGV) and as a non-executive director of Metal Tiger Plc (LON: MTR), which holds a number of investments in gold.

Whilst many aspects of gold mining are common to all mining, it is the final product that makes the business so appealing and like no other. Gold can be sold for cash, which can be in the producer's bank account within days. There's no waiting to accumulate enough concentrate for a shipment, calibrating and cross checking weighbridges, belt weighers and ships survey. No worrying about transportable moisture limits, combustibility and concentrate losses. No collecting tens of samples during shipment and then deciding which assays to contest and send to umpire before the shipment is finally reconciled and final payment made.

Gold always finds a buyer, there's no wondering whether your product will sell. Whether selling into the spot market or into forward sales contracts, the price is pretty much known when the bar leaves the gold room. The sales side is easy, it's the cost management side of things that takes the effort and therein lies the challenge for all the geologists, mining engineers, metallurgists and others that make a mine work.

At this point I believe that a little re-cap of history is relevant.

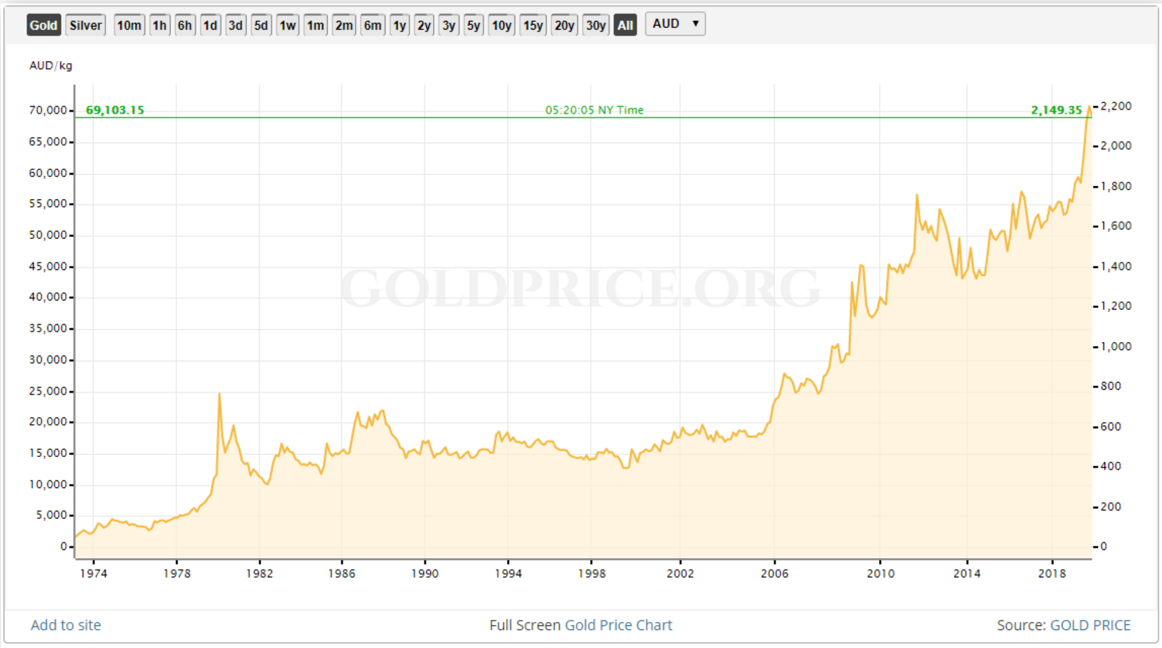
Nixon and the Gold Standard

Following the end of WWII, the Bretton Woods Conference lead to the formation of the International Monetary Fund (IMF) and the establishment of the gold standard, which pegged the price of gold at US$35/ oz. The gold standard lasted 26 years until President Nixon unilaterally terminated the international convertibility of gold in August 1971. Although intended as a short term measure, it eventually led to the abandonment of the gold standard and the price of gold has been free to float ever since.

In January 1980 the US gold price hit a high of US$695/ oz, although the peak for Australia came a month later in February 1980 with a high of A$580.67.

