



Commodity market outlook

This month's focus: Gold

June 2021

Investment recommendations

- **All commodities** – *Overweight*. Commodity investments continue to outperform, benefiting from exceptionally strong demand. Commodity prices should remain elevated over the coming year, benefiting from strong global growth, a weak US dollar and rising inflation. Improving mobility and tight supply makes oil especially attractive.
- **Gold** – *Relative overweight*. As we anticipated in our [March gold focus](#), gold edged up in Q2 fueled by higher inflation and falling real interest rates. While strong global growth reduces its upside against stocks, high inflation and a weak US dollar makes bullion an attractive macro hedge. We recommend overweighting gold over bonds.

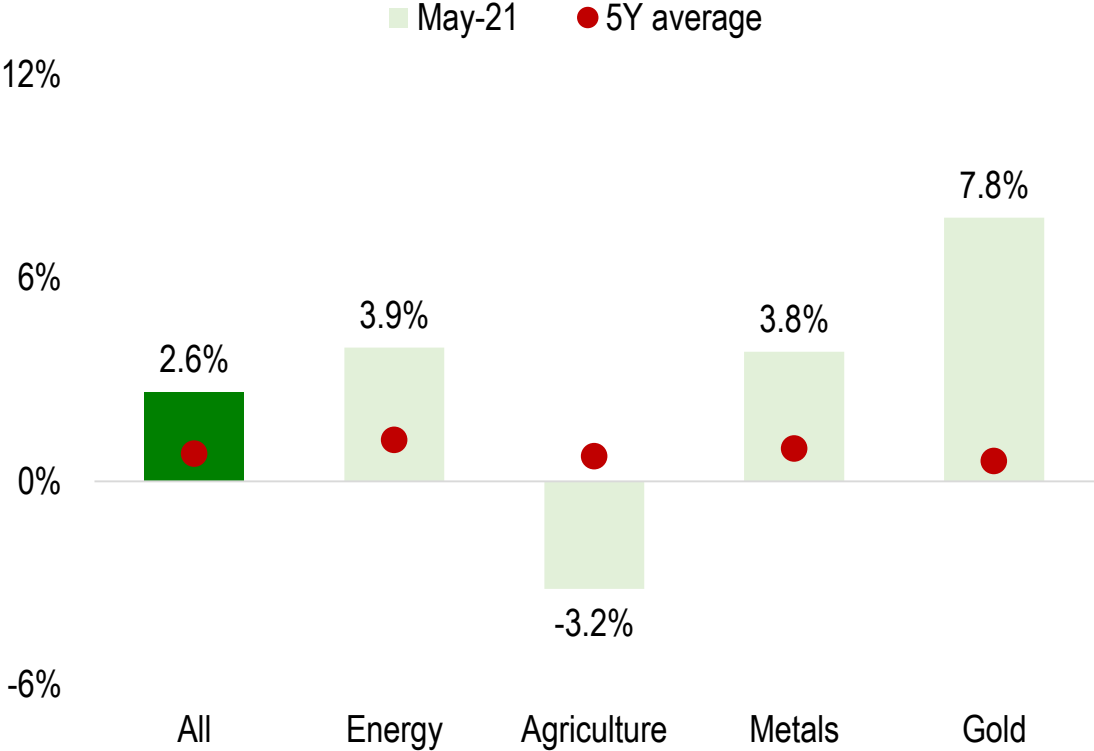
1. All commodities

Broad commodity outlook

- Overall commodity prices rose 2.6% last month, with above-average gains in most industrial segments. After experiencing steep losses in 2020, raw materials are now outperforming most major asset classes.
- Commodity investments continue to benefit from exceptionally strong demand. While initially driven by strong physical usage in China, the current upswing reflects sizeable improvements in global mobility.
- Further mobility gains, a weak US dollar and rising global inflation support new commodity investments, particularly in oil.
- We expect broad commodity prices to strengthen 14% or more over the next 12M, with a 77% probability of positive real returns.

Commodity inflation remains elevated

Commodity price returns
May 2021 (MoM, %)



Source: S&P; Numera calculations

Outperformance vs. all major assets in 2021

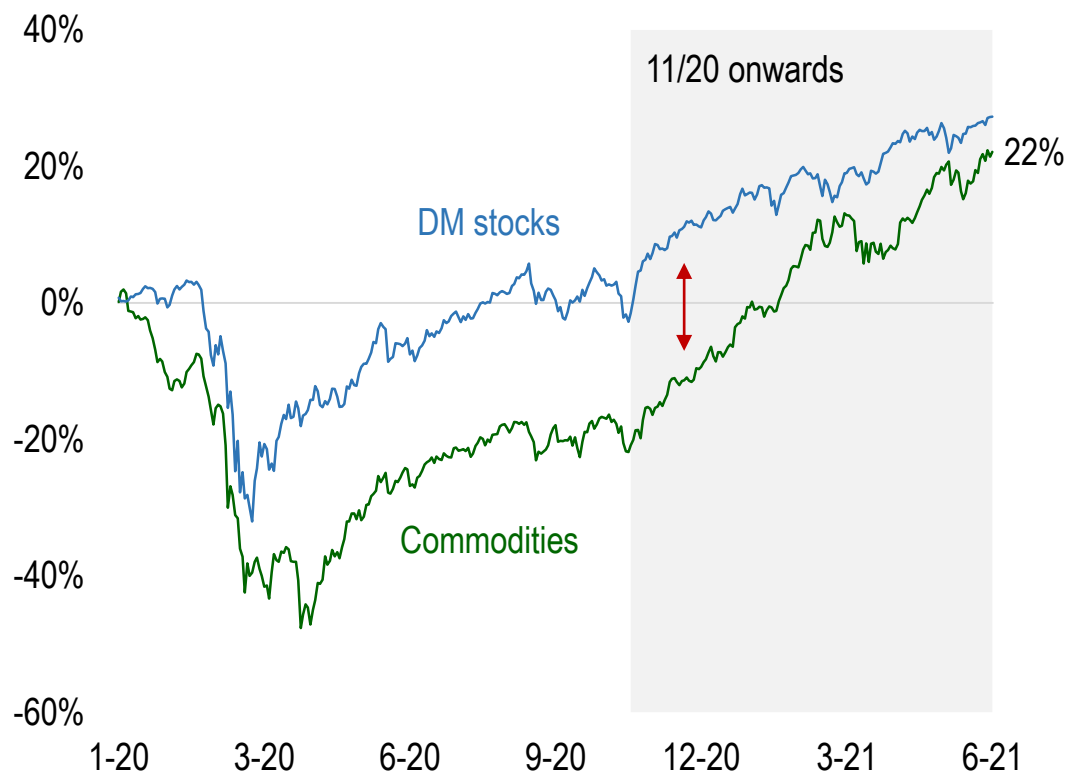
Asset price comparison
Real returns by year (%)

	2017	2018	2019	2020	5M 2021
DM stocks	21	-10	26	15	9
EM stocks	35	-16	16	17	5
Sov. bonds	5	-2	3	8	-6
Corp. bonds	7	-5	9	9	-4
Commodities	4	-16	16	-25	23
Gold	-4	-15	15	19	-2
Long volatility	-73	64	-68	14	-52

Note: Long volatility proxied by the Proshares VIX-short term futures ETF TR index. Colours indicate ranking by year.

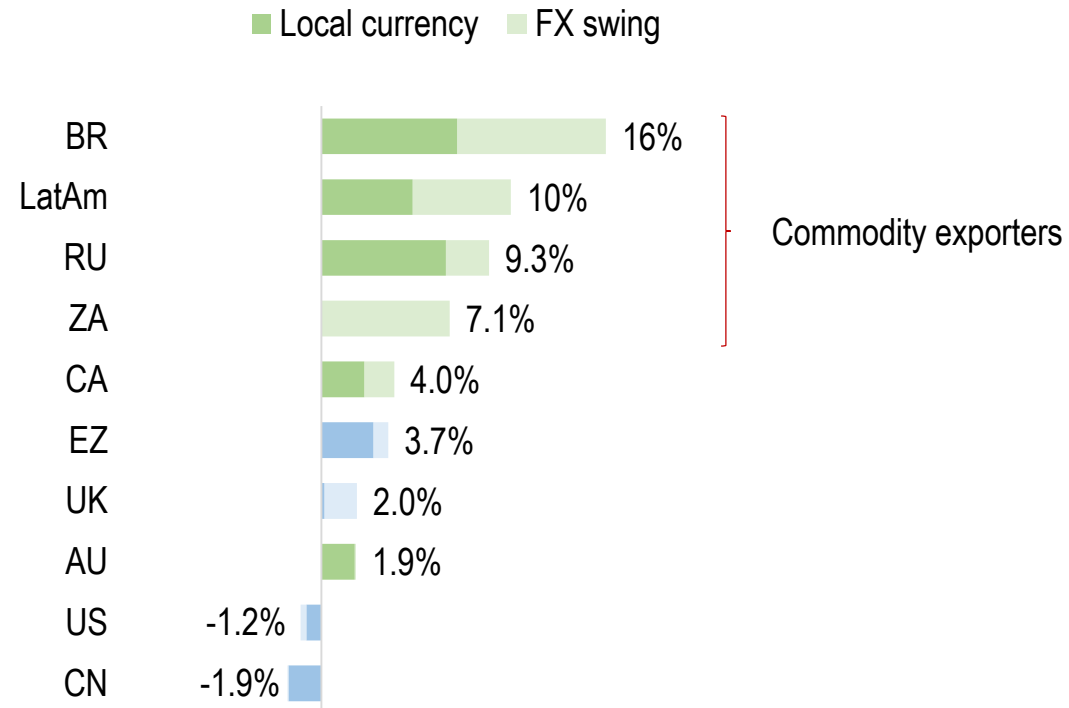
Allowing commodity investments to catch up

Broad commodity prices vs. DM stocks
Cumulative returns since 01/20 (%)



Upswing benefiting resource-rich economies

Excess equity returns by source
vs. DM equities – 05/21

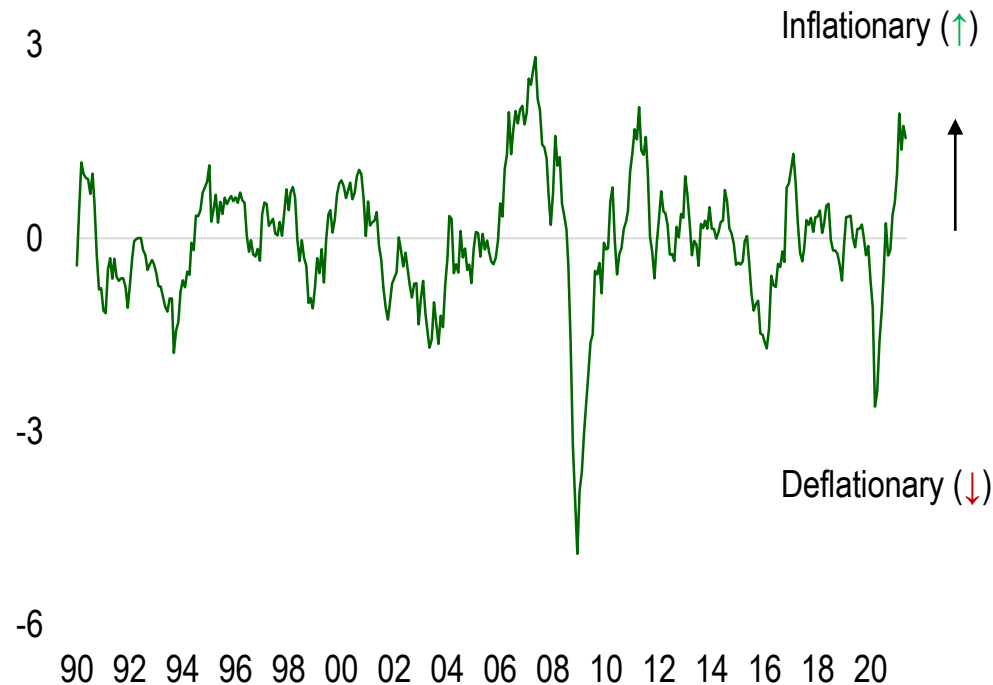


Note: Excess USD returns over DM stocks (World MSCI). Green bars correspond to commodity exporters, blue bars to commodity importers.

Prices supported by very strong demand

Commodities activity index

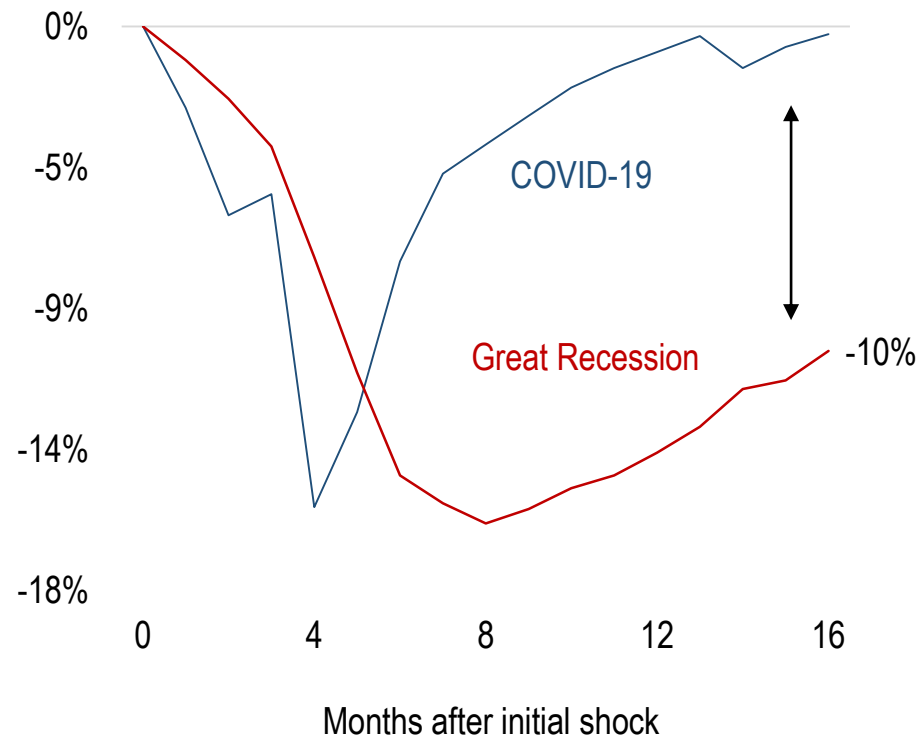
Deviations from trend



Note: Index isolates common fluctuations across a panel of 18 industrial commodities, thereby abstracting from market-specific (idiosyncratic) supply shocks. Index adjusts for USD moves.

