



FROM THE DESK OF

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WHAT'S (G)OLD IS NEW(S) AGAIN

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Gold has long been considered a store of value, especially during times of high inflation or financial distress. Inflation in most developed countries has not been an issue and in some areas such as Japan is actually sought. Financial distress is argued to be on the rise – at least by some market participants. The argument for this case stems from the global government and central bank response to the COVID-19 related business shutdowns. The unprecedented quantity of stimulus injected into the financial system may increase debt to unsustainable levels and have adverse impacts for generations to come. In turn, this may dilute the value of fiat currencies (or at least reduce confidence in them) and lead to higher inflation. Additionally, the record low interest rate environment from the monetary measures reduces the opportunity costs of owning physical gold.

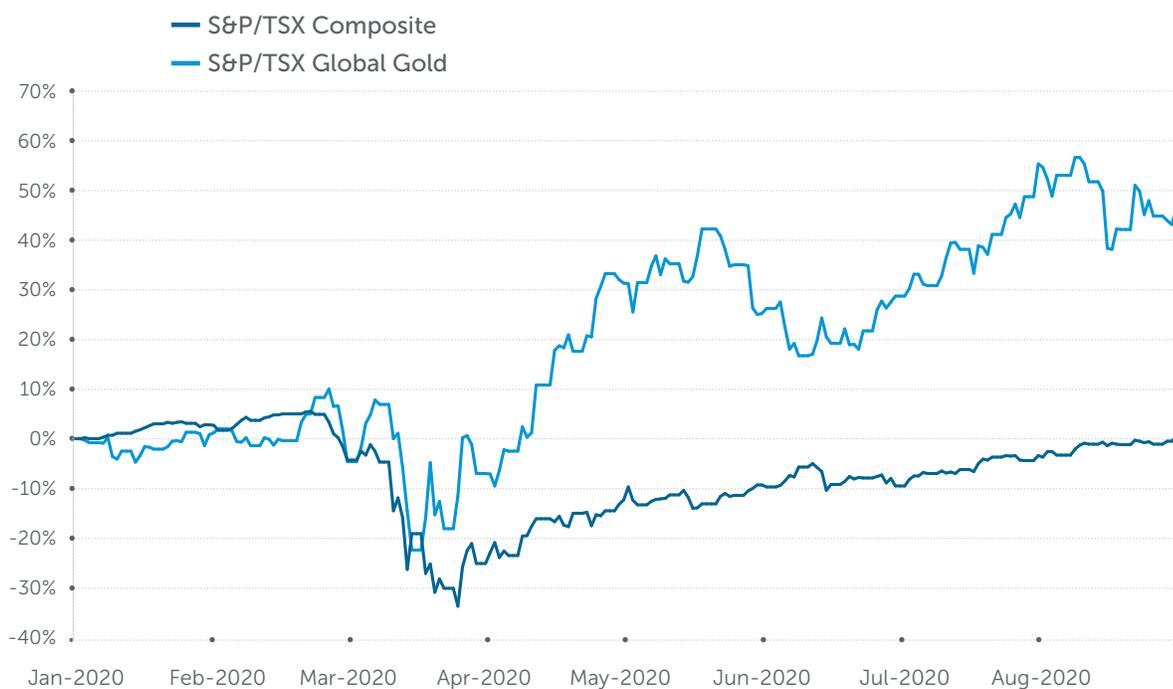
Whether or not this scenario plays out, one thing is clear. Gold prices have been on a tear this year with about a 30% gain and hitting a record high price earlier in the month.



source: Yahoo Finance

From our point of view as a fundamental asset manager, investing in physical gold is a difficult thing to do, especially with our longer term focus. Unlike quality companies that produce goods or offer services, gold doesn't generate any added value. It doesn't earn revenues, profits, cash flows, or pay dividends. It just sits there and you hope someone in the future is willing to pay more than you did for it. Additionally, the price of gold is very sensitive to investor sentiment, which can swing very rapidly. There may be shorter term uses for physical gold (hedging for example), but over a longer time period it faces much competition from investments that generate positive economic value.

Which brings us to the question – “what about gold mining companies”? Propelled by the precious metal's price gains, the S&P/TSX Global Gold (equity) index has also performed very well in 2020 and has handily outpaced the broad Canadian equity market.



Source: Morningstar Direct

With gold mining companies there are some compelling options, but overall it has not been an industry where we would have previously deployed a great deal of capital or have overweight positions for several reasons. Gold mining stocks are sensitive to the price of physical gold, which I've mentioned is very sensitive to investor sentiment. Depending on the location of their mines, companies may have increased geopolitical risks. Rising investor interest in Environmental, Social, and Governance (ESG) factors adds increased scrutiny on mining's impacts on the environment and local communities. Additionally, gold mining companies overall have not shown to be strong allocators of capital in the past and have not held shareholder interests as a top priority in our view.

There are exceptions however. Of the select handful of companies meeting our requirements for quality and value, one company we own across multiple funds is Agnico Eagle Mines. In this article I'm not going to detail the reasons why we like the company because our Portfolio Manager, Sara Shahram, has done a great job explaining this in an Off The Cuff video earlier this year. Please take a moment to enjoy her insights: <https://youtu.be/heXXOU5CZwM?t=386>

Finally, there may be situations where the quality and value characteristics of a gold mining stock may not be optimal as a stand alone investment. However, from a portfolio construction point of view, gold mining companies might provide diversification benefits to the overall portfolio – possibly all the more so in the current pandemic environment. This may be a reason why Berkshire Hathaway recently reported initiating a position in a senior gold mining company, despite Warren Buffet cautioning in the past against the metal because it's not productive like a company or a farm.

We thank you for your continued support.

Ian Hardacre

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