Invesco

Market performance and macro factors

Gold report

Q3 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 Q3 2023

Gold price return in Q3
-3.7%

YTD gold performance
+1.3%

Real bond yields
2.2%
at end of Q3

US Dollar Index rose by
3.2%
in Q3

Data: Bloomberg, as at 30 September 2023.

Market performance

The gold price fell 3.7% in Q3, the second consecutive quarterly decline, although year-to-date the metal's performance remains in positive territory. This quarter's price decline came in the final week as markets reacted to the "higher for longer" interest rate outlook.

Macro factors

Real bond yields in the US finished the quarter at their highest level since 2007, driven by the Fed's hawkish narrative about keeping rates higher for longer. Higher bond yields and a strengthening US dollar were significant headwinds for the gold price as the quarter drew to a close.

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.

Market performance

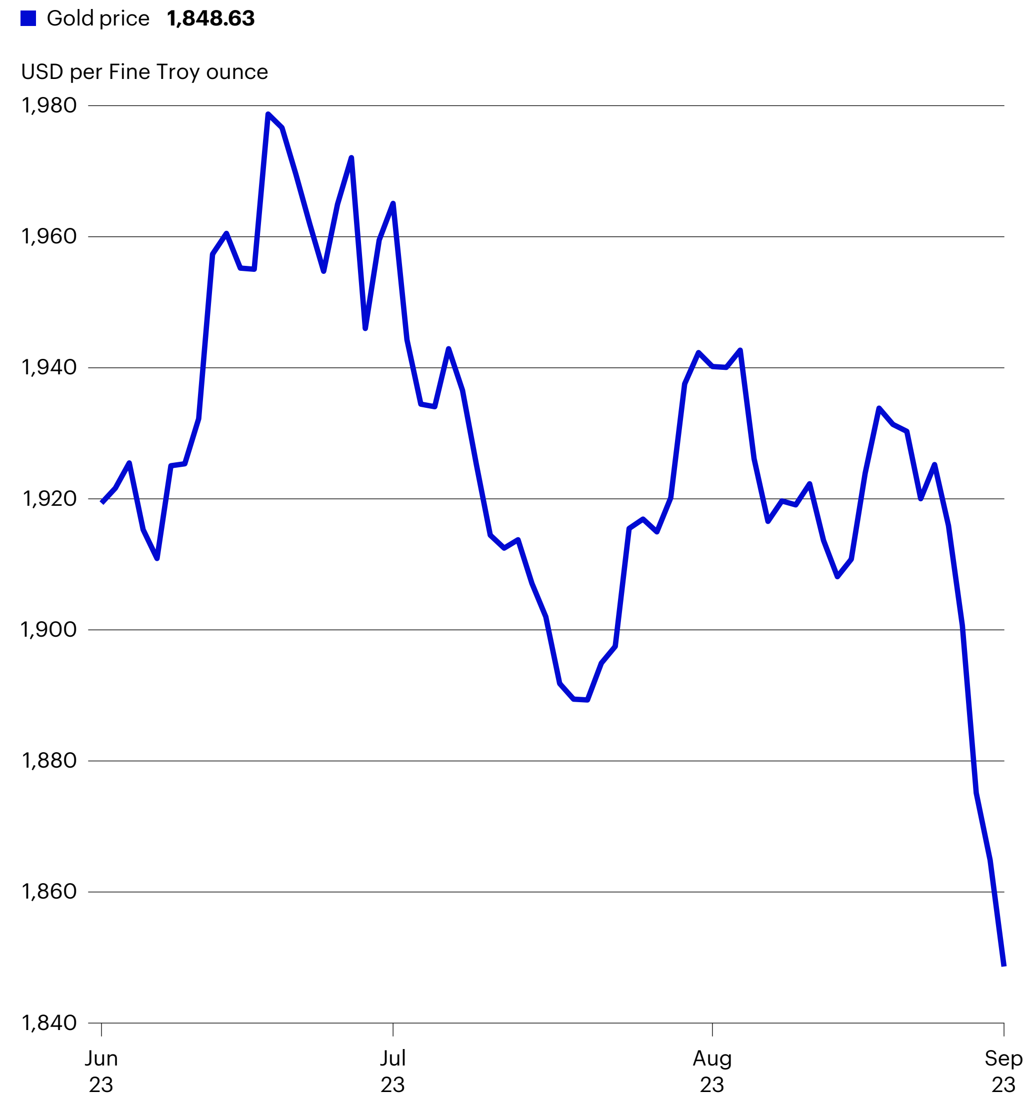
Macro factors

Quarterly price performance

The gold price fell 3.7% in Q3 to end the quarter at $1,849. The sharp drop into the end of September took prices back to levels of March of this year. Premature worries of the outlook for the US economy at the start of the quarter caused the gold price to climb before giving way to higher real yields with the higher-for-longer mantra permeating financial markets, specifically seen in Treasury yields.

