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February 2, 2022

(updated March 2)

The Case For Gold

''If Not Now, When?''

The Case For Gold - Summary

- Gold has been one of the least favoured asset classes during 2021. It is still massively under-owned by retail and institutional investors. We think that is about to change.

- Gold is poised to benefit from favourable demand/supply dynamics, as well as macroeconomic and geopolitical factors, particularly the Ukraine crisis which is adding to inflationary pressures.

- The precious metal is also a great hedge against stagflation. The probability of that scenario has materially increased.

- Real interest rates are negative and will remain so even if central banks start raising interest rates, hence making gold a relatively more attractive investment despite having no yield.

- The unprecedented level of debt that has been accumulated by governments and businesses during the pandemic should hold back central banks from raising interest rates too much.

- The USD's strength in recent weeks has been underpinned by expectations of numerous rate hikes in 2022 and by the conflict in Ukraine. Given concerns of slowing economic growth, high debt levels and rising geopolitical tensions, we think the Fed will be less hawkish than what the market expects. In that case, the USD will likely weaken and gold prices could surge further.

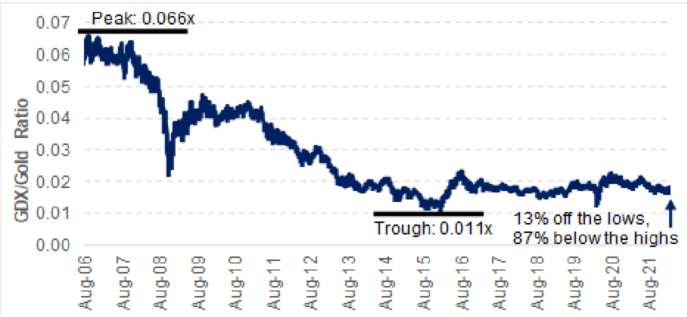
- Gold is still 7% below its all-time high in August 2020, yet the case for gold is arguably stronger now that it was back then.

- Gold is not competing with Bitcoin. The contribution that Bitcoin makes to investors' portfolios is based entirely on returns, whereas gold is both return-enhancing and risk-reducing. The two assets can be complementary.

If not now, when?

Gold: 2021 Performance Summary & Outlook

- Gold's performance in 2021 was driven, to an extent, by offsetting forces:
  - **Headwinds:** higher bond yields, especially during Q1, and a stronger dollar vs. EM, particularly in H2.
  - **Tailwinds:** support from economic data that suggested inflation may not be transitory, as well as negative Covid-related headlines and concerns around new variants.
- All in all, gold finished the year **7%** lower. Additionally, gold ETFs saw net outflows of **$9Bn.**
- Looking ahead, we expect gold to be driven by similar dynamics in 2022. The **persistence of high** (albeit decelerating) **inflation**, combined with **growth concerns**, a potential **peak in the USD**, **high equity market valuations** and **potential new Covid variants**, could result in more frequent market pullbacks and increased demand for gold as a portfolio hedge
- Gold may also find **continued support from Central Bank purchases**, which continues to be an important long-term driver of performance.
- Major sell-side institutions, including J.P.Morgan and Bank of America, have become bearish on gold as they expect interest rates to rise quicker than currently anticipated. However, even if that scenario does materialize, both **nominal and real rates would remain very low** from a historical perspective.
- Furthermore, we think that **current gold prices do not fully reflect geopolitical risks**, notably Ukraine vs. Russia, China vs. US, terror attacks and upcoming important elections.
- Another reason to be bullish on gold is the fact that **investors are still largely underweight:**
  - When investors are more bullish on gold, they tend to buy the miners for leverage (e.g. the GDX ETF). When they are less bullish, they prefer holding physical gold or gold ETFs.
  - **GDX/Gold ratio** is a good indicator of investor sentiment towards gold. If it's rising, investors are becoming more bullish. Currently, the GDX/Gold ratio is 13% off all-time lows, but is still **87% below all-time highs**, suggesting that there are still many investors that could turn bullish soon.



Sources: Cantor Fitzgerald

Sources: World Gold Council, Global Mining Review, Global Risk Insights

Favorable Supply & Demand Dynamics

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- **Jewelry consumption**, a key driver of gold demand (>50% of consumption), **is on the rise again**, especially in Emerging Markets.

