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Market Insights

Gold's Response to War

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Investors are concerned that gold has not responded to the Iran conflict, nor to a dovish Federal Reserve today. Indeed, gold is *down* $500 from the start of the bombing campaign. What is going on? Is the gold bull market over?

Gold, famously, is known a safe-haven asset, and as such might be expected to move up whenever there is geopolitical chaos or a military eruption somewhere in the world. But in practice, it does not always work out that way. In fact, more often than not, gold *declines* in the weeks following a geopolitical event. There are three explanations for this.

- Often, gold moves up in advance of the "event", buying on the rumour and selling on the news.
- The dollar, another safe-haven asset, often rises sharply on any geopolitical event, and since gold is measured in dollars, other things being equal, the dollar-price of gold declines.
- Often a serious geopolitical event sees a liquidity crisis, and gold, being instantly liquid 24-hours a day around the globe, often feels the brunt of selling.

We saw this clearly with the Russian invasion of Ukraine in February 2022. For weeks, as rumours swirled and tanks massed on the border, the gold price moved up, $260 in one month. Within a week of the tanks crossing the border, gold peaked, and soon gave up all of its prior gains.

Whether or not gold advances following a geopolitical event depends not only on the factors above, but also on the extent to which it rose ahead of the event, as well as the other factors surrounding the gold market. Also, if the geopolitical event is viewed as likely contained, the impact on the gold price will be short lived, while if there is a widely held view that the conflict may expand, then the effect on the gold price may be longer.

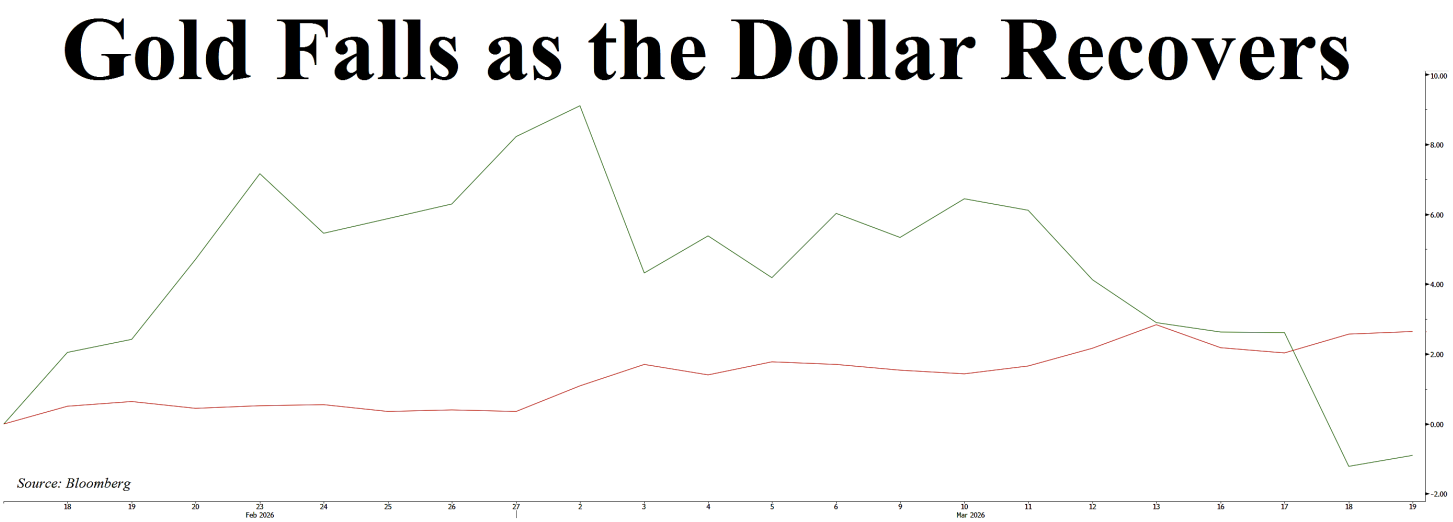
In 1979, gold was already strong

Contrary to 2022, the 1979 takeover of the U.S. Embassy in Tehran and hostage taking was quickly followed by the Russian invasion of Afghanistan and then the failed U.S. rescue mission. Russian power was apparently expanding while U.S. power was undercut. The U.S. dollar actually *declined* in the face of this crisis (the loss of U.S. power and prestige). Gold, of course, was already in a bull market, more than doubling in the year leading up to the hostage taking.

So, it is not surprising that gold moved up sharply after this and remained above the price on the day the Embassy was overrun for another two years (until Ronald Reagan was elected promising a new dawn in America, and the hostages returned home). Note also that the monetary policy that had propelled gold all the way from 1971 was reversed by Fed Chairman Paul Volker.

Where do we stand today?

So what of the current Iran crisis? In classic buy-the-rumour, sell-the-news style, gold appreciated almost $500 in the eight days before the weekend bombing of Iran on the last day of February as tension built in anticipation.



Gold soon started to give that back as the dollar, which had been more-or-less unchanged for the two months prior, suddenly shot up. Interest rates on Treasuries also moved up, providing competition for safe-haven funds.

Higher oil prices also hurt gold

The higher oil price, adding to concerns about consumer prices and reducing expectations for interest rate cuts, also hurt gold. Today, the Federal Reserve not only left rates alone today, as expected, but then indicated that there may be only one rate cut for the balance of this year. Funds futures are pointing to the same. This sudden shift in sentiment comes after wildly optimistic speculation about what a "Trump Fed" might look like. The majority of members of the Fed Open Market Committee are still more concerned about inflation than employment (suggesting higher not lower rates), and the rotations from the current membership make-up to Trump appointees will take time. Chairman Powell today indicated that he is in no rush to step down.

Higher oil prices also hurt gold in another way. A higher price could put pressure on buying from countries such as India, China and other oil-importing emerging nations. These have been major buyers of gold, both official and private.

However, we are less concerned about the effect of higher oil prices on the miners. They would of course add to costs–diesel is the largest single cost input for mines–so would reduce company margins, which have been remarkably strong and rising the last few years, helped by a low oil price. But the impact can be overstated.

A study from Bank of Montreal concluded that costs for gold miners would increase by about 2% for every $10 move in the oil price. So a move from $60 to $100, such as we have seen this month, would increase costs by around 9%. Though meaningful, this would hardly be a disaster. In addition, some companies have hedged their diesel; Agnico, for example, has hedged a little over half of its 2026 estimated exposure at an average of $0.69 per litre. The spot price (NYMEX) is now over $4/litre.

So while a higher oil price is unquestionably a negative for gold mining companies, the impact is manageable. Again, for Agnico, with All-In Sustaining costs of $1,339, and the gold price over $4,800/oz, there is room for

costs to increase and the company to continue to generate margins well above its historical norm, and continue to be wildly profitable.

Now, nearly three weeks after the start of hostilities, gold has given back all of its move up leading into the conflict. Once the war ends or settles down, then the monetary factors that drove gold for the last three years will come to the fore again. The Iran situation, if it lingers on, will simply add to the pressure. The buyers and the reasons they bought have not gone away, and I expect we shall see gold move higher, on balance, for the rest of the year. Indeed, I shall venture that we may have already seen the lows for the year and a turn could be close.

President & CEO

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