Gold price return in Q3

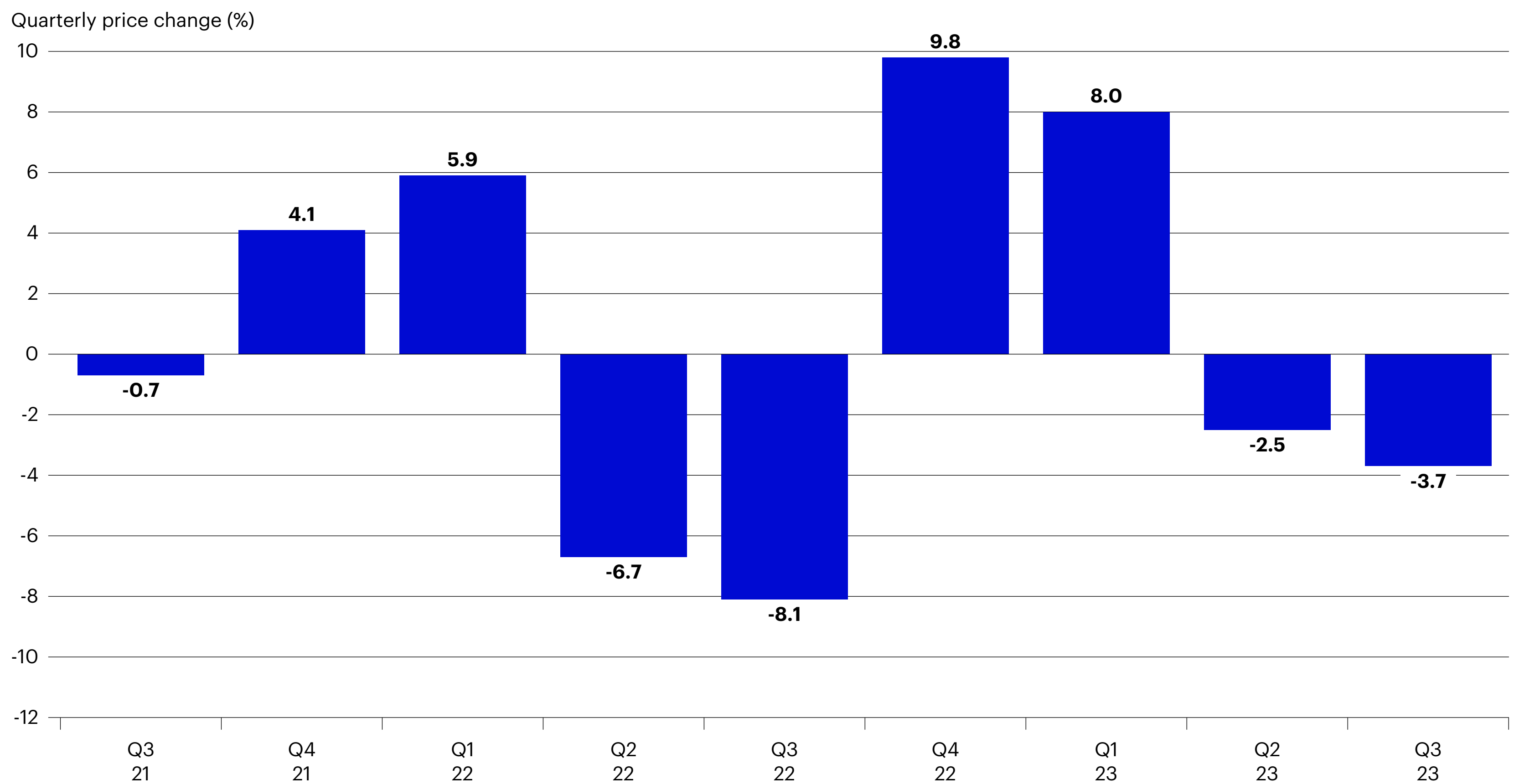
-3.7%



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

Quarterly price returns

Gold had a second consecutive quarter of negative returns following the strong start to the year, though Q3 2023 does compare favourably to the same period last year when the metal returned – 8.1%. As with Q3 2022, the strong US dollar is proving a drag on gold performance as are higher real yields. This year, however, the market and Fed are in congruence that the Fed funds rate is not expected higher from here.



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

Market performance

Quarterly price performance
Quarterly price returns
Annual price returns
Asset class returns
Relative strength of the gold price
Gold price return, nominal and adjusted for inflation
G10 currencies

Macro factors

Gold price and real bond yields
Gold price and Fed balance sheet
Gold price and US interest rates
Gold price and inflation expectations
Gold price and the US Dollar
Gold price and economic risks

