Market Update

Failed monetary policies lift gold

August 2016 www.gold.org

Analysts are scrambling to increase their gold price forecasts, as the gold price continues to rise. The gold price breached US$1,360/oz for a second time in 2016, a level previously seen in early 2014. A weak Japanese bond auction on August 2nd unnerved markets, pushing the gold price up 29% for the year in US dollar terms. Many analysts are interpreting weak Japanese Government Bond demand as a signal that investors are starting to lose confidence in the effectiveness of unconventional monetary policies, following increasingly desperate bids by the world's central banks to reflate the global economy. In this environment, we believe investors are using gold to hedge portfolio risk as they add more stocks and low quality bonds to their asset mix.

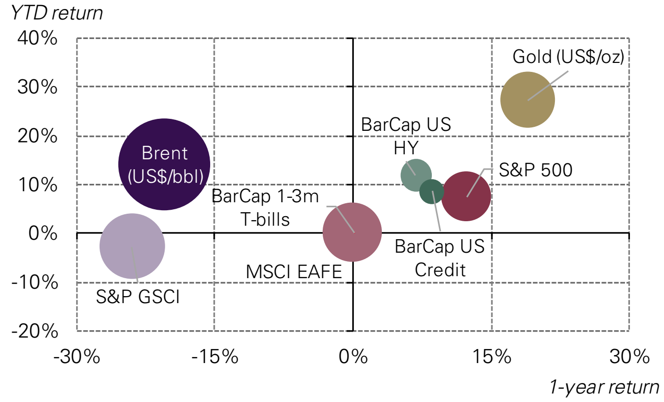
A perfect storm lifts gold up

The gold price continues to rise, moving above US$1,360/oz and increasing by almost 29% in US dollar terms year-to-date (as of 8/2/2016). This has been gold's largest continuous gain since the European sovereign debt crisis in 2010 and 2011.

Gold has been one of the best performing assets so far this year, outpacing all major benchmark indices and with comparable volatility to stocks (**Chart 1**). It has also outperformed commodities such as crude oil, whose prices have plunged since the end of June.

Chart 1: Gold has outperformed most asset classes

YTD, 1-year return, and volatility for various assets*



*As of 2 August 2016. Area of the bubbles represent relative volatility.
Source: Bloomberg, ICE Benchmark Administration Ltd., World Gold Council

Gold's most recent surge was driven in part by weak demand during the 10-year Japanese Government Bond (JGB) auction on August 2nd, as investors have begun to **question the effectiveness of unconventional monetary policies**.

Negative yields, ETF buying next

Amid rising uncertainty in global financial markets after Brexit and the recent slowdown in emerging market economies, the Bank of Japan (BoJ) announced an expansion of its quantitative easing policies. Specifically, BoJ almost doubled its purchases of ETFs to an annual pace of JPY6 trillion (approx. US$60 billion) and, at the same time, doubled the size of its US-dollar lending programme to US$24 billion. Many investors, however, were disappointed, as the market was anticipating larger increases to asset purchases and/or further rate cuts. We believe that the weak JGB auction and ensuing sell-off in global sovereign bonds this week, suggests that **investors may be losing confidence in government securities**.

At the same time, the European Central Bank has signalled they too will further expand quantitative easing in one form or another, while the Bank of England is also expected to cut rates and/or restart its asset purchase programme.

As a hard asset, gold has provided an alternative to balance the long term risks of fiat currencies and ineffective monetary policies.

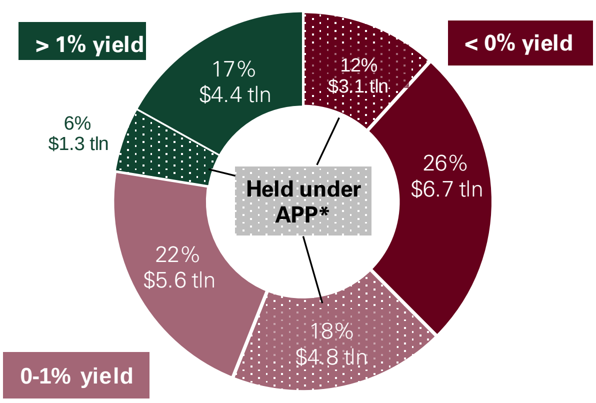
Few options, more risk

Amid expansionary policies, global bond yields are stubbornly low despite some minor adjustments. Currently, close to 40% (US$10 trillion) of high quality sovereign debt is trading with a negative yield. But this widely-cited statistic masks the fact that a significant amount of developed market (DM) sovereign debt is unavailable to investors. More than a third (US$9 trillion) currently sits on central bank balance sheets as part of their asset purchase programmes (**Chart 2**). In reality, we estimate that less than 40% of DM sovereign bonds (US$10 trillion) have a positive yield and are "available" to investors, while only 17% (US$4.4 trillion) is yielding more than 1%.