As the following two charts show, after that early peak, the 80's and 90's were fairly lack lustre for gold, with the exception of the late 80's in Australian dollar terms, due to a weak Australian dollar, which hit a low of US$0.5959 and generally traded at around US$0.70.

Historical Gold Price in USD since 1971 (Goldprice.org)



Historical Gold Price in AUD since 1971 (Goldprice.org)

It was only from around 2000 onwards that the gold price showed a more or less consistently rising trend and from 2005 onwards it appeared to be climbing almost exponentially hitting a peak of US$1,859.20 in August 2011. Interestingly, in inflation adjusted terms, this still didn't hit the January 1980 peak, which would have been US$1,897.24/ oz. Eight years on and although the gold price in USD has risen steeply, peaking at US$1519.10 in September 2019, spurred on by the US/China trade war, this was still around 18% below the August 2011 peak and 31% below the US inflation adjusted 1980 peak, which now sits at US$2,222.46.

The 2011 peak in Australian dollar terms came a few months later in December 2011, when gold reached A$1,707.71, again shy of the inflation adjusted 1980 peak that would have been A$2,187.70. Since then the gold price has performed a little better in Australian dollar terms, with the price benefitting from the steady devaluation of the AUD, resulting in a fairly steady upward trend in the price from the November 2013 low of AU$1371.03 to a peak of AU$2,277.49 in September 2019. The 2011 Australian peak was surpassed in February 2016 and peaked at AU$1,816.76 in July 2016. In the following six months it retraced almost 12% and drifted until August 2018.

In March 2018, the Trump administration initiated tariffs on steel and aluminium and followed up with further tariff imposts in the ensuing months. Aided by a falling Australian dollar the gold price took off in AUD terms. Despite it's dramatic rise, the price has still not eclipsed the 1980 high, which in inflation adjusted terms would now be AU$2,624.45.

Investor Sentiment

If you are an investor, whether you base your investment decisions on fundamentals such as the economy, equity and commodity markets, political and social tensions or whether you prefer the discipline of technical analysis, the future for gold, over the next few years looks good, in my opinion.

When I was invited to write the original article for Resource Global Network in 2016, I did question the wisdom of agreeing to become yet another forecaster. My cynical side says that it is a crowded marketplace in which being right is more likely a question of luck than great insight, nonetheless I was, and still am prepared to throw my hat in the ring.

I am certainly not foolish enough to venture into predicting specific prices and timeframes, however I am prepared to opine on what I see as the general trend for gold is over the next few years.

The only certainty about gold is its capacity to surprise. Many have tried to analyse the metal's price trends to enable forecasts to be made of its future pricing. Analysts have looked for correlations with other commodities only to see their seemingly firm correlation fall over. I am aware of one gold producer who commissioned a consultant to try to produce a model that would predict the price of gold. When the model was tested the output indicated that the price of gold at the time, should lie between US$200 and US$2000 per ounce, certainly a triumph of accuracy over precision.

In late October 2019, Egon von Greyerz, founder and managing partner of Matterhorn Asset Management spoke at the Gold and Alternative Investments Conference in Sydney, starting his presentation by saying that he wasn't gold bug. Instead he said, "I just measure risk" and, "I think we're looking at greatest risk ever in history."

In von Greyerz opinion, all the risk was based in debt, with the whole world affected. "There is no chance of writing off or repaying this debt," he told the conference attendees.

Von Greyerz compared global debt during the GFC of US$125 trillion, with its current level of US$260 trillion and ventured the opinion that this will reach US$2 quadrillion by 2025. "It will all end in tears unfortunately," he said.

He expects bond markets to collapse and interest rates to shoot up, he pronounced that stocks and property were bubble assets.

Whilst von Greyerz presents a gloomy view of the world, he argues that all of this is good for the price of gold and forecasts that the yellow metal will hit US$10,000 an ounce, "as a minimum". And, in case you are a silver bug, if gold hits this dizzying high, he is forecasting a silver price of $666 per ounce based on current ratios.

