Thackray Sector Report

— Every Sector has a Season —

June 5, 2018 Written by Brooke Thackray

GOLD...

Patience is gold(en)... Upcoming Opportunity?

It is not yet the seasonal period for gold, but the performance of gold should be monitored for an upcoming entry opportunity. On average, gold bullion, typically performs well from July 12th to October 9th (Thackray's 2018 Investor's Guide, page 81). Recently, gold has been performing poorly, but it is also setting up for a possible move upwards in its seasonal period or even before the start of the seasonal period.

Market pundits and gold bugs alike became excited when gold bullion reached $1,350 long-term resistance level in April. They quickly pointed out if gold were able to break above its resistance level, $1,400 could be reached in quick order. Unfortunately, for the pundits, gold retraced back down to below $1,300.

In recent years, the strength of the US dollar and real interest rates have had an impact on the price of gold...

Gold bullion valuation is determined by many factors and at different times the factors have varying impacts, including inflation expectations, strength of the US dollar and geopolitical risks. At any one time, investors may perceive that one of the drivers is more important than the others. In recent years, the strength of the US dollar and real interest rates have had an impact on the price of gold.

US dollar

Gold is priced in US dollars and as a result, generally if the US dollar is rising relative to world currencies, gold becomes relatively cheaper. The graph below (Graph #1) shows the performance of gold over the last few years. The resistance level of approximately $1,350 is seen with highs in the price of gold in mid-2017 and early 2016. A solid break above this level for more than a few days will probably signify a positive upward breakout and the possibility of gold moving to $1,400 and even $1,450.

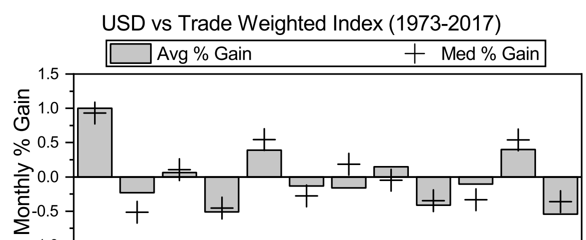
The general inverse relationship with the US dollar can be seen between alternating blue arrows (down for gold and rising for the US dollar) and green arrows (rising for gold and down for the US dollar). It is not the magnitude of change that is important, rather the overall direction of the US dollar relative to world currencies. Generally, when the US dollar was rising in price, gold has retreated and vice versa. Recently, in May, the US dollar was particularly strong and as a result, gold pulled back in price.

Graph #1 - Gold Bullion Price vs. USD (vs. Trade Weighted Index)

One of the reasons not to favor gold during the month of May...

One of the reasons not to favor gold during the month of May is that on average it is one of the strongest months of the year for the US dollar. The graph below (Graph #2) shows the average monthly gain/loss for the US dollar relative to a basket of trade weighted currencies. From 1973 to 2017, the US dollar has been positive 62% of the time and has produced an average gain of 0.4%.

Graph #2 - US Dollar Monthly Performance vs. Trade Weighted Index 1973-2017)



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Avg. % Gain	1.0	-0.2	0.1	-0.5	0.4	-0.1	-0.2	0.1	-0.4	-0.1	0.4	-0.5
Med. % Gain	0.9	-0.5	0.1	-0.5	0.5	-0.3	0.2	-0.0	-0.3	-0.3	0.5	-0.4
Fq %>0	64	44	53	38	62	47	51	49	38	42	60	47

Source Data: Federal Reserve (St. Louis)