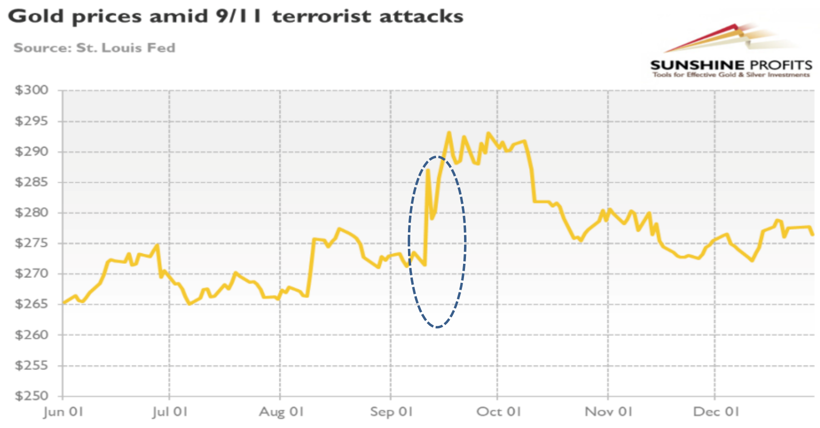
- Below are recent results from major luxury groups that support the statement above:
  - **LVMH's** Watches & Jewelry division grew 40% vs. 2020 and 7% vs. 2019. Their high-end Jewelry sales reached an all-time high.
  - **Richemont's** *Jewellery Maisons* saw sales growth of 38% vs. 2020 and 57% vs. 2019. They saw double-digit sales growth across all regions.
  - **Kering's** *Boucheront* saw exceptional growth in Q3 2021, particularly in China and South Korea.

- **Central Bank gold demand may also provide additional longer-term support**, as they are typically a major source of gold demand, accounting for about 8%-9% of global demand. In 2021, Central Bank gold demand rebounded and the list of buyers has now extended to developed markets.

- On the supply side, **exploration is becoming more expensive and riskier**, leaving major gold miners struggling to replenish their reserves.

Rising Geopolitical Tensions Brighten Gold's Appeal…

- The world today is subject to numerous geopolitical risks that we think gold prices are not fully pricing in:
  - Worsening Russia/Ukraine conflict
  - Deteriorating China-US relationship & tension over Taiwan
  - Important upcoming elections in France and several Emerging Market countries, as well as the US midterms
  - Iran's nuclear advances
  - Major cyber attacks
  - Covid-19 resurgence
  - Major terror attacks
  - North Korea conflict
  - Civil war in Ethiopia
  - Taliban in Afghanistan
  - Migrant crisis in Belarus



- Since **gold is considered a "safe haven" asset** that investors rush to in times of market turbulence and uncertainty, we believe demand could strengthen going forward.

- As an example, during the 1970s, a decade marked by several upheavals in the Middle East including the Iranian Revolution, the Iran-Iraq war and the Soviet invasion of Afghanistan, gold rose 23% in 1977, 37% in 1978 and 126% in 1979.

- Gold also spiked when the US bombed Libya in 1986 and when ISIS attacks put oil supplies in the Middle East at risk. It also spiked on 9/11.

- **The Russia/Ukraine conflict in particular should benefit gold** because it is causing inflation expectations to rise again (Russia is a major exporter of oil, palladium, platinum and other precious metals, while Ukraine is a major exporter of raw materials including agricultural products), and at the same time, it is causing nominal interest rates to fall, meaning real interest rates are falling sharply.

