Gold Will Rise by 6.9% in 2020

Mark Hulbert writes that if gold has an average year in 2020, gold bullion would be a smart bet. Here's why.

MARK HULBERT - DEC 24, 2019 7:00 AM EST

Gold bullion will gain 6.9% next year, adding approximately $103 to the price of an ounce of the yellow metal.

That's assuming gold has an average year in 2020. And, based on various analyses of gold's historical record, that would be a smart bet.

Whether you take this forecast to be good or bad news depends on your prior beliefs. Those who are hoping gold will rise in 2020 to new all-time highs will be disappointed by an average year, of course. That's because gold would have to rise by 30% from current levels to make it to a new all-time high.

That seems most unlikely, for at least three major reasons:

Gold does not exhibit strong year-to-year momentum.

This is an important point because many gold investors think just the opposite. They believe that a strong year for bullion (such as this year, with gold up nearly 16% with just one week left in 2018) is more likely than not followed by another good year — and vice versa.

Yet rigorous statistical tests fail to find compelling evidence of such year-to-year momentum.

The application of those tests is necessary because, when merely eyeballing the data, it can certainly appear as though this momentum exists. Gold rose for 11 calendar years in a row, for example, from 2002 through 2012. And, but for one year along the way, gold bullion was either flat or down in each of the 14 years from 1988 through 2001.

Yet this appearance of momentum is not confirmed by statistical tests at the 95% confidence level that statisticians often use to determine whether a pattern is genuine. Absent significant results, of course, the best guess is that the order of good and bad years in the gold market is random.

This shouldn't come as a surprise, by the way, given the workings of an efficient market. If there were an above-average chance that a good year is followed by another good year, shrewd traders would jump the gun and buy in advance of that second year. This would bid gold's price up before that second year even started, thereby killing the goose that lays the golden egg, so to speak.

Inflation remains low.

This also is an important point to consider, because many gold investors view bullion as a hedge against higher inflation. There appears to be little to hedge, however. According to the Cleveland Fed, the bond markets implicitly are betting that annualized inflation over the next decade will be just 1.71% — and only marginally more than that (2.08%) between now and 2049, 30 years from now.
Needless to say, the markets can be wrong. But I wouldn’t be too quick to blithely dismiss the markets’ implicit bets. The bond markets collectively are worth trillions of dollars, more than the combined market value of all publicly-traded stocks – and far more than the market value of gold and gold-mining stocks. Huge amounts of money are bet each day on mere basis point changes in inflation expectations. It’s most unlikely that they are overlooking anything obvious, or even merely mildly probable, on the inflation front.

In any case, inflation would have to heat up in a very big way before it would support significantly higher prices. I say that because of research conducted by Claude Erb, a former fixed-income and commodities manager at mutual-fund firm TCW Group, and Campbell Harvey, a finance professor at Duke University. (Click here to download their study.) The two constructed a fair value model for gold based on a ratio of gold’s price to the Consumer Price Index, according to which gold’s current fair value is around $930 an ounce.

If you believe their model, the CPI would need to rise at an annualized rate of 5.0% for the next 10 years to merely justify gold’s current price – much less support a run to new all-time highs.

**Gold market sentiment doesn’t support a strong rally.**

Finally, contrarian analysis doesn’t support the notion of a strong gold rally. To be sure, gold market timers aren’t excessively bullish right now, so contrarians aren’t outright bearish on gold. But, by the same token, the gold timers aren’t excessively bearish, either.

Instead, contrarian analysis is exactly neutral on gold’s near-term prospects.

Consider the average recommended gold market exposure level is among short-term gold market timers (as measured by the Hultbert Gold Newsletter Sentiment Index, or HGNSI). This average currently sits at 52.1%, which is higher than 79% of all other daily readings since 2000. Historically, I have found, the strongest gold rallies have begun when the HGNSI is a lot lower than it is now – in negative territory, in fact. That occurs when the average gold timer is recommended an outright short position for gold traders.

Clearly we are a long way away from contrarians being willing to flash a buy signal for gold.

The bottom line: None of the three factors discussed here – the historical precedents, inflation expectations, and gold-timer sentiment – supports the notion that gold will have more than an average year in 2020.

Anything can happen, needless to say. But acknowledging such possibilities is different than making an intelligent bet.