JUNE 2024

The Sharp Perspective

OUR MONTHLY COMMENTARY

Gold pulled back to consolidate, but prices hold up well. The market is waiting for the US Federal Reserve to make its first rate cut

- Profit-taking by funds weighed on prices, but fund short-covering into the dip suggests sentiment is not bearish.
- Traders have chosen to ignore firm treasury yields and a strong dollar as they expect these to turn lower before long…
- …instead, they have focused on other risks, chiefly the geopolitical situation and the approaching US Presidential election. The latter is likely to make investors increasing nervous, which should boost haven demand.
- After two years of profit-taking, ETF investors turned small net buyers in May and June.

Silver prices fell more than gold prices, but the market still looks well supported

- The gold/silver ratio still suggests silver is undervalued compared with gold, a lower interest rate environment that boosts industrial demand may be enough to see the ratio return to more normal levels.

Palladium prices rebound off lows, strikes and potential mine closures underpin the firmer tone

- Funds still net short palladium and the long/short position is looking increasingly polarised, increasing the risk of a short-covering rally.

KEY TAKEAWAYS

- Gold prices correct but hold up well despite, dollar strength.
- Market consolidating while it awaits Fed's first rate cut.
- US Presidential election expected to see increased demand for safe havens.
- Silver looks undervalued compared with gold given potential for strong industrial demand.
- Palladium's outlook looking brighter, fund short position looks vulnerable.

Gold consolidated in June, but held up well compared to other metals

It would seem markets are waiting for the US Federal Reserve to make its move on interest rates and while they are doing so, gold has been biding its time, consolidating within a $100 per oz range, between $2,286.80 and $2,387.75 per oz. Gold has held up better than other metals since it peaked in May, with copper for example spending all of June trending lower, with prices ending June, 13.7% lower than its May peak, compared with gold's 5% pullback.

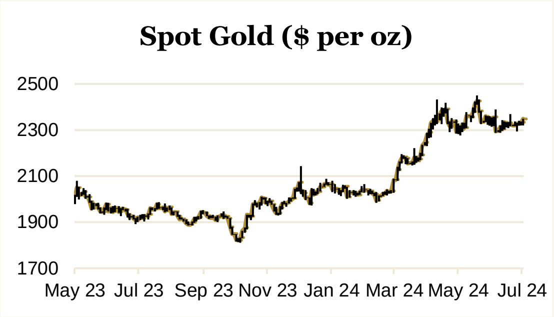

CHART 1

Dollar strong despite likely Fed easing

All signs and indeed expectations are for US interest rates to start being cut soon, with most expecting the first cut to be made in September. Yet, despite this the US dollar has been trending higher again, with the US Dollar Index rising to 106 in June, from 104 in May, and getting close to challenging the April high at 106.50. Normally, dollar strength would weigh on gold prices, as it has done on copper – this suggests gold has relative strength.

Reasons to be bullish have not gone away

While the strong dollar should be a headwind, as indeed elevated US ten-year treasury yields should be, the market may be ignoring these on the understanding they will turn down before too long. This is especially so now that inflation seems to be tamed, US core PCE price index fell to 0.1% in May, from 0.3% in April (revised up from the original reading of 0.2%). If the strength in gold prices has not been broken by the strong dollar and relatively high yields, then it suggests traders may be more worried about other potential developments, including geopolitical risks, equity market valuations and political risks.

Geopolitical, equity and political risks

The current geopolitical concerns over Russia/Ukraine, Israel/Middle East and China/Taiwan are not new, but perhaps what is starting to feature in people's thinking is how will Donald Trump, if elected in November, handle these issues. He has been vocal in saying he can end the Russian-Ukraine war in one day. Being the maverick he is, there seems every reason to be wary of how he handles not only domestic US policy, but foreign policy too. And, given how his actions could have far reaching implication on markets, investors may well want to park more of their portfolios in safe-havens.