Sources: Company filings, World Gold Council, Sunshine Profits

But The Relationship Between Geopolitics & Gold is Blurry

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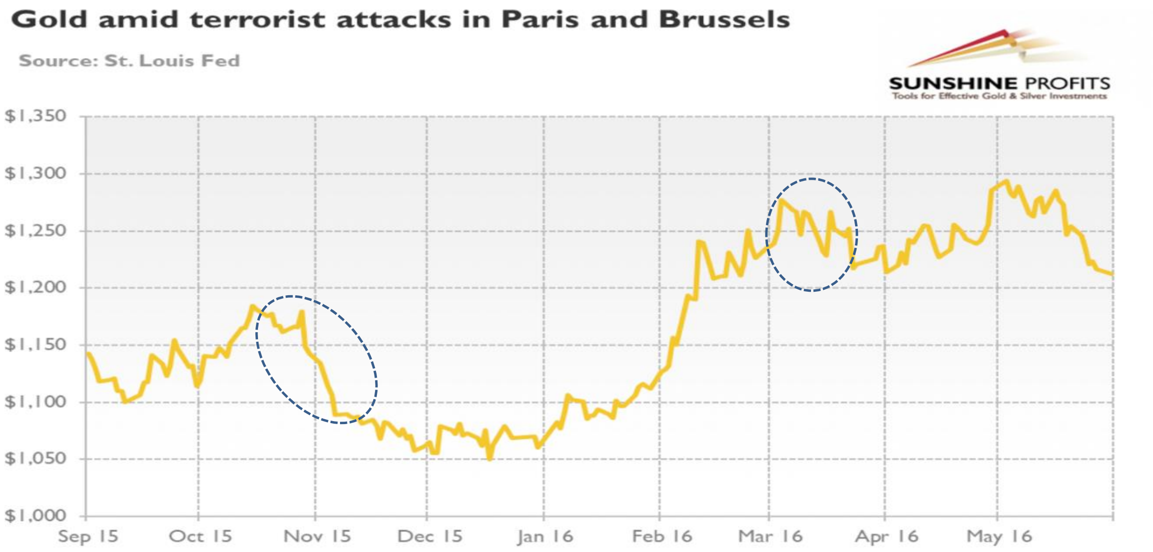
- However, **gold does not always gain due to geopolitical crises**. A good example would be the Paris and Brussels terrorist attacks, when gold prices actually declined.



- There are a few reasons why geopolitical concerns may not affect gold as strongly as it is commonly perceived:

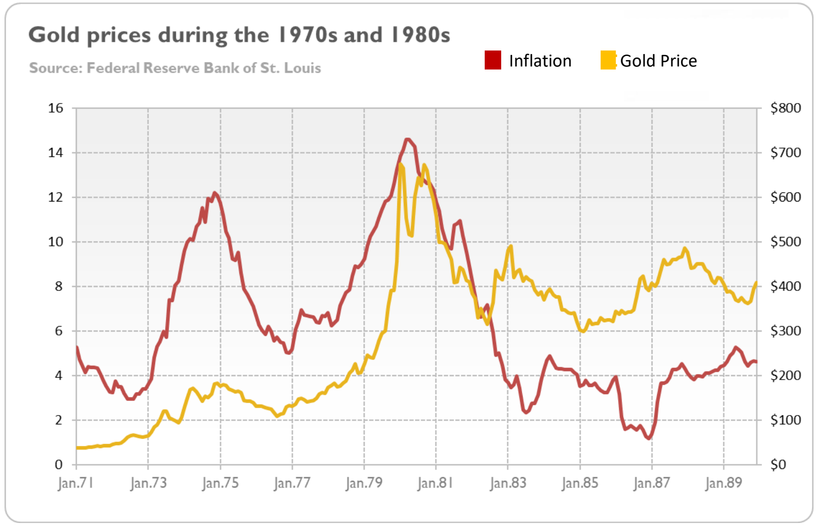
- First, **gold traders buy the rumor and sell the news.** Gold prices rise in anticipation of a conflict, but when rumors turn into action, the price of gold is often unaffected or even decreases.

- Second, **gold is essentially a bet against the US economy**, so terrorist attacks or geopolitical tensions abroad do not really impact gold prices unless the US is involved.

Sources: Sunshine Profits

Gold: A Great Hedge Against Stagflation

- As shown by the chart below, **gold performed very well during the stagflationary 1970s** when inflation and unemployment were both very high:



- According to a Schroders study, historically, the **top performers during periods of stagflation have been gold (+22.1%), commodities (+15%) and REITs (+6.5%), while equities have tended to struggle (-1.5%).**

- The IMF recently lowered their growth forecasts for 2022 on weaker US and China outlooks, two major economies. They now expect **global growth to decelerate** from 5.9% in 2021 to 4.4% in 2022 and 3.8% in 2023 as pent-up demand dissipates and fiscal and monetary support eases across the world.

