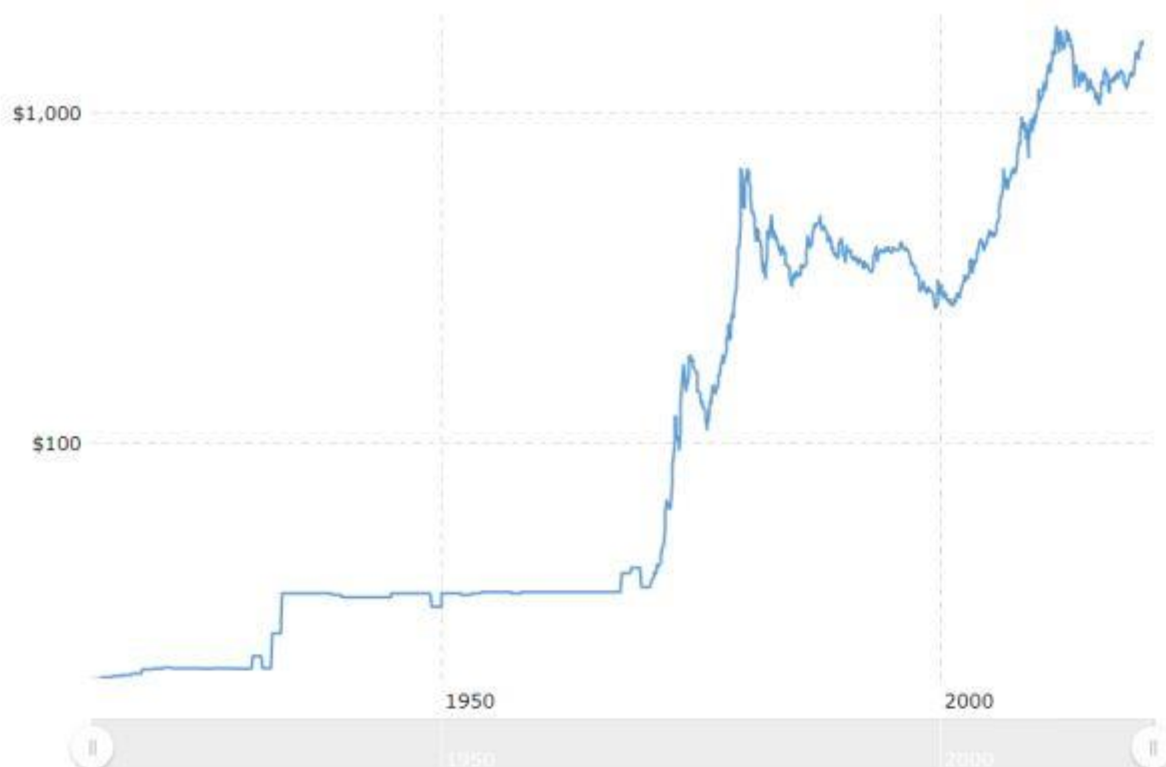
Gold – special report

April 14, 2020

History should not be ignored.

Since the start of the 21st century, gold has been one of the places to invest, **as the precious metal transitioned from being 'the metal used in jewellery' to a much broader role as a backstop of value in times of crisis.** It was however the commencement of the 1970's that gave gold its current investment credentials. The following chart shows the long-term US Dollar gold price:



