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Time to discard old formulas

As is often the case in life, when reality changes (and it is called a "new normal"), one must adapt and abandon old intellectual exercises that have become mental relics. In this sense, and with the humility of recognizing that our approaches to valuing gold no longer effective, I offer a new way of approaching this asset in order to define a strategy more appropriate to the new times. What follows is a new set of criteria to value Gold:

- **Gold is not a crowded trade:** In spite of a 55% surge over the past two years, this rally has garnered limited headlines, unlike the Tech sector. Accordingly, the total market of the precious metal and mining sector is small enough to keep running without hitting the big numbers problems. The sector's size is only US$550bn (roughly what Amazon has added to its market value in one year).

- **Gold bull market usually feed on their own momentum for quite a while:** The 1976-80 rally ended when US short rates were jacked up to break inflation, and the USD rose. The 1985-88 rally ended when Germany pulled out the Accord Plaza deal and the US rates started to rise, and with rates, also the USD. In the 2001-11, president's George W. Bush "guns & butter" policies spurred a weak USD and the concurrent rise of EM, that became a new buyer of gold. This ended when in 2011 the USD started to strengthen. Looking at this history, when gold bull markets get going, they usually feed on their own momentum for quite a while, an only ends when facing higher nominal rates, stronger USD or a rise in real rates. These are the 3 threats to the unfolding gold bull market. About momentum: Gold bull markets may build up over multiyear periods. In the 2001-2011 period, it was the new wealth being created in EM, with a strong affinity to gold, that pushed gold prices higher. In contrast, in the 2011-2020 decade, most of the world's wealth has been created in campuses on the US-West coast, by people with scant interest in this "relic", with EM growth having been much more moderate. Despite this, gold price has ripped higher and is showing strong momentum. Imagine if EM again thrive, led by Asia, what a tailwind that would be for gold.

- **About the three threats to the unfolding gold bull market:** 1) Higher nominal rates: It is almost impossible to find an OECD central banker even thinking of raising interest rates in his or her lifetime. 2) Stronger USD: The US's Current Account. Balance has been

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gradually improving, leading to a shortage of dollars and a rise in its price. We do not foresee a jump in this Current Account balance that will boost the USD again. Rather, the balance (deficit) could remain stable at around 2% of GDP, and keep the USD well supported, but stable. From a strong rebound that could end the gold's bull market. 3) A rise in real rates: Yet if nominal rates are not going to rise, the only way the OECD countries can experience surging real rates is through a n already low inflation rate collapsing more. But how? Collapse in energy prices or real state? Alternatively, a collapse in the Renminbi? There are few signs of such shocks unfolding permanently. With this in mind, it seems that a surge in real rates is not an immediate threat.

- **Gold as the new anti-fragile asset:** Gold, like the US Treasury bond, is an anti-fragile asset. Investors should therefore always carry out the exercise of deciding which anti-fragile asset should be kept in the portfolio to hedge against demand or supply shocks or inflation shocks. The answer will have a lot to do with the perception of which of the two anti-fragile assets is likely to perform better in the future. This, in turn, will depend on the relative supply of the two anti-fragile assets. The one with the lower relative supply will be the one that will perform better and will better display its quality as an anti-fragile asset in the face of a shock. In this respect, we are very clear that the supply of US Treasury bonds will be almost unlimited, whereas the supply of gold will remain very limited over the next decade.

- **Negative yields still make gold attractive:** The disadvantage of gold compared to fixed income instruments (gold does not offer a coupon) is now neutralized, with negative yields in a large number of global bonds (>US$13tn of face value is yielding negative rates).

- **Relative share of gold:** The total value of gold in the world is circa US$6.9tn, a fairly small share (3.2%) of the total global cash market (212tn). The daily volume traded on the LBMA and other gold marketplaces is around US$173bn (just 0.08% of the total in the financial markets).

- **Gold to the S&P500:** This ratio stands at 0.56x, just shy of the LT average of 0.62x. Given our estimated fair value price for the S&P of US$2,962 the price of gold must approach US$1,836 for this ratio to remain near its LT average.

- **Fundamental price for gold at US$1,800 – US$2,000/oz.**

Best

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