- On the inflation side, the US CPI currently sits at **7.5%**, the highest level since 1982 and well above the Fed's 2% target. Many other countries (including the UK and Europe) are experiencing similar trends. The Fed has acknowledged that inflation is proving to be more persistent than what it had anticipated and therefore **dropped the word ''transitory''.** It has also already started tapering bond purchases and signalled its intent to raise interest rates as early as March.

- Additionally, **many emerging and developing economies (ex-China) are withdrawing policy support** to combat inflationary pressures well before the recovery is complete. This will hurt their economies pretty hard, and in particular low-income workers.

- This combination of **slower growth** and **persistent high inflation** should therefore generate investment demand for gold, based on history.

Sources: Sunshine Profits, Federal Reserve Bank of St.Louis, Goldman Sachs, IMF World Economic Outlook

Inverse Correlation With Rates Subsiding

- Gold has historically had a strong negative correlation with nominal and real interest rates. However, this has not been the case in recent months (at least up until mid-February):

- Since the beginning of August 2021, US 10-year yields have been consistently rising (with the exception of last 2 weeks), as illustrated by the blue line in the chart. The 10-year rose from 1.22% to a peak of roughly 2.06%, before pulling back to 1.77% today on concerns of a potential war-induced recession. Up to the 10-year's peak, gold (white line) prices have actually held up and even increased, contradicting historical price behaviour.

- Was gold's resilience in recent months driven by a fall in real interest rates perhaps? Not really. In fact, while the 10-year rose quickly and sharply from August 2021 lows, inflation expectations up until mid-February have barely risen, meaning real interest rates actually rose during the period.

- The resilience in gold prices can therefore be attributable to both its **defensive nature** and to **strong hedge demand amid growing uncertainty**.

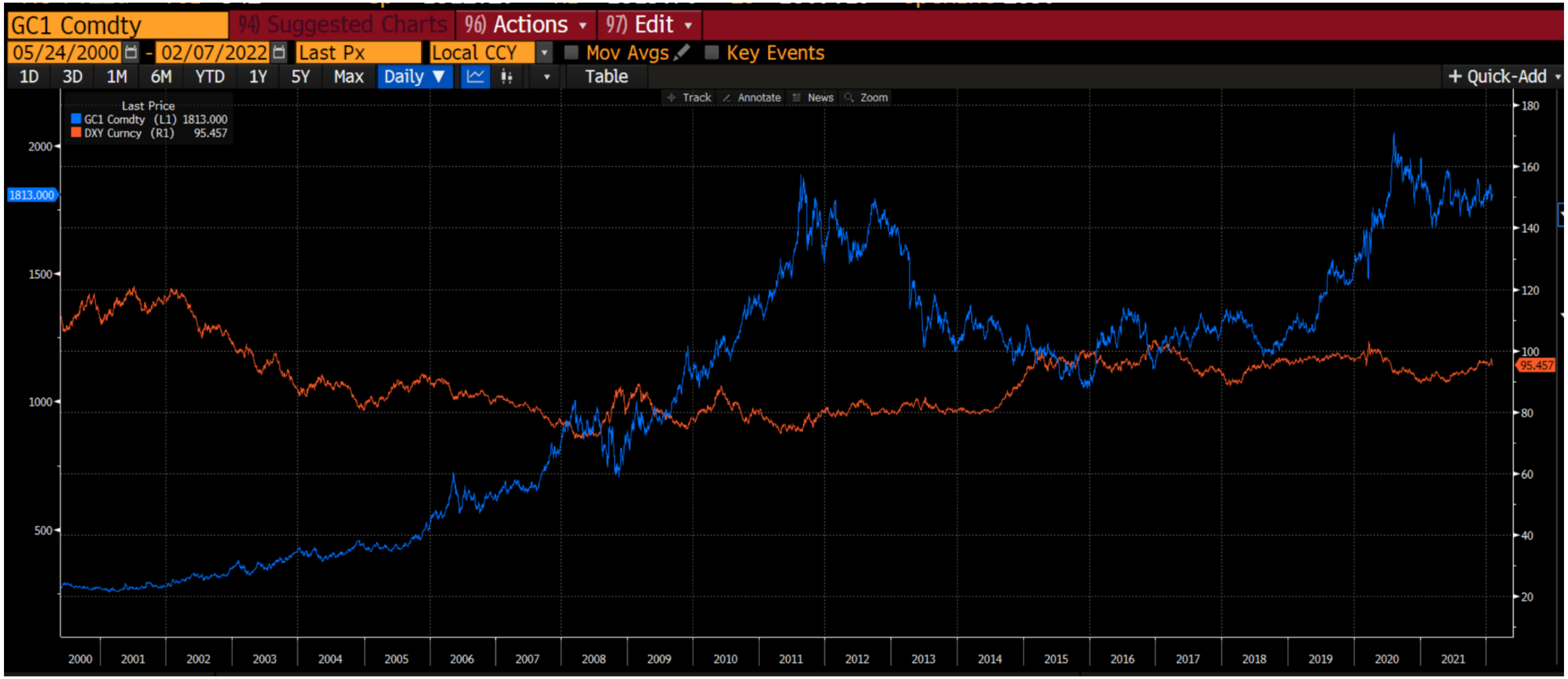
- However, since mid-February, inflation expectations have risen sharply and the 10-year nominal rate has dropped dramatically, putting strong downward pressure on real interest rates and pushing up gold prices, effectively restoring the historical relationship.