Source: Macrotrends

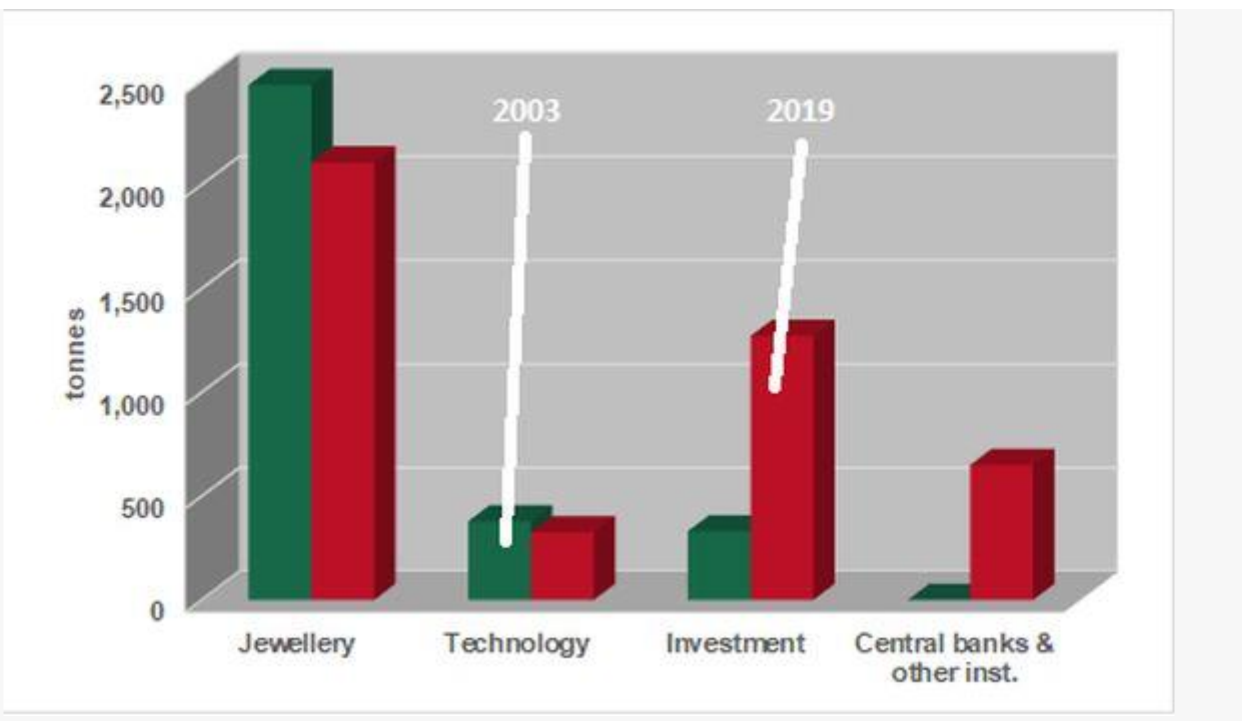
The first hoarding of gold in modern times was in the aftermath of the share market crash of 1929 and the subsequent Great Depression (1929 – 1933). Investors were by 1932 **turning in paper money for gold,** and as the price rose, more was hoarded. President Franklin D. Roosevelt, in April 1933, outlawed US private ownership of gold coins, bullion and gold certificates and he raised the gold price to US$35 ounce (the first major price lift in the above chart), to control the gold price and protect the US Dollar gold standard value.

The advent of US stagflation in the early 1970s, the removal of the gold standard in 1971 and the return of private US gold ownership in 1974, seeded gold's rise to prominence (the second price run in the above chart). US government expansion programmes in the mid-seventies and double-digit inflation culminated in the 1980 global recession, with the gold price peaking at record levels. Post this recession, the world went into a period of growth with limited government expansionary interventions and acceptable inflationary pressures. **The 1980's was punctuated by the stock market crash of 1987 that pushed investors to gold.** The 1990's was a decade of expansion and the gold price did fall over this period, as the Dot.com phenomena took hold in the mid to late 1990's.

Arrival of the 21st century started with a recession in 2001 caused by the dot.com bubble bust and the 9/11 event in the same year, with the gold price reaching a new record high. The turmoil of the start of the 2000's decade was followed by several years of global expansion, with the Chinese government leading the way. The 2000's expansion period ended in the now infamous Global Financial Crisis (GFC) in 2008. While a US and China trade war with its roots in mid-2018 shook investor nerves for some 18-months, until receding in December 2019.

<u>In response to the GFC crisis of 2008-09, most governments embarked on an unprecedented level of fiscal expansion in the form of stimulus packages.</u> **Among the G20 countries alone, the size of fiscal stimulus amounted to circa $2 trillion or roughly 3.0% of world Gross Domestic Product (GDP).** <u>Global 2009 GDP was circa US$60 trillion.</u> Monetary policy reactions saw central banks, globally, cutting cash rates and conducting quantitative easing programmes. **Gold was viewed as a "safe haven" against economic uncertainty, the rise of government debt and the debasing of currencies, that pushed the gold price to record, and yet to be rechallenged, highs in 2011.**

The use of gold in the 21st century has completely changed in just seven short years, given the events over that time. The following chart shows a gold usage comparative between the 2003 and 2019:

