Australian Gold Fund Economic Commentary

When the Tsunami Comes…Which Assets Stand Firm?

24th March 2020

Key Points

- The month-long crash beginning in late February was caused by a perfect storm and caught many investors by surprise.
- Major market indices declined by 25-40%, with individual stocks falling even more. Many investors have been battered and may feel despondent as it happened so quickly and viciously.
- Few assets were left unscathed – equities, mutual funds, commodities, cryptocurrencies, virtually everything.
- Gold managed to shine in the midst, holding its value after adjusting for the appreciation of the US dollar during this time.
- The future is still very much fraught with danger even as governments and central banks are working together to combine monetary and fiscal stimulus.
- Safe havens are emerging, seek financial advice in helping you weather the storm.

The Fastest Market Crash in History?

Very few people would be able to claim that they emerged from the past month financially unscathed as we have seen what is possibly the fastest market crash in history, save the Black October 1987 crash. The confluence of events – the unsustainable global debt load, the geopolitical instability in the Middle East following the bombing of the Iranian Revolutionary Guard Commander Qassim Soleimani, the fallout of the Wuhan virus (also known as the coronavirus) and the breakdown of OPEC following a failure between Russia and Saudi Arabia to meet production cut targets, erupted into a perfect storm that sent the global stock markets tumbling for almost four straight weeks. Investors watched the stock markets that broke record after record in the last three years also broke records on the way down, as daily drops amounted to more than 10%. This has never been seen on a global scale.

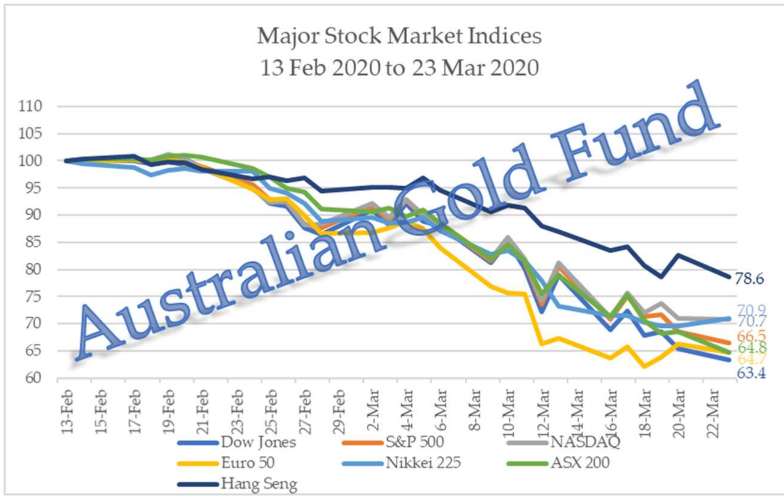
In response to this, the Federal Reserve cut the Federal Funds Rate by 0.5% on Tuesday 3rd March, hoping that this would relieve the market of its decline. However, the market was not placated and fell another 2-3% and this forced the Federal Reserve to bring forward their FOMC meeting two days earlier on Sunday 15th March to cut the Federal Funds Rate by 1% to 0-0.25%. The market responded that day with a 12.93% decline for the Dow Jones, 11.98% for the S&P 500 and 12.32% for NASDAQ. It was carnage.

The dust has not yet settled at the time of writing. In fact, the author expects that the weeks ahead will likely see more jaw-dropping rallies and declines that will make even the most daredevil of speculators cry out for mercy.

In light of this, the author has decided to do a quick analysis of some major market indices, commodities, cryptocurrencies and gold mining stock indices to see how they withstood the selling wave. While this analysis is far from being comprehensive, the aim is to provide some insight for the anxious investors to decide for themselves where they want to be given that this deluge could be far from over.

Spoiler alert – The analysis shows that gold seems to have been the asset class that stood firmest in this crash. And, at the time of writing, the gold price has actually rallied another US$100/oz and A$110/oz to US$1 590/oz and A$2 700/oz, respectively.