Central bank buying

While central bank buying has slowed in recent months, especially following the Peoples Bank of China halting purchases in May, the underlying trend to diversify reserves away from the vulnerabilities of the global financial system, which is dominated by the US, is expected to continue. Russia started accumulating gold in its reserves as long ago as 2008, when it wanted to build up its gold holdings to 10% of its reserves (they now stand at 29%), other central banks, especially in central Europe, Asia and amongst the BRICS have followed suit, with China buying heavily in the 18 months to April 2024. The US's weaponising of the dollar and the payments system, via use of sanctions, means this trend is likely to continue. How big a phenomenon could it be? The US, Germany, Italy and France, each hold around 70% of their reserves in gold. Russia holds around 29%, China around 5% and the other countries on the IMF's list hold an average of around 18%. That means there is plenty of room for a lot more central banks to increase their holdings if the trend to diversify away from the US continues.

Will US election nerves appear?

Investors, as seen by the amount of gold held by ETFs, have only recently started to turn net buyers. ETF holdings stood at 3,098 tonnes on 21st June 21, up 18 tonnes from the recent low of 3,080 tonnes seen at the end of April. At the start of the year, holdings were 3,225 tonnes, with peak holdings of 3,915 tonnes seen in 2020. If investors do get nervous about what a President Trump might mean, then this is another potential sector that could start buying gold again.

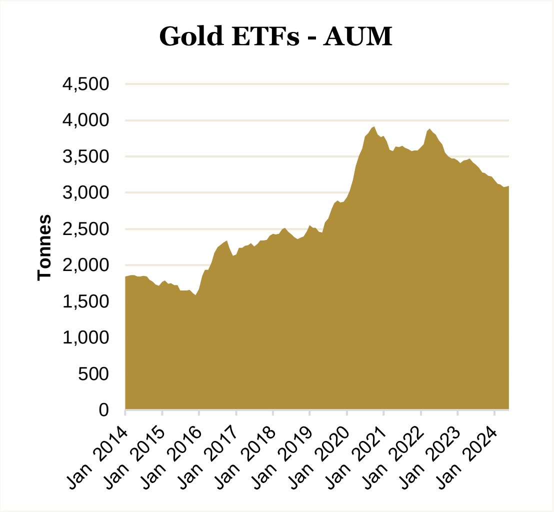

CHART 2

Short-covering drives fund buying

The funds trading Comex gold have continued to add to their net long position in June, with the net long position climbing 9,644 contracts to 246,229 contracts by 25th June. But, the increase was due to short-covering rather than fresh buying, indeed the gross long position fell 1,852 contracts, while the gross short position fell 11,496 contracts. So only light profit-taking by the funds, while the shorts have started to get more nervous. As the chart shows, the net long position was as high as 353,649 contracts in 2020, so the current length is 70% of what it was at the peak.

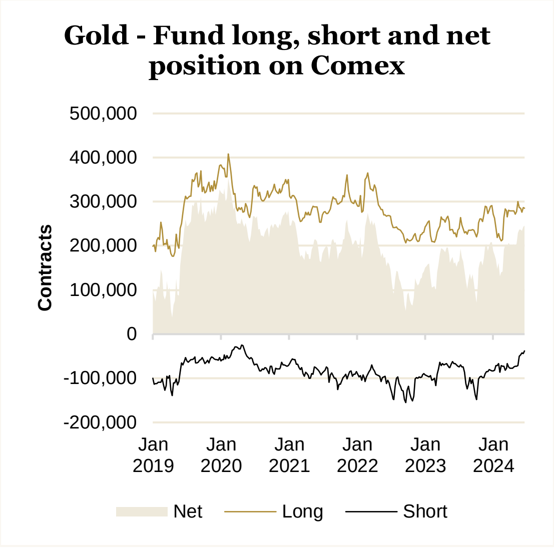

CHART 3

Volume on Comex drops

In line with prices consolidating, volumes on Comex fell to 3.504 million contracts in June, compared with 6.169 million in May and an average of 5.489 million oz over the first four months of the year. Open interest has also fallen to 448,350 contracts, from 459,250 contracts at the end of May, which is in line with the short-covering that dominated fund trading in June.

