thesundaytimes

April 15, 2012

Go for gold, but don't ignore silver

Analysts expect prices of precious metals to rise given the demand

Melissa Tan

Gold may seem attractive to hold amid a climate of economic uncertainty, due to its reputation for being a hedge against inflation.

But given the rally in gold prices in recent months, is it too late to buy in?

Not necessarily. Analysts still expect prices to rise in the long term, citing fervent demand for the yellow metal amid economic uncertainty.

Golden outlook

"Gold currently sits in the US$1,600 to US$1,670 band where it has traded sideways looking for the next catalyst," said Mr Justin Harper, market strategist at IG Markets, a contracts-for-difference provider. (US$1,600 is currently worth S$2,018.)

Global demand for gold last year exceeded US$200 billion for the first time, according to the World Gold Council (WGC), a group that aims to stimulate demand for gold.

Mr Albert Cheng, managing director of the WGC's Far East unit, points to "Asian growth and optimism on the one hand and Western desire to protect assets against uncertainty on the other".

"Central banks became the net purchasers of gold in 2010 creating an additional driving force to the global gold demand."

Said Mr Chan Chiong Kong, an investment analyst at DBS' chief investment office: "Reserve allocation to gold remains very low in Asia and other emerging market countries relative to developed countries... We expect Asian and emerging-market central banks' reserve diversification into gold to go on."

But investors need to be cautious, especially if they do not have holding power.

The last few months have not been kind to those who bought gold when it peaked at around US$1,900 an ounce (28g) last September.

"Towards the end of last year, deteriorating financing conditions triggered some selling and in March 2012, higher bond yields and a stronger US dollar weighed on performance," said Mr Tobias Merath, global head of commodity research at Credit Suisse Private Banking. But he added that "monetary policy is very loose and interest rates look set to remain low for the foreseeable future. This is a very supportive environment for gold and should help prices to recover".

Where is price heading?

"Gold could hit above the high established last year at US$1,921 an ounce if the rally in gold continues into the second half of 2012," said Phillip Futures investment analyst Lynette Tan.

Saying that he remained "moderately bullish", Mr Pranay Gupta, chief investment officer for Asia at Lombard Odier, a Swiss private bank, predicted: "We still see gold trading at US$1,800-plus towards the year end."

At the other end of the spectrum, Mr Harper said that if the price manages to surpass the US$1,700 ceiling, a stronger case could be made for it to approach US$2,000.

Potential pitfalls

Three things could bring gold prices down.

The first is if another financial shock dries up credit lines. If this happens, investors may have to sell assets – such as gold – to raise funds.

A second scenario involves central banks raising interest rates. As gold does not pay out interest, investors may decide to sell off their gold to take profit, triggering a price fall.

The third is a stronger greenback.

"Gold has tended to underperform on periods of US dollar strength," Mr Chan said.

Also, because precious metals are priced in US dollars, they become more expensive for Singaporean buyers when the US dollar strengthens.

Mr Gupta added: "We expect an acceleration in mine supply due to an extended period of high prices and margins."

Consider other metals

Not all that glitters is gold. Investors can also consider precious metals like silver, platinum and palladium, analysts say.

Phillip Futures' Ms Tan said that silver and gold prices tend to move "in tandem" but silver is more volatile, meaning that it can both rise faster and plunge further than gold. "Silver has superior fundamentals due to its industrial usage and relatively lower price. For instance, an investor can afford to buy about 50 times more ounces of silver compared to gold in US dollar terms," she added. "Following the broad market sentiments for gold, silver could go above US$40 in 2012."

Silver is currently around US$32.50 an ounce.

Platinum and palladium, used in cars and electronics, are also worth a look as the electronics sector revives.

IG Markets' Mr Harper said palladium has been the best-performing precious metal this year.

"There are some significant supply constraints from Russia, palladium's biggest producer. Russia has steadily fed palladium to the market for decades... but this seems to have come to an end."

This means palladium could rise as much as 20 per cent this year, with double-digit returns anticipated well into 2014, he said.

How much to hold?

DBS' Mr Chan said an investor seeking moderate returns should allocate 5 per cent of his portfolio into alternative investments, which include gold.

Credit Suisse's Mr Merath recommends holding 2.5 per cent in gold and 2.5 per cent in other commodities including other precious metals, regardless of risk appetite.

Mr Cheng, of the WGC, said independent analysis by consultancy Oxford Economics suggests investors should keep around 5 per cent of their portfolio in gold, in a low growth, low inflation climate, for example, where long-term economic growth is 2.25 per cent and with annual inflation running at 2 per cent.

If inflation is higher, investors should hold more gold, he said.

How to invest in gold

For gold and silver, the easiest way to invest is to walk into a goldsmith's shop and pick up the physical metal. As they are portable in small quantities, you can take them home instead of paying storage fees. You are also not exposed to counterparty risk.

Investment-grade precious metals can also be traded in the form of exchange-traded futures or over-the-counter spot contracts, though those tend to involve leveraged or margin trading.

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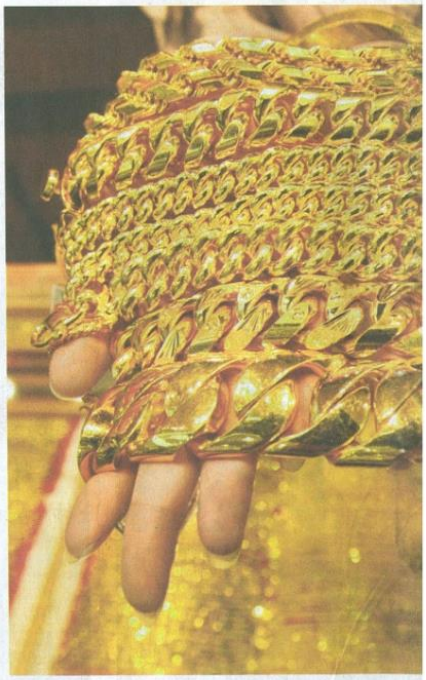

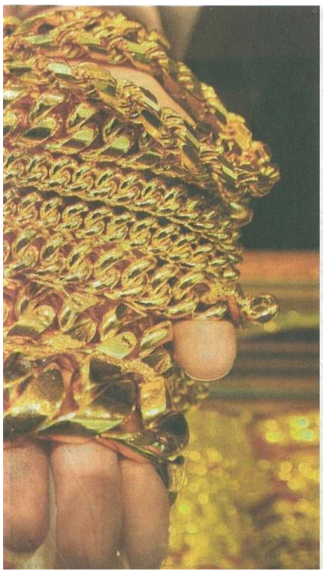

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Global demand for gold (left) last year exceeded US$200 billion (S$250 billion) for the first time. Investors can also consider palladium (above), the best-performing precious metal this year.