Stock Market Indices

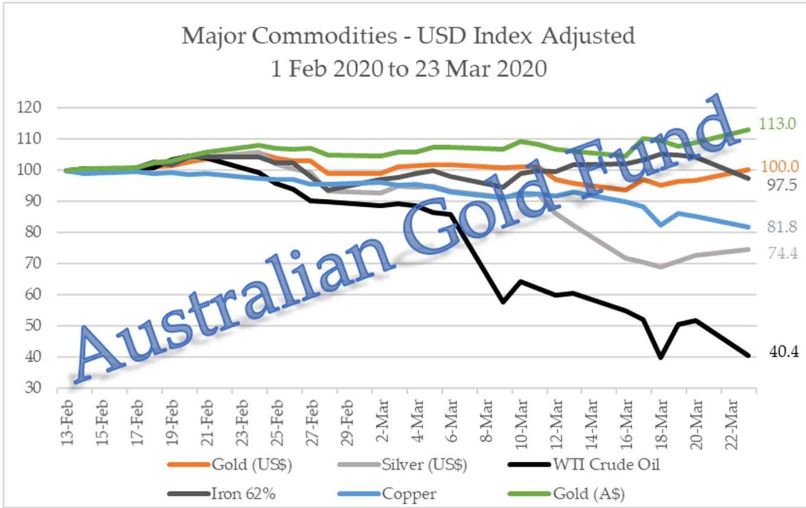


	Dow Jones	S&P 500	NASDAQ	Euro 50	Nikkei 225	ASX 200	Hang Seng
Overall Decline	-36.6%	-33.5%	-29.3%	-35.3%	-29.1%	-35.2%	-21.4%
Min Daily Return	-12.93%	-11.98%	-12.32%	-12.38%	-6.08%	-9.70%	-4.86%
Max Daily Return	9.43%	9.32%	9.35%	3.85%	2.02%	5.83%	5.05%

The global stocks markets appeared to have peaked on Thursday 13th February and then began to wobble in the coming week. The markets began to tumble on Monday 24th February as the world began to digest the severity of the Wuhan virus being more than just a disease that would affect China. It had begun to spread in various nations and the number of infections commenced its exponential climb. The Dow Jones fell 3.5% or 1 079 points and this began to create a selling wave. Other countries saw their stock indices began to take significant declines. By the end of the week, the Dow Jones fell over 12%, the Nikkei 9.5%, the Euro 50 8.7%, the Hang Seng 4.1% and the ASX 200 7.5%. The wild ride had only just begun.

By Monday 23rd March, most major stock market indices have fallen over 30%. During this time, there were days where the market recovered almost 10% (Friday 13th March), but this was short-lived possibly as a result of short covering.

Major Commodities



	Gold (US$)	Silver (US$)	WTI Crude Oil	Iron 62%	Copper	Gold (A$)
Overall Decline	0.04%	-25.56%	-59.57%	-2.50%	-18.18%	12.97%
Min Daily Return	-3.99%	-12.95%	-32.70%	-6.37%	-6.74%	-1.95%
Max Daily Return	3.81%	2.68%	26.81%	4.40%	4.39%	5.15%

Commodities were generally more robust in this market decline than the equity markets. However, this is also due to the fact that the US Dollar Index strengthened slightly during this period, by 3.6% to be precise. As commodity prices are measured in US dollar terms, we should recognise that when the US dollar strengthened, this impacts on the commodity prices.

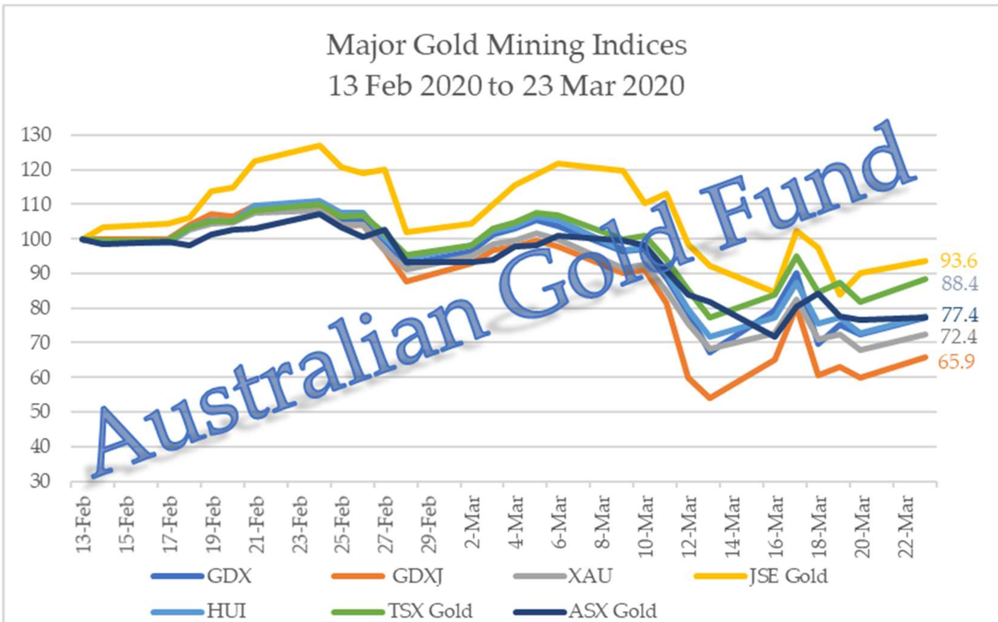
Gold shone during this period, despite having its moments of weakness in the middle of this month as the market decline caused investors to sell paper contracts to cover their losses in other assets. However, as it became apparent that the Federal Reserve would not just cut the Federal Funds Rate to 0-0.25% once more but they would buy back trillions of dollars of corporate bonds and possibly even equity, gold found a bid. Moreover, the Australian dollar tumbled some 15% during this period, and thus propelled the gold in Australian dollar terms to all-time highs once again.

