Market performance and macro factors

Gold report

Q2 2023

Introduction

In the first part of our quarterly Gold Report, we review the performance of the gold price and touch upon other asset classes as well as explore significant macro factors, including bond yields, the US Dollar and inflation expectations.

Key facts from Q2 2023

Gold price return in Q2
-2.5%

Gold performance in H1 2023
+5.2%

Real bond yields
1.62%
at end of Q2

Peak US Fed Funds rate
5.4%
now expected

Data: Bloomberg, as at 30 June 2023.

Market performance

Pages 03 – 09

The gold price lost 2.5% in Q2 2023, giving up some of the gains from the previous two quarters. The US interest rate outlook was arguably the biggest driver, with the market increasing its expectation for where rates will peak.

Macro factors

Pages 10 – 15

The Fed paused its rate hikes in the final month of the quarter but issued more hawkish comments about the future. The impact of the Fed's aggressive tightening has not yet appeared in economic activity and the labour market remains stronger than expected.

Please note that we may refer to supply and demand dynamics in this commentary but will take a more in-depth look into these specific contributors in a subsequent report.

Quarterly price performance

The gold price lost 2.5% in the second quarter to end at $1,919. This returned it to levels of the previous quarter despite hitting intra-quarter highs not seen since the invasion of Ukraine last year. Speculation of the path of US interest rates continued to be a driver of gold performance as there were also short-lived pressures from the US debt ceiling and uprising of the Wagner group.

Gold price return in Q2

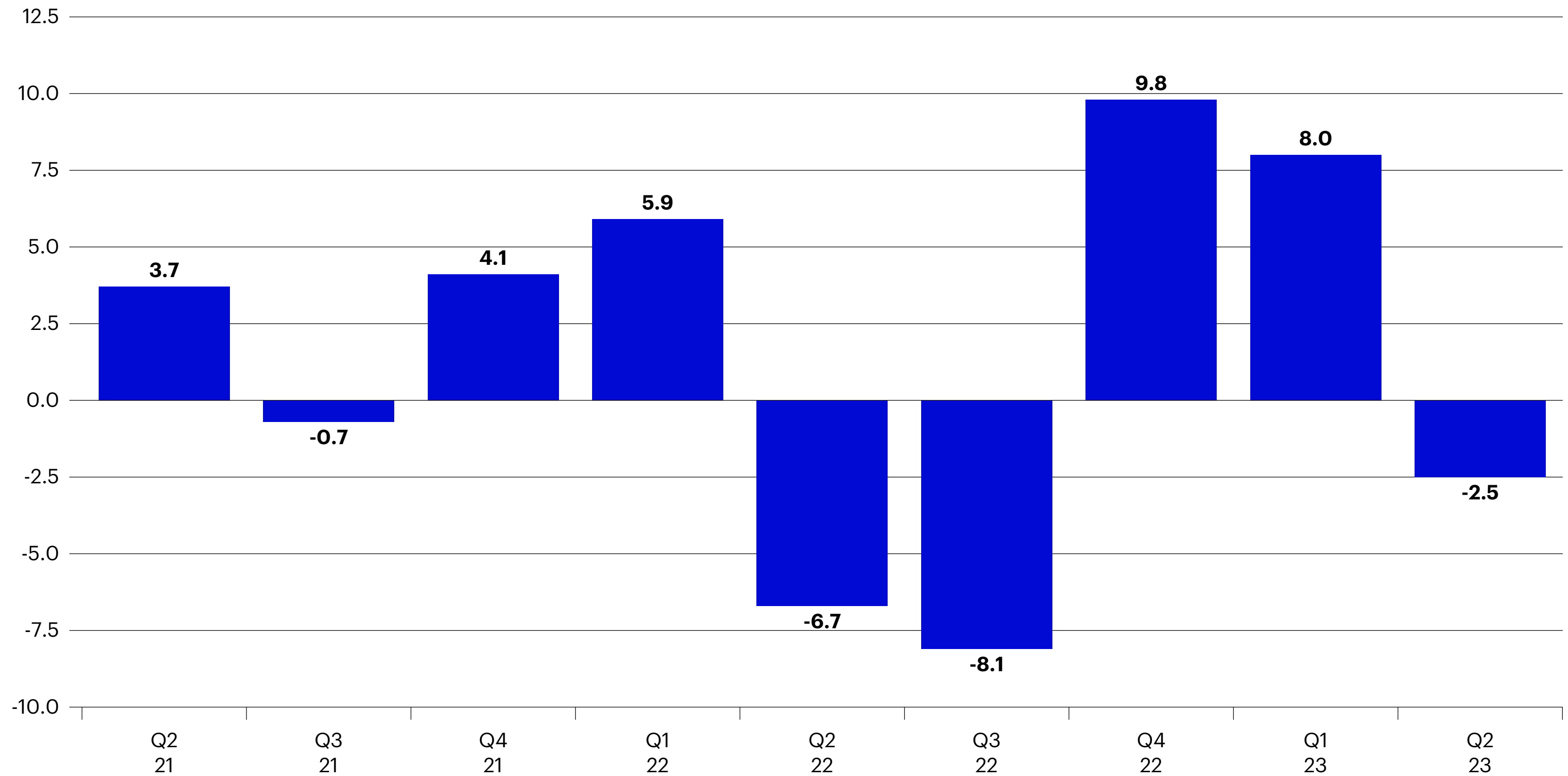
-2.5%

Past performance is not a reliable indicator of future returns. Source: Bloomberg, in USD, from 31 March 2023 to 30 June 2023.

Quarterly price returns

Performance in Q2 broke the trend from the previous two quarters of strong positive returns. The key change was not just that the peak Fed funds rate would be 40 basis points (bps) higher than previously estimated but also that it would not be reached until November this year. In Q4 2022, although expectations for peak rate were pushed back, forecasts of the peak rate were cut by 80bps and by the end of Q1 2023 market projections were for peak rate to be hit in a matter of weeks. The higher-for-longer profile of the Fed funds rate as now adopted by the markets is a negative for gold.