TECHNICAL ANALYSIS

Gold prices on the chart have turned sideways since April, and since pulling back after the May peak, volatility has lessened with prices trading withing a $100 per oz range since late-May. In technical analysis terms, a head-and-shoulders (H&S) pattern could be forming on the chart with a slightly inclined neckline, at $2,294 per oz in early-July. But, unless the neckline is broken, the H&S will not be triggered. Below the H&S there is also likely to be support down to $2,277 per oz.

SUMMARY

Gold prices are consolidating and are generally holding up well. While there is potential for prices to correct further, there are still many bullish factors in the market, especially from the geopolitical and political risks that lie ahead.

Gold Statistics

	2020	2021	2022	2023	Q1 2024	Q2 2024	May-24	Jun-24
London prices								
$/oz	1,769.97	1,799.87	1,801.17	1,942.99	2,069.33	2,337.69	2,351.35	2,325.84
£/oz	1,378.80	1,308.41	1,457.43	1,562.57	1,630.54	1,852.42	1,861.85	1,829.57
€/oz	1,549.38	1,308.41	1,457.43	1,796.32	1,905.12	2,067.61	2,175.62	2,161.36
Parity prices								
Australian - A$/oz	2,544	2,393	2,589	2,924	3,153	3,547	3,548	3,501
South Africa Rand/kg	29,352	26,519	29,139	35,952	39,142	42,780	43,312	42,772
Japan Y/g	189,104	197,644	241,248	273,806	307,850	364,369	366,410	367,342
India Rupee/oz	131,445	133,434	142,184	160,596	171,999	195,010	196,032	194,161
COMEX - futures contracts								
Stocks ('000oz)#	38,157	33,805	23,180	19,191	17,585	16,505	16,617	16,505
Vol (million contracts)*					15.74	15.89	6.17	3.50
OI ('000 contracts)#					508	448	459	448
CFTC (Futures Only Data) non-commercial								
Net Positions#	268,872	213,157	136,880	207,718	199,294	246,229	236,585	246,229

Figures are period averages unless marked by *, indicating total in the period, or #, indicating value at the end of the period.

~ = data not available yet, *italics* = estimates, OI= Open Interest on the exchange

Silver follows gold lower

Silver prices underwent a steeper pullback from the May high ($32.51/oz) than gold did, with prices correcting some 12% to $28.57/oz, compared with gold's 5% drop. This is not surprising, as silver tends to outperform gold on the way up and on the way down. As a result, the gold/silver ratio climbed to 1:80, from May's low of 1:73. That said, at the end of June, silver was up 22.4% since the start of the year, while gold was up 12.8%.

Interest rate cuts doubly good for silver

Given the strong gains in precious metals, some pause for consolidation is healthy, but the outlook for silver demand remains strong and the rollout of weaker monetary policy in major economies should be good for silver on two counts. First, it will boost economic activity, which will increase industrial demand and make the economics of renewable energy projects more workable. Silver's use in photovoltaic cells is the faster area of growth for silver demand, growing 64% in 2023, compared with 2022. Second, as with gold, lower interest rates reduce the opportunity cost of holding precious metals. The European Central Bank has already started its rate cutting and the market expects the US Federal Reserve to follow suit in September.

