MyStratWeekly
Market views and strategy

Ostrum ASSET MANAGEMENT

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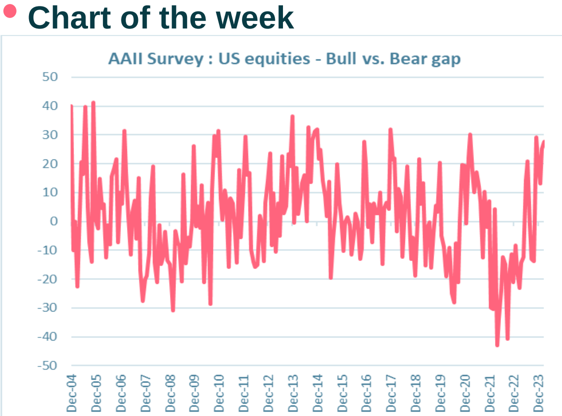
Topic of the week: The New Gold Rush

- **Gold prices have reached historic highs;**
- **Financial conditions are determinants of short-term prices prospects;**
- **However, demand, particularly from central banks, is an important determinant in the long term;**
- **Since 2008, the demand for gold from central banks in emerging countries has more than doubled;**
- **This reflects a willingness to diversify away from the dollar for economic and geopolitical reasons;**
- **The precious yellow metal also serves as a means to circumvent international sanctions.**

Market review: The return of specific risk

- **United States: growth in 4Q revised to 3.4%;**
- **• Global stocks up 8.8% in the 1st quarter;**
- **• The budget deficit weighs on the OAT spread;**
- **• The specific risk returns to high yield.**

Chart of the week



Source: Bloomberg, Ostrum AM

The American Association of Indivudal Investors (AAII) produces a survey of market participants to gauge sentiment across financial markets.

The chart shows investor responses regarding the US equity markets. The bull vs. bear gap stands at 27.6 % indicating a high level of bullishness among US stock investors.

Excessive optimsm is sometimes followed by a market correction.

Figure of the week

5.5

Source : Bloomberg

This represents France’s fiscal deficit as a share of GDP in 2023. Revised data came in much higher than anticipated due to a revenue shortfall of close to 20 billion euros.

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• Topic of the week

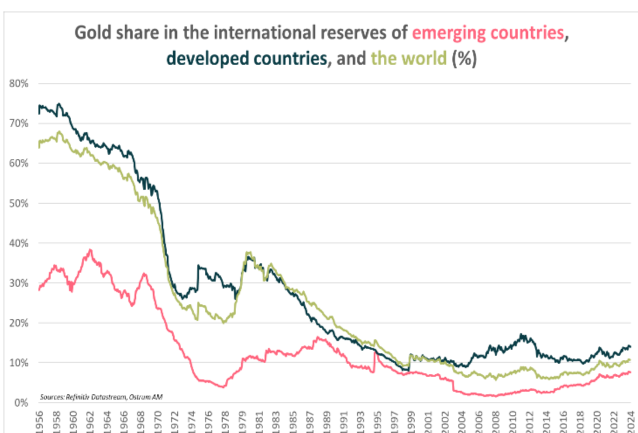
The New Gold Rush

Gold prices hit a historic record by surpassing $2,250 per ounce following the latest FOMC. Over the course of a year, gold prices have surged by 12%. While financial conditions determine the short-term outlook for the precious yellow metal, the increasing demand from emerging markets central banks is a significant factor for its long-term trend.

Gold in Central Banks' Reserves

Gold has unique characteristics: no risk of default and a real value. These properties have given it a central role during the development of "paper" currencies, which were based on the gold standard, meaning that currencies were exchangeable for a certain weight of the precious yellow metal. Western central banks then held significant gold reserves to ensure the value of their currencies until the end of the Bretton Woods system in 1971, which ended gold's role as the guarantor of the value of global currencies.

