GOLD SILVER

The 7 Lessons from Gold's Unprecedented First Quarter 2020

Jeff Clark, Senior Analyst, GoldSilver.com

APR 3, 2020

The word "unprecedented" doesn't adequately capture what the world—and the gold market—experienced in the first three months of 2020.

Covid-19 came almost out of nowhere, a black swan event that engulfed the world. The gold market, like everything else, was impacted in extraordinary ways.

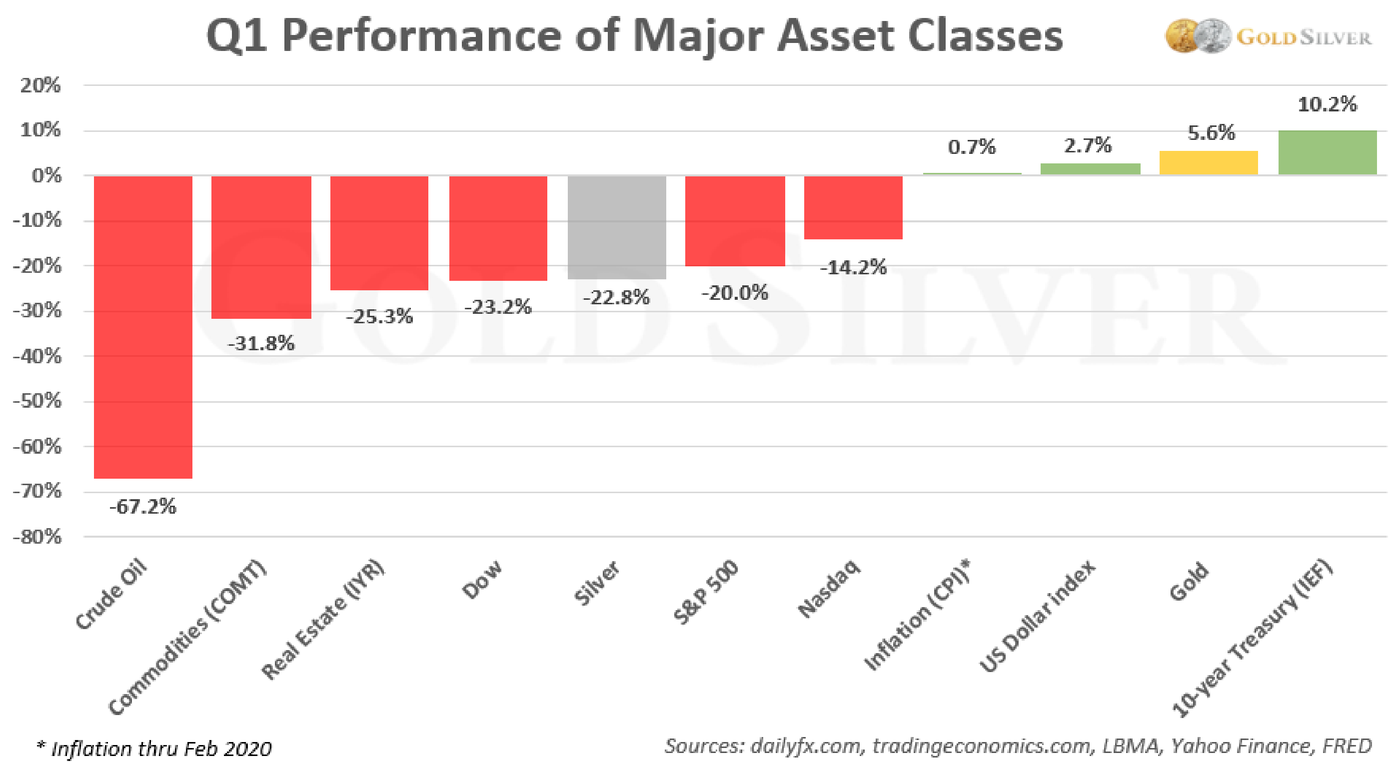
It's useful to look at what transpired last quarter in our industry, because there were some very clear lessons. These lessons will help us all better understand, and better prepare, for what might be ahead.