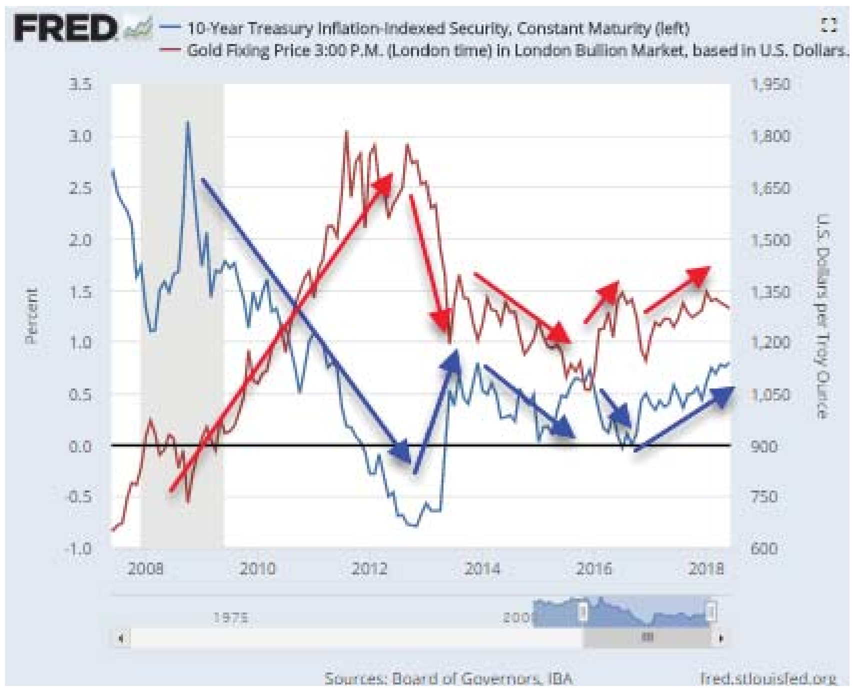
Real Interest Rates

Gold tends to be more attractive when real interest rates are negative, or trending down...

Investors have a choice of investments. Gold tends to be more attractive when real interest rates are negative, or trending down. If investors can invest in interest bearing securities and earn a real return, this is more favorable to a lot of investors when compared to the alternative of owning gold which does not pay any interests or dividends.

The graph below (Graph #3) uses the yield on the 10 Year US Treasury Inflation Protected Note as a proxy for the real rate of interest (nominal interest rate minus inflation). From 2008 to 2013, the real interest rate was declining (blue line) and the price of gold rising (red line). In late 2013, the real interest rate started to increase and the price of gold declined. For most of 2014 and 2015, both the real interest rate and the price of gold was declining. At this time, the US dollar was rallying rapidly (Graph #1), which had more of an impact than the falling real interest rate. In 2016, gold returned to its standard inverse relationship with the real interest rate. In 2017, both gold and the real interest rate increased, as once again the US dollar played a major role in affecting the price of gold. In 2017, the US dollar declined rapidly for most of the year. More recently, in 2018, the US dollar has shown some strength which has helped keep the price of gold in check. In addition, the real interest rate has been rising, which has also been a negative influence on the price of gold.

Graph #3 - Real Interest Rates vs. Gold Bullion (London PM)



Gold Seasonality

Gold has a strong seasonal period from July 12th to October 9th. The major driver behind the seasonal trend is the increased demand for gold in the forth quarter...

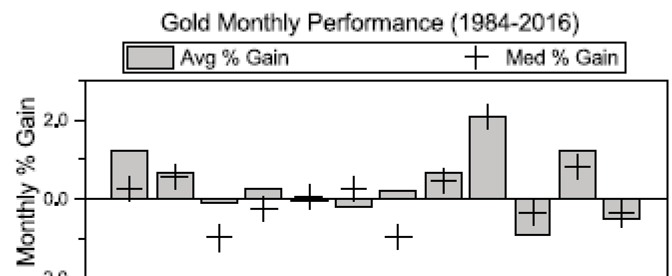
Gold has a strong seasonal period from July 12th to October 9th. The major driver behind the seasonal trend is the increased demand for gold in the forth quarter. Approximately two-thirds of gold produce each year is consumed in the fabrication of jewelry (Thackray's 2018 Investor's Guide). Most of this demand occurs in the fourth quarter of the year. The Indian wedding season is largely responsible for this trend, but Western societies also consume most of their gold in the fourth quarter, which translates into an increase in demand for gold bullion in the third quarter. Jewelry fabricators need to buy bullion ahead of the fourth quarter in order to fashion gold jewelry.

It is not just the increased demand that on average helps push gold prices up in the third quarter, but also the average decline in interest rates that tends to take place in August and September. The period of seasonal strength for government bonds is from May 6th to October 3rd, but the sweet spot for the trade (where most of the gains are made and the highest frequency of success occurs), is in August and September.

The graph below (Graph #4) shows the average monthly performance of gold from 1984 to 2016. In this time period, the strongest month for gold bullion has been September with an average gain of 2.1% and a positive performance 67% of the time. August is also strong, with an average return of 0.7% and a track record of being positive 61% of the time.

