Gold and silver to SHINE AGAIN?

Commodity prices have taken a battering, but the double whammy of QE tapering and economic recovery may change that, says Ceri Jones

The commodities super-cycle of 2000-2008, which produced roughly 20 per cent compound annual returns, was driven by scarcity of supply to meet the demands of emerging nations – notably China. Investment in the mining and extraction industries has now caught up with demand, ironically at a time when the latter is levelling out. Western markets such as the US and UK are recovering, but they are less commodity-intensive than emerging markets, where the construction of infrastructure has been fast and furious. As a result, prices of base metals such as copper and aluminium have moved sharply lower this year since China's growth stumbled, and only oil, which is primarily influenced by the geopolitical backdrop, has risen.

One of the worst-hit commodities has been gold, which has been plunging inversely to optimism in the US economy, falling from record highs of over $1,900 (£1,175) an ounce in August 2011 to below $1,260. Silver has followed with marked volatility, fluctuating by 20-30 per cent for every 10 per cent in gold's movement and sinking to around $20.

However, at these rock-bottom levels, bargain hunters have been buying up exchange traded funds, particularly in silver, while sales of the US Mint's 2013 American Eagle silver bullion coin recently hit a record high. There will also be support from improving industrial demand, which accounts for around half of silver consumption, for example in water purification, medicines and solar power.

> "REDUCED LIQUIDITY WILL TRIGGER A CREDIT BEAR MARKET"
> Julien Garran

For the next six months, the fate of gold will be inextricably linked with speculation around the US economy and the extent to which the US Federal Reserve Bank moves to end quantitative easing.

TAPERING ISSUES

'This would reduce liquidity, undermine growth and trigger a bear market in credit, US stocks and global risk assets,' says UBS analyst Julien Garran. 'We see upside to gold and silver, because we think the market will eventually come to believe that the Fed either will not start tapering or will need to end tapering to kick-start the economy.'

A more apocalyptic version of this prediction has also been gaining support recently. Precious metals adviser Jim Sinclair forecasts a gold price of $3,500 by the end of 2016 – and, wait for it... $50,000 by 2020 – because he believes there is unprecedented manipulation of precious metal prices, and that ultimately many western governments will be forced to copy the Cyprus banking bailout in confiscating savers' cash held on deposit, which in turn will encourage investors to hold physical assets to protect their wealth.

Charteris Treasury Portfolio Managers sees a larger and more arbitrary cycle at work in precious metal prices. Chairman Ian Williams believes silver, which hit bottom on 28 June, could soar to $150 per ounce by October 2015, on the basis that it follows a 10 to 10.5 year cycle with low points in 1972, 1982, March 1993 and a new mega-low in June 2013. 'Silver is one of the most volatile assets on earth; for example it climbed 36-fold in the eight years after 1972,' Williams says. 'A sevenfold increase in the silver price [to $150] is no big deal, given its historical precedent.'

BOMBED OUT MINERS

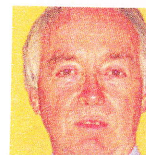
Gold could rise to around $3,500 next year, he adds, and mining companies are chronically oversold. If you divide the gold price by the share index and track it back to 1984, the normal range is between three and six. That ratio is now 14, which he views as a signal that mining companies are bombed out, and that to readjust to historical norms they will have to rise by 300 per cent.

'We expect silver to rise two to three times more than gold and we expect miners to rise two to three times more than bullion,' he adds. 'Needless to say, silver miners should do better than gold miners, but gold miners will do well enough. This is why we changed our fund [WAY Charteris Gold Portfolio] this year from a gold fund to a gold and precious metals fund with 65 per cent in silver miners.'

In the short term, gold and silver will also benefit from the rebalancing of commodity indices in early January, owing to the combined effect of an increased target weight and price depreciation since the 2013 rebalancing. Analysis from Standard Chartered Bank shows that the biggest losers will be natural gas and West Texas Intermediate (WTI) crude oil.