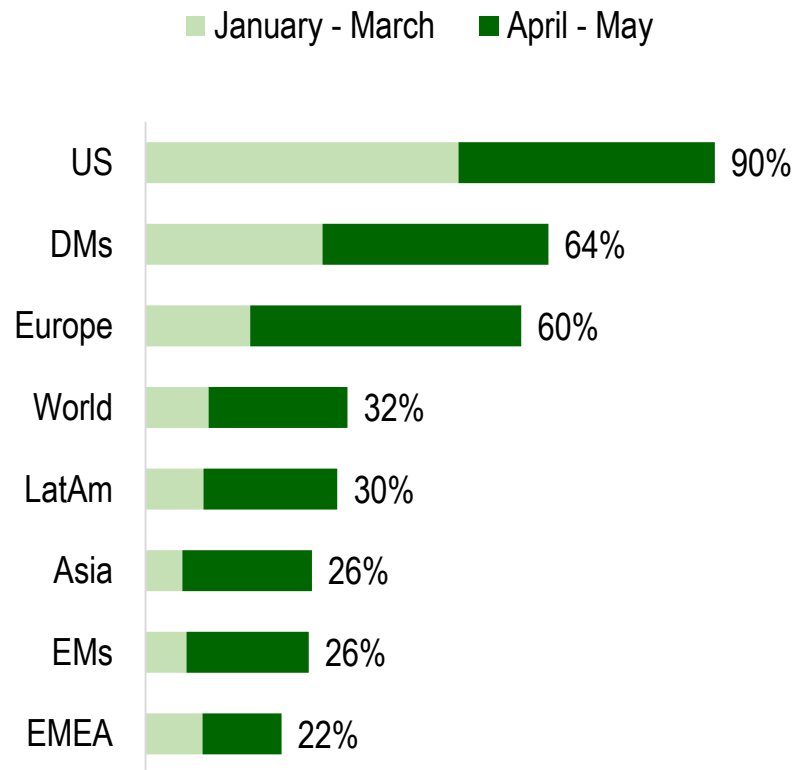
Reflecting a swift recovery in manufacturing

World manufacturing in deep recessions
Deviations from baseline (%)



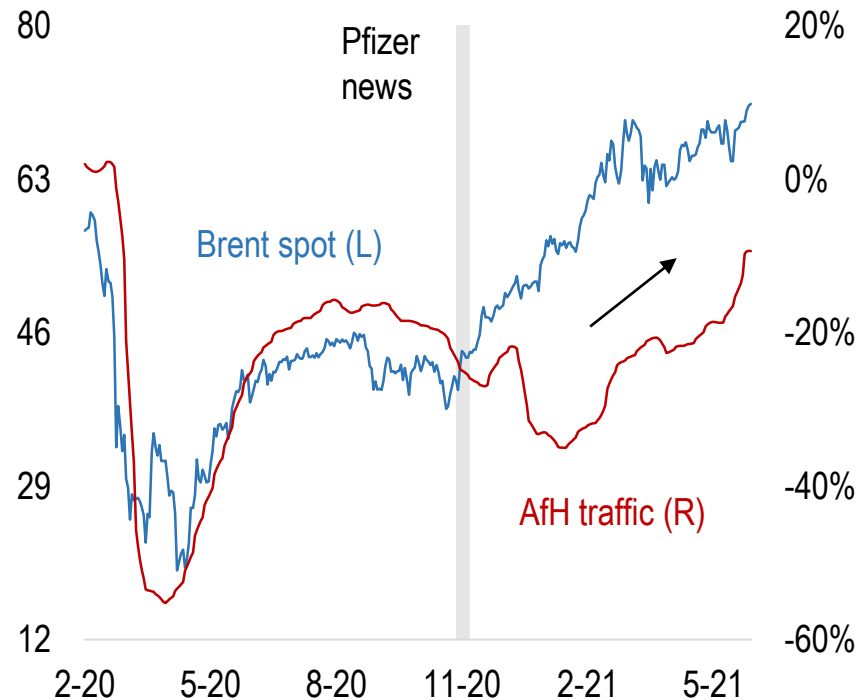
And (more recently) accelerating vaccinations

COVID vaccine doses administered
Total doses / population (%)



Stronger mobility especially beneficial to oil

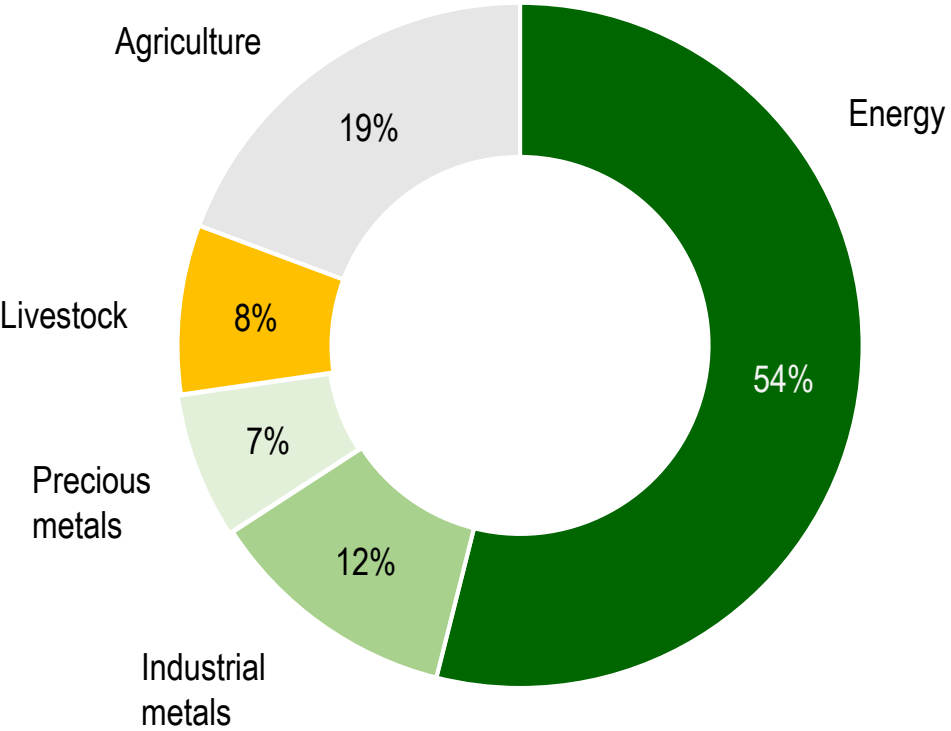
Brent spot price vs. global mobility
USD/bbl and % change



Note: Chart compares Brent spot prices to the change in global away-from-home (AfH) traffic versus January 2020.

By far the largest commodity market

S&P GSCI index weights
Production weights (%)

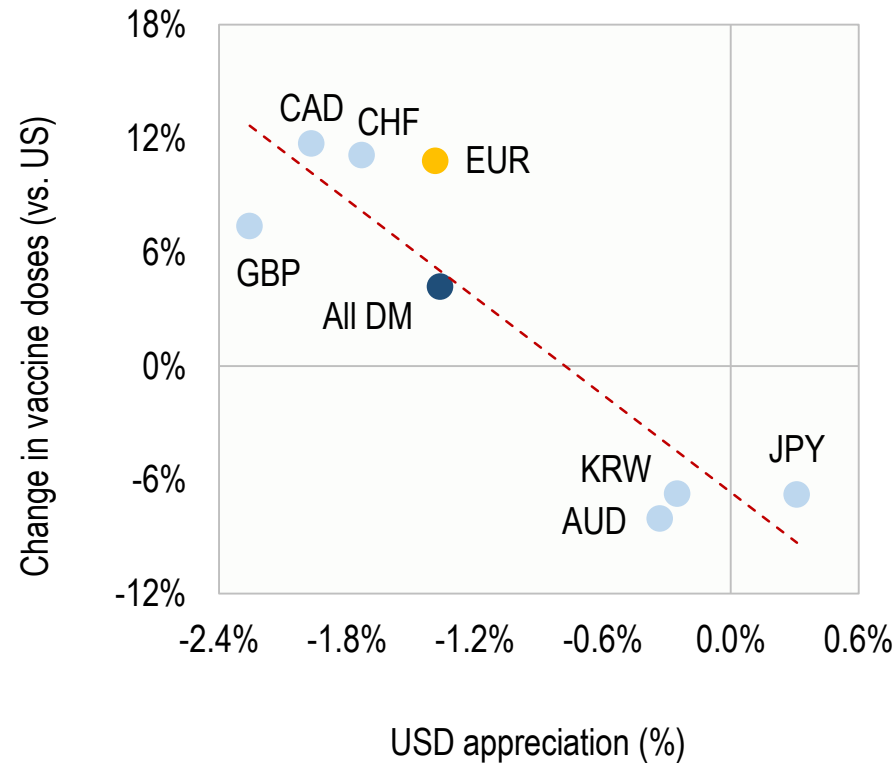


Source: S&P Dow Jones

Rising global vaccinations also weighing on USD

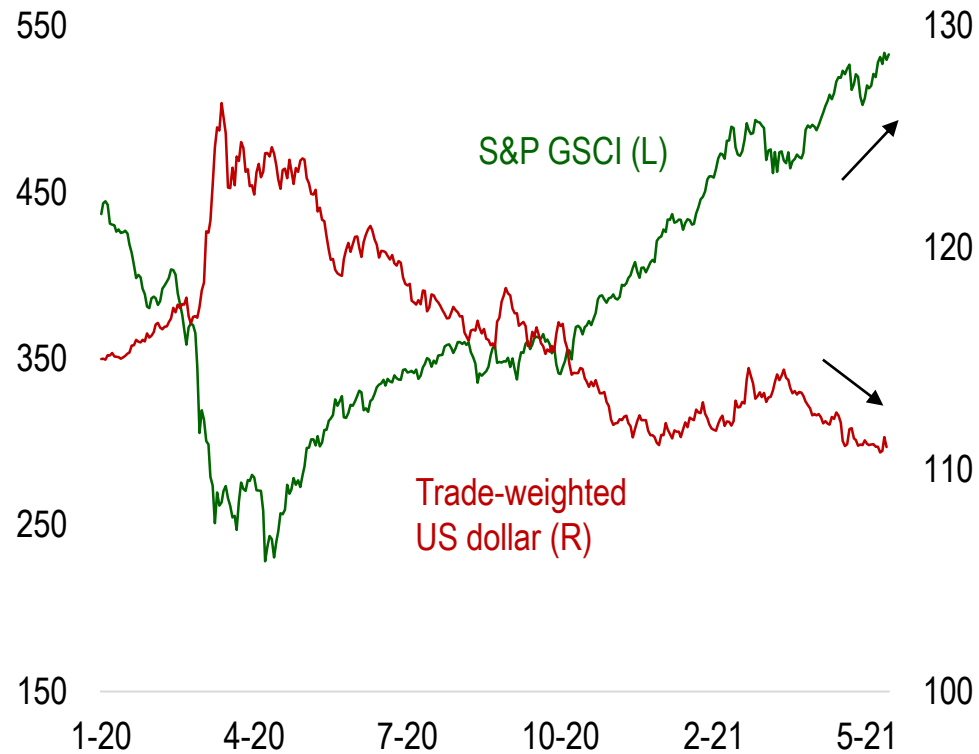
DM FX vs. COVID vaccinations – 05/21

USD and relative vaccination rates



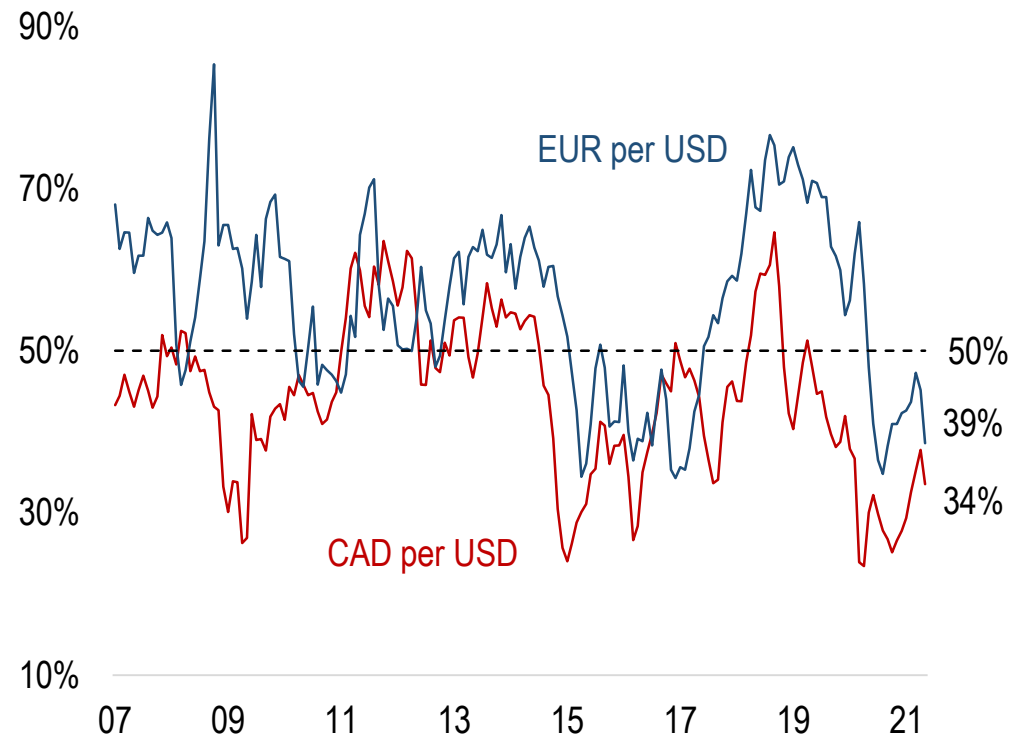
Again boosting overall commodity prices

All commodities vs. USD
Price indices



The dollar should continue to weaken, ...

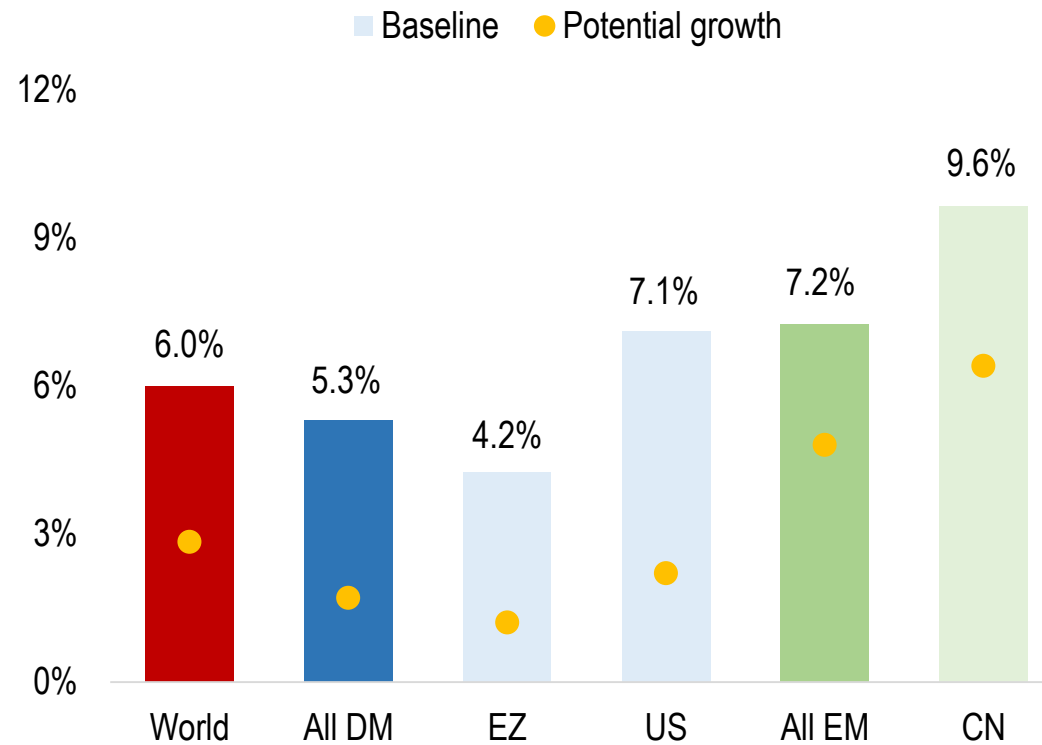
USD appreciation probabilities 12-months ahead (%)



Note: Likelihood of USD strengthening against the EUR and CAD 12M out. Probabilities above 50% indicate USD appreciation is the most likely outcome.