Quarterly price change (%)



Past performance is not a reliable indicator of future returns. Source: Bloomberg, in USD, as at 30 June 2023.

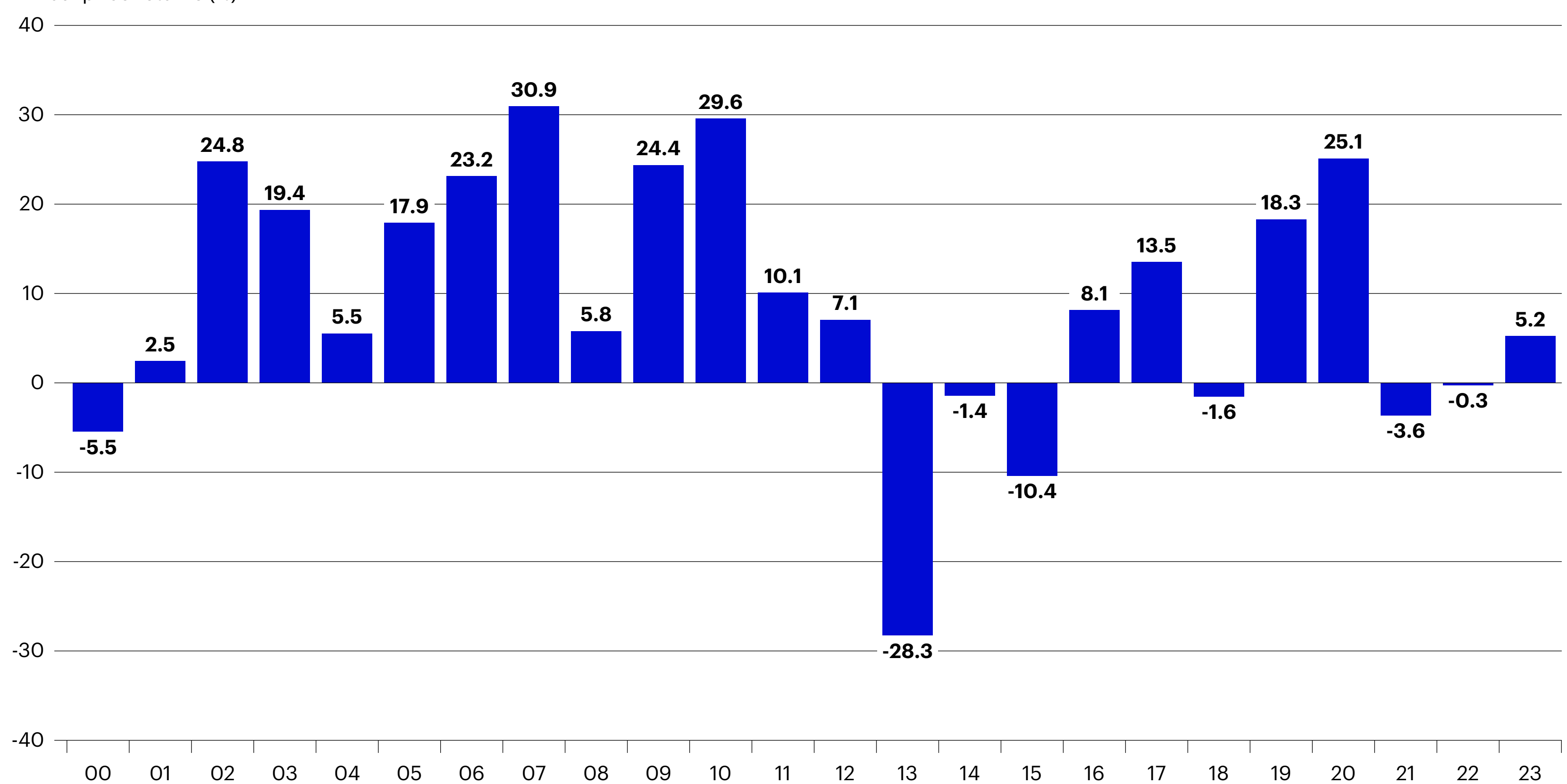
Annual price returns

For the first half of 2023, gold has added 5.2%, ahead of where the metal was at this point last year as H1 2022 returned -1.2%. This is the best start to the year for gold since 2020 when it delivered 17.4% as investors turned to the perceived safe-haven commodity at the start of the pandemic.

Gold performance in H1 2023

+5.2%

Annual price returns (%)



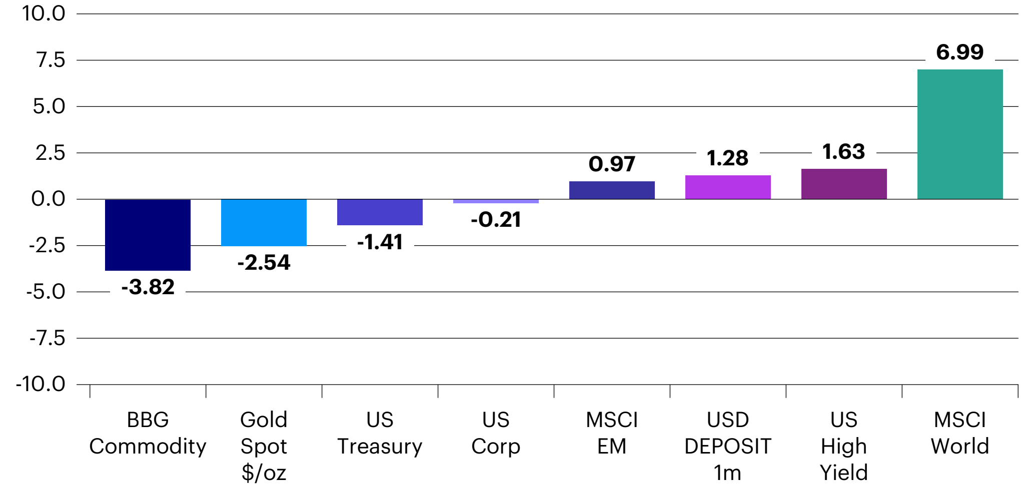
Past performance is not a reliable indicator of future returns. Source: Bloomberg, in USD. 2023 YTD to 30 June 2023.

