Commentary for the First quarter of 2018

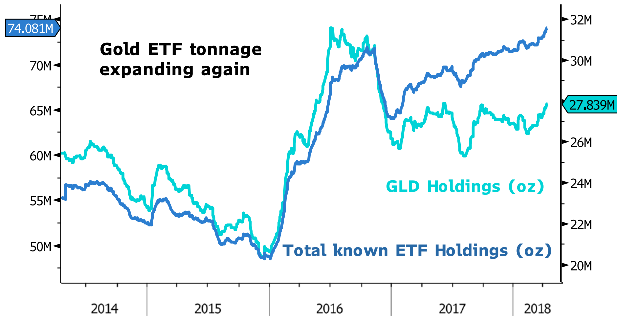
Spring is in the air ... but still a happy camper?

The first quarter of 2018 settled a lot of uncertainties but some remaining doubts continue to pressure precious metals equity values.

First the new Fed president not only hiked in March but also spoke out in favor of more hikes in 2018 and 2019. Even in the face of a single-day-draw-down of 700 points in the Dow, his speech did not flaunt. This confirms our vision that the Fed Put is no longer valid, at least not to the point it supported the Pavlovian reflex – to buy the dip in equities while selling every volatility spike – previously.

Powell has made it clear that the Fed will now work more for Main Street than for Wall Street. The Fed is eager to normalize rates under the cover of worldwide synchronized growth. US tax cuts, deregulation and growing US budget deficit spending coupled with full employment (unemployment is at 4%) and renascent inflation expectations. It's thinking is something like: "if we hike too slowly now, we will be forced to hike more rapidly later, with the risk of killing the economic cycle, provoking a new recession". The Fed expects only marginal effects from Trump's trade wars. Since the March rate hike, Fed speakers all went in the same direction. QT (quantitative tightening or balance sheet reduction) will continue as planned and three to four hikes for 2018 are warranted, even in the light of the market volatility of the latest months. The Fed minutes from the March hike reunion also unanimously pleaded for QT and higher Fed rates.

Once again the gold price went up in the days following the March hike. You are aware of our vision that hikes under the current monetary conditions are inflationary in the sense of creating inflation by putting an end to the fall in money velocity that has been going on for decades. We see this opinion slowly gaining traction by market observers. Even Goldman Sachs, not a notorious 'Goldbug' institution, declared itself positive on the gold price in March, by the mouth of Jeffrey Currie, GS head of commodities. This slow change in market sentiment towards gold is also visible in the physical gold ETFs, as the GLD tonnage is expanding continuously since QT and rate hiking have started for real.



We draw the following conclusions out of the recent wild market gyrations.

- The believe in the Fed Put is slowly dying. (see infra.) This implies that the market will slowly become more risk averse.

- The confidence in the current upcycle is shaken but still alive. In the face of the ultimate runup – the FANGs – the reaction to Tesla's problems and to Facebook's upheaval is still very measured. Lower iPhone sales did not strongly impact Apple's valuation either. Even war mongering from Washington and Trump, be it in Middle East, against Russia or against trading partners, seem to have only short term impacts.

- Government bonds and bonds in general were not systematically bought up during the equity draw downs. This is a real change! 10Y treasuries kept close distance with the 2.8 level. We consider that the decade long bull market in bonds is over. We see interest rates to continue to rise and are bearish on all government debt. But the momentum is still young, and more heavy bond corrections are expected to be more of a 2019 thing, when stagflation risks will be more evident. The worst value is seen in euroland, especially in bund yields. Once the 10Y bund rises above 0.82-0.90, momentum could turn ugly.

- We still believe a last blow-up-top formation will push equities higher, once the current short term correction or market consolidation ends. Here we maintain that the Dow will outperform, helped by international capital flows in an ever more uncertain world. Perception (not reality) that America becomes and behaves great again, can make the Dow a save haven bid, even when valuations are already stretched. The difference in return from the Dax versus the Dow in recent quarters foreshadows this. Over the last few months, the positive economic surprises out of euroland seem to become scarcer by the day.

- On the dollar, we still believe it's value will rise. Optimism

on the 'greatness' of the US (full employment, ability to support higher rates while still growing above 2.5%, lower federal taxes, deficit spending stimuli and deregulation) with a bold acting Trump on the world scene (military, trade, etc.) should start a dollar revival at some point in the future, maybe for the second semester. You know of our conviction that such a dollar rise can become virulent in 2019. Once the Fed will be 4 to 5 rate hikes further (see our 2017 Q4 commentary from January), in a low world growth scenario (2019), with growing inflation, the dollar becomes scarce and over-indebted foreign actors bid the US dollar up. We also maintain that risk averse capital flows will also look more and more towards the dollar as a perceived less-risky currency. So yes, the market is still pausing before the Dow and dollar blow-up starts. Be aware that a Trump impeachment could invalidate this scenario.

- Gold has behaved well in this volatile market. The sloping of the resistance around $1370 is still ongoing. The western world sees physical gold nowadays more as a portfolio-risk-diversifier and a possible inflation hedge in a more uncertain, risk averse world. Hence the slow but steady growth of gold ETFs foment gold prices upwards. Chinese and even US jewelry demand is growing nicely as well. India is still in a 'normal gold demand' rebuild phase, after the Modi attacks (gold import taxes, 'black money attack' excuse government extorsion program). For India the creation of the Gold Board preludes a coming lowering of the gold import tax rates in the coming months, another positive. Sharia gold and blockchain gold are also contributing to an upward tilt. The gold silver ratio also has not turned down yet, so a lack of confidence is still rampant and believe in higher prices is still absent for the moment.

- The Indian market is still rebuilding.

- Fear that the dollar will surge (on rate hikes) and cause a crush in gold prices still lives on.

- The crisis is over, why invest in precious metals? Indeed still too many in the West only bid for gold exposure when they are driven by fear. But this is changing, see Goldman Sachs' change, see ETF inflows, see the rerating on majors and royalties by institutions like Bank of America. Some are now even starting to promote Newmont, Goldcorp and even Barrick as value and diversification plays.

We could go on but we think we've captured the most important causes, explaining why precious metals equity is still lagging gold prices.

Auguring signs that give us confidence that a turning point is near, are also multiple.

How long can the balance sheet improvement and the growing free cash flows from the mines continue with falling stock quotes? The more the Dow runs, the more the mines will become a screaming buy. Big institutions are already redirecting flows as they see mines as a diversifying and return enhancing investment. See also Jeffrey Gundlach's (the new Bond King) call for gold. George-Milling Stanley from mega institutional player State Street recently said he sees gold up in 2018 based on good economics ramping up jewelry demand. So we do not need an Armageddon to see gold prices rising.

The study from Jeff Christian (CPM Group's managing director) will certainly be reread in the coming months. His study shows that the return from a 20% gold, 40% bonds and 40% equity portfolio, beats a 50/50 bond equity portfolio amply and systematically since the 1970s! A rework of the famous Ibbotson (University of Chicago) early 1980 study, will impress mainstream economists, more and more confused by actual market behavior.

Capital flows are coming to precious metals. Where analysts were foretelling a Barrick default some years ago, they are now

in full rerating mode.

In our 2017 Q4 January commentary, we stated that the revival of inflation and higher rates would become more certain after September 2018. We are not there yet, timewise.

So dear investor, do not worry yourself to despair. Gold equity will soon recapture with its legacy of leveraging on the returns of gold bullion. You are in good company with your iW investments. The COT report for the commercials' position has now even turned long on silver. Do they also see that spring is coming for precious metals campers? Rendezvous for a market update in September.

for iW Partners,

the fund manager