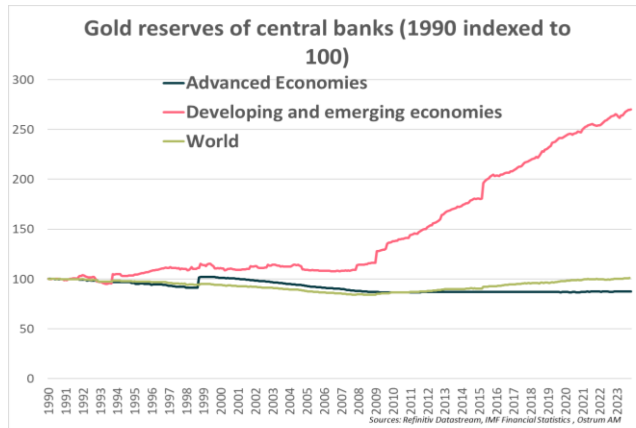
Since then, the share of gold in the reserves of Western central banks has continued to decline, dropping from nearly 72% in 1956 to 20% in the early 1990s, as shown in the graph below.



This is explained by the success of Central Banks in controlling inflation after the 1980s. Gold, which was used to quickly raise capital for interventions in the foreign exchange market to defend currencies, appeared to be less and less necessary. However, gold currently represents 10% of Central Bank reserves, which is not insignificant.

The year 2008 marked a turning point in the behavior of emerging markets central banks.

While the precious yellow metal currently represents only 7% of the reserves of Central Banks in emerging countries, their gold reserves have more than doubled since 2008, as shown in the graph below.



China, Russia, India, and Turkey are the main contributors. The rapid increase in the gold reserves of emerging markets central banks reflects a willingness to diversify away from the dollar, which still represents two-thirds of central banks reserves globally.

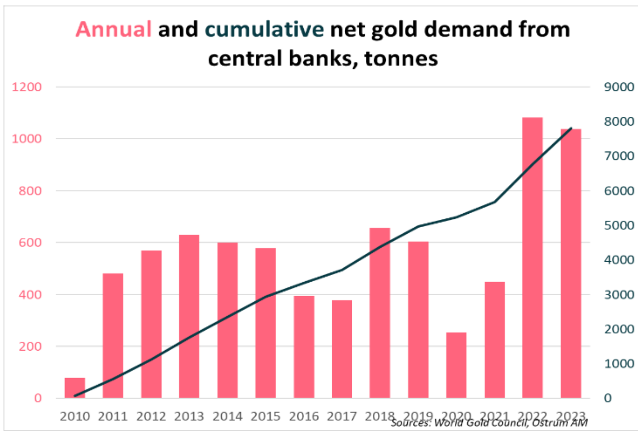
The declining confidence of emerging countries in the greenback is linked to both economic and geopolitical considerations. Indeed, the 2008 financial crisis highlighted the liquidity risk of the dollar, eroding confidence in the stability of the American financial system. In the same year, China launched its yuan-based currency swap framework to provide liquidity to emerging markets central banks facing a shortage of dollars.

The colossal indebtedness of the United States also raises fears of a loss of confidence in the greenback, which could support the demand for gold. According to the latest projections from the CBO, US public debt could reach 107% of GDP by 2029, surpassing the peak of 105% reached during World War II.

What substitute then for the dollar? The Chinese currency is not yet ready to compete with the greenback, as the growth of its financial markets does not keep pace with its economic expansion. The euro carries a political risk, as demonstrated by the Brexit episode. Therefore, emerging markets central banks have turned to the barbarous relic to diversify their reserves.

The war in Ukraine has revived the appetite for the precious yellow metal.

The G7's decision to freeze the 300 billion dollars in assets of the Central Bank of Russia raised the question of whether reserves could be better preserved in another form, shielded from sanctions. Since the outbreak of the war in Ukraine, central banks' net purchases of gold have significantly increased, as shown in the graph below.



Since 2010, central banks have accumulated 7,800 tons of gold, with more than a quarter purchased in the last two years. Most purchases come from emerging countries. China is the largest buyer of gold. Last year, the PBoC reported a total increase of 225 tons in its gold reserves, the largest increase since 1977! Its gold reserves reached 2,235 tons but represent only 4% of its total reserves.

Poland is the second largest buyer. This is explained by the country's proximity to the Ukrainian conflict. Between April and November, the National Bank of Poland (NBP) bought 130 tons of gold, increasing its gold holdings by 57% to 359 tons. This is also a record purchase volume for the NPB. Its governor had indicated a willingness to increase the share of gold in the country's international reserves from 12% (current level) to 20%.

The year 2024 is also expected to be a year of strong demand for gold, due to the geopolitical context – war in Ukraine, tensions in the Red Sea, and conflict in the Middle East – but also because of the busy electoral calendar. Most elections, including the U.S. presidential election, have global ramifications, reflecting the overlap between politics and geopolitics.