Interestingly, besides gold holding its ground during this period in US dollar terms, iron ore also was relatively solid. This outcome surprised the author given that the Wuhan virus has led to much of China being in lockdown mode and this would have reduced global demand for iron ore, given China is the biggest consumer of iron ore. Perhaps the iron ore price may decline in the coming months, or it may not in light of the largest fiscal stimulus and central bank monetary stimulus that is at hand.

Copper declined around 18% during this period and is trending downwards, in line with expectations. Silver surprisingly began its tumble two weeks ago and ended the period 25.6% lower. At one stage, it dropped below US$12/oz. Strictly speaking, silver is still perceived to be an industrial metal rather than a monetary metal.

Finally, and not the least, crude oil had its monumental knockout blow on 9th March when OPEC spectacularly collapsed when Russia and Saudi Arabia refused to agree on cutting production in order to keep the price from falling. Oil had been weak since the start of the year and made a short-lived rally in the wake of the death of Soleimani in the hands of an American drone strike, but this did not last as China succumbed to the virus and they began to dump oil into the market.

Gold Mining Stocks



	GDX	GDXJ	XAU	JSE Gold	HUI	TSX Gold	ASX Gold
Decline	-22.56%	-34.07%	-27.61%	-6.39%	-22.39%	-11.64%	-22.58%
Max Daily Decline	-22.82%	-26.27%	-13.59%	-14.98%	-13.49%	-10.97%	-12.35%
Max Daily Rally	18.37%	23.65%	13.06%	20.97%	12.90%	13.12%	12.40%

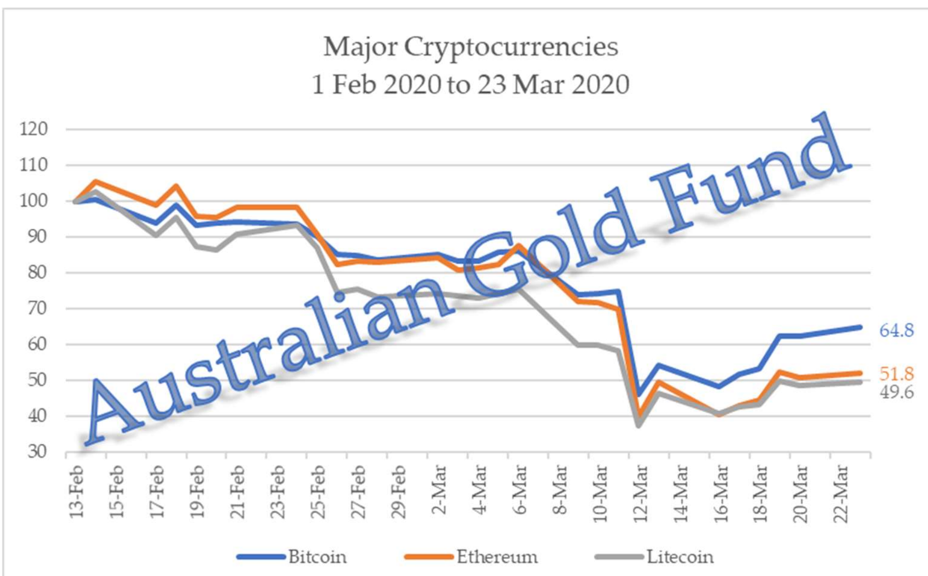
The gold mining stocks, unlike physical gold, behaved much like equities in this period. This should not be surprising as market investors holding equities would be caught up with the general sell-off and liquidated their gold mining stock holdings. This is especially the case if investors have purchased stocks on margin loans. In a sell-off, margin calls lead to investors being forced to sell to cover their shortfalls, even if their stocks are winners.