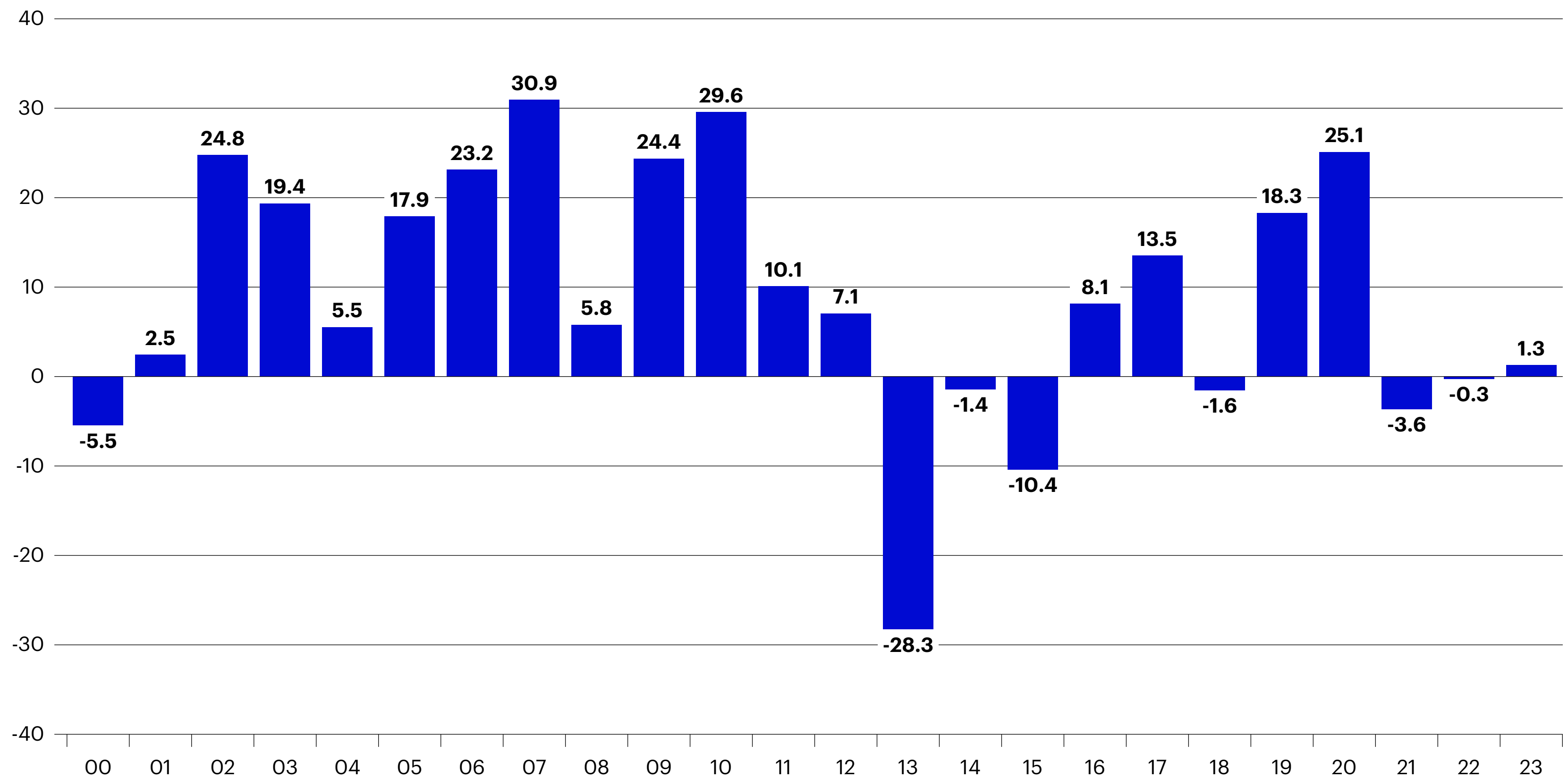
Annual price returns

Year-to-date gold still has a positive return of 1.3% to the end of September, due to the strong performance in the first quarter of the year. Although there has been selling by ETFs, emerging market central banks have been a key support as they have prioritised diversifying reserves ahead of the higher yields.

YTD gold performance

+1.3%

Annual price returns (%)



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

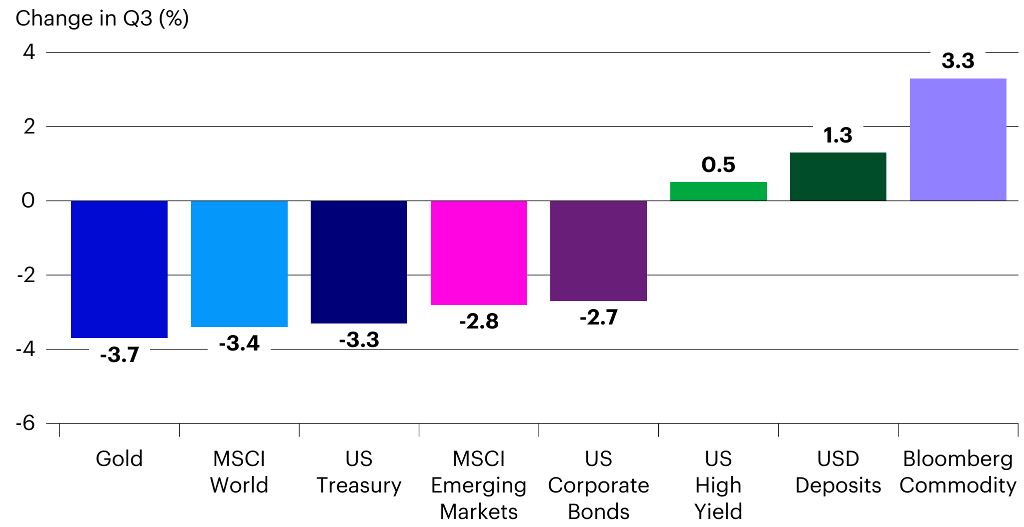
Market performance

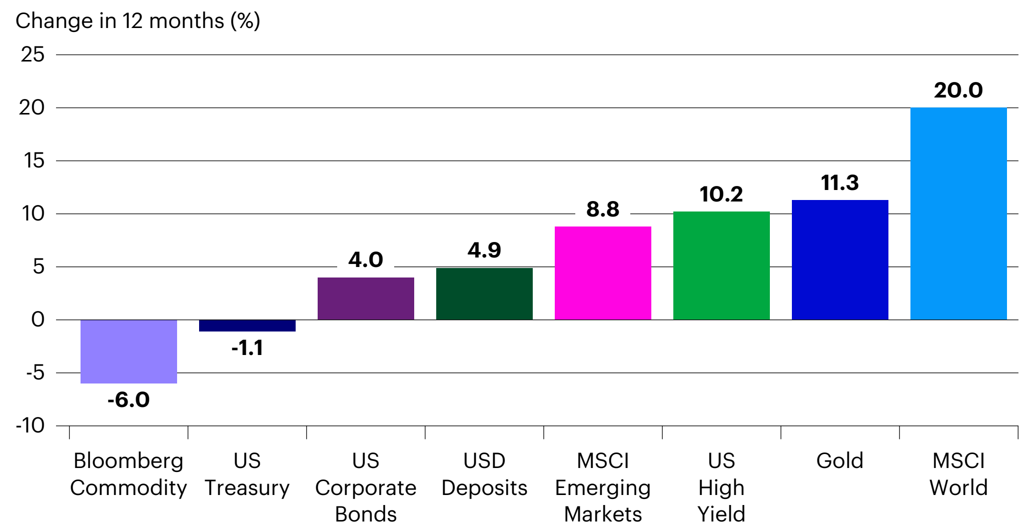
Macro factors

Asset class returns

This was a difficult quarter for investors to generate a positive return as, outside of cash, only high yield and commodities ended the quarter higher. Obviously, commodities were not uniform outperformers; gold was the worst performing asset class, but the wider commodity complex was lifted specifically by the outperformance of the energy sub-index. This is the opposite to 12-month performance. The opportunity cost of holding the metal against cash is increasingly high; cash deposits are yielding above 5% on an annualised basis against non-yielding gold.

Over the past 12-months, gold has outperformed most risk assets despite the adverse macro backdrop. It has only been outperformed by equities and specifically developed market equities led by the US and its bias to growth stocks. There has also been improvement in Japanese governance, which has attracted investment there. Fixed income assets, particularly those with a longer duration, have underperformed as the markets adapt to the higher-for-longer narrative. Higher central bank rates are going to make it harder for risk assets to replicate recent returns in the near future.