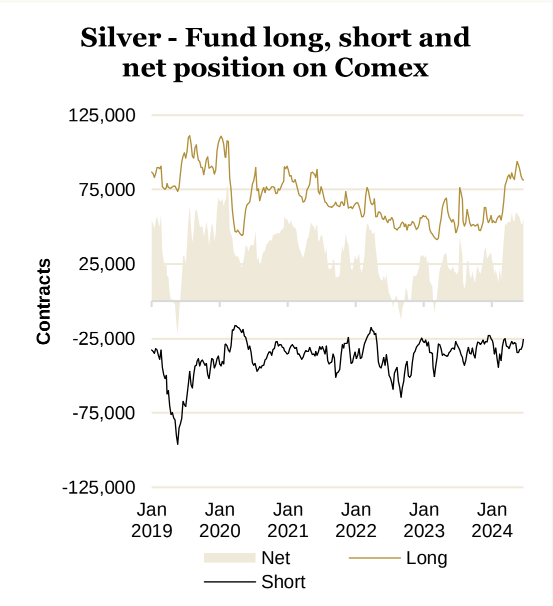

CHART 4

Fund short-covering

The net long fund position in Comex silver fell in late May and early June to 51,692 contracts on 11th June, from May's peak of 59,644 contracts, which was driven mainly by longs taking profits. It has since climbed back to 55,978 contacts, with the rebound generally driven by short-covering. Since the May peak, the longs have cut their position by 12,775 contracts and the shorts have reduced their position by 9,109 contracts. The fact the pullback in prices has not been met by fresh short selling suggests the market is not turning bearish. Indeed the black line on the chart shows the gross short position is getting to the low end of the range.

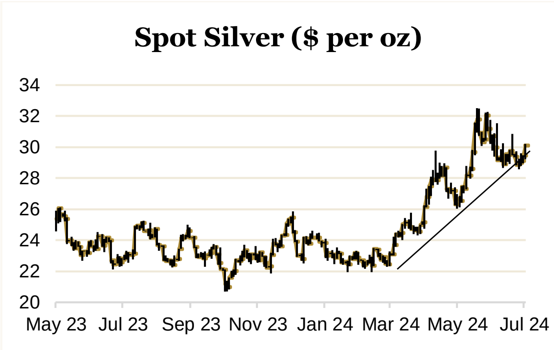

CHART 5

TECHNICAL

Last month we said "prices have already pulled well above the upward trend line now, so some consolidation is likely." This indeed has unfolded, with prices now back around where the trend is and therefore no longer looking overbought. The pullback since the May high looks like another flag on the chart, with this year's series of higher highs and higher lows intact.

SUMMARY

Silver has performed strongly this year, so its deeper pullback than gold in June is not a concern. Also, it is worth noting that the gold/silver ratio is relatively high at 1:77, compared with the long term average which stands around the 1:65 level. With lower interest rates likely to boost industrial demand and with investors expected to get more nervous in the run up to the US Presidential election, combined with the ongoing and widespread geopolitical unrest, it would not be surprising to see investor interest in silver pick-up in the months ahead.

Silver Statistics

	2020	2021	2022	2023	Q1 2024	Q2 2024	May-24	Jun-24
London Prices (US$/oz)								
Spot London price	20.55	25.14	21.73	23.39	23.36	28.86	29.40	29.59
Parity (London) prices								
Japan (Y/g)	2,196	2,761	2,911	3,296	3,475	4,500	4,582	4,673
India (Rupee/oz)	1,526	1,864	1,715	1,933	1,942	2,408	2,451	2,470
COMEX - futures contracts								
Stocks ('000oz)#	396.5	355.7	299.0	253.9	292.7	255.7	261.9	255.7
Vol (million contracts)*					4.59	7.20	2.13	2.09
OI ('000 contracts)#					160.7	155.3	180.4	155.3
CFTC (Futures Only Data) non-commercial								
Net Positions#	54,779	26,458	31,027	31,863	50,836	50,836	57,183	55,978
Other Indicators								
Gold/Silver ratio#	1:72	1:78	1:76	1:86	1:86	1:86	1:77	1:79
Figures are period averages unless marked by *, indicating total in the period, or #, indicating value at the end of the period.								
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What's the rally in palladium telling us?