Asset class returns

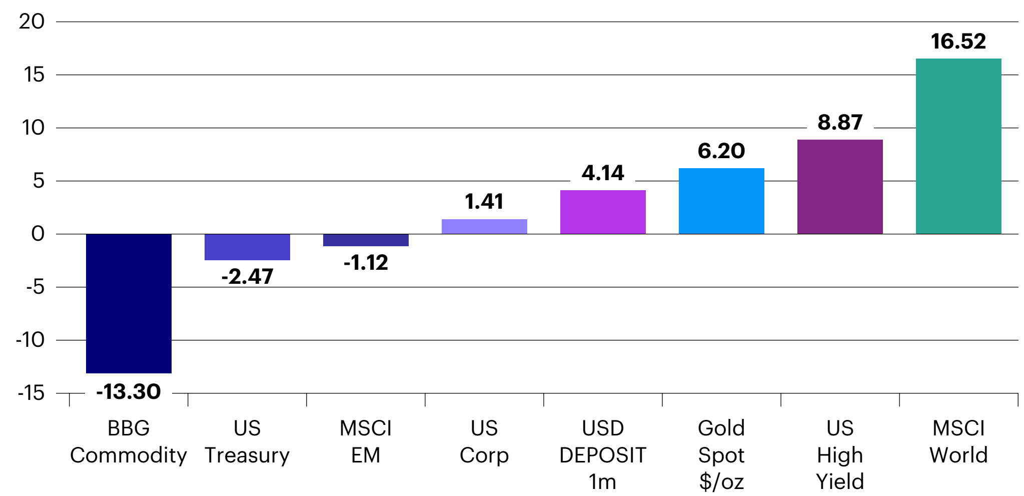
Recent equity performance has been concentrated in a handful of stocks that largely are a play on the theme of Artificial Intelligence causing the specific outperformance of developed markets over emerging market equities. Better-than-expected US economic data has seen a narrowing of spreads but also some discernment in the high-yield sector giving rise to investment opportunities.

As for the quarter, and the same as over the past 12 months, commodities, as viewed as a whole, have delivered the worst performance with supply shocks fading and the most pessimistic expectations not having materialised. Although commodity inflation is falling away, inflation is still playing out in the services sector causing policy rates to remain high and squeezing government bonds as cash returns remain relatively attractive.

Quarterly asset class returns (%)



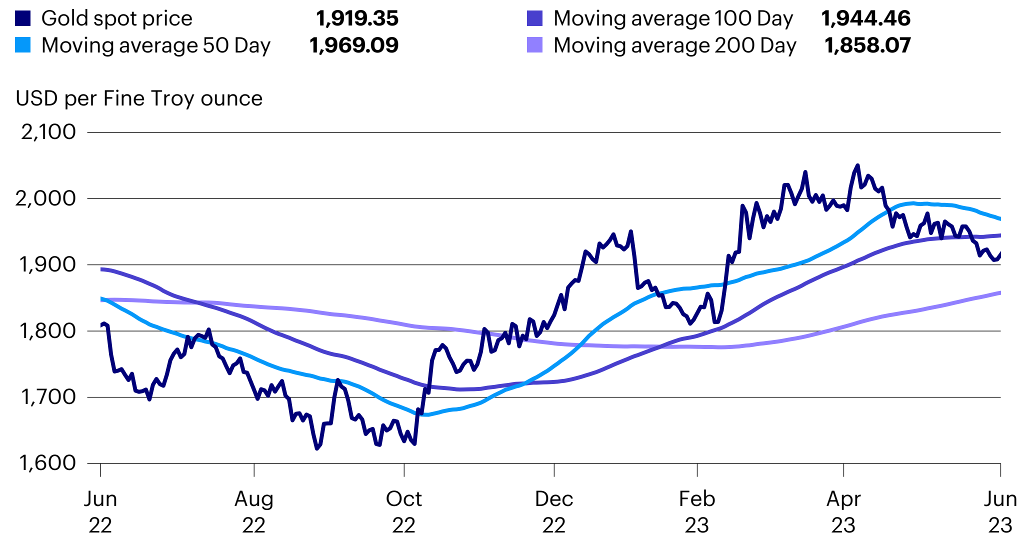
12-month asset class returns (%)

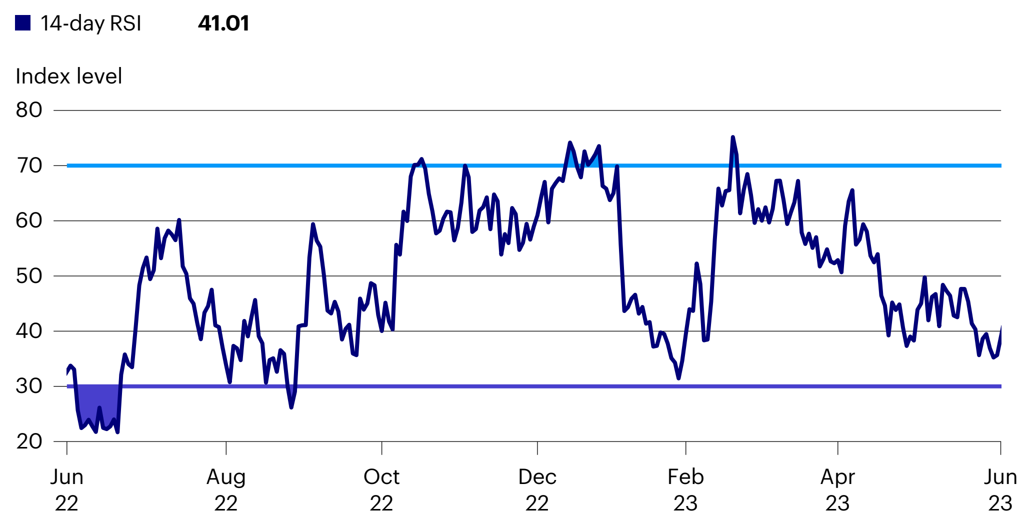


Past performance is not a reliable indicator of future returns. Source: Bloomberg, in USD, as at 30 June 2023.