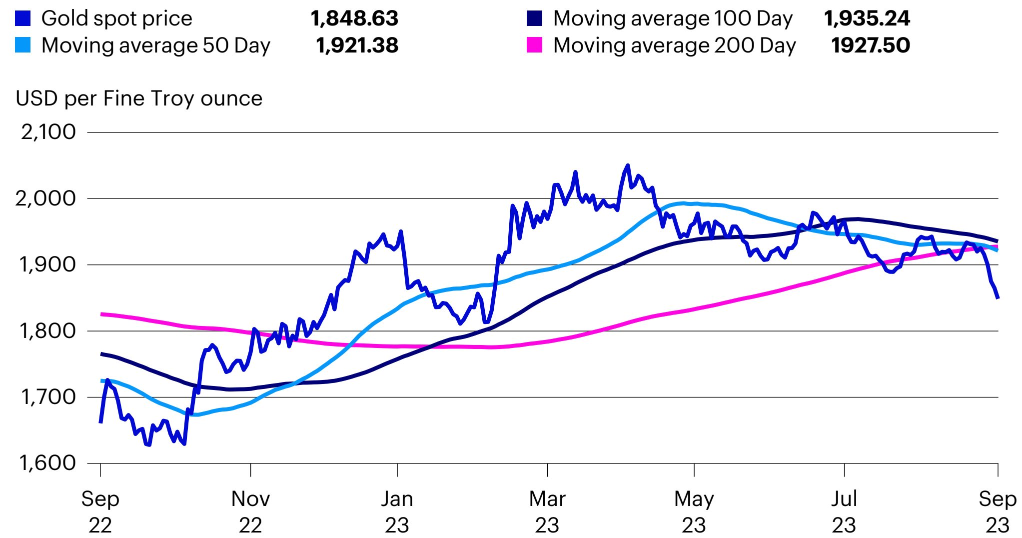




Past performance is not a reliable indicator of future returns. Source: Bloomberg, in USD, as at 30 September 2023.

Relative strength of the gold price

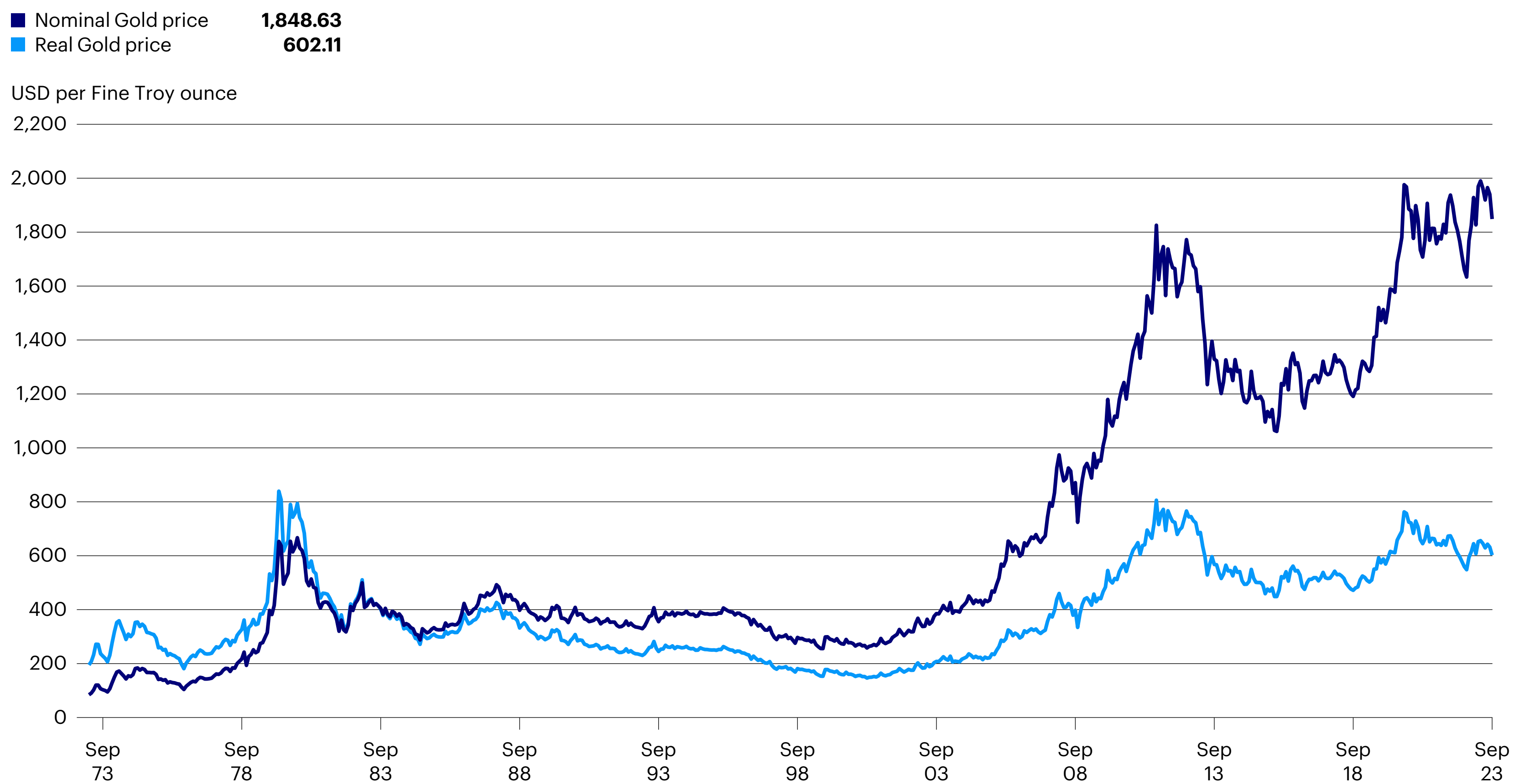
The sharp leg down in the gold price at the end of the quarter followed the Fed's direction that the Fed funds rate would remain elevated into September of 2024, six months beyond what the market had priced in. This caused the metal to break through its support levels and, in the last trading session of the quarter, gold entered oversold territory according to the 14-day relative strength indicator.