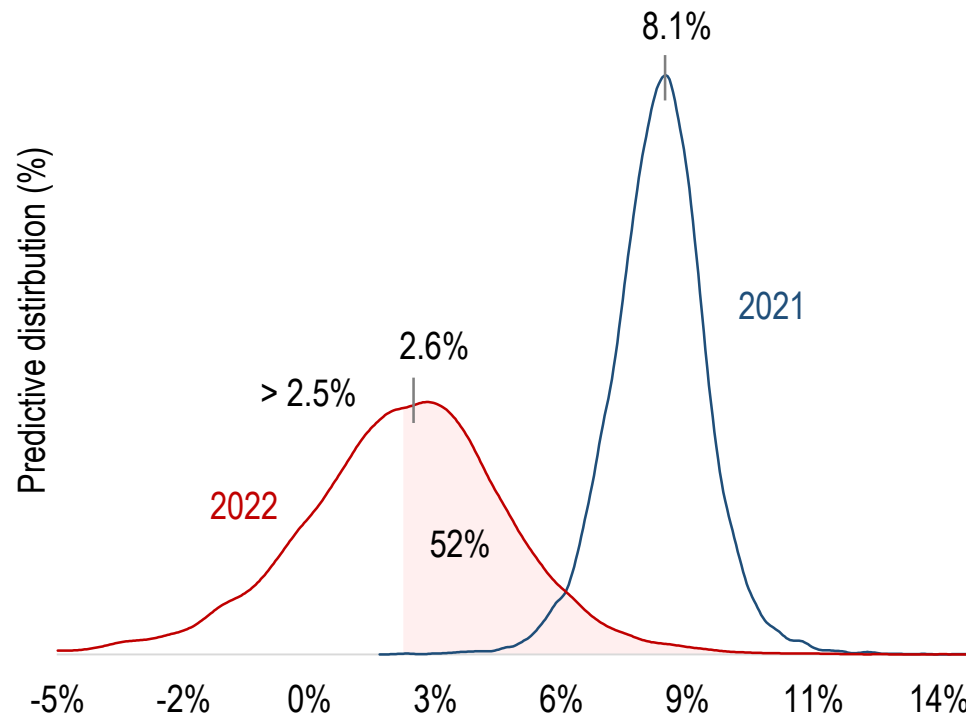
... global growth should double potential, ...

Global GDP growth – 2021
Baseline scenarios (%)



... and inflationary pressures should accentuate

World PPI inflation – 2021/22
Probability forecasts (%)

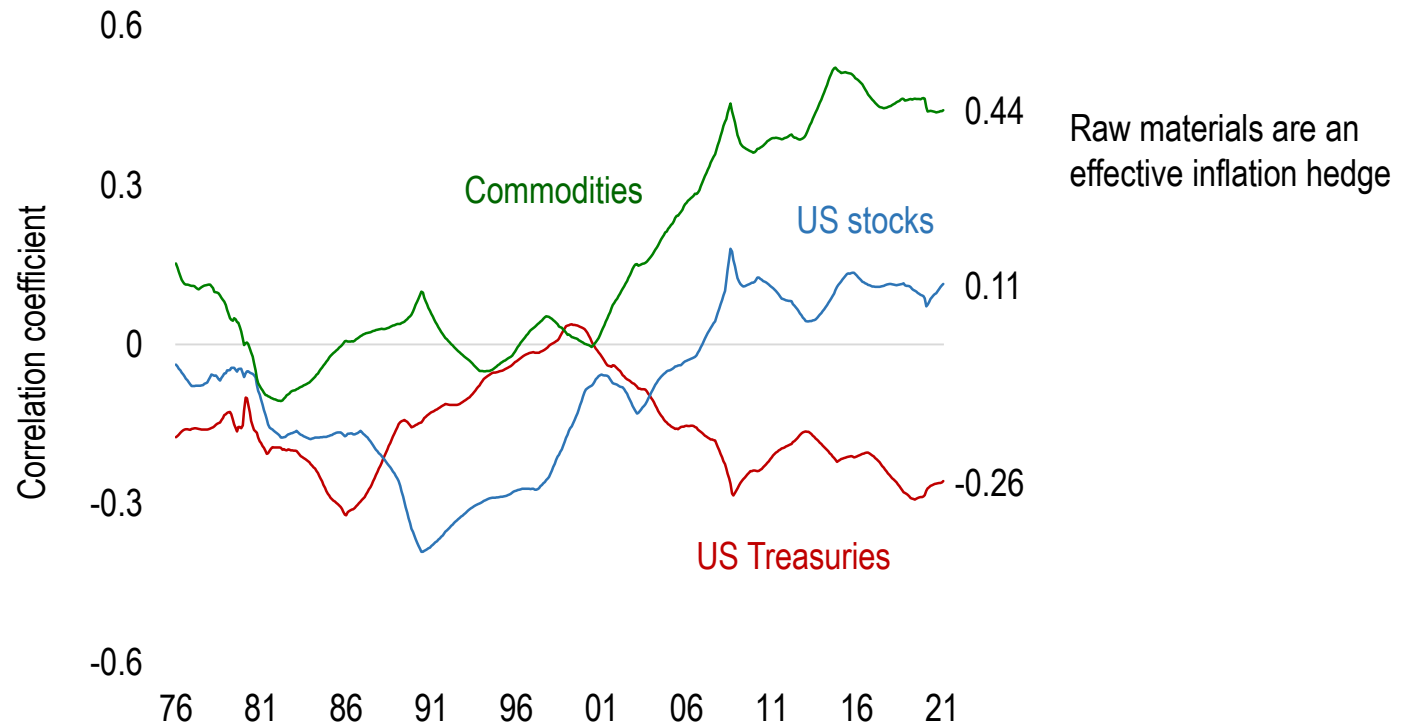


Note: Chart displays probability densities for global PPI inflation for 2021 and 2022. Shaded area denotes likelihood of inflation (PPI growth).

Encouraging 'rotation' towards commodities

Asset returns vs. US inflation

Time-varying correlations



Note: Chart tracks the time-varying correlation between US month-over-month CPI inflation and monthly nominal returns on selected asset prices.

Macro context points to further price gains

S&P commodity price index

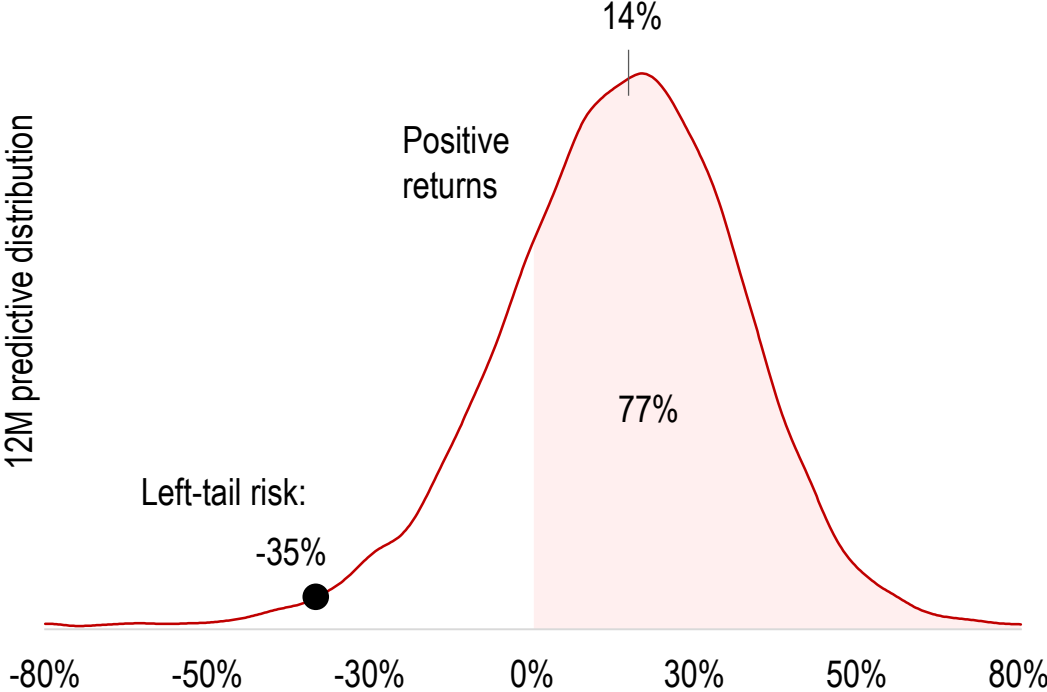
2010 = 100



Note: Fan chart shows 50 / 80 / 95% prediction intervals.

Commodities retain a very high upside

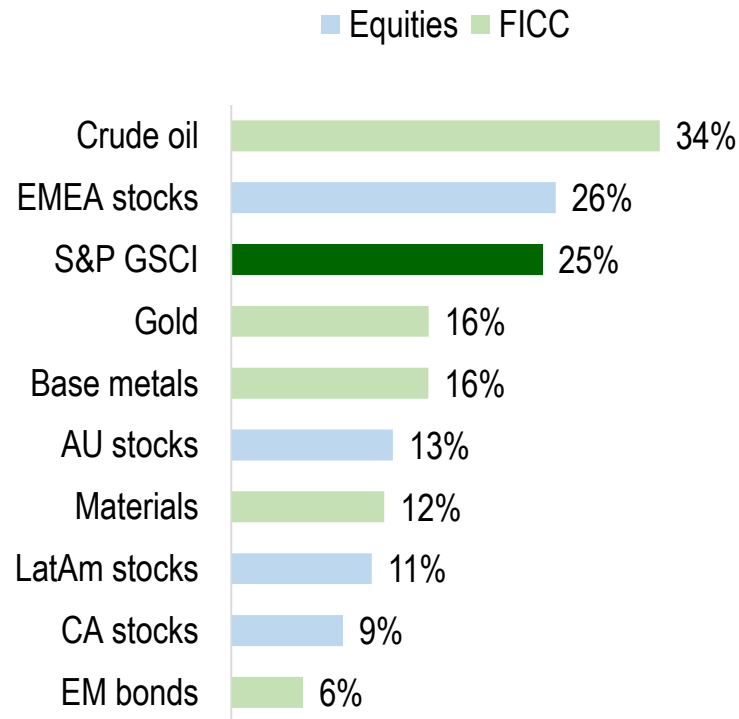
S&P commodity price index
12M probability forecast (%)



Note: Expected returns are the mean of the predictive distribution. Black dot is the 5% conditional value-at-risk, expected future losses below the 5% quantile. Shaded area denotes likelihood of positive returns.

Consistent with past 'reflationary' episodes

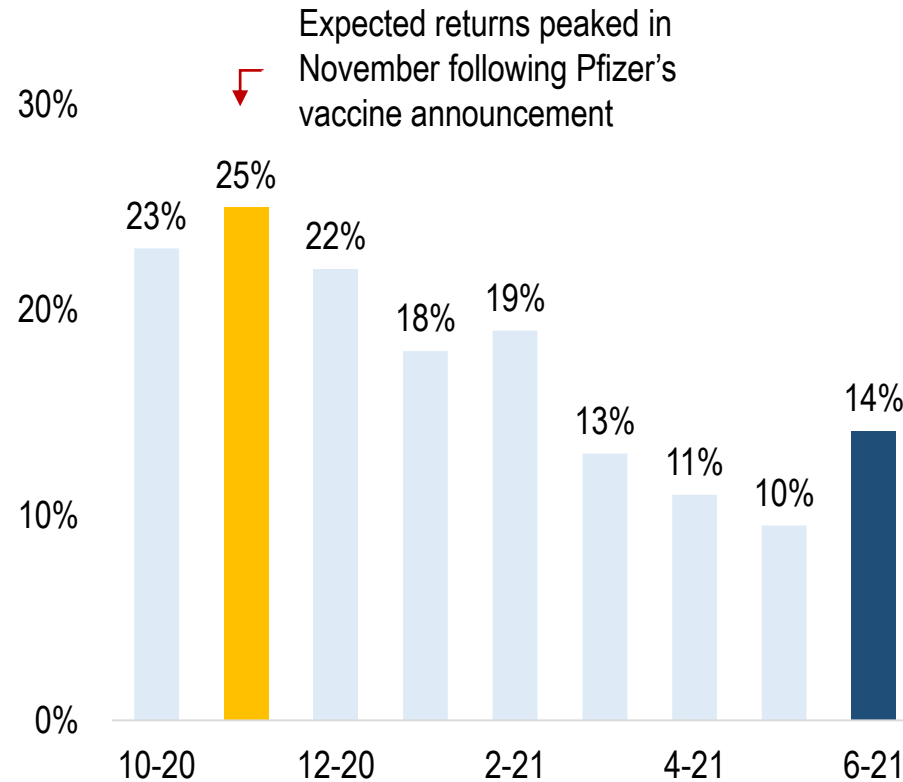
Excess returns in reflationary regimes
Average excess returns (%)



Note: Average excess returns versus DM stocks during global 'reflationary' regimes since 1987. Reflation defined as the combination of above-trend global growth, rising global inflation, monetary easing and USD weakness.