Relative strength of the gold price

Although the 50-day moving average did fall over the course of the quarter, no technical signals were prompted as it did not cross the rising longer-term moving averages. The speed of the general downtrend in the gold price was also tempered and so, using the 14-day relative strength index, a buy signal was not triggered.





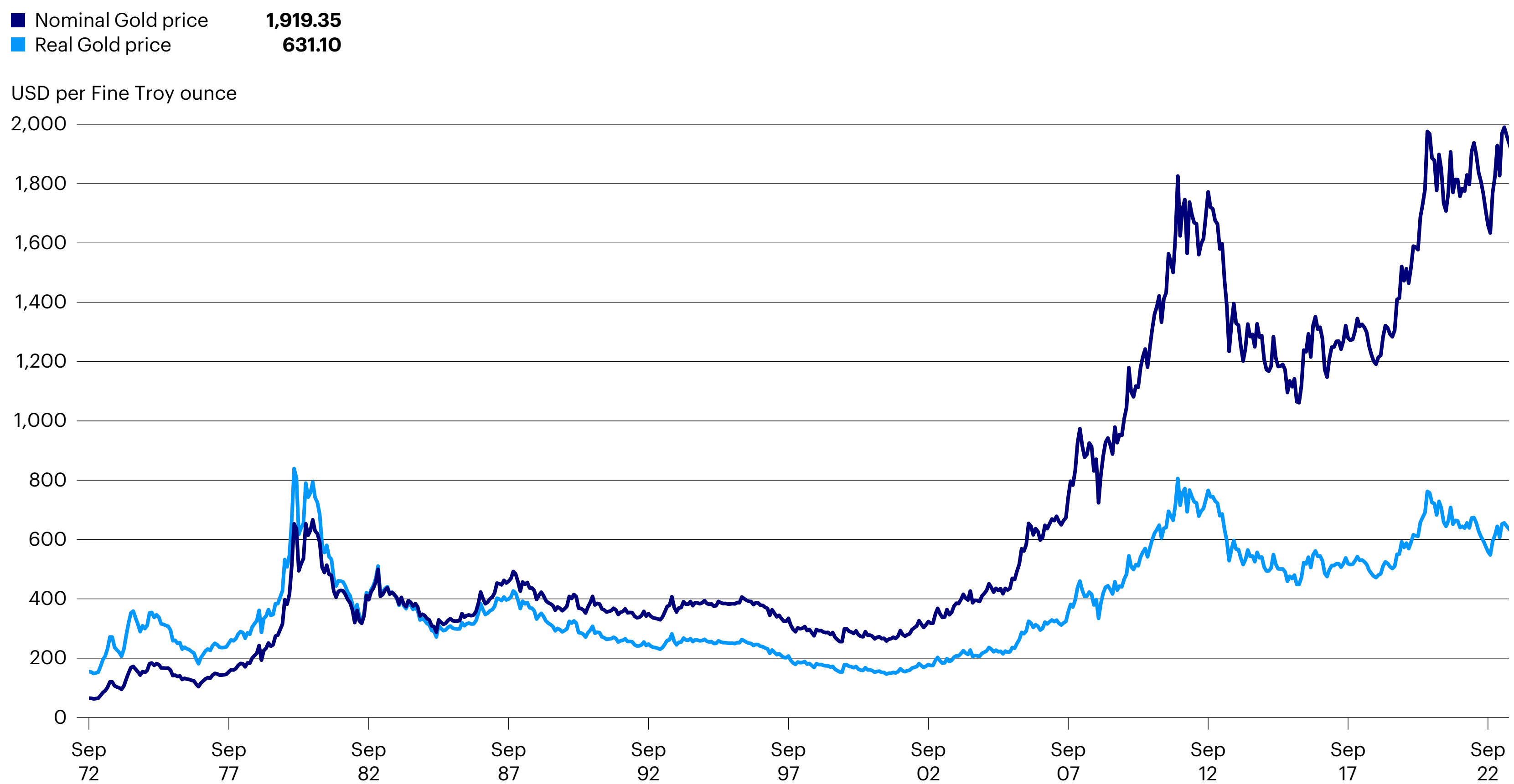
Past performance is not a reliable indicator of future returns. Source: Bloomberg, in USD, to 30 June 2023.

Market performance

Macro factors

Gold price return, nominal and adjusted for inflation

As inflation pressures extended the negative nominal return of gold translated to a worse real return in the quarter. In Q2 2023, gold lost 3.3% in real terms. For the 12 months to the end of Q2 2023, gold returned 6.2% in nominal terms, which equates to 3.5% when adjusted for inflation.