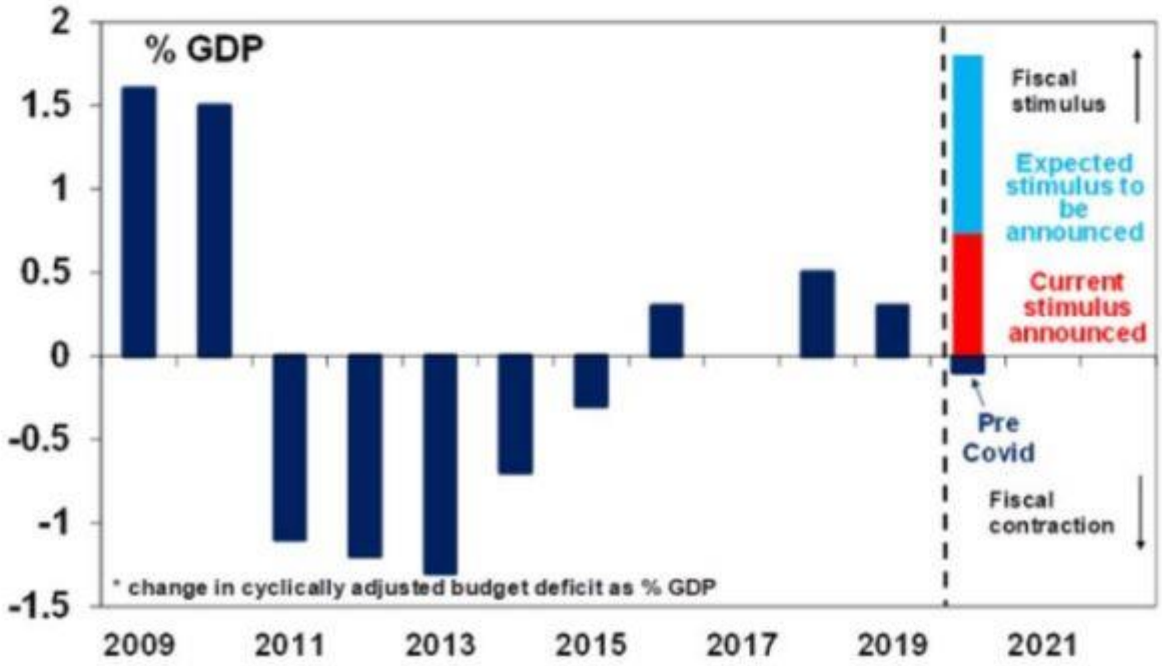


Source: World Gold Council

Over the course of seven years, there has been a clear shift away from gold usage to value. <u>Why in 2020 is history pertinent, with the world in the grip of a COVID-19 pandemic?</u>

The economic responses are remarkablly similar, as countries lockdown to stem the pandemic spread; leading to a paralysis of the global economy. The gold price in this period of uncertainty is perhaps going to test the record 2011 highs, **as the "safe haven" premium in gold rises.**

The COVID-19 pandemic remains an active and ongoing "safe haven" play for gold. **<u>We believe amid the pandemic war and also in a post COVID-19 environment, "a storm" is brewing for gold</u>.** With the COVID-19 pandemic impacting every economy, fiscal and monetary programmes are back and in vengeance. The following table shows the forecast 2020 fiscal spending by the G20 countries as a percentage of G20 GPD in the current COVID-19 environment:



Source: Bloomberg

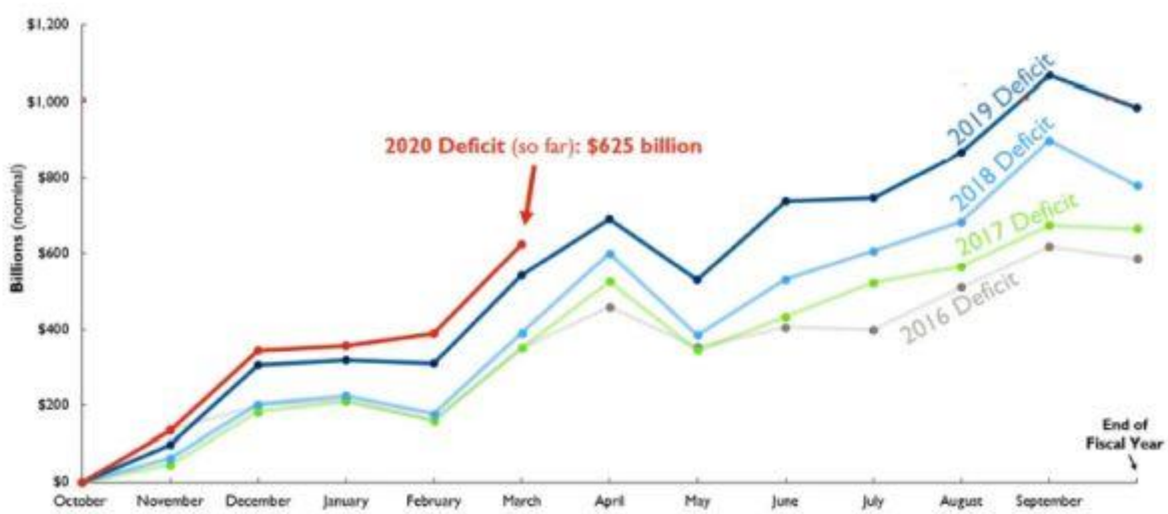
With total G20 GPD standing at circa US$67 trillion, a 1¾% fiscal spend would equate to a forecast US$1.2 trillion. Already, President Donald Trump is pressing for a COVID-19 fiscal package of US$2.0 trillion for the US alone. <u>The G20 fiscal spending in 2009 amounted to only US$2.0 trillion.</u> **These fiscal programmes will have a significant and, we believe, longer term tailwind impact on the gold price, as the ripple effect in the post COVID-19 global economy rolls out.**