Gold to circumvent sanctions: The Example of Russia

Gold transactions offer advantages for bypassing sanctions, such as anonymity, low traceability, and alternatives to Western financial centers where the United States and its allies can restrict trade flows. Following the U.S. and European sanctions imposed after the annexation of Crimea in 2014, Russia began significant gold purchases. The graph below depicts the share of gold in the reserves of the Russian Central Bank.

The proportion of the precious yellow metal in reserves increased from 10% in 2013 to 26% in 2023. Since 2013, Russia had been preparing for potential sanctions. Its strategy of accumulating gold allowed it to withstand the impact, as the gold market remained isolated from the sanctions.

The sanctions imposed by NATO only affected maritime transport and trade to Russia. After British sanctions prohibited gold imports from Russia, the United Arab Emirates quickly became a hub for Russian gold transactions, enabling Russia to exchange its gold for dollars and thus circumvent NATO sanctions. The United Arab Emirates imported 96.4 tonnes ($6.2 billion) of Russian gold in 2022, compared with 1.3 tonnes imported in 2021.

Conclusion

Central banks' interest in gold grew after the 2008 financial crisis, which revealed the liquidity risk of the dollar. In 2022, the freezing of Russia's $300 billion reserves by the G7 countries following the invasion of Ukraine served as an electroshock for emerging countries. In the absence of an alternative to the dollar, gold quickly became the way to preserve reserves from U.S. sanctions. The demand from emerging markets central bank for the precious yellow metal is expected to remain high due to the geopolitical context: war in Ukraine, tensions in the Red Sea, and conflict in the Middle East. This is a decisive factor for long-term price trends.

Zouhoure Bousbih

Market review

The return of specifc risk

The 1st quarter ended on a very positive note for equities and credit. Be careful, however, of the specific risk on high yield and government bonds.

The week preceding the Easter weekend is even quieter this year as it coincides with the quarterly closing. Activity on the primary bond market is slowed down by the window dressing of bank balance sheets at the end of the financial quarter. Against this backdrop, investors tend to take profits on their winning bets. The tightening of sovereign bond spreads is fading as fiscal deficit fundamentals come back into play. The first quarter of 2024 nevertheless remains solid for risky assets. Global stocks (MSCI World) are up 8.8% at the March close. In turn, 10-year government bond yields rebounded by 27 bp (Bund at 2.30%) to 40 bp (Gilt) despite the prospect of monetary relief. The T-note yield stands at 4.20%. The persistence of inflation still raises questions about the start of the monetary cycle. Euro IG credit spreads remain around 80 bp against swap. The strength of the US greenback contrasts with the unusual weakness of the Japanese yen at the end of the fiscal year. The meeting of the BoJ and the MoF perhaps foreshadows an intervention around 152 on the dollar-yen exchange rate.

The US economy experienced a first quarter in line with potential growth after a solid 4th quarter of 2023 (revised to 3.4% annualized rate). Household spending remains a key driver of US growth (+3.3%). Investment in structures continues to grow at a sustained pace (+10.9%), which should lead to a recovery in capital goods expenditure, which was surprisingly downbeat in the second half (-2.5%). Research and development spending accelerates to 4.3% over the last three months of 2023. February data foreshadows a further increase in consumption which should grow close to 2.5% in the March quarter. The reduction in consumer price inflation is more gradual than expected. The deflator rose by 0.1 pp to 2.5% in February. In the euro area, surveys depict a gradual but uneven recovery within the monetary union. Germany keeps lagging behind. In France, the current situation of public finances requires corrective measures. Consumption remains very soft. Disinflation (2.4% according to the French HICP for February) will not have had the expected effect of boosting spending. The withdrawal of measures capping the cost of living, which appears necessary for budgetary consolidation, is causing inflation to rise in Spain (3.2%) or Italy (1.3%). Credit to the private sector is slowly improving (+0.6% over one year) after the sharp decline following interest rate increases.