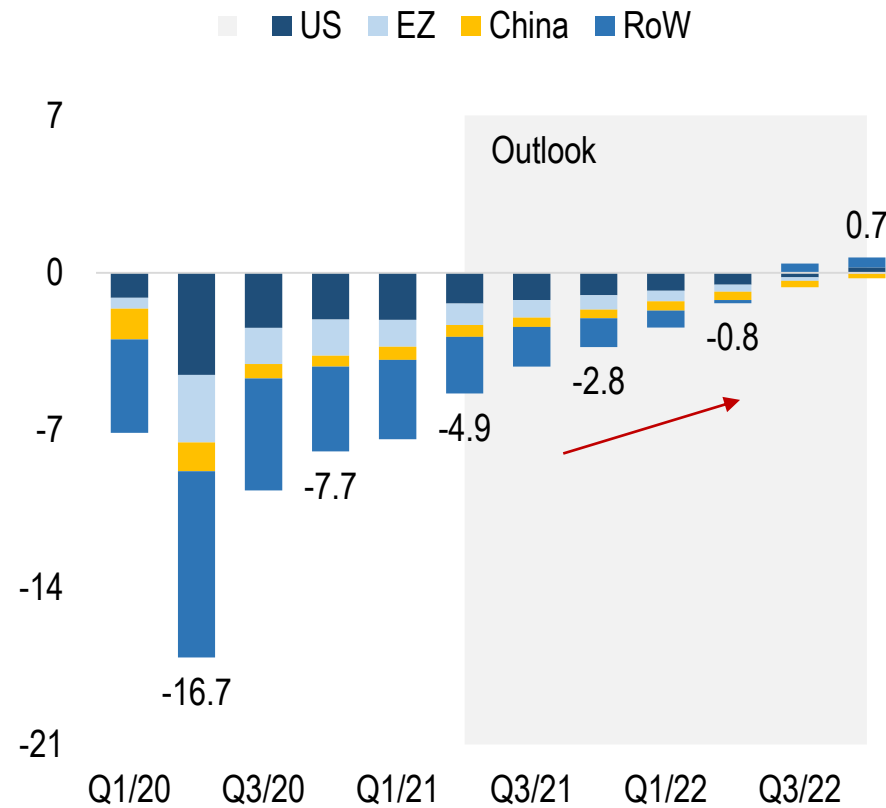
Upside has improved versus earlier this year

S&P commodity price index
12M expected returns (%)



As rising mobility boosts oil price outlook

COVID-19 impact on oil consumption
Deviations from baseline (Mbbbl / day)



2. Gold prices

Review

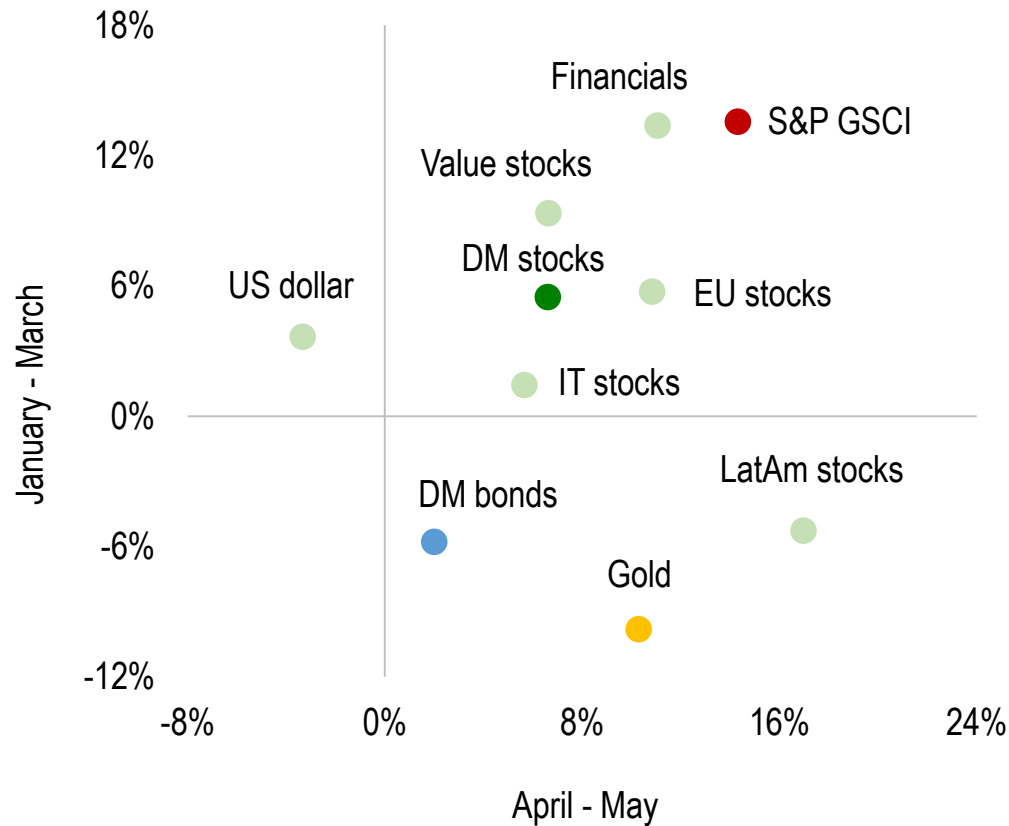
Gold prices up \$200 / ounce since April

Gold market events timeline
LBMA spot (USD / ounce)



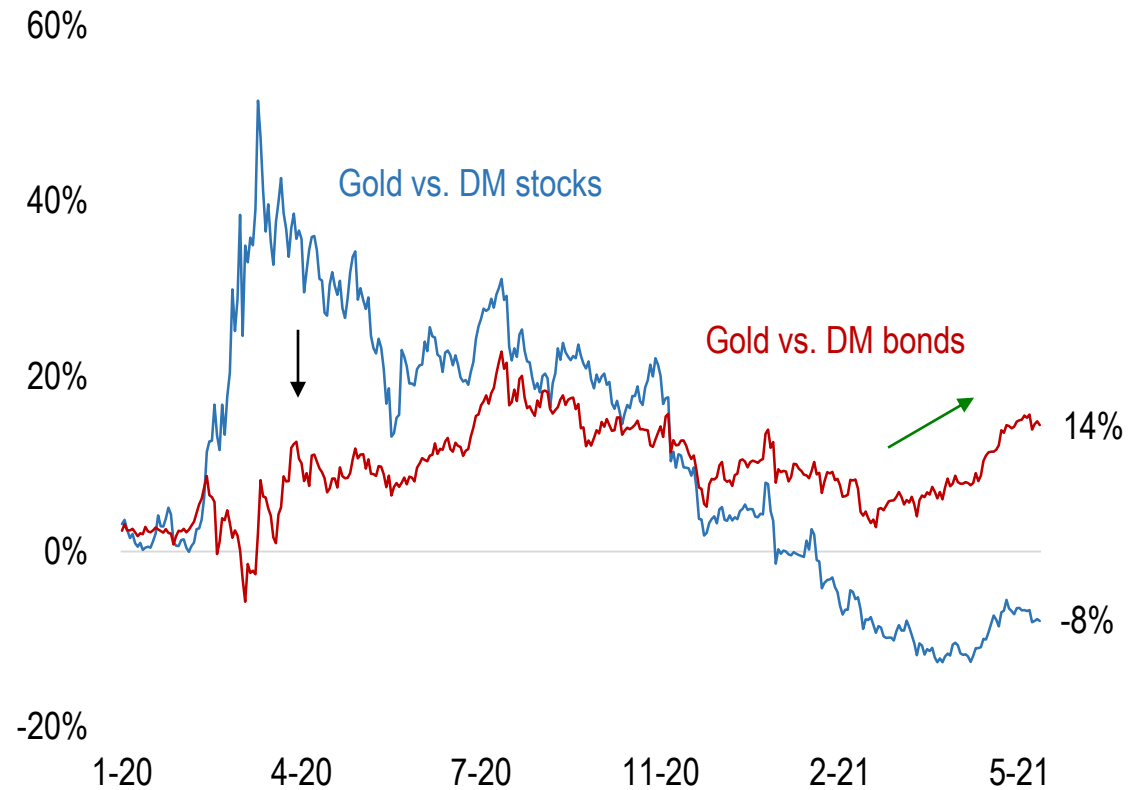
Recovering lost ground after a dismal Q1

Equity and FICC prices
2021 total returns (%)



Especially versus other 'safe haven' assets

Excess gold returns since 01/20
Cumulative price returns (%)



In real terms, prices 15% below all-time high

Real gold prices
2021 USD / ounce



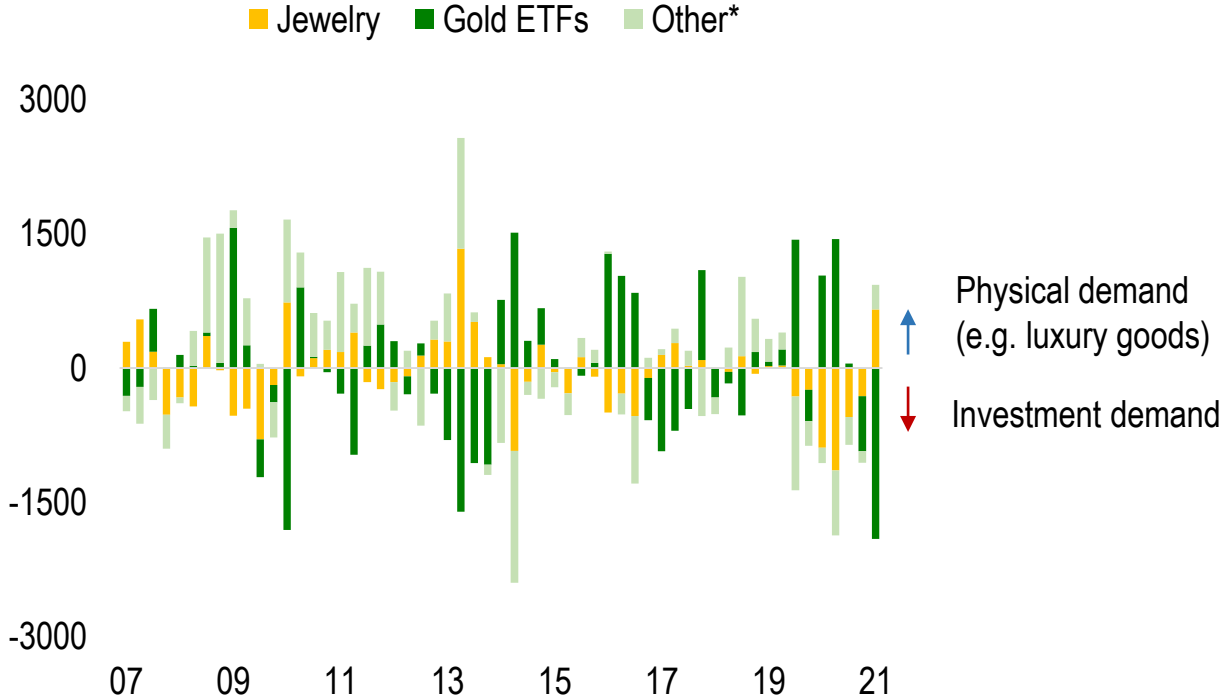
Note: Deflated with US headline CPI, re-indexed to February 2021 = 100. Dashed grey lines are official NBER recession dates.

What explains the recent recovery?

- As we predicted in the [March gold focus](#), prices recovered from their Q1 sell-off. Bullion is up about \$200 / ounce (~10%) since early April.
- Rising inflation is the key factor behind the recent recovery. Gold is an effective inflation hedge, particularly versus bonds. Higher inflation is also lowering real yields, reducing the opportunity cost of hard assets.
- Our modelling reveals that inflation hedging and low real rates explain about 75% of the increase in real gold prices since April.
- The reduction in real yields has pushed gold back to its 'fair' value. We currently estimate this equilibrium value at around \$1850 / ounce.

Gold demand continued to slide in Q1/21

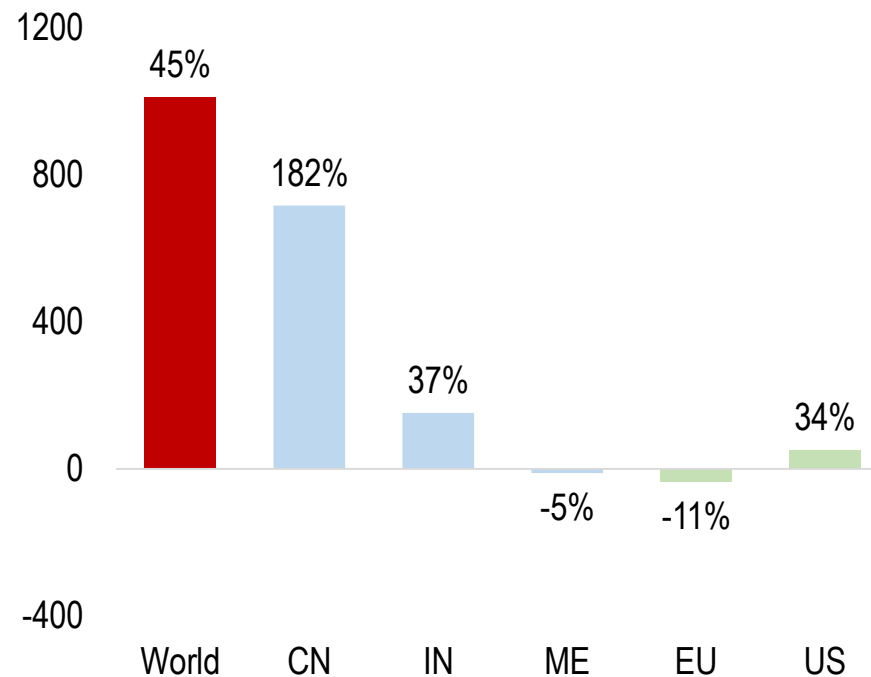
Global gold demand by end-use
Metric tonnes (Δ YoY)



* Gold bars and coins, central bank reserves, technology.

Even as consumer purchases picked up

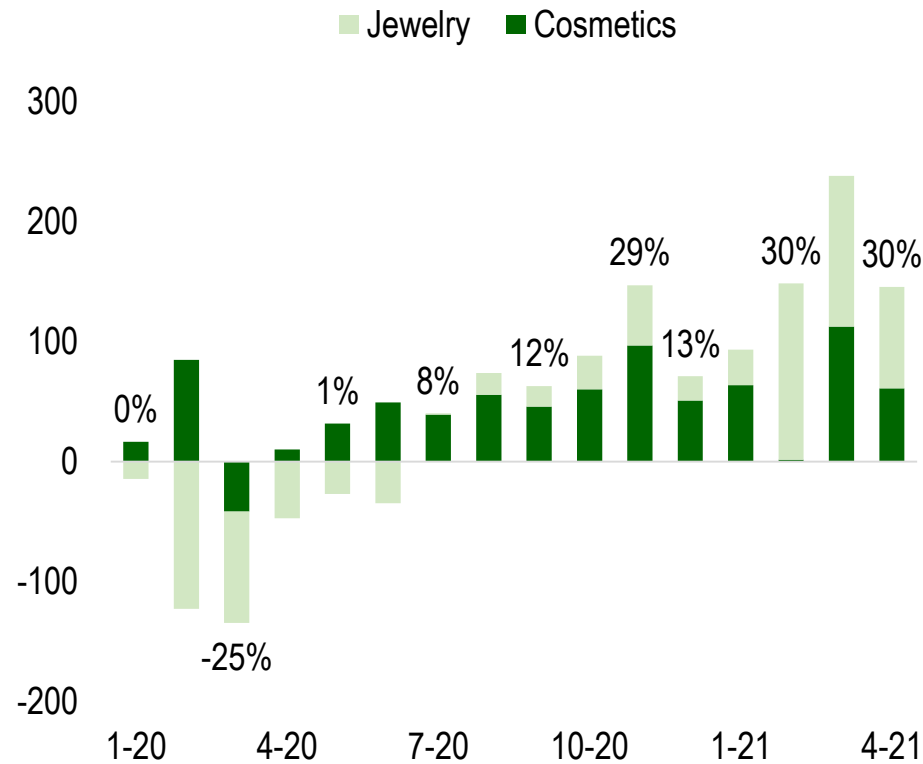
Consumer gold demand – Q1/21
YoY (MT and %)



Note: Consumer demand is the sum of jewelry and bar & coin investment. Both segments traditionally represent ~80% of the overall gold market.