<u>Central banks have also unfurled quantitative easing programmes and have slashed cash rates to counter the COVID-19 disruptions to individual economies</u>. The US Federal Reserve (FED) has forecast buying assets "in the amounts needed" to support the smooth market functioning and effective transmission of monetary policy. The Fed had previous set a <u>US$700 billion limit for asset purchases.</u> In addition, the Fed announced **several new lending programmes worth US$300 billion to support all corners of the financial markets.**

<u>The culmination of these fiscal and monetary policy actions and their quantum will, we believe, debase currencies and be a tailwind for the gold price.</u> <u>This thematic we have discussed in many of our daily market updates to Members.</u>

<u>The US Dollar Index is the key factor, and especially the inverse relationship it has with the gold price.</u> Strategists and economists are almost universally bearish on the US dollar in 2020, highlighting that the greenback could turn down.

This is a view that we have had for some time, as we expect **<u>the surge in US government spending and the rising US debt pool will pressure the US Dollar</u>**. The US Federal budget running in an ever growing deficit is key factor that we believe will be a tailwind on the gold price over 2020. The following image shows the US Federal governments' monthly budget deficits (in US Dollars):



Source: Bipartisanpolicy

Estimates put the 2020 US government deficit in the range of US$1.0 billion to US$1.3 billion due to early company tax rat cuts. Trumps proposed COVID-19 spending package and reduction in payroll taxes will only **swell what is already forecast to be a significant budget deficit.**

Total US debt has ballooned to US$22 trillion, to reach the highest level since records have been kept. The debt pool will continue to grow and at an accelerated rate in the near-term. A slowing US GDP, we believe, will impact on the debt metrics and weigh on the US Dollar. Annual US GDP growth has slowed to the last read for the December quarter 2019 of 2.1%, with the COVID-19 impacted forecast for 2020 to be around circa 1.3%.

The danger signals are in the wings already and fighting a COVID-19 pandemic with additional fiscal measures, as is already being proposed by Trump will only exacerbate the growing debt problem.
The current COVID-19 pandemic has added additional momentum to the gold price in 2020. **We believe the factors that we saw at the beginning of 2020 remain in play for a higher gold price in 2020.** With the COVID-19 pandemic now playing its way through the worlds' population and economy, we highlight a number of our gold exposures with Saracen Mineral Holdings (ASX:SAR) covered separately in this report:

Evolution Mining (ASX:EVN)

<u>Evolution Mining has reported good numbers both financially and operationally over a number of years,</u> while a higher gold price has been a real boost. Evolution Mining reported a surge in underlying net profit for 1H20, to drive the trend on. Shareholders have not been forgotten with the strong results translating to a surge dividends.

We support Evolution Mining on **the strength of its balance sheet** to generate growth. Evolution holds the ground across its six sites to deliver growth and a management team capable of seizing these opportunities. The company's acquisition of Red Lake in Canada recently adds geographical diversity at the right time in our view.

St Barbara (ASX:SBM)

St Barbara's fiscal 2019 was not a highlight year for the company, with gold production slipping for the first time in several years. On top of this fall, St Barbara faced rising cost trends. The culmination of these factors resulted in a weak full year result for 2019 and a cut in the dividend for the year. **The arrival of gold production from Atlantic has the potential, we believe, to be a turn-key** and consign 2019 to the history books and with it, a return of greater confidence in the share price.

St Barbara's mining performance going forward is showing signs of improving and will be the basis for future growth. We consider St Barbara's assets have the potential to drive future shareholder value, with Atlantic acquisition the first successful move to achieve this.

Gold Road Resources (ASX:GOR)

The December quarter activities is the first for Gold Road Resources with meaningful numbers for its Gruyere mine (Gold Road's interest 50%), and the diagnosis is good. Gruyere has come in under its capital budget and is operating as expected. Ramp-up is progressing well, and pleasingly production will come in toward the top-end of guidance for 2019 and operating costs will come in within its guidance range. From the data reads for the balance sheet, one could be mistaken to think that Gold Road has been producing for years.

With Gruyere now in operation and ramping up successfully, we will continue to closely monitor this phase of the operation of the mine, to ensure it hits specifications. The December quarter data reads provided confidence, as Gruyere is operating a little better than its baseline.

Disclosure: Interests associated with Fat Prophets hold shares in Evolution Mining, Saracen Minerals. Gold Road Resources and St Barbara.