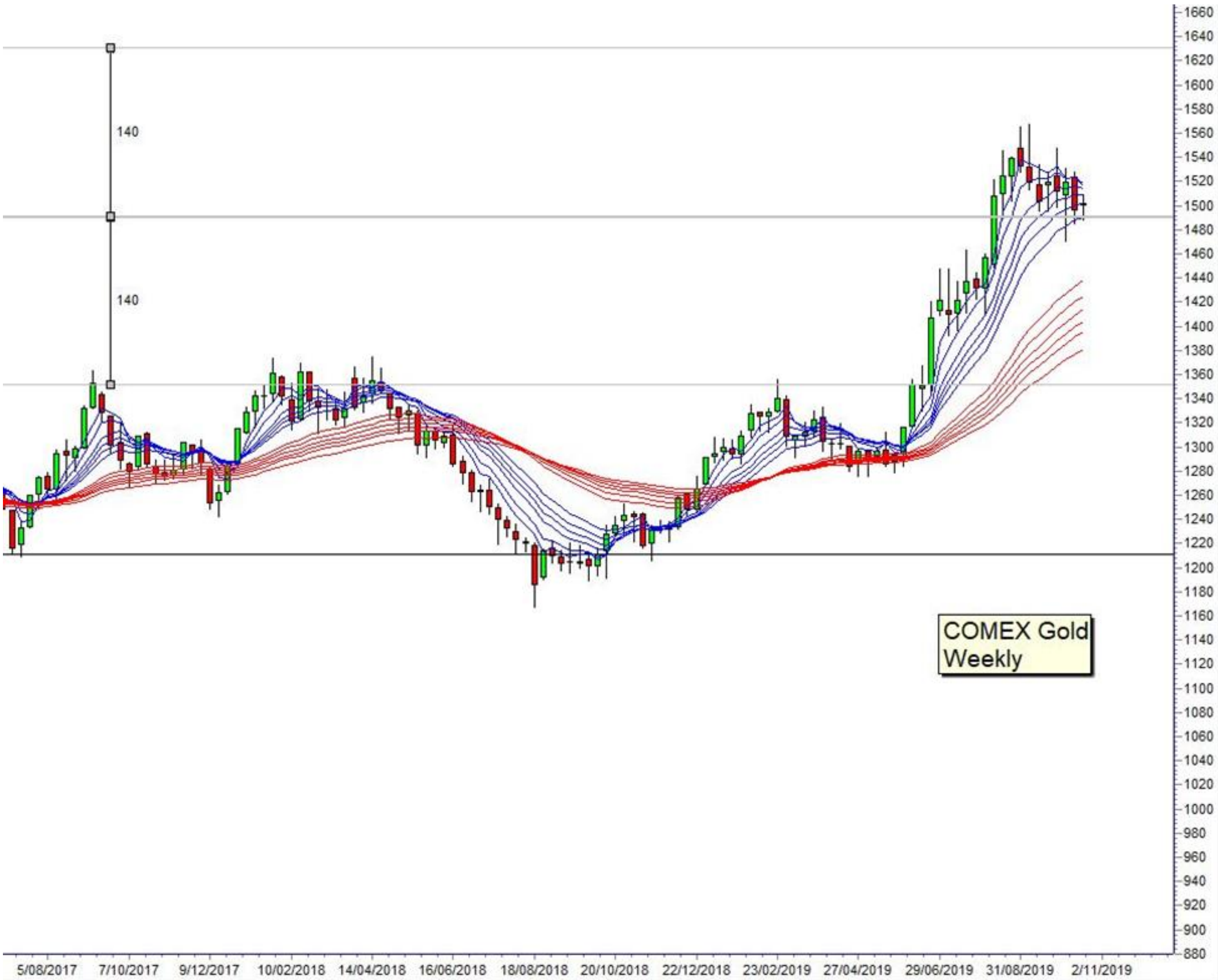
Most of us, I think, would argue that many people turn to gold in times of crisis or uncertainty as a means of storing and maybe even transporting wealth. Whether it is social, political or economic turmoil the gold price can often be seen to respond positively to these events, so it is reasonable to argue that the gold price, likes volatility. The trouble is identifying exactly which events will lead to a sustained price trend and those that may just be a brief blip on the chart. As with so many aspects of the market, I believe that the gold price is often driven by sentiment rather than any sound financial rationale.

