Market Flash

16 April 2013

Gold Sell-Off

Speculators are rushing to sell gold as negative sentiment gathers momentum

Gold had its largest ever daily price decline, falling by USD125/oz on Monday to end the day at USD1348/oz. In percentage terms the 9% decline is the largest since 1983, and takes price falls in the last two sessions to 14% or USD210/oz.

Gold's former appeal

Gold's safe haven status had led it to rally some 170% between 2008 and 2011 driven by investor fears of a collapse in the global financial system. Unprecedented central bank balance sheet expansion also raised concerns of rampant inflation. However, gold has range traded since 3Q11 amid improving sentiment. Gold's inability to rally in March despite renewed eurozone troubles, was possibly the turning point in investor sentiment towards gold.

Shift in investor sentiment

The key reasons to own gold over the last few years appear to be currently missing. Gold's price struggle in recent months has coincided with the large increase in fund allocations towards the US dollar, while 'safe-haven' flows have unwound as financial concerns emanating from Cyprus diminish. Fears of a systematic collapse in the global financial system had also abated, as new and innovative policy measures emerged to help stabilise the financial markets.

While investors no longer fear a financial collapse, inflation concerns have also taken a backseat in the face of limited global economic momentum and easing upstream price pressures. In the past two weeks, weaker than expected economic and housing data from the US, coupled with China's disappointing 1QGDP readings, further cemented investors' weak inflation expectations.

Adding to investors' unease in recent days was the ECB's statement that Cyprus must use the proceeds from the sale of its gold reserves to cover losses from the ECB's emergency lending to Cypriot banks. Notably, while Cyprus' gold holdings are small, investors fear that this could set a precedent for other European periphery countries, which have significant gold reserves.

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Current sell-off looks oversold

Looking longer term, the current gold sell-off appears oversold. Quantitative easing by global central banks could eventually result in inflation, potentially boosting gold prices. Low prices are also likely to attract buyers of physical gold, especially those from the emerging markets.

However, given the extent of the existing momentum, picking the low point is challenging. We think a base in ETF selling and fresh ETF buying would be required to restore confidence. SPDR Gold Trust holdings fell by 1.5 million ounces or 4% last week, the largest weekly decline in holdings since August 2011. Further ETF gold selling still looks likely, with the market particularly vulnerable to negative speculation. In addition, gold prices may be further weighed down by the 18.5% increase in collateral requirements for COMEX gold and silver futures, effective from close of business Tuesday, as cash strapped investors may resort to paring some of their gold holdings in order to meet margin requirements.

In terms of industry fundamentals, we believe that gold prices could test the estimated cost price for the industry, that is, about US$1300/oz. However, the technical picture calls for more caution - prices could retrace towards US$1300/oz-US$1310/oz, with the risk of extending towards US$1245/oz. Our technical analysis suggests that near term rebounds may struggle to cross US$1465/oz, and these interim rebounds are likely to represent trading ranges, rather than a return to the preceding uptrend.

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