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

Gold price return, nominal and adjusted for inflation

Although inflation was lower in the quarter, it remains high in comparison to the last 20 years. The inflation backdrop exacerbates gold's quarterly performance in real standings, lowering the metal's performance to -4.5% in inflation-adjusted terms for Q3 2023. Over the past 12 months to the end of September, gold has returned 7.4% on a real basis.

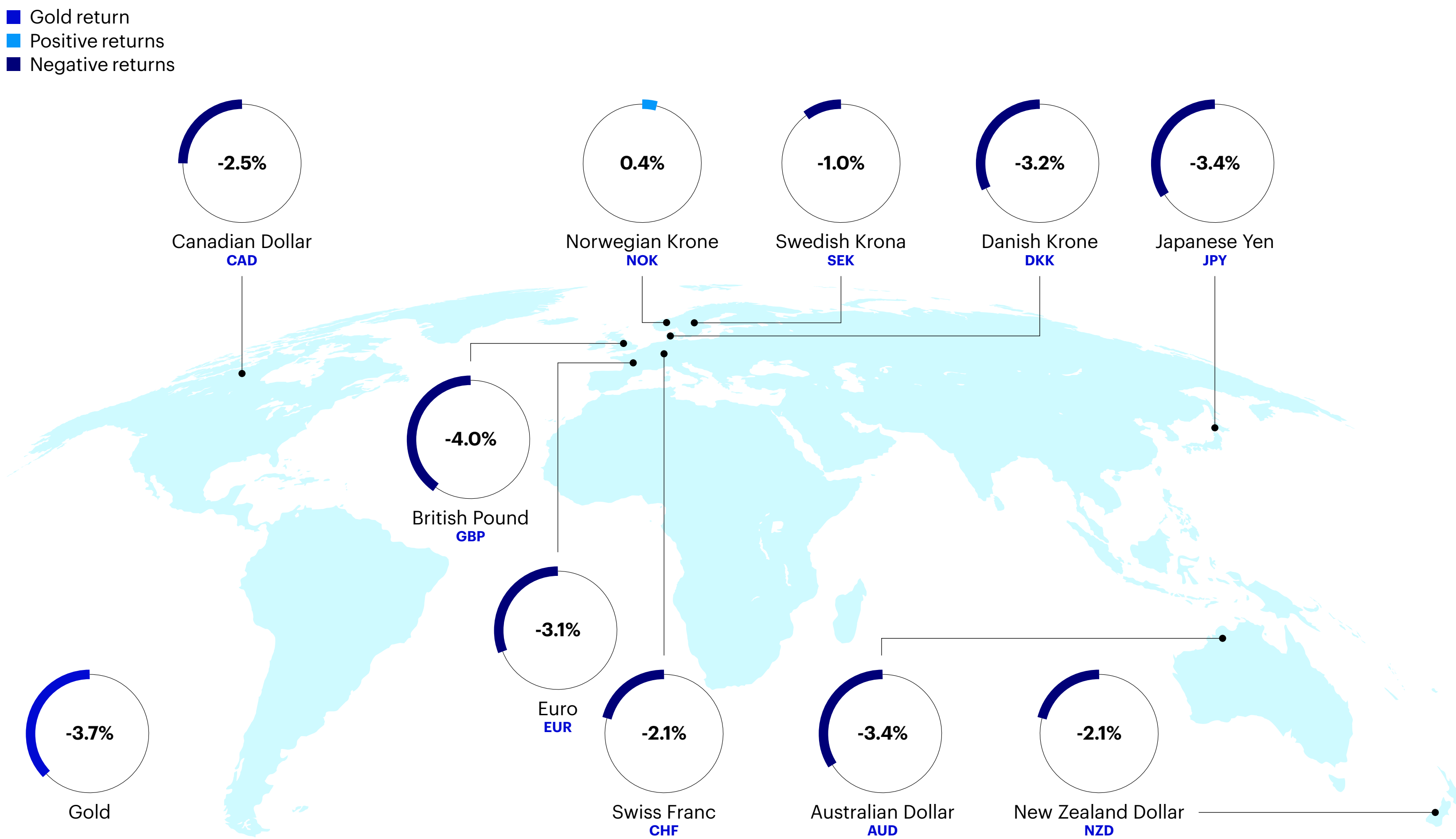


Past performance is not a reliable indicator of future returns. Source: Bloomberg, in USD, to 30 September 2023.

G10 currencies

Gold was outperformed by most major currencies in the quarter as the overriding theme was the strong US dollar on the back of a hawkish Fed. Scandinavian currencies were the best performers against the USD but it was only the Norwegian krone which gained against the dollar following the Central Bank of Norway's rate rise during the quarter and its signal of a further rate rise by the end of the year when the US has already hit peak policy rate.

Q3 returns of gold and G10 currencies in USD (%)



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Gold price and real bond yields

US real yields ended the quarter at 2.2%, their highest level since 2007, and were the key force putting downward pressure on the gold price. The US economy has been remarkably strong compared to its peers, as well as forecasts at the start of the year, which has pushed yields higher. The velocity in the change on yields may make investors nervous in itself but there is growing scepticism that the underlying growth cannot be maintained over the coming months, especially as interest rates are forecasted to be higher for an extended period.