Written in the Charts

It is the issue of sentiment that brings me to the chartists who propose that markets simply reflect sentiment and if you can read the sentiment, then you can make well timed decisions regarding investments.

One such commentator is Daryl Guppy, who I quoted in the original 2016 article. I invited Daryl to provide his latest thoughts and he gave me his latest article on the topic, published on 22 October 2019 for CNBC. In his 2016 article he analysed the gold chart and suggested that if the price held above US$1200 that this would signal an upturn in the price trend that could be sustained for some time. In his latest article, Guppy observes that there has been a prolonged period of sideways consolidation from March 2016 until June 2019. It is his view that this protracted period of consolidation provided the base for the powerful breakout to current levels. Daryl notes that meeting the target level of around $1490 was not a surprise as this was calculated taking the width of the trading band between $1210 and $1350 and projecting this upwards to set the new target.

For those wondering if the next upside target is near $1630, then Daryl suggests that whilst this target may be achievable, it is unlikely to happen in the short term given that there has not been a period of consolidation at current levels. It is his view that traders can expect gold to continue its consolidation near the $1490 level and test this as a support level. Further, he suggests that strong support at this level could be a base for a new rally towards $1630, but that this is likely to take some time to develop.



Gold Price Chart with Short Term and Long Term GMMA indicators (Daryl Guppy / CNBC)

To further support this view, Daryl uses his eponymous analysis tool the Guppy Multiple Moving Average (GMMA) indicator as shown in the chart above. The short term group of averages; shown in blue, reflects the opinions of traders, whilst the long-term group; shown in red, reflects the thinking of investors. Daryl's analysis suggests that the wide separation in the long-term group indicates the bullish bias for gold is well supported and that the upper edge of the long-term GMMA provides another support level for any sustained price move below $1490. Continued sideways consolidation in the gold price would see this upper band move towards $1490 and, in his opinion, if this condition is satisfied then this would provide the basis for a trend continuation towards $1630.

Uncertainty the New World Order

Whilst metal prices have recovered from their lows of early 2016; most are up between 25% and 30%, with zinc and nickel the standouts with price appreciation of 75% and 102% respectively, the impact of the trade wars can clearly be seen in the charts of metal prices.

The mood of the industry is generally more positive than it was three years ago, and I have heard a number of reports of "skills shortages", something that was a feature of the mining “super cycle”. However, I believe that the current skills shortage has been brought about by people becoming disillusioned with the industry due to the widespread unemployment at the end of the boom. Some professionals decided that it was time to retire and have left the industry, whilst many of those who would have filled operational roles are now reluctant to give up, lower paying, but generally more secure jobs closer to home.

Conventional wisdom says that having a commodity-based economy almost inevitably means that when the commodities upon which the country relies for export earnings diminish in value, so too does the buying value of the country's currency, and vice versa. Yet, notwithstanding the increase in metal prices since 2016, the Australian dollar is worth less than when I wrote the original article in April 2016; it spent much of that month at or above US 75¢ but has been at or below US 70¢ since April this year.

In the October 2019 minutes of Monetary Policy Meeting of the Reserve Bank (of Australia) Board, the RBA Board observed that, *“...the lower exchange rate was also supporting growth.*”

This devaluation of the currency is a double-edged sword. Whilst it makes imported goods more expensive it means that exports sold in US dollars can produce significant revenues in the local currency. This is exactly what we have seen with the gold price in Australian dollars.

If one compares the two charts for the gold price presented earlier, the uplift in the price of gold due to the devaluation of the currency is very evident. At the time of writing the US dollar price of gold is US$1484 yet in Australian dollars the price is A$2149.