It should be noted that July has on average been mediocre for gold and has had a median loss of 1.0%. The seasonal period for gold bullion starts in mid-July. Downdrafts in July often represent good entry opportunities in the gold bullion sector.

Graph #4 - Gold Bullion Price Monthly Avg. Price (1984-2016)



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Avg. % Gain	1.2	0.6	-0.1	0.3	-0.0	-0.2	0.2	0.7	2.1	-0.9	1.2	-0.5
Med. % Gain	0.3	0.6	-1.0	-0.3	0.1	0.3	-1.0	0.5	2.1	-0.4	0.8	-0.4
Fq %>0	52	55	45	45	52	55	48	61	67	42	64	39
Fq %>S&P 500	52	45	36	42	48	45	48	48	67	27	55	30

Thackray's 2018 Investor's Guide

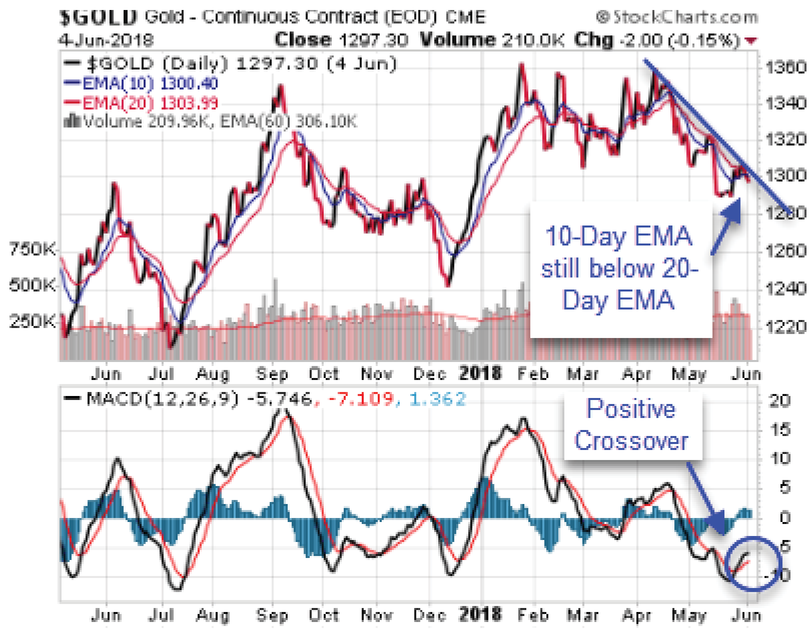
Timing the entry into gold bullion

A large correction in the price of gold towards the end of June is often a good entry point....

Although the seasonal period for gold starts on July 12th, generally there is an entry window of one month before and one month after the start of the seasonal period. If technicals improve and gold starts to show strength, an entry in June can make sense. Warning: June is one of the poorer months for gold bullion and can be volatile. A large correction in the price of gold towards the end of June is often a good entry point. On the other hand, an entry into a gold bullion position could be delayed into August, especially if the US dollar maintains its positive trend.

From a timing perspective, gold may show stronger technicals after the Federal Reserve meeting on June 13th. The Federal Reserve is widely expected to raise its federal funds rate in this meeting. At the time of this writing, using the CME Groups FedWatch Tool, investors have pegged the probability at 96% that the Federal Reserve will raise its federal funds rate at its next meeting. After a strong Nonfarm Payroll report on Friday June 1st, investors are swaying to the viewpoint that the Federal Reserve may be more hawkish in their tone. When investors expect the Federal Reserve to increase its federal funds rate, gold has often stumbled into the FOMC meeting date and then shown strength a few days later. This scenario would help to support strengthening technicals and justification to enter into a gold bullion position before the start of seasonal period.

Graph #5 - Gold Bullion Technicals



Given that gold has already corrected below $1300, there is an increased chance that gold may start to rally before the beginning of its seasonal period...

The ideal entry point for gold would be for gold to correct to $1,250 for July 12th before rallying. It could happen, but not likely. Given that gold has already corrected below $1,300, there is an increased chance that gold may start to rally before the beginning of its seasonal period. Positive indications for the price of gold would be if the 10-day exponential moving average crossed above the 20-day exponential moving average. MACD has already registered a bullish crossover with the signal line crossing over the rising MACD line. If the 10-Day exponential moving average were to also cross above the 20-Day exponential moving average, this would help establish an upward trend in gold and indicate a possible favorable entry point into gold bullion before its seasonal start date.

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