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Gold retains its luster despite the near-term lure of equities

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The apparent switch by speculators from gold to equities in the immediate aftermath of the US presidential election points to a highly optimistic view of the ebbing of political and policy risks. We fear that this might be somewhat premature, and expect a resumption of a 6-9 month downtrend in both the USD and UST yields to be supportive for gold. Crucially, the fundamental supports for the demand for gold as a hedge and diversifier remain very much intact. We maintain our 12-month target at 2,900/oz, and continue to recommend a 5% allocation to gold in USD-denominated balanced portfolios.

In the wake of Donald Trump's presidential election win, the price of gold has fallen as much as 4.5% and was still down around 3.5% as of Friday (8 November). This has been accompanied by a 4.7% rise in the S&P 500 as of Friday; along with a fall in the VIX volatility index from 22 to under 15, levels last seen in mid-August. It appears that the markets have decided to focus almost entirely on the equity-positive aspects of the Trump policy platform (as far it is known), while possibly assuming that the more-disruptive elements of his policy rhetoric might not come to pass.

But investors need to remember that much is still unknown about Trump's policy agenda, including which existing policies might be reversed. This uncertainty is very much double-edged, especially given the market's lopsided pricing in of risks. Investors should continue to retain gold as a portfolio hedge for the following reasons.

Gold's fundamental supports remain intact. First, inflows into gold-backed exchange-traded funds should continue as the US Fed cuts rates further. Second, the longer-term risks (like a potential sharp increase in the US fiscal deficit), and the impact of potential tariffs on the US and global economy should drive a revival in demand for hedges. Third, the ongoing demand from central banks to diversify the USD portion of FX reserves should, if anything, be supported by tariffs and the growing US fiscal deficit.

The fall in the gold price is excessive relative to past episodes. While the passing of the election does indeed remove some amount of uncertainty and risk, the fall in the price of gold this time round seems excessive. The median price reaction of gold over the last two dozen US elections is broadly flat the day after the election, with a median fall of just over 3% in the following month.

Possible reversal in UST yields. The switch by speculators from gold to equities was accompanied by a rise in US Treasury (UST) yields and an extended USD rally, both of which tend to be negatively correlated with the price of gold. We think both could resume a downtrend over the next 6-9 months. UST yields could decline as growth and inflation decelerate. The USD meanwhile could weaken over the medium term on a combination of a shrinking carry advantage over other currencies, and the US' significant twin fiscal and current account deficits. We expect that the 10-year UST yield could fall to around 3.50% by 1Q2025, from around 4.30% currently. We also expect the USD to weaken, mainly in the medium term, against the EUR, GBP and AUD through 2Q2025.

We would suggest investors look to buy gold on dips at around USD 2,600/oz. We keep our target at 2,900/oz over 12 months. We also continue to recommend a 5% allocation to gold in USD-denominated balanced portfolios.

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