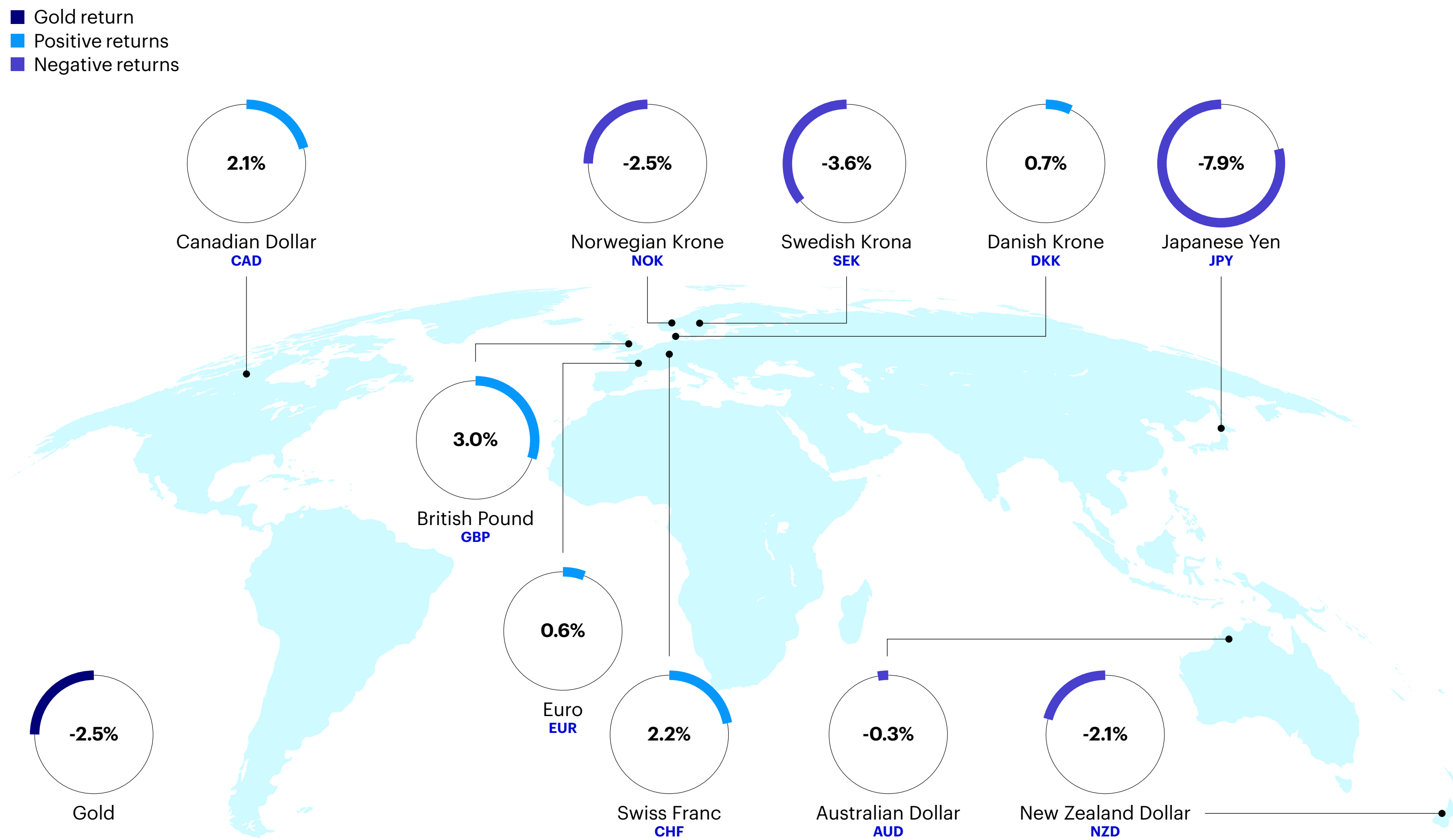


Past performance is not a reliable indicator of future returns. Source: Bloomberg, in USD, to 30 June 2023.

G10 currencies

Sterling had the strongest quarter against the USD in comparison to other major currencies as higher rate forecasts were recoupled to the base rate and away from the unfunded UK Government spending plan of September's budget. Interest rate differentials remain the key driver in bilateral currency performance.

Q2 returns of gold and G10 currencies in USD (%)



Past performance is not a reliable indicator of future returns. Source: Bloomberg, in USD, to 30 June 2023.