Whilst all in sustaining costs (AISC) of Australian gold producers have moved up significantly over the past three years from around A$1100 per ounce to closer to A$1300, the current gold price in AUD terms still represents a very healthy margin over cost. For companies like Kirkland Lake with an AISC of around A$865 per ounce, mining gold is an extraordinarily profitable activity. Of course, if von Greyerz is correct, there may come a time when they and their shareholders might be best served by not converting the gold into cash unless they have to.

At the time that I wrote the original article I had recently read Patrick Dixon's book called *The Future Of (Almost) Everything*, in which he set out his predictions for the next 10 to 20 years. Amongst other things Dixon foresaw significant global volatility; social, political and economic. In some ways this is self-evident if we look at the current state of the world.

Whilst the migrant crisis in Europe no longer attracts the media attention that it once did, the challenges that it presents have not been resolved and will not be solved overnight. Germany is facing a "grey bubble" as the population ages towards retirement and the country needs the skills, energy and enthusiasm of the migrants to support this ageing population otherwise its economy may become overburdened. Yet these new migrants are creating social tensions within the country and a resurgence in right wing political groups. This could potentially be exacerbated by recent events in Syria.

We all knew that the Chinese driven commodity boom could not last forever and that double digit growth rates were unsustainable in the long run. Yet somehow, we still seem to have been surprised by the slowdown in China's frenetic growth rate and its consequences for commodity prices and those economies dependent on their export. The Chinese economy is having to adjust from a growth phase with heavy investment in infrastructure, to a consumption phase. How quickly it makes the adjustment and how rapidly the growth rate stabilises at a sustainable rate is still a significant question mark. We can only hope that China's leaders understand the challenge and have a strategy to manage the transition smoothly. A sudden and significant slowing of the Chinese growth rate is likely to have dire impacts for the global economy.

As we are all too aware, late 2016 saw the election of Donald Trump as President of the United States of America, an event that almost everyone predicted would never happen. Trump has shown himself to be capricious and unfiltered. Not feeling bound by the norms of politics and diplomacy he engages with the American people and the world via Twitter. His actions, at times, appear to surprise even those closest to him. The Trump instigated trade war with China is impacting both countries and acting as a drag on the global economy.

Whilst the US stock market has performed well during Trump's presidency, the stock market is not the economy and many economists question whether the US economy is doing as well as the president keeps proclaiming. In its latest forecast of global economic growth, the IMF has said, "*Global growth is forecast at 3.0 percent for 2019, its lowest level since 2008–09 and a 0.3 percentage point downgrade from the April 2019 World Economic Outlook.* " Further it suggests that, "*a projected slowdown in China and the United States, and prominent downside risks, a much more subdued pace of global activity could well materialize.*"

My 2016 article predated the Brexit vote, although I did note that it was due to occur later that year. Of course, we all know the outcome of that vote and have witnessed the ensuing political, social and economic turmoil that it has created. I'm sure that many of us could agree with Joe O'Brien the ABC news presenter who recently referred to it as the "*Brexit debacle*". Perhaps the forthcoming general election in the UK will resolve the matter, however, we appear to be living in a period where the greatest certainty is uncertainty and no outcome should be taken for granted.

More recently, there has been civil unrest in Chile, previously considered one of the more progressive and stable countries in South America.

One could go on, but for those interested, I would highly recommend that you get hold of a copy of Dixon's book.

And the Winner is, Gold

The message that I want to convey is that uncertainty and volatility will continue to be a feature of life around the globe for at least the next ten years and possibly longer. This all bodes well for a sustained period of good gold prices, certainly good enough to see gold miners provide their shareholders with decent returns and a few of us mining professionals continue in gainful employment. We might even see the price surpass the inflation adjusted 1980 peak, even if just for a short period!

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About Mining Explained

Mining Explained is an online training organisation established by Neville Bergin, with the objective of educating retail investors about the exploration and mining industry to assist them in making more informed investment decisions.

All enquiries: MiningExplained@gmail.com