Among the gold mining stocks, it is not surprising that the smaller gold mining stocks were sold down more aggressively. The GDXJ has declined by over 34% during this period, though also with the widest range of daily movements. The Philadelphia Gold/Silver Index (XAU) fell over 27% because silver mining companies were heavily sold off by investors as silver declined in mid-March. The GDX and NYSE Arca Gold Bugs Index (HUI) fell by a similar level of around 22-23%, with the larger gold mining companies like Barrick and Newmont standing their ground during this period, but still being down around 10-15%. The ASX All Ordinaries Gold Index surprisingly fell 22.6% during this period, despite the Australian dollar having fallen 15% and was meant to offset the decline. Again, it goes to show that the market is not rational in times of a sell-off.

The Toronto Stock Exchange Gold Index and the Johannesburg Stock Exchange Gold Index both were quite resilient in this period, falling by 11.6% and almost 7%, respectively. However, Canada may be imposing more strict lockdown conditions in the coming period, which may lead to some Canadian mines suspending production. This could lead to some selling down of Canadian mining companies with domestic operations. As for South African gold mining companies, they appear to offer a beacon of light in the prevailing storm for South African investors.

Finally, the author finds it perplexing that as the gold-oil ratio has skyrocketed in the wake of the crude oil price collapsing, investors have not yet returned to gold mining stocks. After all, in the coming quarters, producers should largely benefit from substantially lower operating costs. Though, the author does recognise that in the last few quarters, gold mining companies have delivered largely mediocre operating results in their quarterly reports. Many mines have been plagued by operational problems, processing plant breakdown or interruptions as well as declining ore grade. The persistence of this problem may have left a sour taste in investors' mouth and many investors decided to sell into the decline, unwilling to take chances.

Cryptocurrencies



	Bitcoin	Ethereum	Litecoin
Decline	-35.17%	-48.15%	-50.42%
Max Daily Decline	-38.47%	-43.29%	-36.17%
Max Daily Rally	17.33%	25.07%	24.48%

The darling asset class of the millennials and those who believe they are mankind's trailblazers; cryptocurrencies have enjoyed a meteoric rise in the last fifteen months since the massive collapse in late 2018. But as the clouds gathered and the storm rolled, cryptocurrencies went the same path as the major market equities. However, the rope appeared to snap across all cryptocurrencies on 10th March when they all experienced a further decline of as much as 40%, when they had declined some 20% prior to this. For whatever reason, a number of investors sold heavily. Many took this opportunity, interestingly enough, to buy back in and the cryptocurrencies pared around 20% of the decline. The technical indicators appear to suggest that cryptocurrencies may have been the first to find their bottom in this market crash, but only after falling some 60% from their pre-crash levels.

At this stage, Bitcoin stands around 35.2% lower than their levels in mid-February, faring better than Ethereum, which has declined 48% and Litecoin is still just over 50% lower. What is quite stomach churning about holding cryptocurrencies is that they are by far the most volatile asset class among those this analysis has considered – with daily declines of as much as 43%!

An interesting question ensues from this – will equities need to fall as much as cryptocurrencies before they find a bottom, notwithstanding the monetary and fiscal stimulus?

Conclusion

The famous saying that markets go up via the stairs and fall off a cliff is so apt for what we have experienced the past month. With virtually all asset classes falling in price, no doubt many have seen their portfolios decline. Major market indices have seen declines of 25-40% and individual stocks would have been all but decimated, especially if the company has a leveraged balance sheet or their operations have to be suspended due to lockdown laws. Few assets have been able to escape broad-based selling down by panicked investors. However, in the midst of all this, gold has stood out as being a place of refuge. Being a steady and quiet performer during all these years, gold managed to retain its price while taking into account the US dollar appreciating during this period due to a flight to safety. While cash is king, the crown is made of gold.

What should not be missed though is that the market going forward is likely to be volatile and many investors are still jittery. However, if this analysis has provided some insights, it should show that some asset classes may be proving itself to be safe havens, while some offer a wilder ride with potential of delivering outsized gains. But, in all this, tread carefully for wealth favours the patient and the prudent.

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