Palladium prices have fallen hard over the past two years, dropping to a low of $854 per oz in February, after a high of $3,430 per oz in March 2022, a 75% fall. But, since the second half of June, prices have rebounded strongly from $870.60 per oz to $1,056.90 per oz. By comparision, platinum has followed a more subdued path - after setting a high at $1,340 per oz in 2021, it fell to a low of $821 per oz, a 38.7% drop, and has oscillated sides since then, capped by supply above $1,140 per oz. So what has been driving palladium prices? On the way down, palladium prices suffered as high prices meant it started to be substituted out of catalytic converters in favour of platium. For palladium, which is almost entirely used in catalytic converters, the prospect of it losing market share to platinum was one issue, the second issue was that petrol/diesel vehicles were also losing market share to electric vehicles – a double negative whammy for palladium.

So what about the rebound?

Firstly, Sibanye Stillwater announced that if palladium prices did not rise then it will be forced to close its US mines, that primarily produce palladium. The second reason is that with palladium prices now around the same level as platinum, there is less substitution pressure. Thirdly, as battery only EV (BEV) sales growth has slowed in Europe and North America, petrol and diesel cars are not losing market share so fast. In addition, demand for plug-in hybrids (PHEV) that still require an auto catalyst, is strong and has been growing at a faster pace even in China, relative to BEVs. All of which suggests demand for auto catalysts is unlikely to fall off a cliff, as initially feared. In turn, this suggests palladium may have overshot on the downside.

Risk of short-covering as funds are short and polarised on palladium

Another factor that could see palladium prices over perform platinum on the upside now is the fund position. The net fund position in palladium is short 12,906 contracts, with 8,224 longs against 21,130 shorts. As the chart shows, the positions are polarised – there is a lot of room for short-covering. The net fund position in platinum is already long, 20,603 contracts and does not have such a extreme short position.