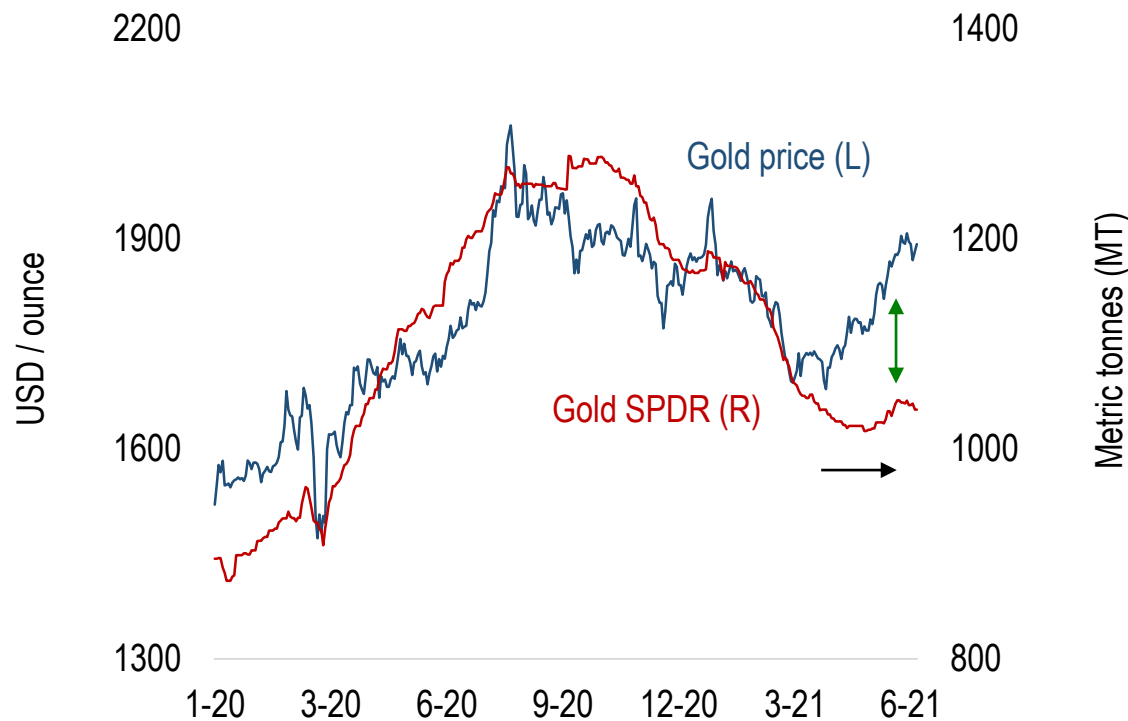
Buoyed by soaring luxury sales in China

China luxury retail sales
YoY (BN RMB and %)



Investor demand stabilizing after Q1 sell-off

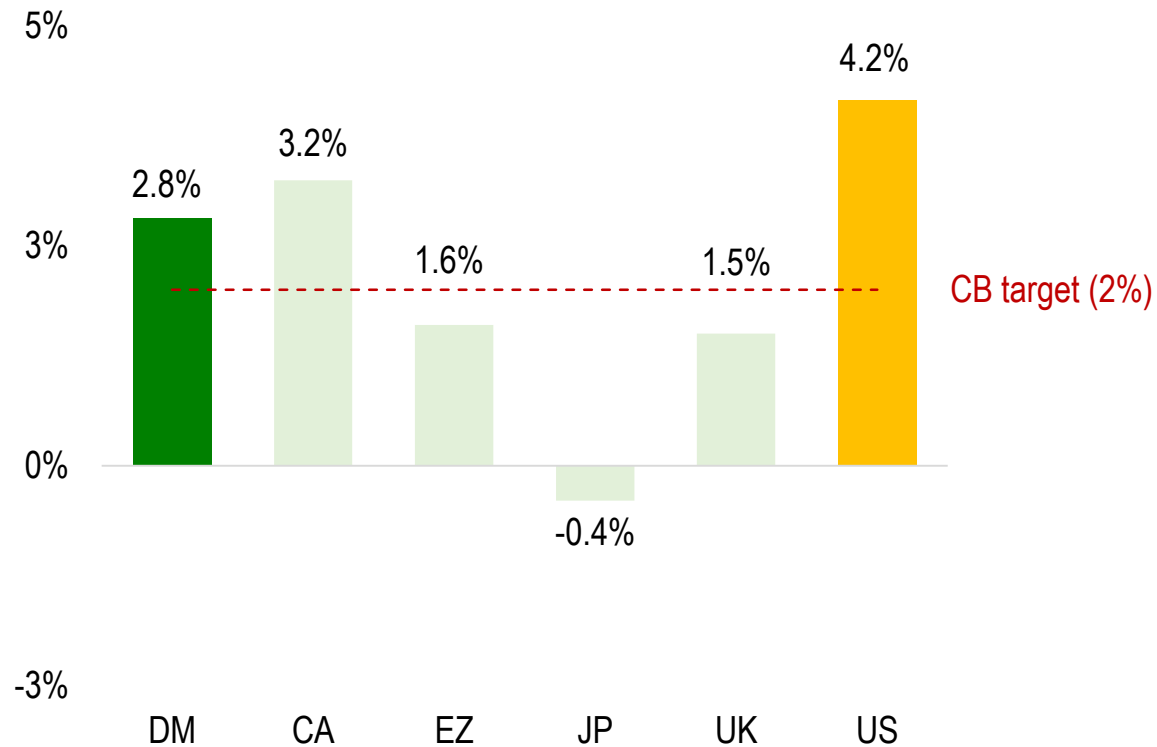
Gold price vs. SPDR holdings
USD / ounce and metric tonnes



Note: SPDR is the world's largest gold ETF (with investments backed by physical gold held in custody at bank vaults).

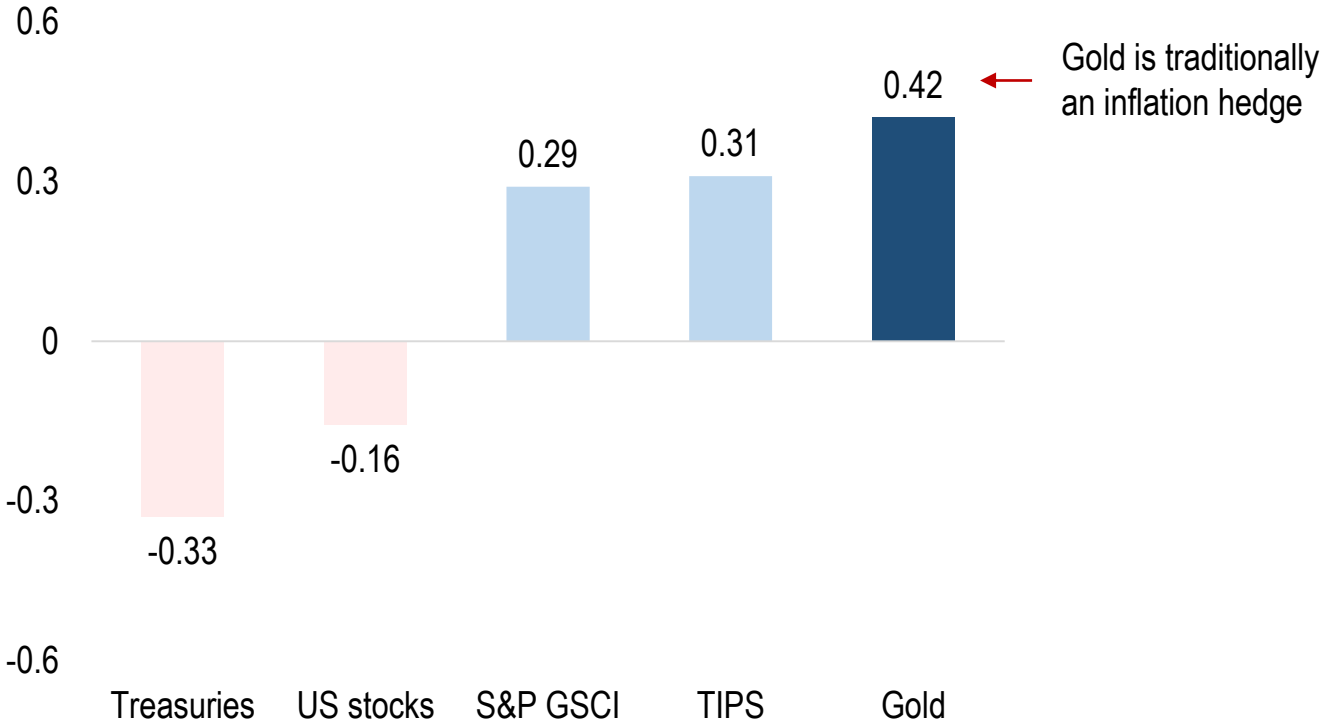
Rising inflation is a key factor behind Q2 rally

DM CPI inflation – 04/21
Year-on-year (%)



Owing to bullion's role as an inflation 'hedge'

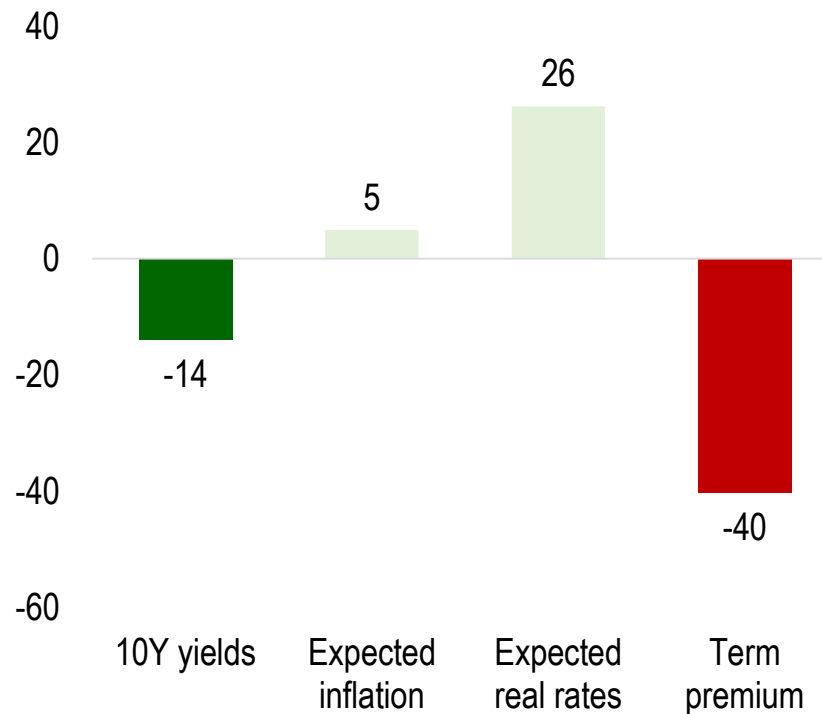
Asset prices vs. US inflation
Correlations (1970 – 2021)



Note: Correlation coefficient between US CPI inflation and annual returns on: US sovereign bonds and stocks, all commodities (S&P GSCI), US inflation-protected bonds, and gold.

In addition, long-term yields have stabilized

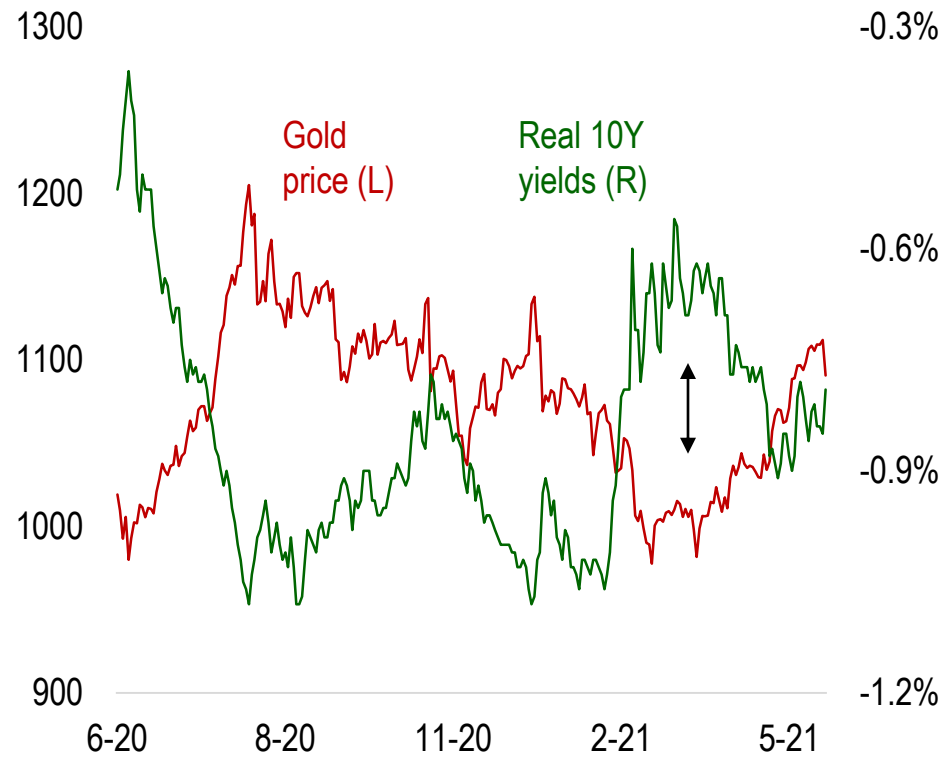
Term premium decomposition – 10Y yields
Change in yields (bps) – Last 2M



Note: Chart breaks down change in 10Y Treasury yields since early April into its estimated expectations (inflation + real rates) and term premium components.

