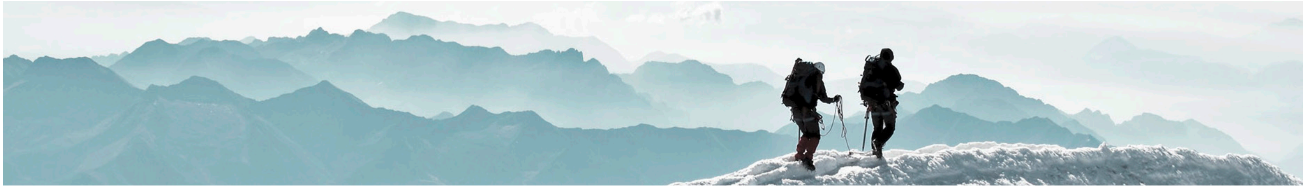
iW PARTNERS

ASSET MANAGEMENT - ASSET SERVICES - ASSET SOLUTIONS



Does gold's breakout signal recovery ahead for gold miners?

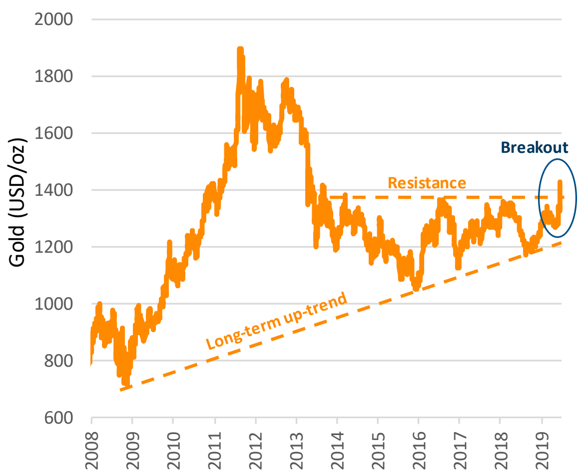
26 June 2019

The gold price rose to its highest in almost six years this week, in US dollar terms, breaking out of the trading range which has held since the end of the downturn in the gold sector several years ago.

Gold producers' share prices remain at historically low levels relative to the gold price and relative to broader equity markets, yet the return of momentum to the gold sector, coupled with the substantial beneficial reforms undertaken by a selection of leading gold producers, suggest a change in miners' fortunes and an opportunity for investors as this undervalued sector moves into recovery.

Technical indicators suggest that higher prices are a strong possibility in the near-term, while macroeconomic factors such as falling real interest rates, high debt levels and concerns over the USChina trade war provide a supportive longer-term backdrop for the gold sector. Furthermore, heightened volatility and rising financial sector risk continue to support demand for gold, given its status as an effective portfolio diversifier and safe haven investment.

Gold has broken out

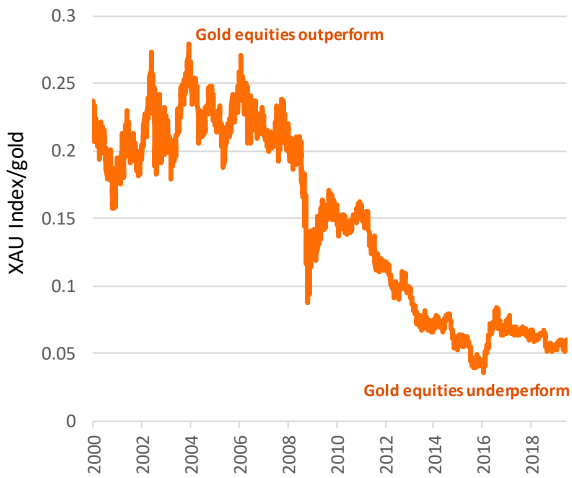


Source: Bloomberg, Baker Steel Capital Managers LLP. Data at 25 June 2019.

Why has gold broken out?