Real bond yields

2.2%

at end of Q3

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

Gold price and Fed balance sheet

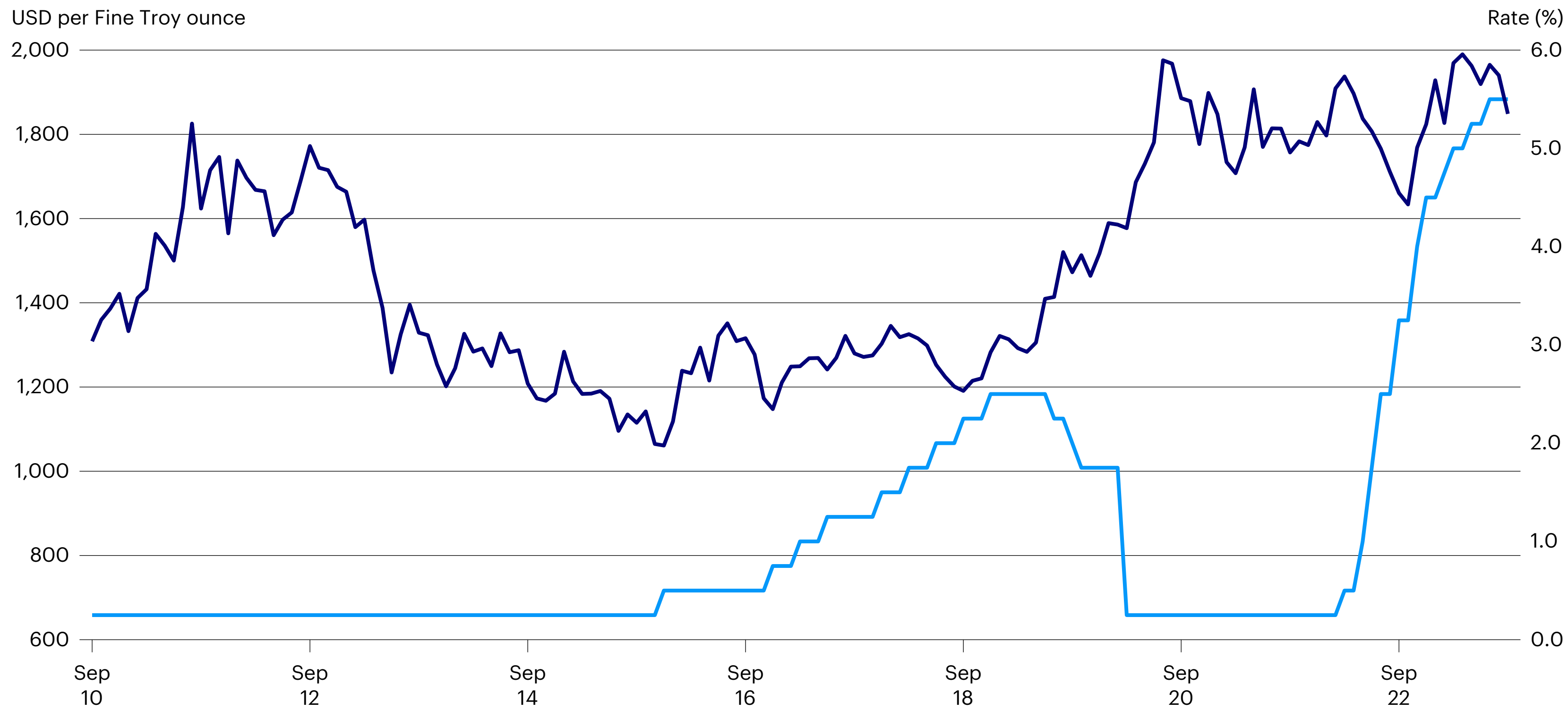
The Fed's balance sheet has continued to contract as its quantitative programme continues. At the end of the Q3 2023, the balance sheet had reduced a further 4.1% to $8.0 trillion. Higher yields, supported by higher economic growth but also on unease over US Government debt levels, have caused some to speculate there could be another Silicon Valley Bank event, which would cause the balance sheet to expand again. This seems unlikely given the scrutiny applied to retail banks' balance sheets earlier in the year and that the Fed's Bank Term Funding Program's stock has not significantly increased over the quarter.

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

Gold price and US interest rates

As per market expectations, the Fed added another rate hike during the quarter taking the Fed funds rate to 5.5%. What wasn't anticipated was the Fed's extension in its view of holding the policy rate at current levels out to Q3 2024. This hawkishness wrong-footed the market and caused a sharp drop in the gold price into the end of September; however, it is more the case that peak rate has been reached and rates will be held here for longer.