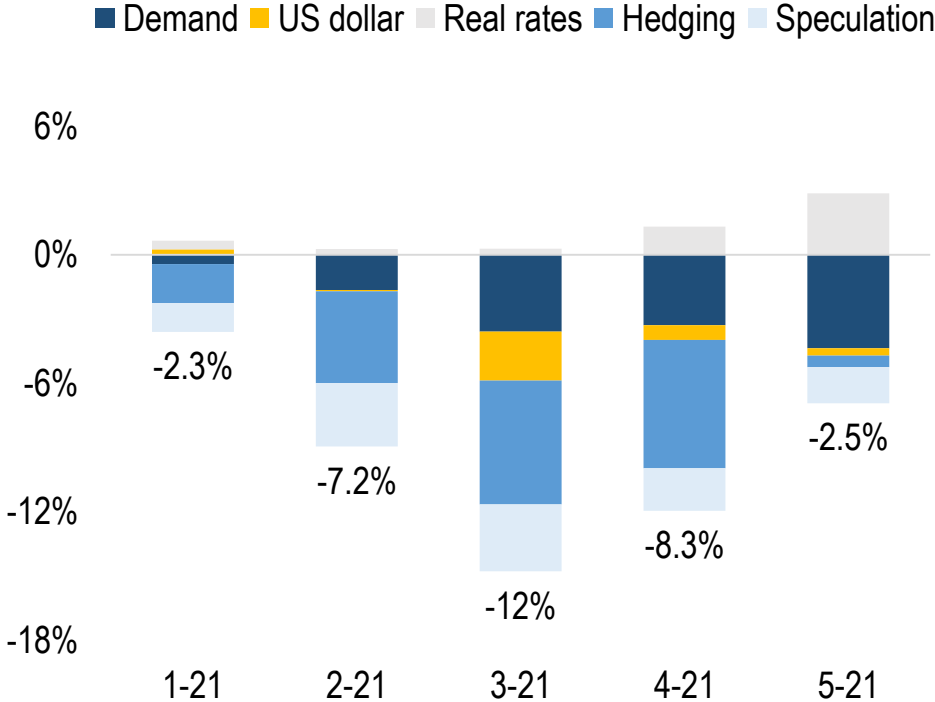
Both factors causing a reversal in real rates

Gold prices vs. 10Y real US yields
USD / ounce and %



Q1 demand sell-off remains a key drag

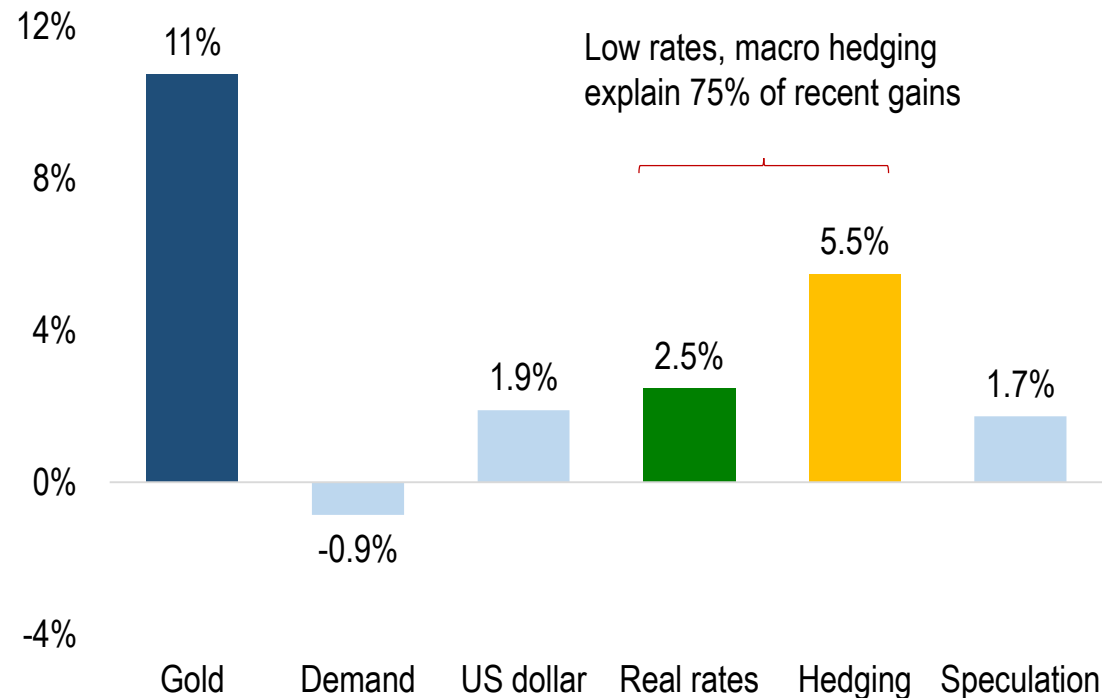
Drivers decomposition – Gold prices
2021 cumulative real returns (%)



Note: Contribution of market drivers to change in real gold prices vs. 12/20. Hedging captures both flight-to-safety and diversification effects. Speculation proxied by net long gold positions in CMX.

But hedging, lower real rates pairing losses

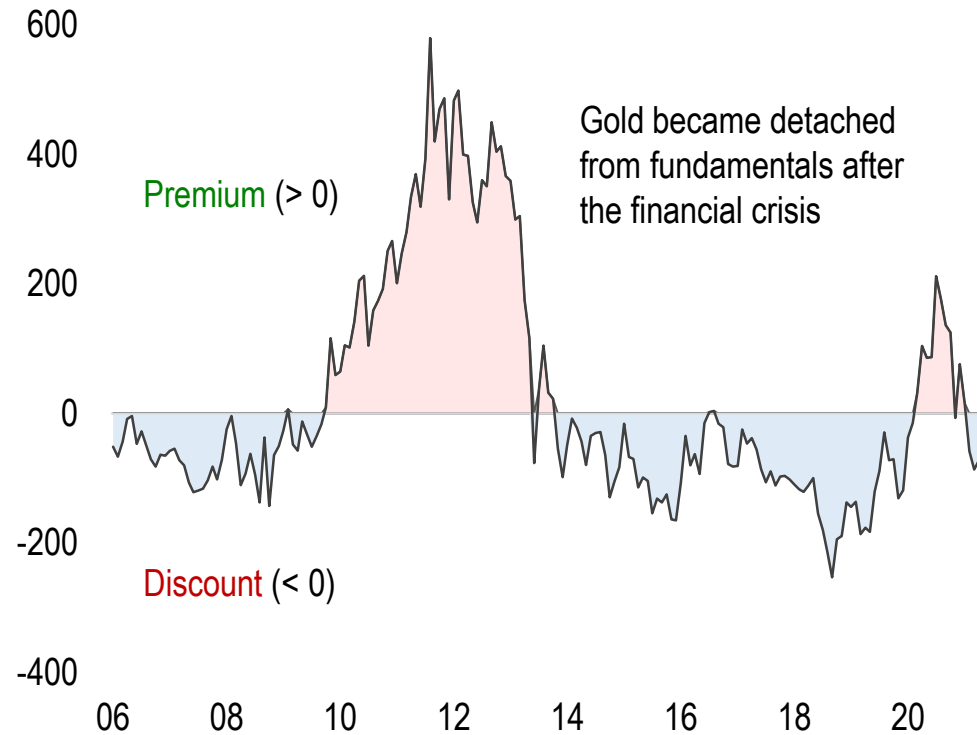
Drivers decomposition – Gold prices
Real returns since 03/21 (%)



Note: Contribution of market drivers to change in real gold prices in 2020. Hedging captures both flight-to-safety and diversification effects. Speculation proxied by net long gold positions in CMX.

Gold now trading close to its 'fair' value

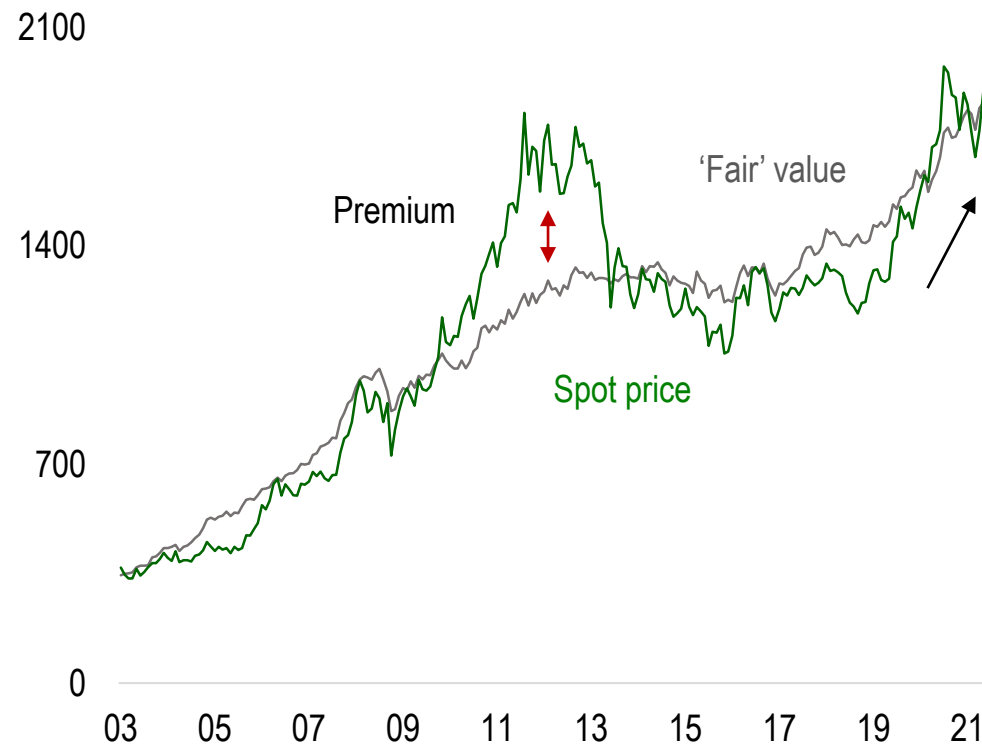
Gold risk premium
USD / ounce



Note: The gold risk premium is obtained by comparing the LBMA spot price to its modelled 'fair' (or equilibrium) value. A positive gap indicates gold is trading at a premium and vice versa.

Intrinsic value of gold around \$1850 / ounce

Gold spot vs. 'fair' value
USD / ounce



Low rates, a weak USD
and rising inflation expect.
explain high 'fair' value

Note: The 'fair' value is the gold price consistent with market fundamentals. If the spot price exceeds this equilibrium value, then gold trades at a premium.

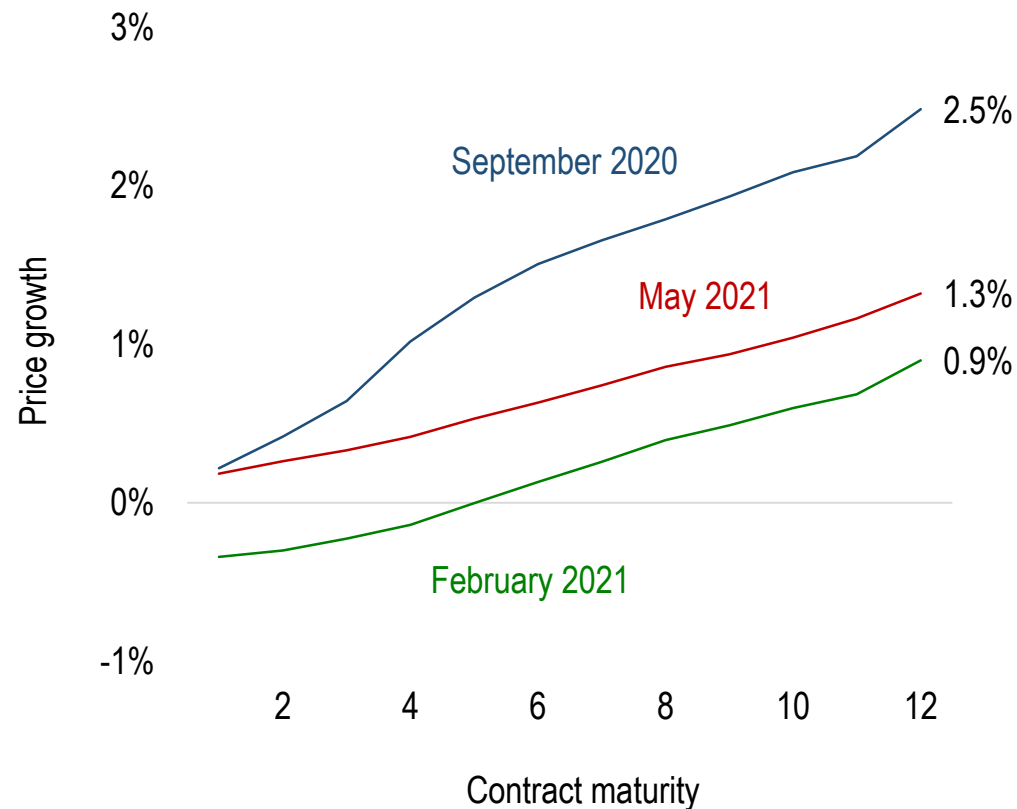
Outlook

Gold market outlook

- Investors continue to anticipate modest price gains over the next 12M. The 12M gold forward is now \$1920, 1.3% higher than in May 2021.
- This is a very conservative prediction. While falling uncertainty limits 'flight-to-safety' demand, gold should benefit from stronger physical usage, a weak USD, rising inflation and expansionary monetary policy.
- Gold prices should exceed \$1950 by this time next year. There is a 60% chance that gold investments will deliver positive real returns 12M out.
- Although high growth prospects worsens its upside against equities, gold remains an effective macro hedge. Favouring gold over bonds improves the quality of investment portfolios.