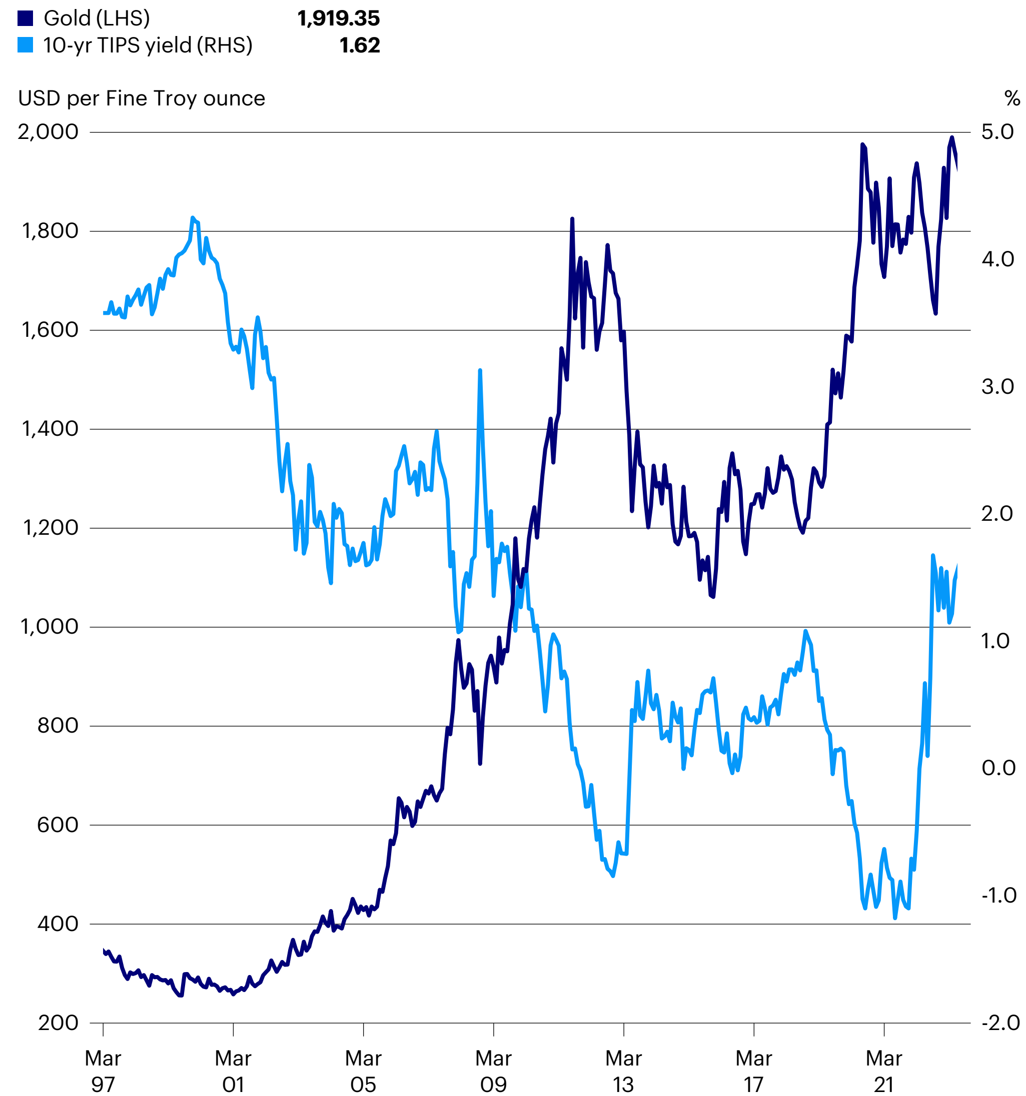
Gold price and real bond yields

The US real yield on the 10-yr TIPS ended the quarter at 1.62%, climbing from 1.15% at the end of March – almost recovering to the levels ahead of the collapse of Silicon Valley Bank (SVB). US economic data has been mixed although generally better than expected as projections were that economic activity should now be feeling the impact of the Fed's aggressive tightening from last year given the approximations of the lag. Surprisingly, the third estimate of Q1 US GDP was upgraded strongly further dividing opinions on whether the US is to experience a soft or hard landing over the coming 12 months.

Real bond yields

1.62%

at end of Q2



Past performance is not a reliable indicator of future returns. Source: Bloomberg, in USD, to 30 June 2023.

Gold price and Fed balance sheet

The Fed's balance sheet resumed its shrinking plan this quarter having shed the additional assets it absorbed to move the US banking sector past the SVB and Signature Bank collapses in March. Overall, the Fed's balance sheet fell 4.2% in Q2 2023 ending June at $8.3 trillion, similar to August 2021 levels. As the banking sector was deemed not to need this support and stress subsiding, the gold price fell.

Past performance is not a reliable indicator of future returns. Source: Bloomberg, in USD, to 30 June 2023.

Gold price and US interest rates

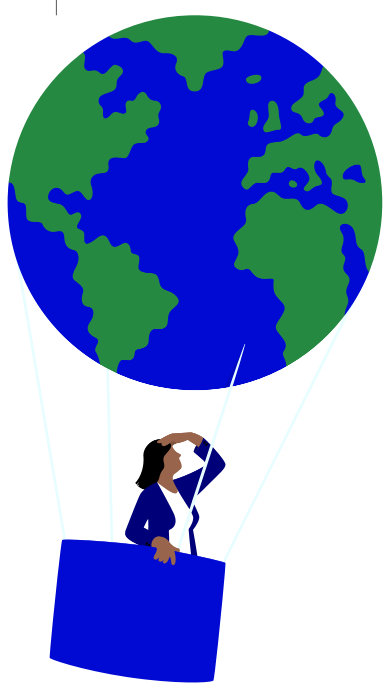
The Fed added another 25bps to the Fed funds rate although the more noteworthy action was the lack of action at the last Fed meeting of the month as the FOMC decided to take a pause in its hiking cycle. Despite the pause, forecasts for further rate hikes gained pace putting downward pressure on the price of non-yielding gold. US peak rate was pushed out to November from May at the start of the quarter and is now estimated at 5.4% from 5.0%.

