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Gold heads north on weak US employment results

A weak non-farm payrolls report in the United States saw gold prices rally strongly on Tuesday night, Australian time, heading up into the USD $1340 range, continuing a solid week for precious metals, which have rallied since the US government ended its shutdown, and pushed their debt-ceiling debate into early 2014.

From a low of around USD $1255 only a few days ago, gold has rallied near USD $90, and silver has followed suit too, up from below USD $20.50 on the 15th October to USD $22.06 on the 22nd October.

As we speak, the gold price is currently trading at USD $1332.05 and silver is at USD $22.59.

From their low point in late June, precious metals are now up 11.75% (gold) and 19.78% (silver), a reasonably strong rally in H2 2013, although still obviously a long way below where they started the year.

And whilst it's not certain that the correction in gold and silver prices is over, the recent weakness in the USD, and the likely delay of Fed tapering have given some not-entirely-misplaced encouragement to precious metal bulls.

Even Bank of America Merrill Lynch have turned bullish in the short-term, and the reasonable strength in precious metal miners has also been encouraging. On top of that, overall sentiment is still dead in the water, with a CNBC gold sentiment survey from a couple of weeks back showing 83% bearishness.

That's typically a good sign from a contrarian perspective.

If gold can break decisively above the USD $1340- $1350 range then we could well be on the way back to test USD $1400, although gold probably needs to break above USD $1420 before we can be certain that we've seen the worst of this correction and that the June low really was the bottom.

US non-farm payrolls and the state of the American labour market

Economic commentators and market analysts are definitely happy that the US government shutdown is over, and that that the debt ceiling issue has been pushed into next year, as it will now allow for a whole heap of data releases which were held back throughout the whole fiasco.

And whilst there has been some data out in the past week of note, including a decline in the NY Empire State Manufacturing Index, a decline in the National Association of Home Builders Index, a rise in initial jobless claims and a decline

in existing home sales (all poor results), markets were overwhelmingly focused on the September non-farm payrolls report, which was released late Tuesday night Australian time.

The headline print of 148,000 job creations was well short of the 180,000 that the market was expecting, with Goldman Sachs and Barclays predicting the US added 200,000 jobs for the month.

The September report was also well below the 193,000 that were created in August (this number was revised up).

Average hourly earnings and the average workweek were essentially unchanged, as was the Labour Force Participation Rate, which remained steady at 63.2%, its lowest level in over 30 years.

The fall in this rate (which was over 66% when the GFC hit) has been one of the major factors in lowering the official unemployment rate, which dropped to 7.2%, as more and more Americans simply give up looking for work.

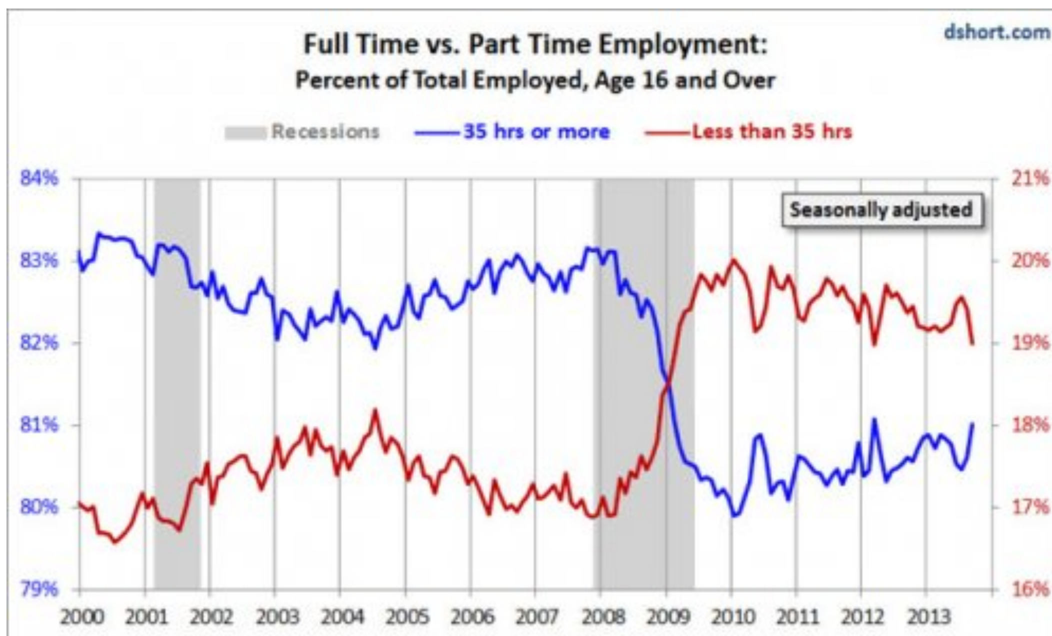
And, whilst mainstream analysts in many cases dismiss the fall in this rate as a function of the ageing population, the reality is that it's predominantly Americans in the pre-retirement demographic that have seen net job growth since the GFC hit, as they stay in the workforce longer in order to provide for themselves as they head into retirement.