Here are the 7 lessons from what was one of the most volatile and chaotic quarters in gold's history…'

Price

To state the obvious, the gold price was volatile last quarter. It rose roughly $150, nearly 10%, from its January low to February high, when coronavirus headlines hit North America. As the rout in equity markets picked up steam, however, gold succumbed to the pressure, falling nearly $200 from late February to early March, an 11.8% drop in three short weeks.
But by the end of the quarter, despite the volatility and selloffs, gold had done its job: the price ended higher than where it started.

Here's how gold performed vs. other major asset classes in the first three months of 2020.



Amidst a sea of losses, gold was up 5.6% last quarter. This is especially noteworthy since gold has now risen six consecutive quarters.

In contrast, all major stock indexes were lower. In fact, the Dow booked its worst Q1 in 124 years.

Silver didn't fare so well, and in fact logged its worst quarter since 2013. As we've shown before, silver does not perform as well as gold in stock market crashes.
The 10-year Treasury outperformed gold, and while the US dollar rose, it lagged the gold price.

Lesson #1: Gold did its job. The price rose in one of the most tumultuous and scary quarters in modern history.

Liquidity

During those periods gold fell, some investors questioned why mankind's oldest crisis hedge declined in the middle of a global pandemic.

In short, the rout in equity markets forced margin calls and immediate liquidity needs. Cash was desperately needed to meet unexpected and sudden margin requirements and offset losses elsewhere. To a large extent, gold was sold to meet those needs.

Keep in mind that many gold positions were sitting on a profit. Gold was up 18.8% last year, and up 10% in early 2020 trading, so profits were ripe for the taking.

A similar effect was seen in October 2008. The sudden crash in equity markets pressured investors and traders to sell gold to meet margin demands.

This fact highlights another advantage of gold, one sometimes overlooked:

Lesson #2: Gold can provide liquidity if and when you need it.

Demand

As any precious metals investor knows, demand for gold and silver soared last quarter. The rush for metal was so high that it overwhelmed the industry.

Retail demand for physical product was, by any account, greater than what was seen during Y2K, 9/11, and the 2008 Financial Crisis. It was so overwhelming that many trading desks shut down—many products were simply not available, and what was available was backordered 3+ months.

Institutional demand also soared, particularly after Goldman Sachs released a report saying gold was at an "inflection point" and that it was "time to buy on the back of the new Fed stimulus measures."

The Comex was tested like never before. In response the exchange recently moved 34 tonnes, about 13% of total holdings, from the "eligible" to the "registered" category to increase deliverable ounces.

The London Bullion Market Association (LBMA) was also tested. Banks requested that the CME allow gold bars in London to be used to settle its contracts. Contracts in NY also traded at a $60 premium to London, the highest spread since 1980.

Lesson #3: Gold demand rose because investors were nervous, uncertain, and outright frightened. This shows it is still viewed by the world as a crisis hedge, an important fact since more crises are ahead.

Supply

In a relatively short period of time, the availability of physical metal was in short supply.

Not only did demand itself gobble up more supply than usual, the virus hindered the industry's ability to supply metal. The entire supply chain was disrupted, something many insiders thought would never occur. Here's a summary:

- The US and Royal Canadian Mints both shut down. A West Point Mint police officer recently tested positive for Covid-19.
- Many wholesalers went off line, with those still taking orders saying delivery would be three months or longer.
- Many gold refineries around the world closed. Three refineries in Switzerland, a global hub for precious metals refining, suspended operations, which took 1,500 tonnes of gold annually offline. The huge Rand Refinery in South Africa was operating at a reduced capacity at last report.
- With most airline flights canceled, it became difficult to transport metal, as well as more expensive. One airplane can only take so much gold, as the value can't exceed what an insurance policy will cover.
- Mining operations have also been disrupted. Several countries announced nationwide shutdowns, including South Africa, Chile, Peru, Argentina, Canada, with others hinting they may shutter operations.
- Some mines and refiners stopped deliveries even though they had not formally announced it. Countries like China and Indonesia have not publicly reported, though news sources have reported various shutdowns.

The disruption to the industry affected every part of the supply chain. It forced premiums to rocket higher, with all intermediaries charging higher margins to cover the increased volatility, credit risk, and cost to source metal. Due to the rise in premiums, lower prices did not, for the most part, give investors a better value.

Lesson #4: While bottleneck issues complicated supply, it reinforces that one must buy their insurance before the house is on fire.

Unlimited Fiat Currency

The response to Covid-19 by governments was swift and dramatic.