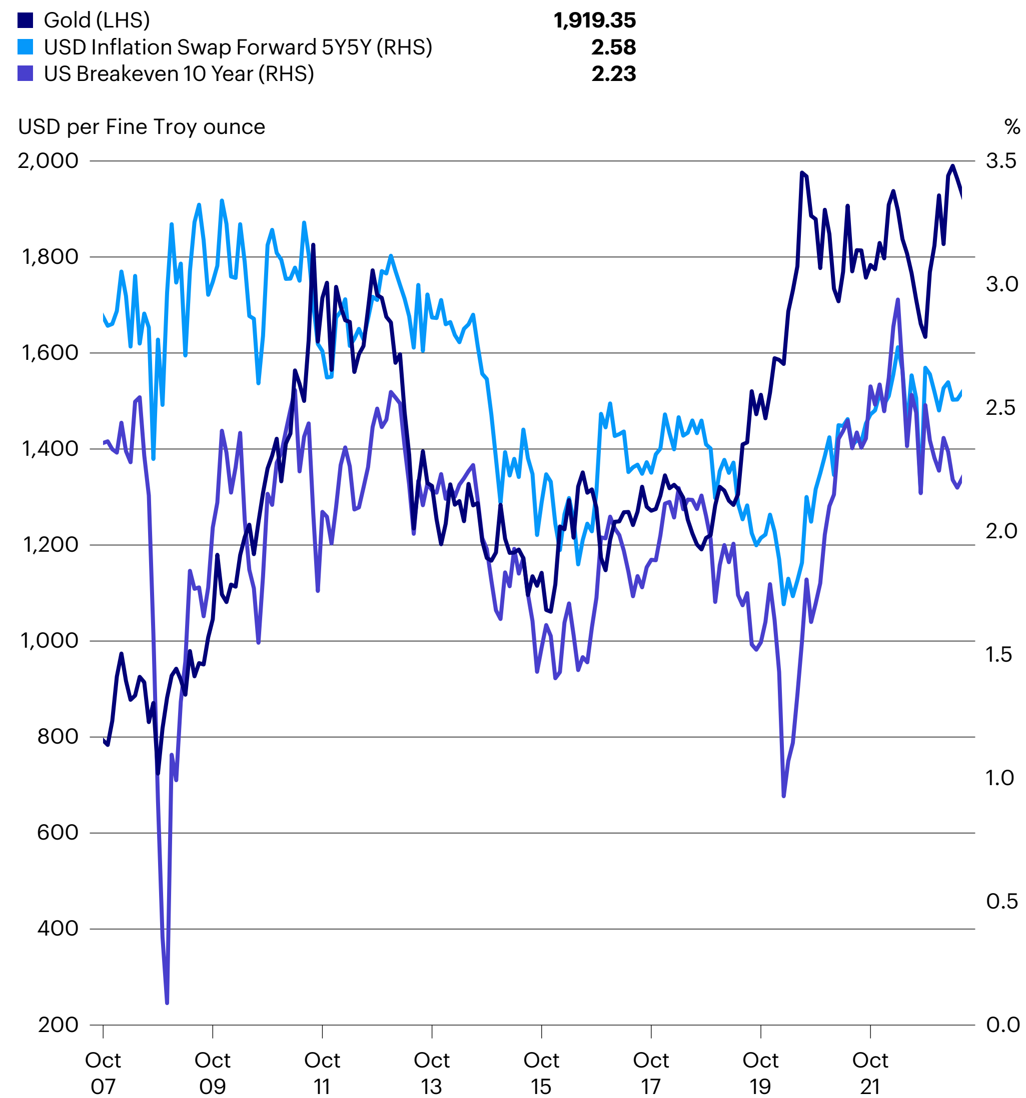
Peak US Fed Funds rate
5.4%
now expected

Past performance is not a reliable indicator of future returns. Source: Bloomberg, in USD, to 30 June 2023.

Gold price and inflation expectations

The US 10yr breakeven trended toward the Fed's 2% target over the course of Q2 2023 though the 5y5y inflation swap treaded water around 2.6%. The Fed has continued its hawkish rhetoric as the labour market continues to confound expectations. There are geographical points of weakness and from a sector perspective manufacturing is relatively weak but there is no data convincing the Fed it ought to outright end the tightening cycle let alone take the further step of cutting rates – at least in this calendar year. On this factor, upside to gold is limited as the policy pressure is to take inflation expectations down towards 2%.

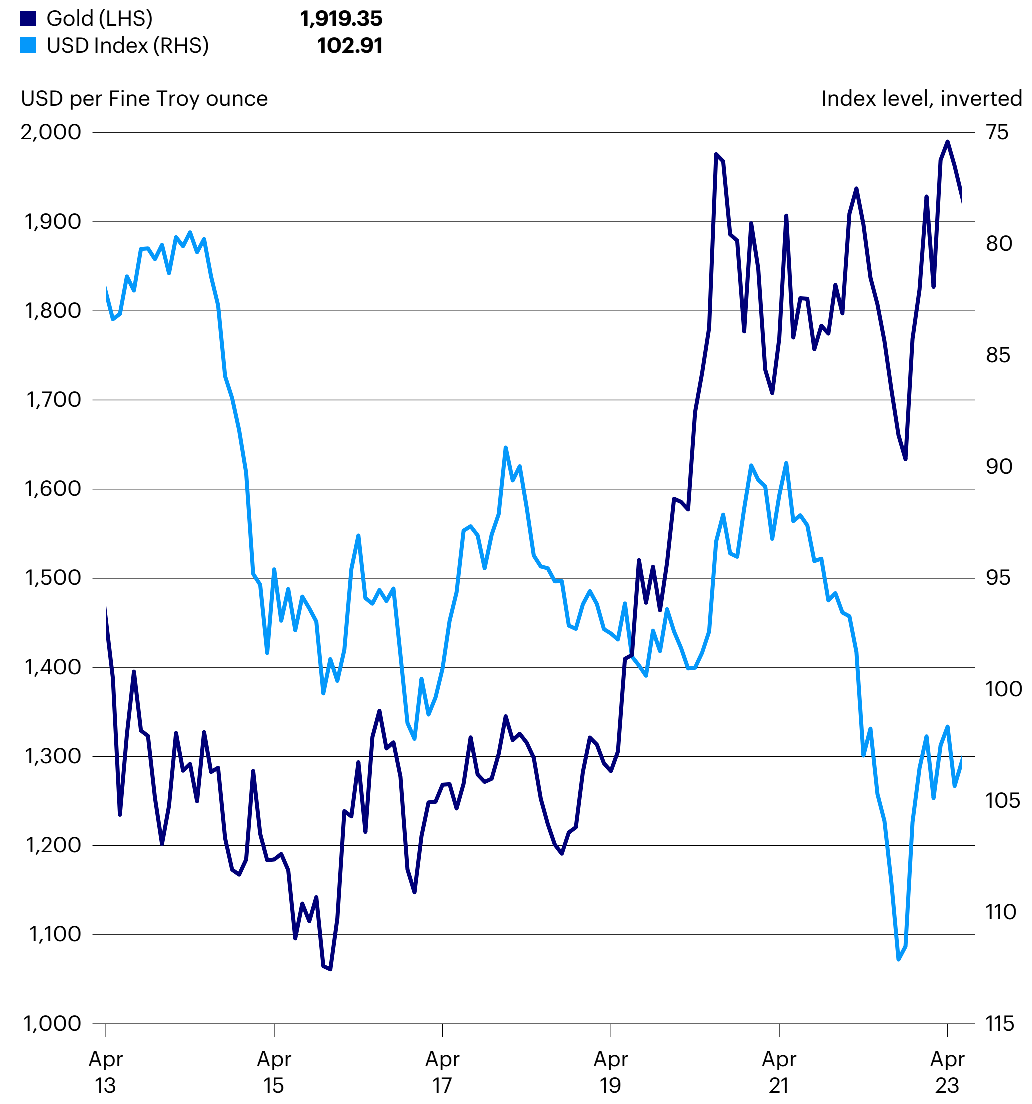




Past performance is not a reliable indicator of future returns. Source: Bloomberg, in USD, to 30 June 2023.