Two major catalysts can be identified as the key drivers for gold recent breakout. Firstly, there has been a subtle but highly significant shift in tone by the US Federal Reserve following its June FOMC meeting. Despite keeping the federal funds rate at 2.25% - 2.50% Fed Chairman Jerome Powell indicated that the central bank may be less patient on lowering borrowing costs, opening the door to a potential interest rate cut later this year. The Fed also noted that US economic activity has moderated, representing a slight downgrade from the solid economic performance of the past few years. Many market participants now expect one or more US rate cuts this year, although the size of cut remains open to speculation. Nonetheless the Fed appears increasingly inclined towards looser monetary policy and shows a willingness to allow inflationary pressure to run. Historically falling real interest rates have proved a highly supported environment for gold and gold equities.

Gold stocks have become severely undervalued

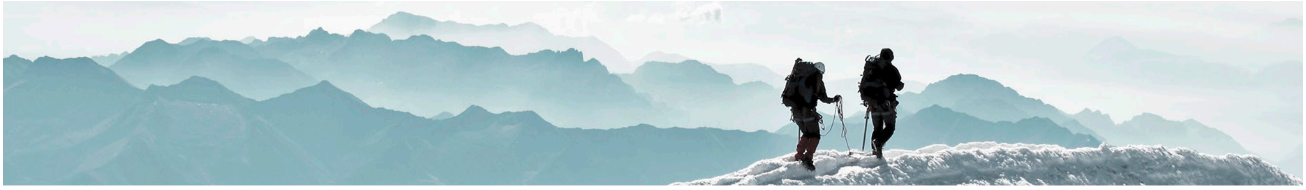


Source: Bloomberg, Baker Steel Capital Managers LLP. Data at 25 June 2019.

A second catalyst for gold has been the weaker outlook for the US dollar, following strength which has proved a headwind for the gold price in recent years. Importantly, the focus of Trump's rhetoric appears to be shifting from trade war towards a potential currency war, highlighted by recent comments from the President targeting the perceived artificial weakness of many of the US's trading partners' currencies. Most of the US's trade partners have maintained substantially looser monetary policy than the US in recent years, an important factor for an Administration which has placed correcting trade imbalances at the heart of its economic policies and would favour low interest rates and a competitive exchange rate to boost US exports.

iW PARTNERS

ASSET MANAGEMENT - ASSET SERVICES - ASSET SOLUTIONS



A range of other factors have also contributed towards gold's resurgence in recent weeks. Notably geopolitical tension between Iran and the US, driven by an escalation of hostility in the Gulf and belligerent rhetoric from both sides, continues to boost demand for safe haven investments such as gold. Meanwhile investors' broader concerns over slowing global economic growth forecasts and high levels of public and private debt continue to boost demand for portfolio diversification.

What impact will higher gold price have on gold producers?

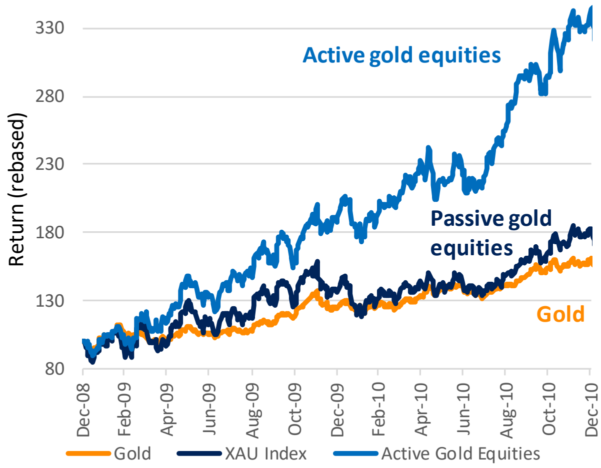
Gold stocks fell out of favour with investors following the sector's downturn in the early part of this decade, however since late-2015 the gold sector's recovery has been building. Gold's current breakout will undoubtedly have a beneficial impact on gold producers' bottom lines and a sustained recovery of gold prices will likely prove a strong driver for gold stocks in the coming months.