Digging further into the detail, the four areas which contributed the most to job 'growth' were transportation and warehousing, retail trade, temporary help and government workers, which was something of a surprise as that last component hasn't been particularly strong of late.

This type of job growth continues a trend that has been evident since the onset of the GFC, which is a trend towards more part-time, and typically lower-paying jobs. It's not only the quantity of job growth that has been disappointing, but the quality too.

This is in no way to besmirch these jobs, or the people doing them, but from a purely economic perspective, clearly a person employed full-time on a high salary has more buying power in the economy, meaning their spending can do more to create sales, profits and ultimately employment opportunities for others, than a more poorly-paid, part-time worker.

Note that this is a trend that will likely be impacted negatively going forward, due to the passage of the Affordable Care Act (Obamacare), as there are stricter regulations and more serious burdens for the employer to carry, should they employ full-time rather than part-time workers.



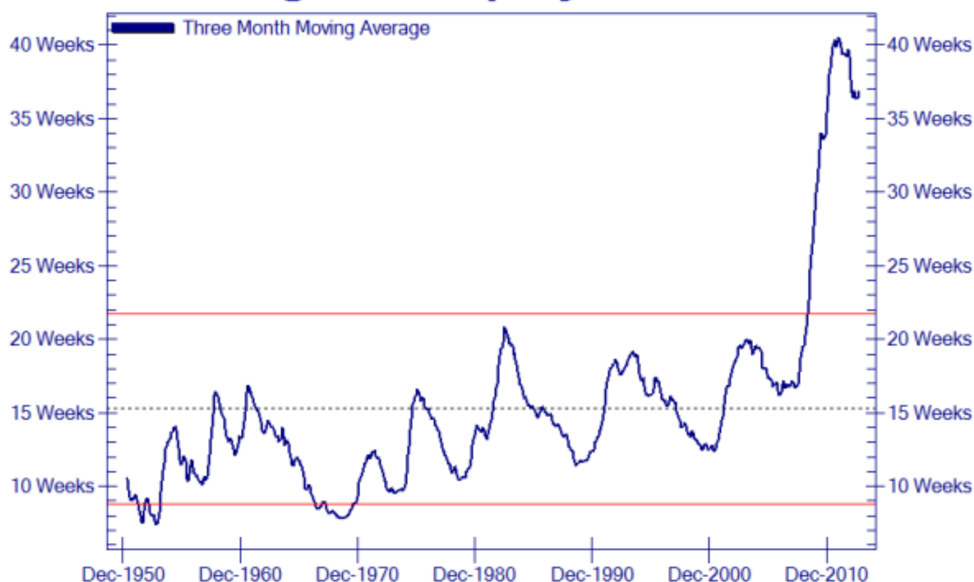
Source: Doug Short (via Financial Sense): full article here.

Job openings in the US have also been trending down, which portends a tougher time ahead for the unemployed in America.

Though not up to the end of September, in July of 2013, there were 3.7 million job openings in America, which is a full 1 million jobs on offer lower than at the same point pre-GFC in March 2007, highlighting how far from recovering from the GFC we truly are.

In light of weak non-farm payroll prints since then, it's unlikely the job opening situation will have improved in the last 3 months.

The deterioration in job openings helps explain why the current crop of unemployed Americans are having to deal with an unprecedented amount of time out of the workforce, which you can see clearly in the chart below:



Source: Zerohedge

They say that a picture tells a thousand words. If ever there was a chart to sharply highlight how different the post-GFC period is to the 'norm' for the previous 50 years, the plight of America's unemployed in terms of how long they remain out of the workforce is certainly up there.

Turning back to the payrolls report specifically, what can't be doubted is that there has been an undisputed weakening in the trend of payroll growth. Over the past 12 months the trend in payroll growth is a respectable (if not strong) 185,000 jobs a month, within sight of the 200,000 number many economists feel delineates between a genuine US recovery or otherwise.