Gold price and the US Dollar

Over Q2 2023, the USD index was slightly higher as the more persistent inflation experienced across developed markets saw other central banks indicate their respective policy rates would also be higher-for-longer than previously anticipated. Although the USD has a strong negative correlation with the gold price, dollar strength can be predicated on interest rate moves and higher rates are already priced in.



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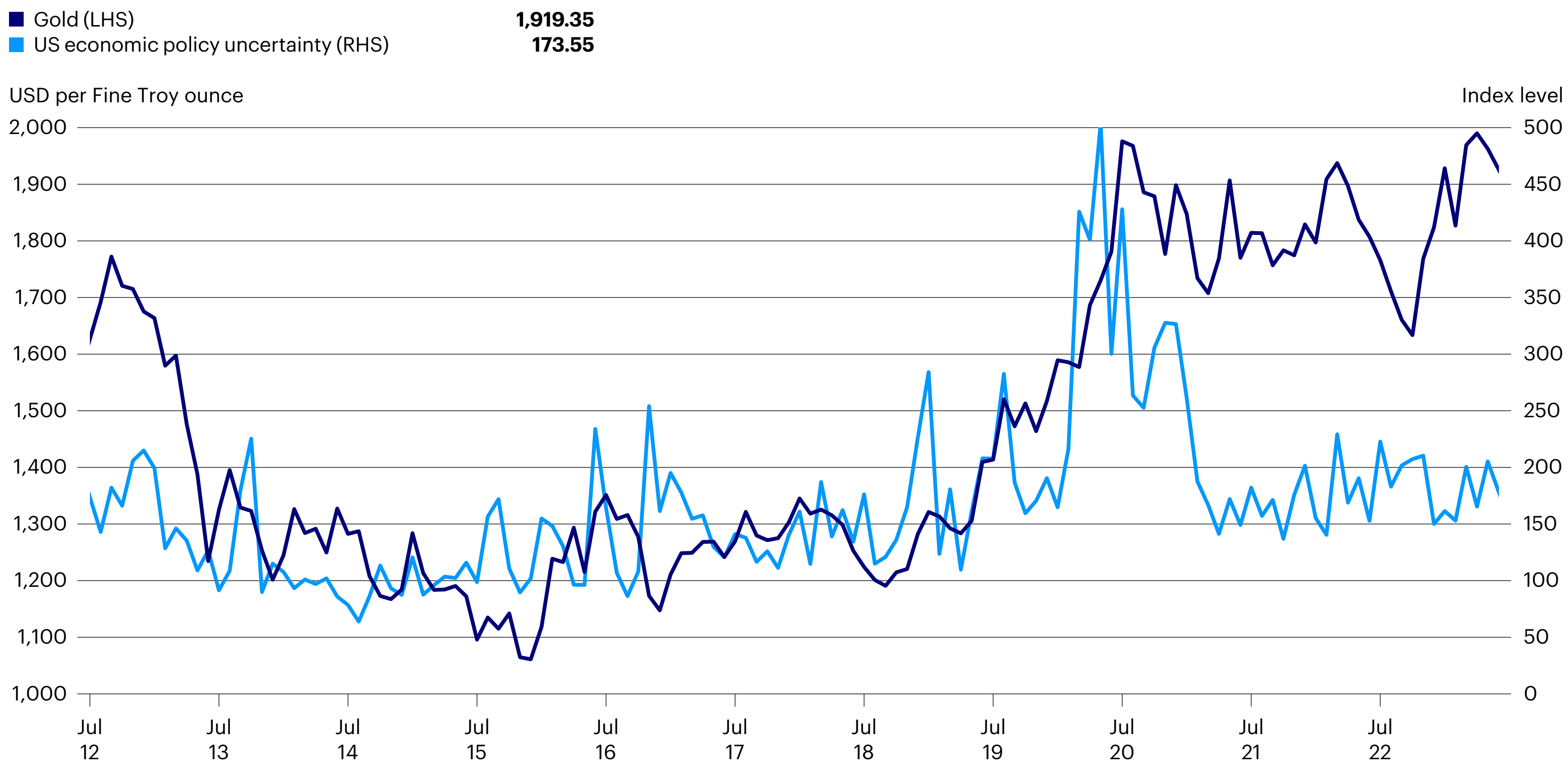
Gold price and economic risks

Although US economic policy uncertainty has been variable over the past two years, there is a slight upward trend. The gold price decoupled from economic uncertainty a few months into the pandemic; policymakers published and followed their plans causing uncertainty to fall from remarkably high levels, but the gold price did not recede. The gold price has also detached from a simple model of USD strength and expected inflation – although there is still signalling power in these variables. Gold has benefitted from broader and more global uncertainty with geopolitics in general as we have seen central banks, especially in the emerging markets, diversify their reserves away from USD assets and be significant buyers of gold.



Past performance is not a reliable indicator of future returns. Source: Bloomberg, in USD, to 30 June 2023.

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Data as at 30 June 2023, unless otherwise stated.

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