Markets anticipate modest price gains

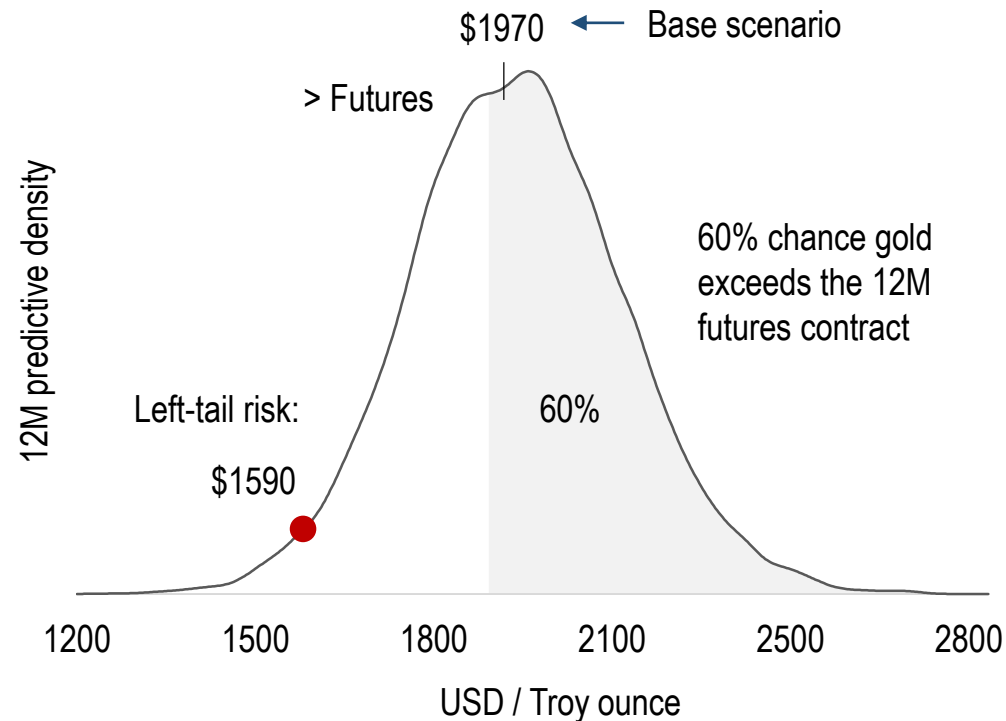
Gold COMEX futures
12M futures / spot price



Markets expect
gold to rise 1.3%
to ~ \$1920

But upside is higher than trader expectations

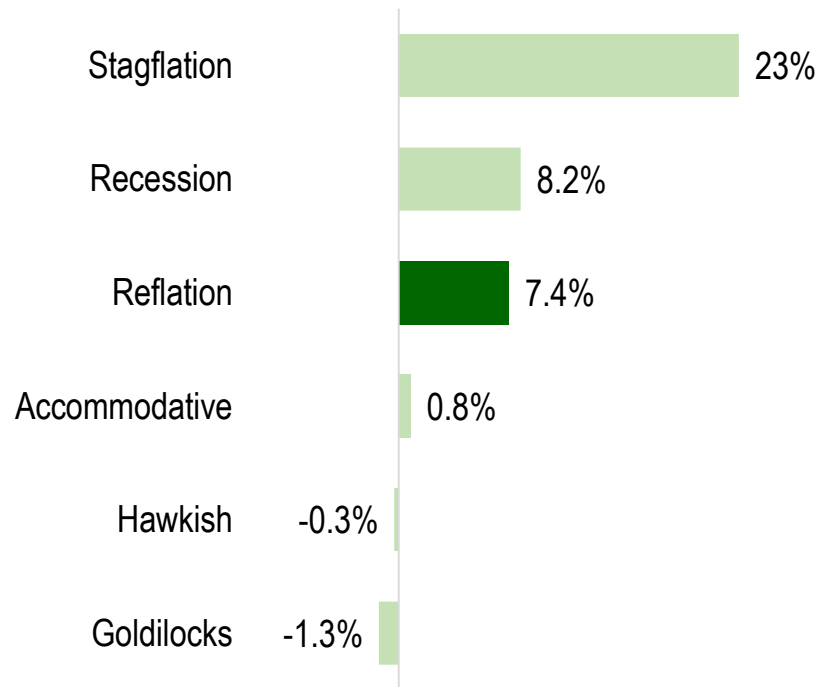
Gold spot price (USD)
12M probability forecast



Note: Grey area denotes probability of spot prices exceeding latest 12M futures contract (\$1750) and \$2000 / ounce. Red dot is the conditional value-at-risk, expected prices at the 5% quantile.

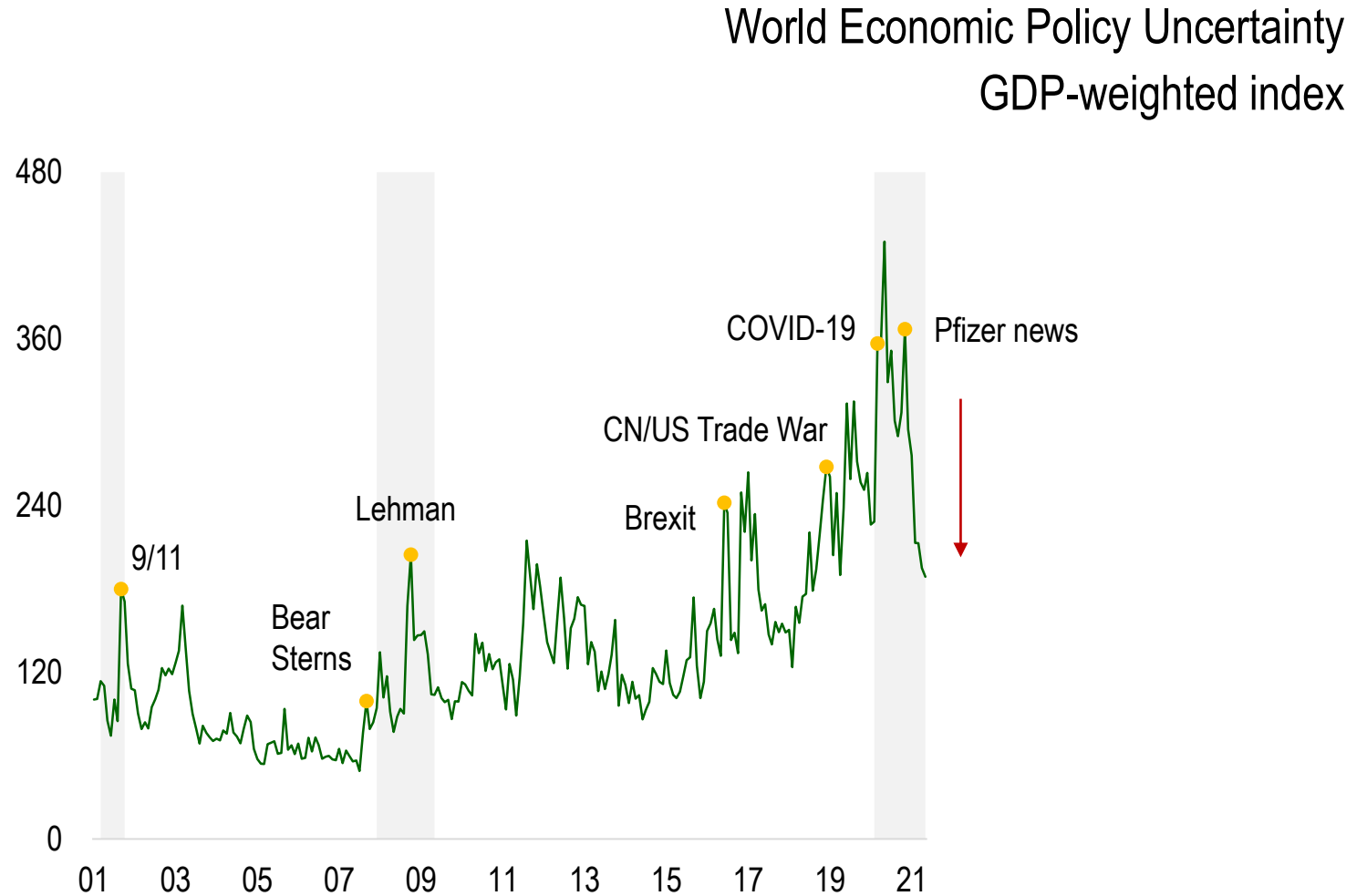
Bullion usually fares well during 'reflation'

Gold returns across macro regimes
Average nominal returns, 1970-20



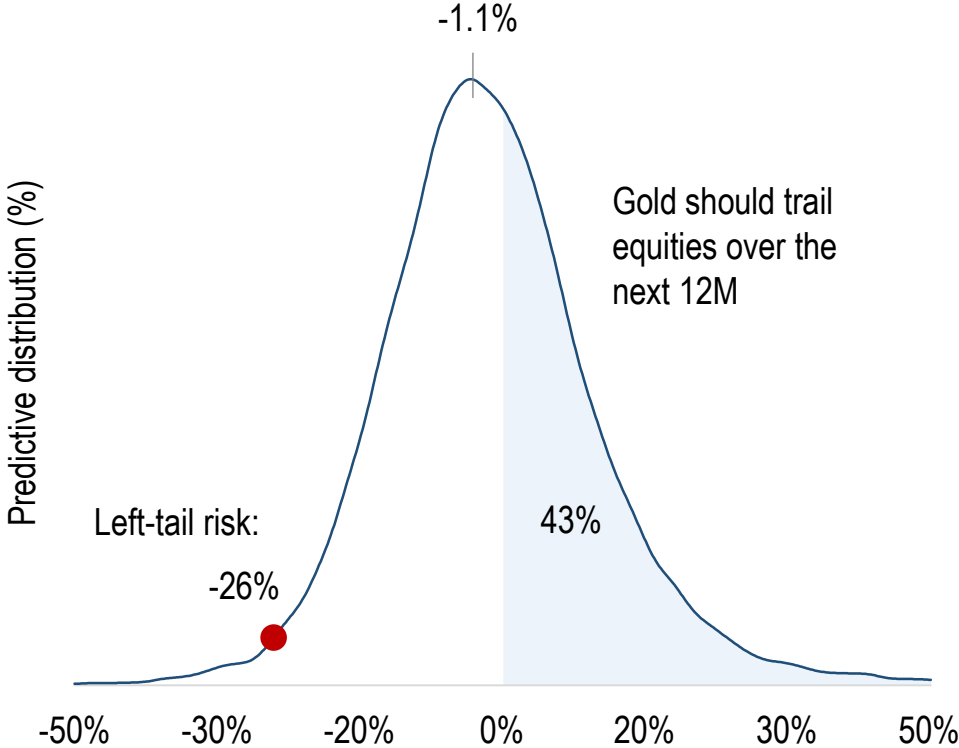
Note: Regimes based on interaction between US growth, inflation and Fed policy. 'Reflation' stands for recovery in economic activity, rising inflationary pressures and Fed easing.

Falling uncertainty caps 'flight-to-safety' demand



Which weakens upside vs. equity investments

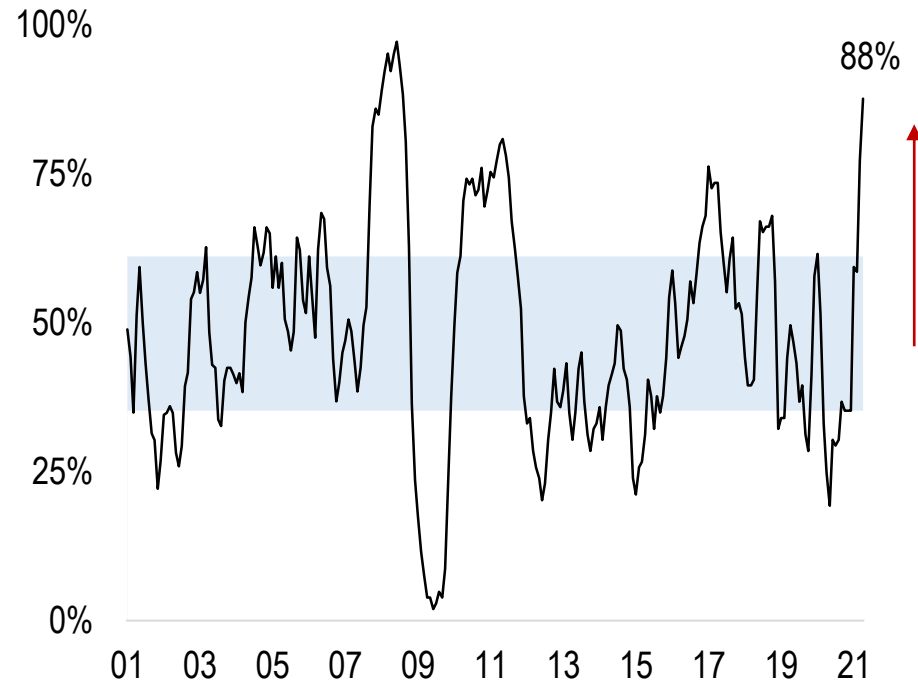
Gold vs. DM stocks – 12M out
Excess gold returns probability (%)



Note: Probability distribution for excess gold returns versus DM equity investments. Shaded area denotes the likelihood of gold investments outperforming over a 12M holding period.

But rising inflation improves its hedging appeal

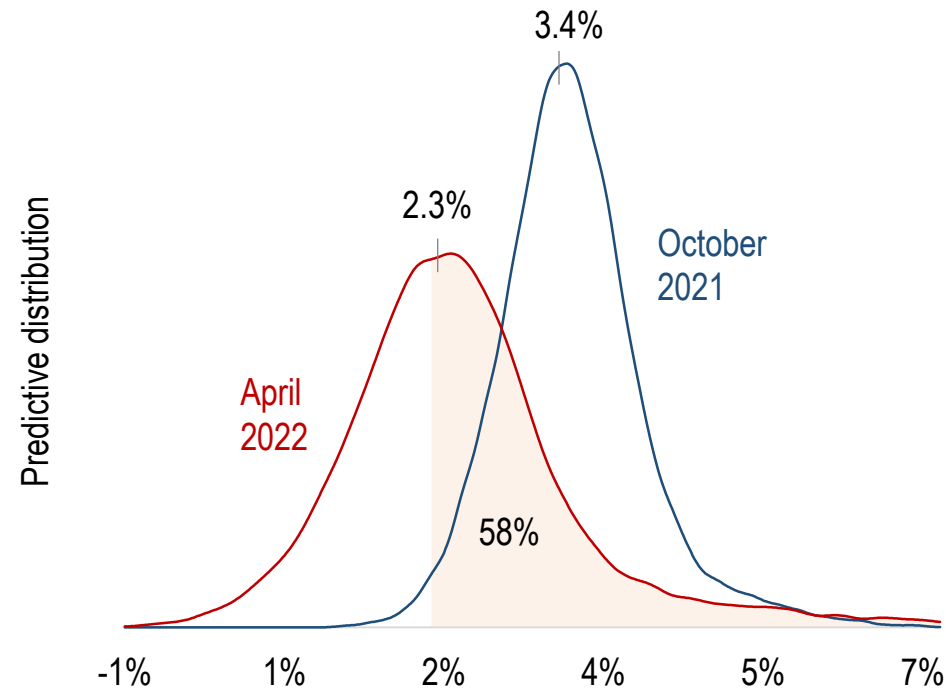
Economies with rising inflation
% countries in the world



Note: Rising inflation defined as headline YoY inflation higher than the average of the 12 previous months. Shaded area denotes the interquartile range.