In our view, lower opportunity costs and a more limited set of investable assets has, in turn, notably increased the lure of gold.

Chart 2: Only a fraction of DM sovereign debt that is available to investors trades with positive yield

Outstanding sovereign debt sorted by yield (US$26 trillion)



*Sovereign debt held by the Federal Reserve, Bank of Japan, European Central Bank, Bank of England under their respective Asset Purchase Programmes (APP) for monetary policy.

Source: Bloomberg, World Gold Council

With limited options, disenfranchised investors are also **adding risk to their portfolios**. There have been record flows into equities and corporate bonds (both high grade and high yield), as investors search for higher returns. But this has also made valuations more expensive (the S&P 500, Dow Jones and Nasdaq have all hit new historical records). This has altered the balance of traditional portfolios, making them more susceptible to corrections and volatility. In a recent article, the Wall Street Journal estimated that investors looking to obtain a 7.5% annual return would need to tolerate twice as much volatility as they did ten years ago!

In this environment, we believe investors are using gold to hedge portfolio risk as they add more stocks and low quality bonds to their asset mix.

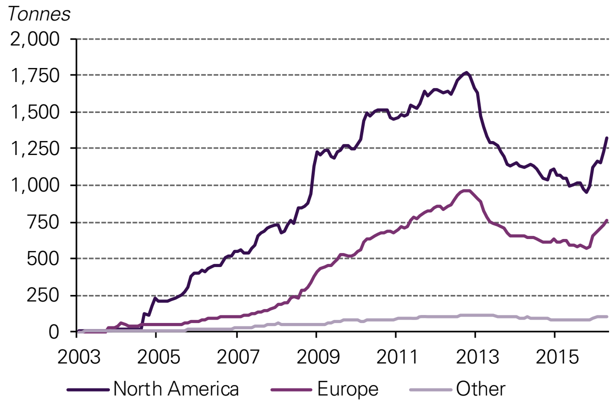
Gold as a valuable alternative

Together, these factors have led to higher investor inflows. Gold backed ETFs have seen record inflows, adding 630 tonnes (US$25 billion) year-to-date (as of 7/31/2016), and bringing their collective global gold holdings to 2,240 tonnes. This is a substantial increase, but still 25% below their 2012 high (**Chart 3**).

While some of these flows may be more tactically driven, led by price momentum and risk aversion, quantitative analysis on (partial) available data coupled with anecdotal evidence suggests that there is interest across many types of investors and that many are re-building their strategic positions in gold.

Chart 3: Gold-backed ETFs have accelerated their inflows, but holdings remain well below their high

Cumulative ETF gold holdings by region*



*As of 31 July 2016.

Source: Respective gold-backed ETF providers, World Gold Council

Gold analysts have increased their forecasts. UBS now expects US$1,400/oz for the end of the year, while Credit Suisse and Bank of America Merrill Lynch have it even higher at US$1,500/oz over the next 6 months. The median Bloomberg forecast for the end of 2016, based on 16 analysts, is 16% higher than it was at the beginning of the year.

About the World Gold Council

The World Gold Council is the market development organisation for the gold industry. Our purpose is to stimulate and sustain demand for gold, provide industry leadership, and be the global authority on the gold market.

We develop gold-backed solutions, services and products, based on authoritative market insight and we work with a range of partners to put our ideas into action. As a result, we create structural shifts in demand for gold across key market sectors. We provide insights into the international gold markets, helping people to understand the wealth preservation qualities of gold and its role in meeting the social and environmental needs of society.

Based in the UK, with operations in India, the Far East and the US, the World Gold Council is an association whose members comprise the world's leading gold mining companies.

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