The Treasuries market is stabilizing about 4.20% on 10-year bonds at the quarterly close. The speech of Christopher Waller, who put his hawkish suit back on, sparked a modest upward pressure on the 2-year notes (4.62%). The cap on long-term rates is adjusting lower regularly despite a bumpy inflation profile. In the eurozone, the Bund is trading at around 2.30% before the prolonged Easter weekend. Investors' attention is once again focused on budget deficits. The French slippage, at 5.5% of GDP in 2023, reveals the effect of disinflation on tax revenue (€20 billion short of expectations) and the inertia of public spending. In this context, which is otherwise favorable to profit-taking, the spread on the 10-year OAT rose above the 50 bp threshold. The decisions of Fitch and Moody's on April 26 and then S&P at the end of May could accelerate the underperformance of French debt. The OAT spread widening is impacting all government bonds in the euro area.

Euro credit is holding up. The average spread against swap turns out to be stable around 80 bp. Reduced activity on the primary market at the end of the quarter offset the slowdown in flows. The moderate widening of swap spreads could nevertheless lead to a widening in credit spreads over the coming weeks. The swap spread tends to foreshadow the direction of asset swap spreads. Specific risk is back in the high yield segment. The expected decompression of spreads on the lowest ratings seems to be confirmed.

Global stocks are up 8.8% over the first three months of the year. In Europe, banks are leading the way with an increase of 14% in March. In the United States, energy, basic materials and utilities are taking over from technology.

Axel Botte

Main market indicators

G4 Government Bonds	02-Apr-24	1wk (bp)	1m (bp)	2024 (bp)
EUR Bunds 2y	2.87%	0	-2	+47
EUR Bunds 10y	2.36%	+1	-5	+34
EUR Bunds 2s10s	-50.9bp	+1	-3	-12
USD Treasuries 2y	4.7%	+11	+17	+45
USD Treasuries 10y	4.32%	+9	+14	+44
USD Treasuries 2s10s	-38bp	-2	-3	-1
GBP Gilt 10y	4.02%	+5	-9	+49
JPY JGB 10y	0.75%	+1	-9	-26
€ Sovereign Spreads (10y)	02-Apr-24	1wk (bp)	1m (bp)	2024 (bp)
France	51bp	+2	0	-3
Italy	138bp	+8	+0	-29
Spain	84bp	+1	-2	-12
Inflation Break-evens (10y)	02-Apr-24	1wk (bp)	1m (bp)	2024 (bp)
EUR 10y Inflation Swap	2.2%	-4	-3	+7
USD 10y Inflation Swap	2.57%	+2	+3	+16
GBP 10y Inflation Swap	3.67%	-2	+3	+14
EUR Credit Indices	02-Apr-24	1wk (bp)	1m (bp)	2024 (bp)
EUR Corporate Credit OAS	114bp	+0	-7	-24
EUR Agencies OAS	61bp	+1	-2	-9
EUR Securitized - Covered OAS	64bp	-1	-5	-14
EUR Pan-European High Yield OAS	364bp	+9	+13	-35
EUR/USD CDS Indices 5y	02-Apr-24	1wk (bp)	1m (bp)	2024 (bp)
iTraxx IG	55bp	-1	+0	-4
iTraxx Crossover	299bp	-1	+1	-14
CDX IG	52bp	0	+1	-4
CDX High Yield	334bp	+16	+3	-22
Emerging Markets	02-Apr-24	1wk (bp)	1m (bp)	2024 (bp)
JPM EMBI Global Div. Spread	336bp	-8	-33	-48
Currencies	02-Apr-24	1wk (%)	1m (%)	2024 (%)
EUR/USD	$1.073	-0.933	-1.179	-2.8
GBP/USD	$1.256	-0.562	-1.103	-1.4
USD/JPY	JPY 152	-0.106	-0.791	-7.0
Commodity Futures	02-Apr-24	-1wk ($)	-1m ($)	2024 (%)
Crude Brent	$88.1	$2.0	$5.4	14.9
Gold	$2 255.4	$78.5	$138.8	9.3
Equity Market Indices	02-Apr-24	-1wk (%)	-1m (%)	2024 (%)
S&P 500	5 244	0.18	2.08	9.9
EuroStoxx 50	5 083	1.04	4.22	12.4
CAC 40	8 206	0.66	3.51	8.8
Nikkei 225	39 839	-1.38	-0.18	19.0
Shanghai Composite	3 075	1.43	1.58	3.4
VIX - Implied Volatility Index	13.65	4.52	4.12	9.6

Source: Bloomberg, Ostrum AM

Additional notes

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