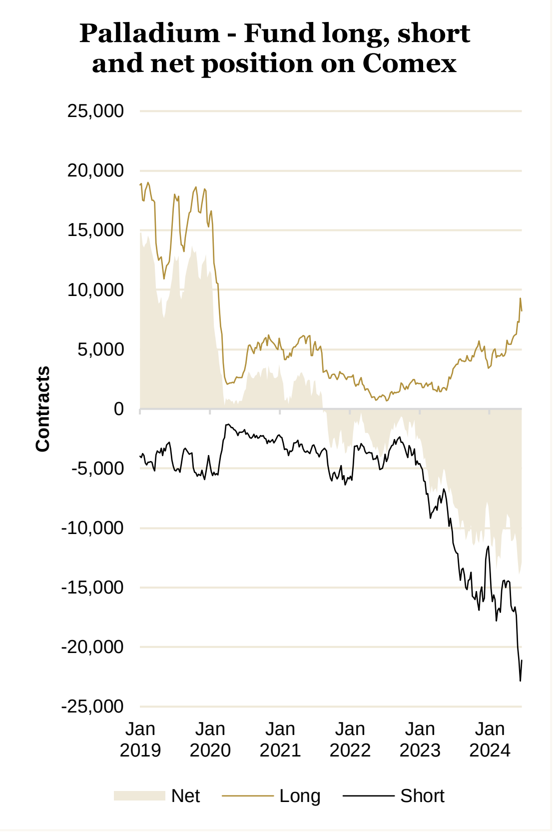

CHART 6

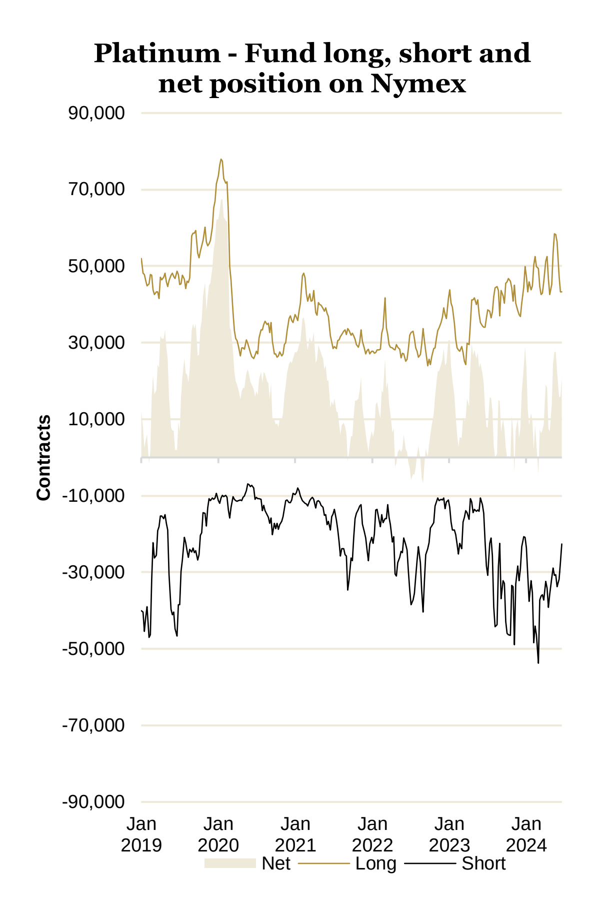

CHART 7

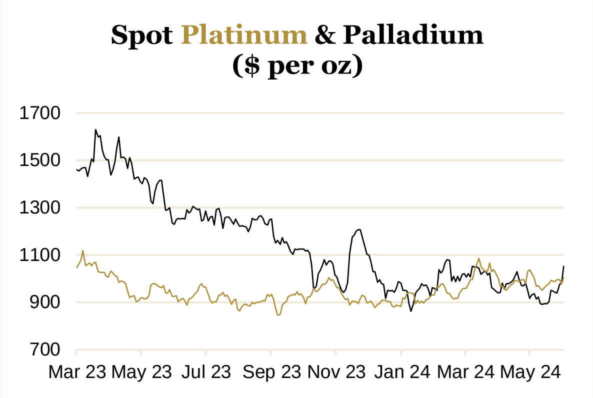

CHART 8

SUMMARY – Palladium prices have shot higher in June and are now back above those of platinum. While the potential for production cutbacks may have provided a narrative for a rebound, the market's outlook as improved in that there is less substitution pressure, the overall demand for auto catalyts is not so weak and perhaps above all there is significant potential for fund short-covering, as indeed we mention in the May report. Short-covering in a thin market can lead to some fast price moves, so we would not be surprised to see more price volatility in palladium.

PGM Statistics

	2020	2021	2022	2023	Q1 2024	Q2 2024	May-24	Jun-24
London Prices (US$/oz)								
Platinum	884.49	1091.24	961.24	966.88	915.79	980.94	1015.95	984.97
Palladium	2197.06	2398.86	2108.33	1338.69	989.99	972.46	976.41	924.40
Japanese Parity Prices (Y/g)								
Platinum	94,499	119,829	128,748	136,253	138,591	152,928	158,315	155,565
Palladium	234,734	263,419	282,390	188,648	149,827	151,514	152,153	146,000
South African Parity Prices (Rand/kg)								
Platinum	14,668	16,078	15,551	17,891	17,097	17,956	18,714	18,114
NYMEX Stocks ('000oz)								
Platinum#	623.10	482.00	167.20	206.20	200.96	174.84	189.24	146.77
Palladium#	138.1	95.2	53.4	36.7	51.4	34.7	36.5	31.2
CFTC (Futures Only Data) non-commercial#								
Platinum	25,829	4,469	24,666	23,662	7,195	18,322	27,567	20,603
Palladium	2,714	-3,109	-2,206	-7,801	-9,900	-11,685	-11,079	-12,906
Other Indicators (US$/oz)#								
Pt-Au spread	-816	-858	-747	-1,056	-1,400	-1,353	-1,289	-1,353
Pt-Pd spread	-1,295	-966	-723	-113	-107	2	-121	2

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