Over 50 countries cut rates last quarter, including the Eurozone, UK, Japan, Canada, and Switzerland, among others. The US Fed cut rates twice—the first unscheduled action since 2008—bringing rates to near zero.

Further, global liquidity injections were on a scale never before seen. The US Fed said it will buy an “unlimited amount of government debt, as well as corporate and municipal bonds,” in what will result in the biggest expansion of its balance sheet in American history.

Globally, according to Bank of America, **a total of $12 trillion in stimulus has been pledged; $7 trillion in monetary stimulus and $5 trillion in fiscal stimulus.**
The magnitude and speed of the response was greater than at any time in history.

Lesson #5: Any reasonable conclusion about the amount of global stimulus must acknowledge not just the need to own gold, but the prospect of much higher prices as a direct result.

Inflation

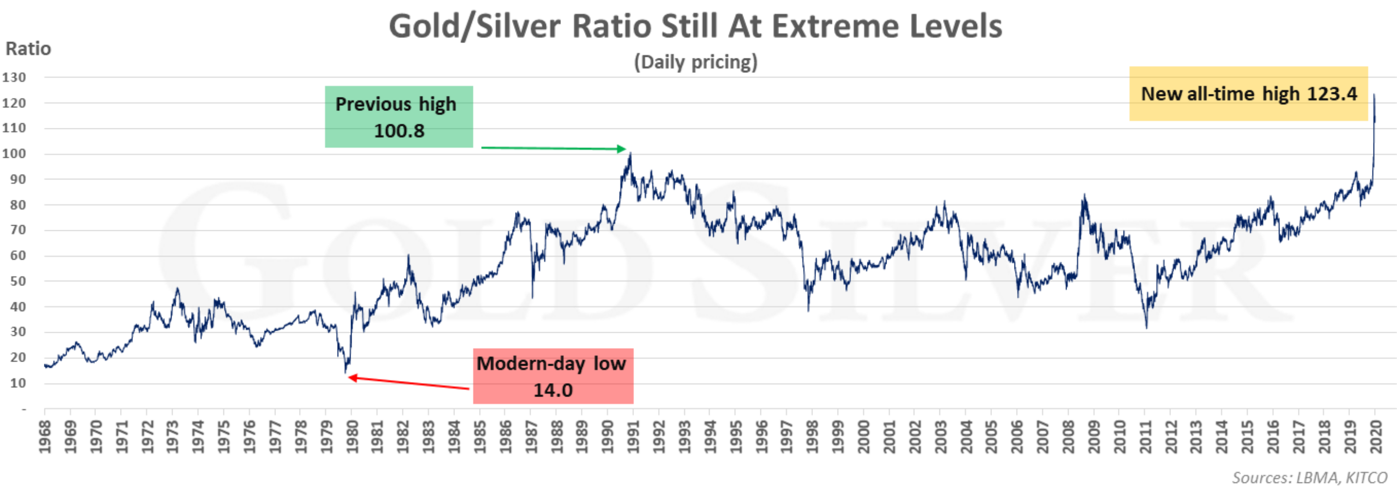
Recent policy decisions by the Fed and most central banks are likely to have long-lasting ramifications on the global economy. These decisions underscore the investment case for gold, as well as the likelihood of demand remaining high for the foreseeable future.

The US deficit was already high, and now will grow even further. The same is true in developed economies. Currency debasement exceeds what was seen in the Global Financial Crisis, the concern this time is that it could lead to actual inflation, not just the fear of it.

Lesson #6: Hold a meaningful amount of physical gold and silver to offset future inflation, perhaps hyperinflation.

Historic Gold/Silver Ratio

The gold/silver ratio (gold price divided by the [silver price]) made history last quarter. Its prior record high was 100.8 in 1991—but it hit 123.4 on March 17.



The ratio remains at extreme level, ending the quarter at 112.4.

Lesson #7: The ratio may not be done climbing, but the value offered by silver, relative to gold, is hard to overstate.

The Hard Asset Advantage

Perhaps forebodingly, I said in last quarter's report that "a black swan event or sudden crisis could lead to even bigger advances in the gold price." Little did I know.

The advantages of holding physical gold have been made abundantly clear.

I encourage every investor to make sure they have a meaningful amount of physical gold and silver, as we continue to face the challenges of a global pandemic, and the subsequent economic and monetary fallout.