There have been fundamental changes within the gold mining sector since the end of the last bull market. A selection of gold companies have undertaken significant reforms to improve their businesses, repair balance sheets, improve capital discipline and to improve returns to shareholders. Yet these positive reforms have not been enacted across the board and substantial disparities exist between producers in terms of management effectiveness, capital discipline and alignment of interest with shareholders. For those gold producers which have successfully implemented improvements to operations, management and financial position, the consequences of rising gold prices are particularly positive. While margins should expand for all producers, yet it will be those which practice fiscal discipline that stand to reap disproportionately large rewards as costs are kept under control. It is these companies which offer investors the greatest upside potential in a rising gold price environment.

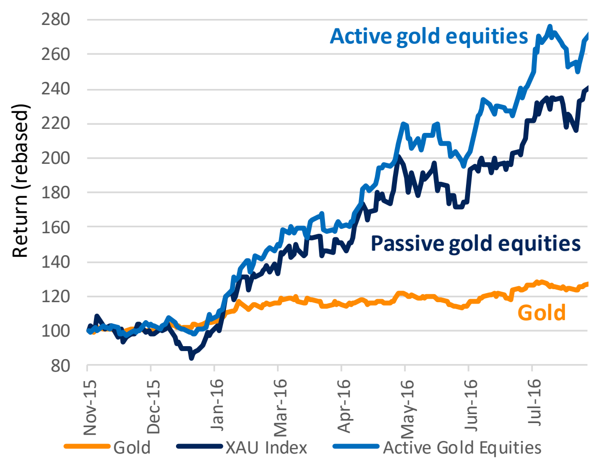
A common rationale for investing in gold equities is that these companies typically provide operational leverage to a rising gold price, historically outperforming physical gold by multiples during a gold sector rally. As positive investor sentiment returns to the gold sector we believe a re-rating of gold equities is imminent, following a period of depressed valuations for gold companies. Previous gold equity bull markets highlight the sizeable upside potential under a rising gold price environment.

Superior returns through active management – previous bull markets

Gold and gold equities -2008-2010



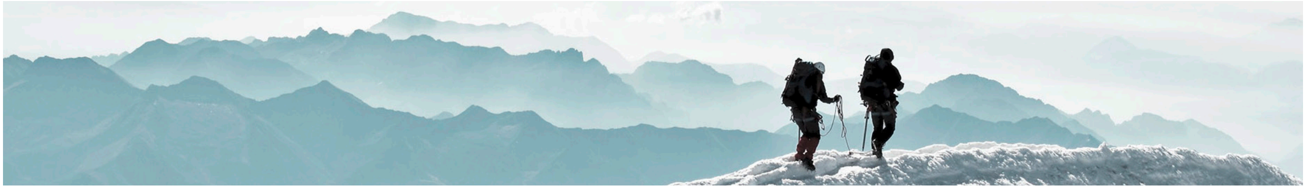
Gold and gold equities -2015-2016



Source: Bloomberg, Baker Steel Capital Managers LLP. Data at 25 June 2019. All data in US dollar terms.

Note, Active gold equities are represented by BAKERSTEEL Precious Metals Fund I2 EUR, Passive gold equities are represented by the XAU Index.

Given the disparities which exist within the sector it is our firm view that active investment management is required to generate superior risk-adjusted returns. As the recovery develops the challenge for investors will be to focus on those companies which can protect their margins and avoid those which lack discipline and effective cost controls.



Gold's uptrend appears well-established. While a pullback may occur in the short-term, particularly if the US dollar rallies or geopolitical tension subsides, the significance of gold's break-out is clear, signalling the beginning of the next phase of the gold sector's recovery. With the outlook for gold backed by a supportive macroeconomic background, most notably due to low real interest rates and high debt levels, and with a multitude of near-term catalysts, such as concerns over slowing economic growth and a range of geopolitical flashpoints, rising demand for gold appears likely to continue.

History has shown that when the gold price makes significant gains, gold stocks tend to outperform the metal. At a time when value investments are becoming increasingly hard for investors to find, with global equity markets near all-time highs after a ten year equity bull market, we believe the gold mining sector may be one of the few areas where investors can access and undervalues sector as it enters a recovery phase.