US inflation should remain above Fed target

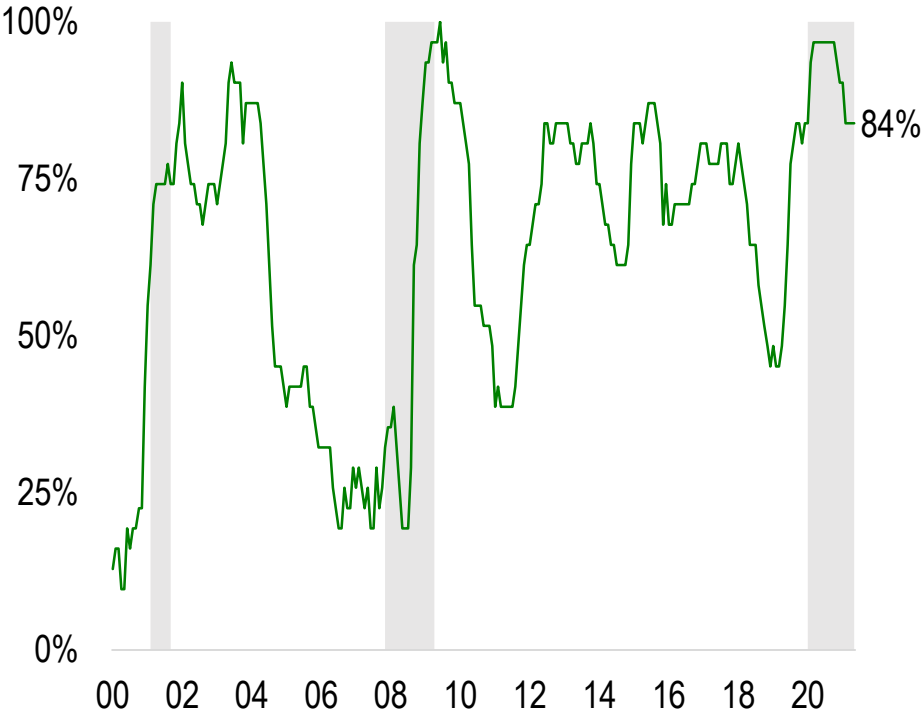
US PCE inflation outlook
Probability forecasts (%)



Note: Probability forecasts for headline PCE inflation for October 2021 and April 2022. Shaded area denotes probability of above-target inflation 12M out. source: Numera Analytics.

Global monetary policy is highly expansionary

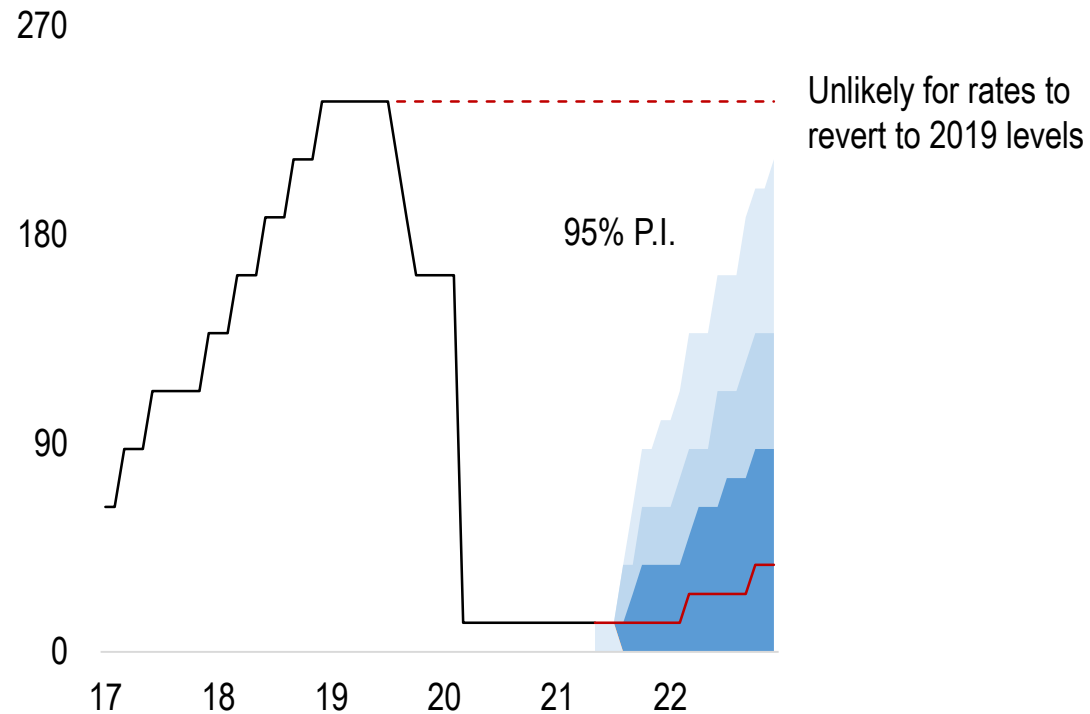
Expansionary monetary policy
% countries in easing cycles



Note: Easing cycles defined as periods of falling policy rates.

And multiple rate hikes remain unlikely

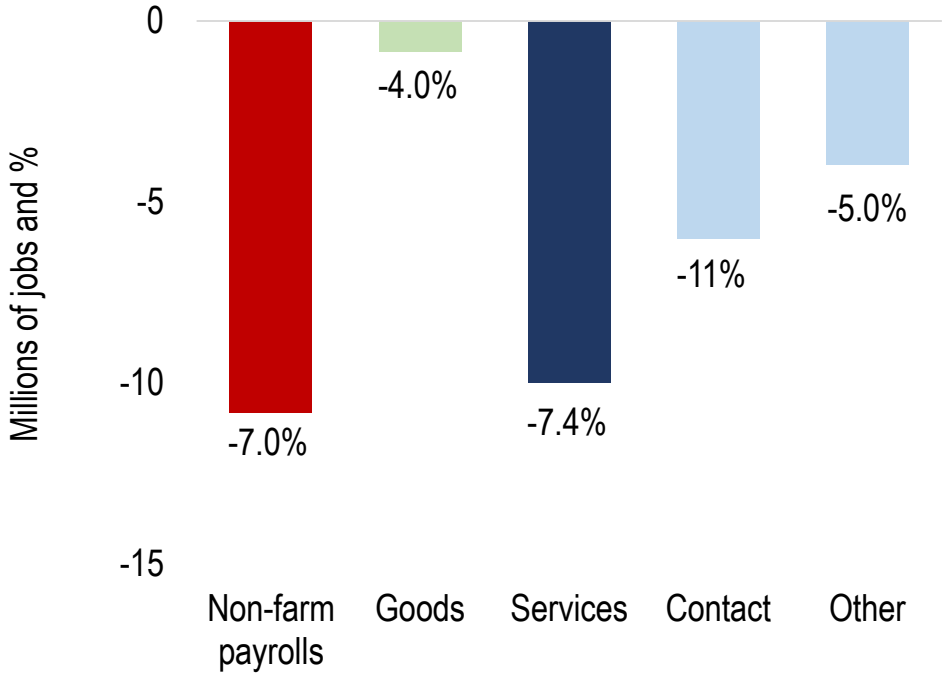
Fed funds target outlook Basis points, 2021-23



Note: Fan chart represents 50 / 85 / 95% prediction intervals. Base scenario is the mean of the predictive distribution at each forecast horizon.

Given still significant employment losses

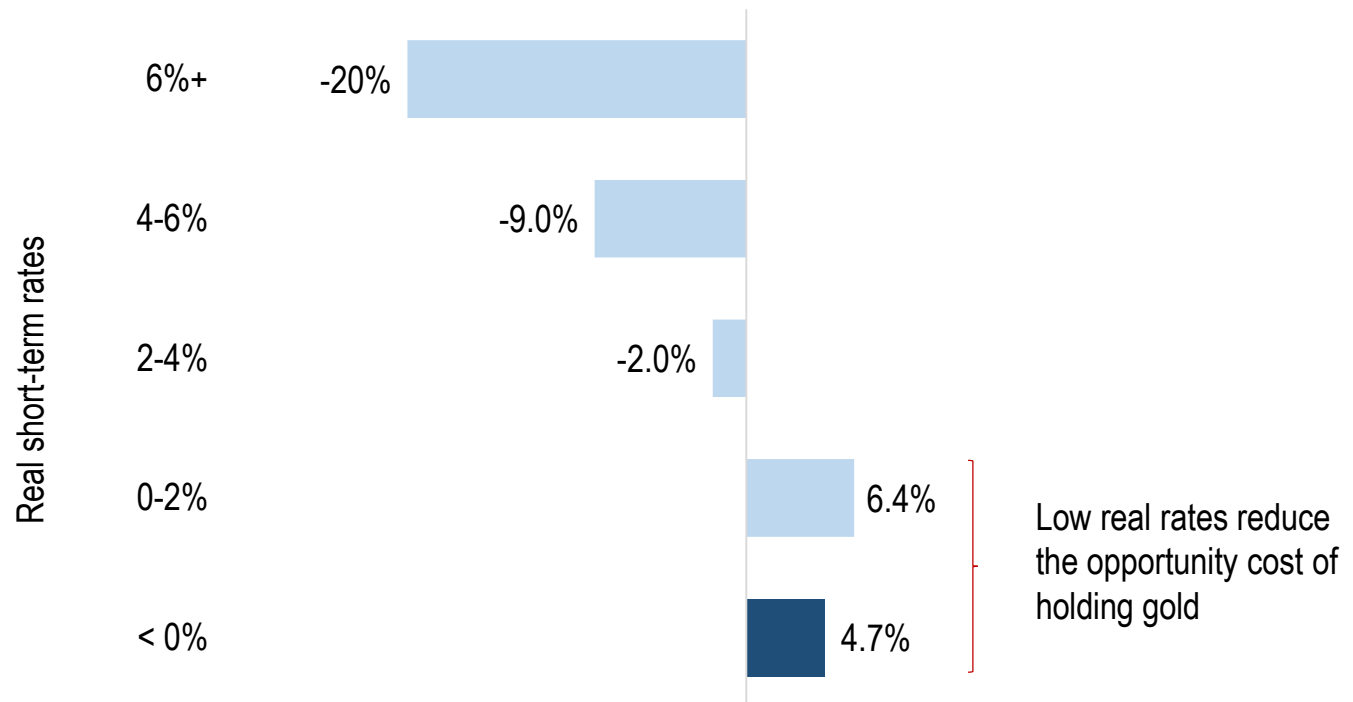
US COVID-19 employment shortfall
Remaining jobs lost – 05/21



Note: Chart breaks down the total employment shortfall by sector (in millions of jobs and % deviations from the pre-COVID path). Source: Numera Analytics.

Low real interest rates benefit gold prices

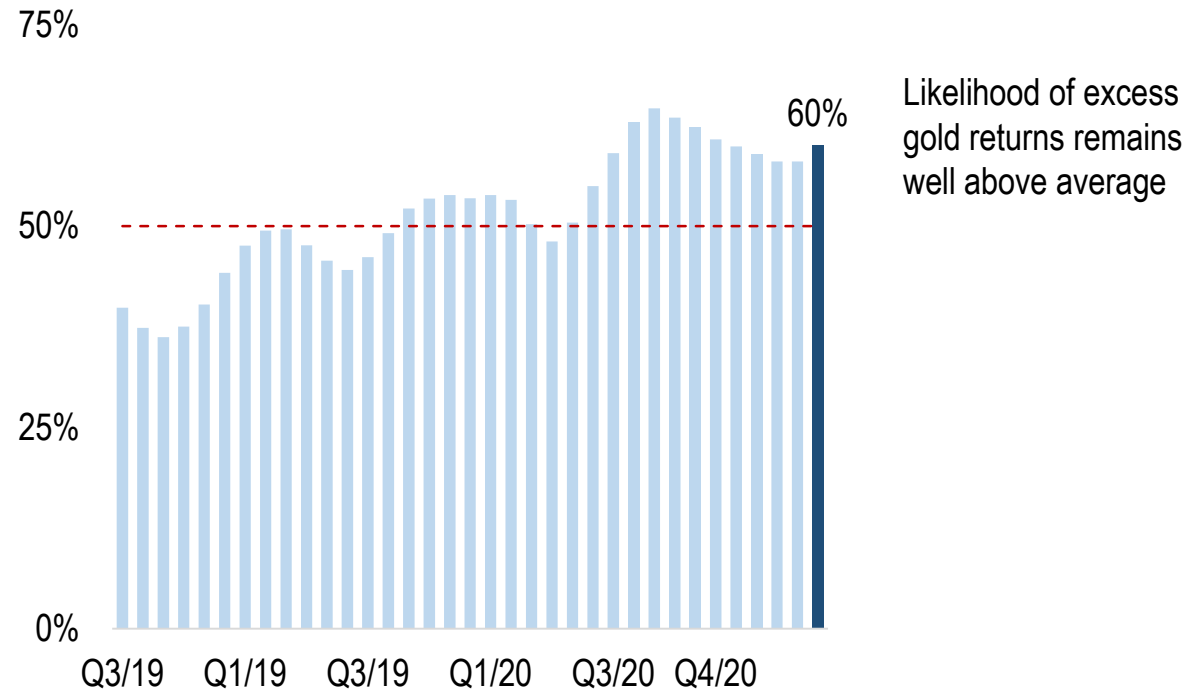
Gold vs. real interest rates
Average real returns, 1970-20



Note: Average real gold returns at various real interest rate intervals. Real rates defined as the effective Fed funds minus 1Y inflation expectations.

High probability that gold outperforms bonds

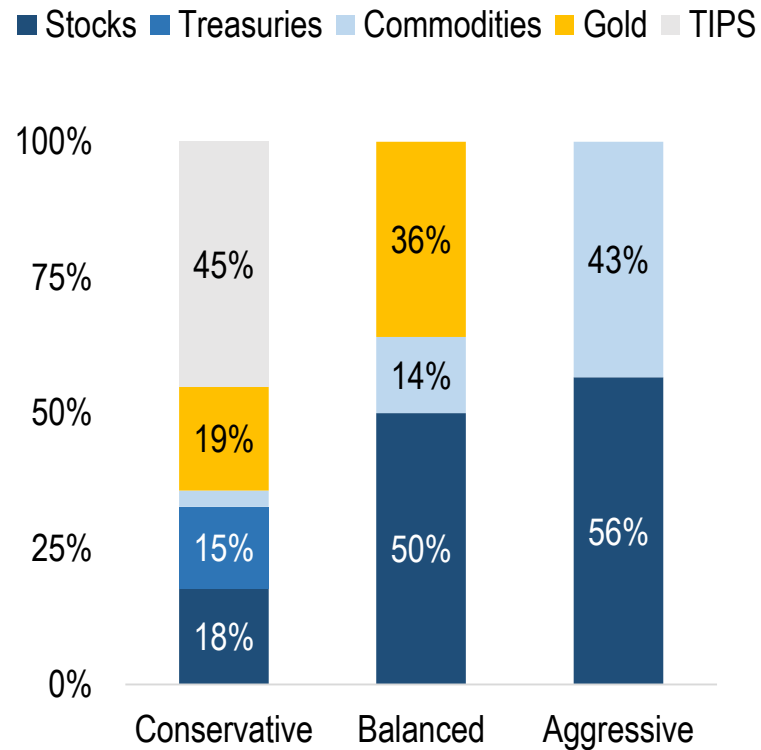
Gold vs. US Treasury bonds – 12M out
Excess gold returns probability (%)



Note: Chart tracks probability of 12M investments in gold (S&P GSCI TR) outperforming US sovereign bond holdings.

Balanced investors should overweight gold

Optimal portfolio weights
12M holdings



Note: Chart shows optimal portfolio weights for 12M US equity and FICC investments. The weights maximize the 12M Omega ratios for simulated portfolios for investors with varying risk tolerance (conservative, balanced and growth profiles).



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