However, over the last 3 months, the trend in payroll growth is only 143,000 jobs per month, well short of what would be needed to signify genuine strengthening in the US labour market, or in the economy as a whole.

For an excellent read into the disappointing state of the US job market, I'd recommend the following report by Westpac, which you can access via the Macrobusiness website.

And this weakness is one of the main reasons that the market now no longer expects that the Fed will taper its QE programme any time soon, with Goldman Sachs now expecting that at the earliest, the Fed will begin tapering in March 2014.

Whilst Goldmans could be correct, it must be re-stated that earlier this year, the market was convinced that the US economy was on the cusp of a strong economic recovery, the housing market was coming back to the life, and not only would tapering begin in September, but that QE would be wound up in its entirety by early 2014.

This article, which appeared in Bloomberg earlier this year even indicates that most members of the Fed itself were of the opinion that QE could be wound up by the end of 2013 at the latest.

Yet here we are, barely 2 months away from the end of 2013, and tapering has not, and likely will not even begin this year, the labour market is weakening, and mortgage applications and refinance activity (good proxies for the strength of the housing market) are down 50% or more since their early 2013 highs.

Tapering of QE also appears off the table for now, especially with the appointment of Janet Yellen.

And the new market expectation, that the Fed taper will no longer occur this year has seen a bout of continued USD weakness, not only helping to push gold up but, alarmingly, at least for the RBA, seen a strong rise in the AUD.

After falling below USD $0.90 a couple of months ago, the AUD has rallied strongly, rising to well over USD $0.96 as we speak, helping to holdback AUD

denominated precious metal prices, and providing a buying opportunity for domestic investors who are bullish in their outlook as I am.

Australian investment guru talks markets, money printing, and why he owns gold in his portfolios

In last weekend's Australian Financial Review, there was a tremendous interview conducted with Matthew Mclennan, who works for First Eagle Investment Management out of New York, responsible for managing roughly $80 billion in funds, which are primarily invested in global equities, cash and gold.

The whole interview is worth reading, as he touches on the risks of financial repression via low interest rates and quantitative easing, his outlook for the Australian economy, our housing market and our banking sector.

Most important though were his observations about gold, the nature of money itself and the dangerous path we are on.

I've included a few quotes and paragraphs from the article that I think were particularly interesting (my emphasis):

On whether or not policymakers are making a mistake by trying to diversify away the business cycle:

"Originally, central bankers would provide liquidity as a means of last resort. Now we have created a world that is dependent on, or addicted, to central bank liquidity. That's the issue.

We have had an unprecedented messing of the private price mechanism, and the valuable signals that market prices infer over the medium term, through efforts by governments to thwart the adjustment process.

The underlying concern is that you have had a series of "fake prices". First, the price of money has been faked through central banks lowering interest rates to artificially low levels.

So how can you expect to have real economic adjustment, and a proper allocation of scarce capital to its most productive purpose, when ***the price of the money has been faked?"***

In relation to a question about whether or not he was more worried about inflation or deflation;

"*the 10 per cent allocation to gold is a very long-dated hedge against the risk that the manmade financial system breaks at some point because it is not on a sustainable trajectory.*

And if you want to own a potential hedge against frailties of the manmade system you have to own something that occurs in nature – and the reason gold is useful in that context is because it is chemically inert.

The paradox of gold is that its utility as a monetary reserve is its uselessness as a commodity. *Because it is not very useful, its demand is more resilient in the face of business cycle crisis than other commodities. And as it does not rot, rust or waste, it is not just resilient but also a natural resource perpetuity,* ***out-lasting corporate fads and sovereign regimes.***

It also helps that it is scarce with less than one ounce of gold per capita in the world. We believe the antidote to monetary abundance is real assets, be they businesses or gold, that are resilient, long in duration and scarce in nature."

And finally, Aussie inflation figures

In other news, Australian inflation figures were out for the year, officially rising 2.2% for the year, a relatively benign figure if one looks only at the headlines.

Whilst the annual number was nothing to spook the market, the 1.2% increase in prices for the quarter alone certainly got people's attention. If annualised, that would work out to an inflation rate the better part of 5% per year. This is essentially double the cash-rate.

Price rises in fuel, holidays, accommodation, electricity, property rates and water and sewerage treatment were particularly acute, ranging between 3.5% and 9.9% for the period.

No wonder people are finding cost of living pressures harder and harder to deal with, and why investors/savers can't really store their wealth in a bank account anymore with interest rates at only 2.50%.

Sounds like a good environment to be an investor in precious metals.

Until next week,

Jordan Eliseo
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