Gold (LHS)	**1,848.63**
Fed funds rate – upper bound (RHS)	**5.50**



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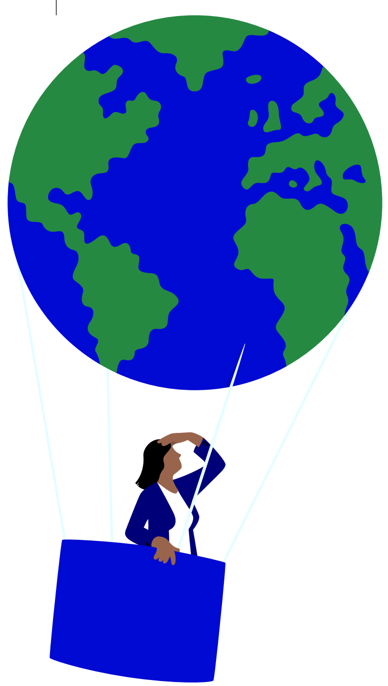
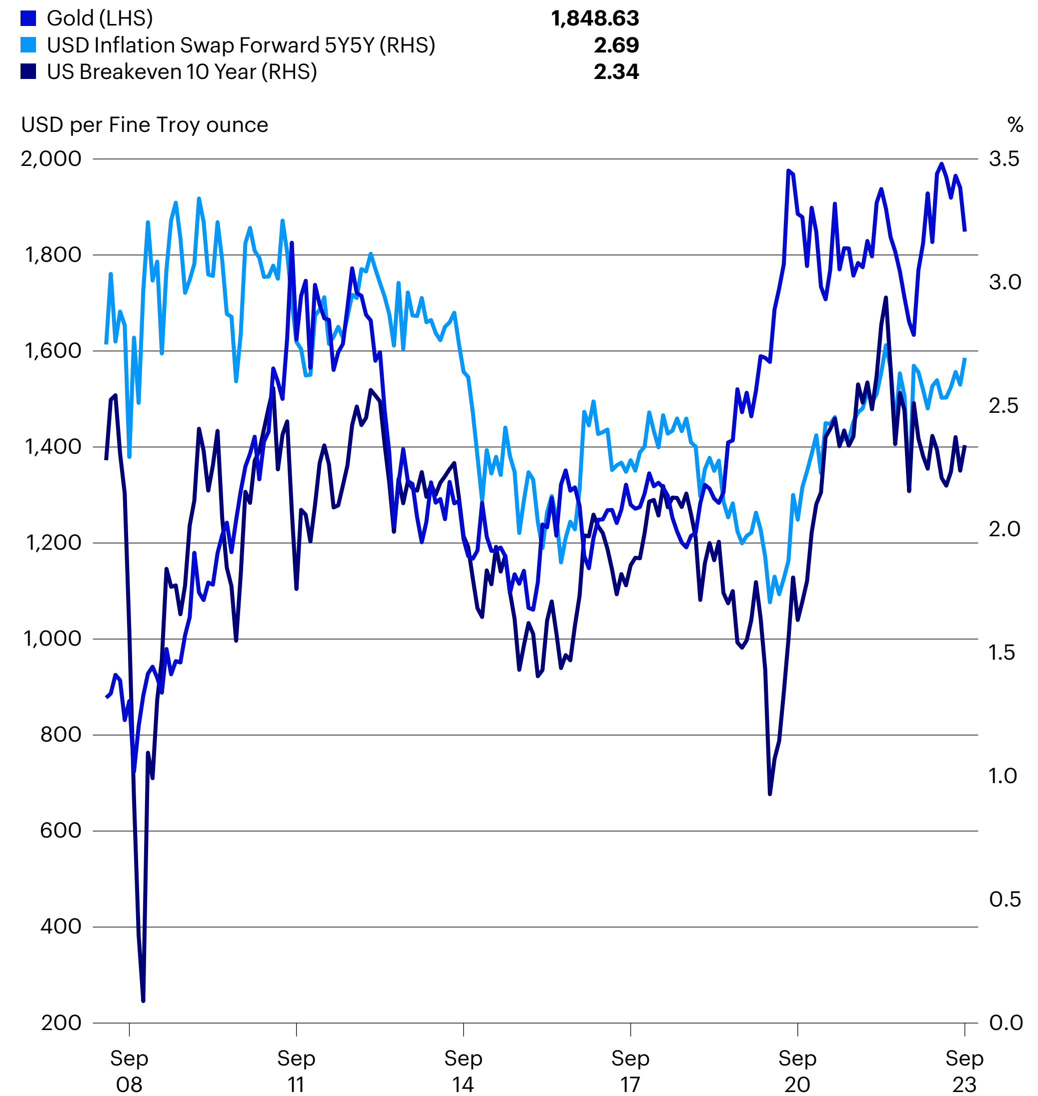
Gold price and inflation expectations

The year-on-year US CPI data for September at 3.7% was marginally higher than the Bloomberg consensus forecast of 3.6%. Through the quarter, CPI data has climbed higher from the 3.0% achieved at the end of Q2 2023. The higher realised data has influenced inflation expectations and both the 10yr breakeven and 5y5y inflation swap ended Q3 2023 higher than at the start of the quarter. Despite the higher inflation backdrop, which is keeping central banks in hawkish mode, this did not encourage the gold price higher as, in part, the metal compares unfavourably against yielding assets.