- So it seems that **gold prices are pushing higher regardless of where interest rates are heading.**

Sources: Bloomberg

Strong Negative Correlation With The Dollar

- As can be seen from the chart below, gold has historically had a strong negative correlation with the US Dollar (DXY index):



- We have reason to believe that **the USD might be peaking**. In fact, the USD's strength throughout 2021 and especially January 2022 was mainly attributable to expectations of numerous upcoming rate hikes, with some institutions expecting up to 7 rate hikes this year.

- We believe interest rate increases by the Fed will be far fewer than the markets expect, in which case the USD will likely drop and gold will rally as demand for commodities from EM countries increases.

- Our view is backed by the unprecedented level of debt that has been accumulated in the US over the past few years, in addition to concerns over slowing economic growth (labor force participation rate is very low despite full employment), which we believe will prevent the Fed from raising interest rates too much otherwise countless defaults will occur and the economy will plunge into a recession.

Sources: Bloomberg

Gold vs. Bitcoin

- **Gold and Bitcoin have different purposes and characteristics**. Firstly, Bitcoin is much more volatile than gold. Second, Bitcoin is typically purchased for speculative reasons, while gold is bought for defensive/risk-reduction reasons in addition to price appreciation. Unlike Bitcoin, gold can improve a portfolio's Sharpe ratio. So the two asset classes do not really compete with each other but could actually be complementary.

- **Gold is a risk-off inflation hedge, Bitcoin is a risk-on inflation hedge.** The current market environment supports the former.

- In fact, Bank of America found that ''Bitcoin has not been compelling as an inflation hedge as commodities and even equities provide better correlations to inflation''. They also believe that the argument for holding Bitcoin is not diversification, volatility reduction or inflation protection, but rather sheer price appreciation.

- Furthermore, a Morningstar analysis concluded that ''the assertion that cryptocurrency hedges against inflation rests on scanty evidence.'' They also added that ''while it's reasonable to suppose that cryptocurrency will help a portfolio survive inflation's ravages, that plan is far from guaranteed''.

- ''If you put a gun to my head and you said I can only have one, I would choose gold'' – Ray Dalio on Bitcoin vs. Gold

- However, there is a slight possibility that Bitcoin may steal gold's thunder over the long-term: Bitcoin is a superior money technology that is easier to store, verify and move around. Its supply also has a hard limit of 21m coins, making it much scarcer than gold. Moreover, Bitcoin resonates better with retail traders, millennials and Gen Z which are increasingly becoming important market participants. That is a risk that we must bear in mind.

Sources: CNBC

How To Play Gold ?

➢ There are many different ways to play gold:

- **GDXJ** – tracks junior gold miners (for more leverage)
- **GDX** – ETF that tracks major gold miners
- **GLD** – ETF that tracks gold spot price (lowest leverage)
- **Barrick Gold** or **Newmont** – high-quality gold mining stocks

➢ We are long gold since late January 2022 and still see further upside.

Sources: CNBC

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