In contrast, there is more consensus around industrial metals, which most commentators believe will remain in surplus in 2014, although a reversal in China's reform process has led to a sharp rise in infrastructure orders, temporarily tightening the copper and iron ore markets.

'China is the main consumer of copper, consuming 40 per cent of all supply, and 85 per cent of this is used in the construction industry,' says Josef Wolfesberger, multi-asset strategies fund manager at Raiffeisen Capital Management. Copper is currently below $7,020 a tonne and he expects a sideways move in 2014.



> "SILVER COULD SOAR TO $150 PER OUNCE BY OCTOBER 2015"
> Ian Williams

'Aluminium is much more dependent on Europe and the US,' he adds. 'If growth projections of 1.4 per cent for Europe and 2.6 per cent for the US materialise, then we expect a 10-15 per cent increase on the current $1,800 per tonne – but we do not believe that the underlying economy is as good as PMI [purchasing managers index] data implies.'

'In oil, geopolitical factors have receded and peak demand in developed markets has probably passed,' says Wolfesberger. 'The supply side increase from North America and Canada is the main influence on the market, and stabilising demand from the US means WTI will rise 10 per cent in 2014, while Brent should be less impacted at around $115 [up 4.5 per cent]. Crucially, for the medium term, there will be a continued migration to gas from oil in the US – gas is currently five times cheaper than oil, and over five years this will have a major impact.'

Being weather dependent, agricultural commodities are harder to forecast, but foodstuff prices have tumbled this year, driven by a rebound in supply across the US, and also in Latin America, where Brazil and Argentina have seen strong harvests.

Overall, many fund managers are underweight the commodity sector, seeing better pockets of opportunity in equity markets.

METAL AND OIL PREDICTIONS FOR 2014

We have collated some price predictions for next year from the professionals, but bear in mind there are many factors at work in these markets, so analysts often get their predictions wrong.

GOLD/OUNCE
Barclays: $1,310
Goldman Sachs: $1,750
HSBC Global Research: $1,435
Charteris: $3,500
Jim Sinclair: $2,400, and $3,200-3,500 by end 2016
Sucden: $1,270-1,350

SILVER/OUNCE
Sucden: $16-26 in 2015
Barclays: $19.50
Charteris: $150 in 2015

INDUSTRIAL METALS/TONNE
COPPER
Raiffeisen Capital Mgmt: $7,000
Barclays: $6,750
Sucden: $7,000-7,500
ALUMINIUM
Raiffeisen Capital Mgmt: $1,980-2,070
Barclays: $1,838
Sucden: $1,750-2,000

Miners: UBS is bullish on gold and silver and likes Goldcorp, Franco Nevada, Silver Wheaton, Fresnillo; and defensive in industrial commodities, preferring Rio.

OIL/BARREL
US Energy Information Administration: WTI $95; Brent $103
Barclays: WTI $104; Brent $110

NATURAL RESOURCES FUND CHOICES

BlackRock World Mining, managed by Evy Hambro, has lost investors 20 per cent over a year; but Hambro believes this is the result of poor management at mining companies. We concur that the trust could bounce back as gold miners overhaul their management teams and re-rate. The **JPMorgan Natural Resources Fund** also has a good long-term record in outperforming the index, but is down 17.5 per cent over the year.

For investors seeking a high-conviction fund specialising in oil and gas exploration and production companies, the **Artemis Global Energy** fund run by John Dodd and ex-oil man Richard Hulf is concentrated in just 40 such stocks. It has lost 5 per cent in the past six months, however, suffering in comparison to a benchmark that has a high proportion in integrated oil and gas producers.

Baring Global Agriculture has the flexibility to invest in companies in the fertiliser, machinery, logistics, and food manufacturers and retailing sectors, which means it can perform well under different conditions.

For passive management, smart beta ETF provider Ossiam recently launched the **Risk-Weighted Enhanced Commodity Ex-Grains Index Total Return fund** (CRWU), which allocates cash between 20 commodities futures contracts according to a risk-weighted scheme.