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Market performance

Macro factors

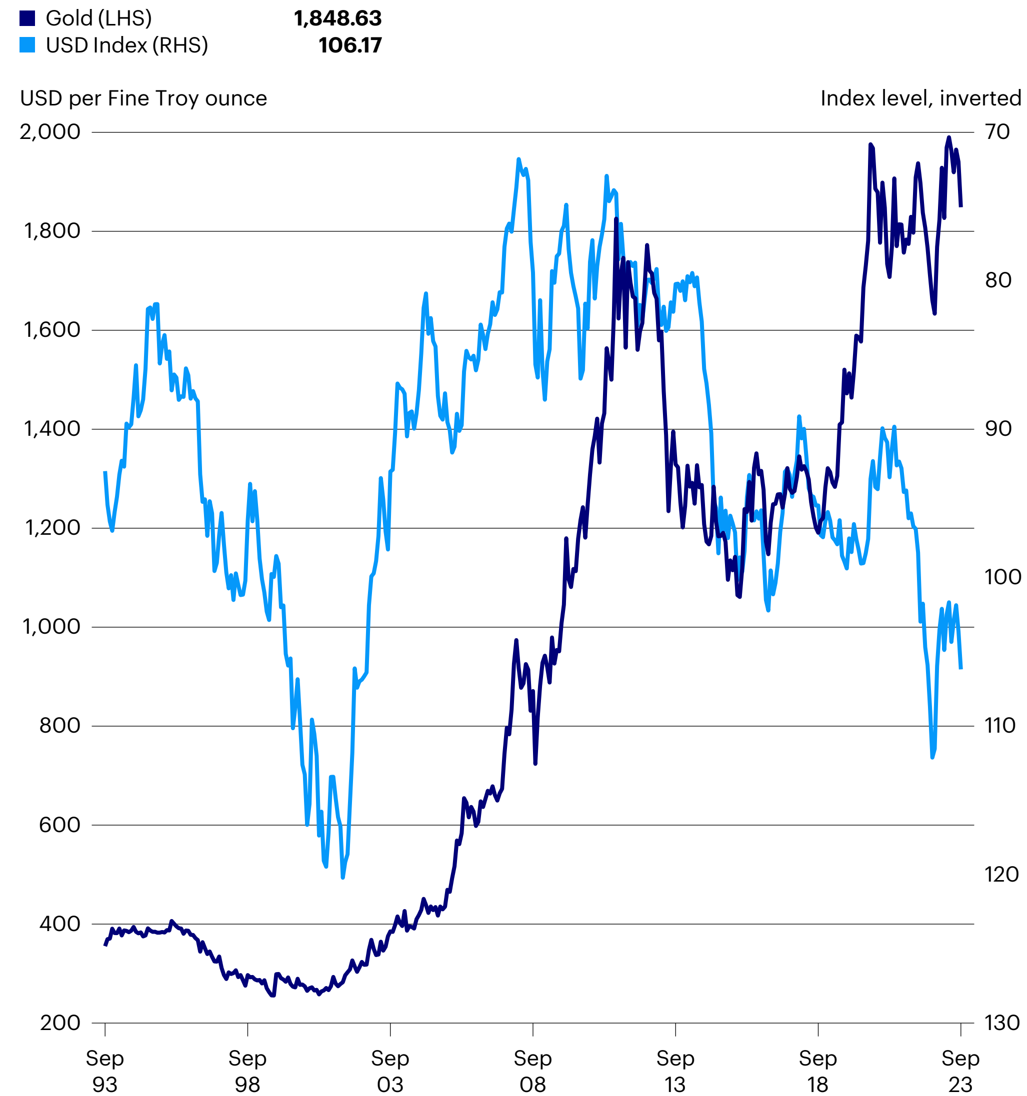
Gold price and the US Dollar

On the back of higher real yields, the USD index strengthened 3.2% in Q3 2023, taking it back to levels of 12 months previous, when markets began to prematurely price in Fed rate cuts. At the same time as the Fed assumed to be at peak rate, there is growing evidence that other major central banks (outside of Japan) are also at their peak rate. The focus for interest rate differentials in relation to currency strength now comes in the timing of the first rate cuts to stimulate cooling economies. Currently, the US looks in a much stronger position than its peers but cooling economic data should be a positive for gold.

US Dollar Index rose by

3.2%

in Q3



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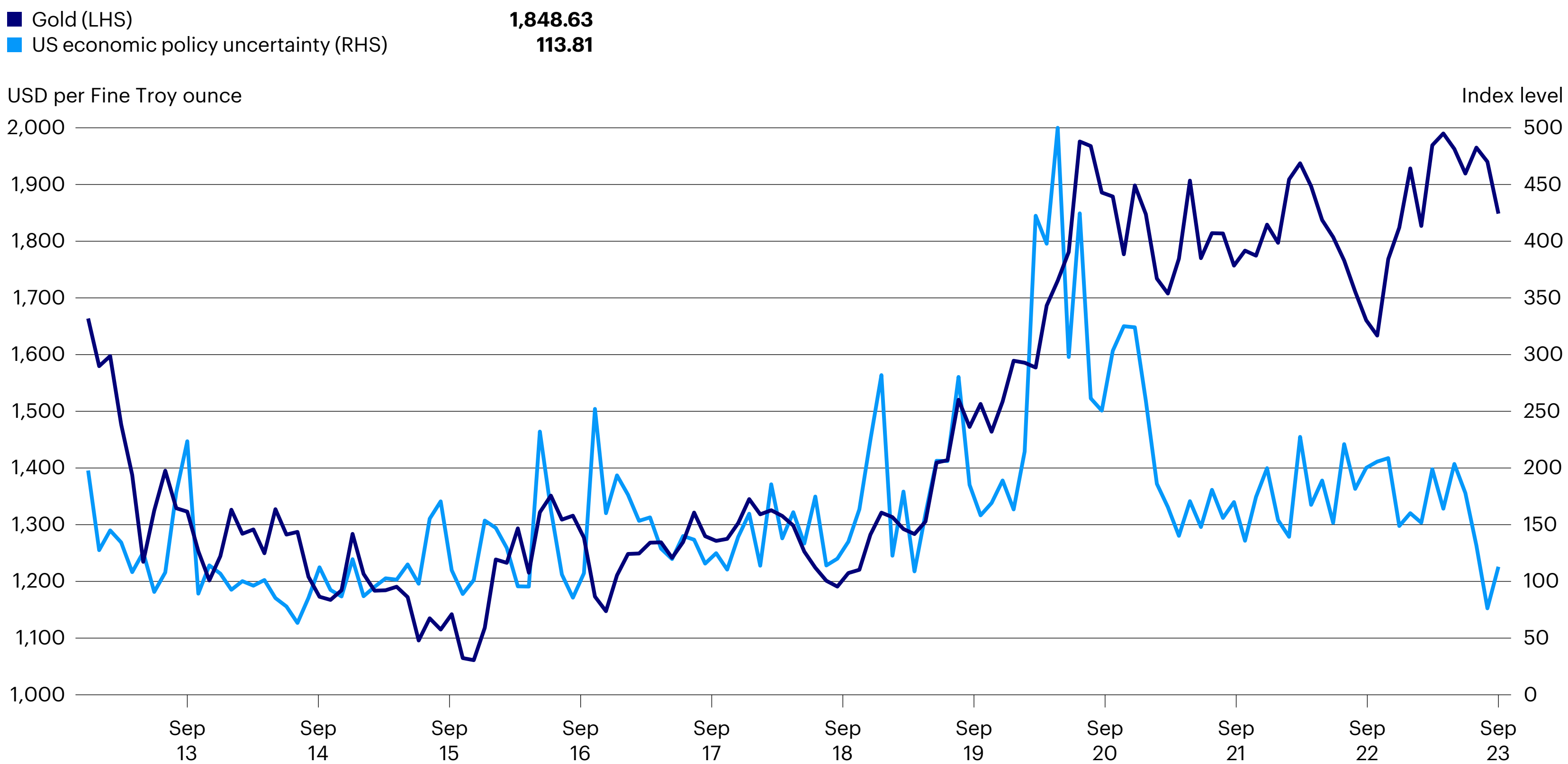
Gold price and economic risks

Economic policy uncertainty dropped sharply over the summer before rebounding to still relatively low levels at the end of September. Here, economic uncertainty is based on newspaper articles containing the term: 'uncertainty' or 'uncertain'; the terms 'economic' or 'economy'; and one or more of the following terms: 'congress', 'legislation', 'white house', 'regulation', 'federal reserve', or 'deficit'. Given the US is yet to appoint a Speaker of the House of Representatives or resolve the debt ceiling issues, the uncertainty index may rise in the near-term but macro drivers have proved more influential post the invasion of Ukraine.



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Data as at 30 September 2023, unless otherwise stated.

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