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Storm in a port

Before the world's central banks barged in on a quiet Sunday afternoon with plans to mitigate the economic effects of the coronavirus through a massive program of rate reduction and credit creation, gold and the companies that mine it could hardly catch a bid. Nor was Monday much different. You wonder what it takes to unnerve the holders of the currencies that tumble off the digital presses by the trillions.

Gold mines are the subject, and *Grant's* is bullish on them, as even first-time readers might have predicted. The question before the house is whether a critical mass of complacent dollar holders will come around to agree with us.

They should, but we understand the arguments for why some have not. One such contention is that the unannounced recession means deflation. Prices will broadly fall, and the value of the sometimes derided "fiat" dollar will reciprocally rise. Bonds, being long-dated promises to pay dollars, will therefore deliver handsome returns almost no matter how little they yield today. Central banks are powerless to stop the collapse.

For us, however, we trace an indelible arc of monetary evolution: unconventional policies begetting radical policies, low interest rates leading to even lower interest rates; and "QE for the banks" as the vanguard of "QE for the people." Central banks have indeed run out of rates to cut, and quantitative easing is plainly encountering the law of diminishing returns. But governments never really "run out of ammunition." Sooner or later, even the algos must start to wonder if the governments' money will hold its value.

Getting down to brass tacks, we are bullish on Barrick Gold Corp., Kirkland Lake Gold Ltd. and Agnico Eagle Mines Ltd. (GOLD, KL and AEM on the Big Board, respectively). For portfolio investors, we single out a pair of mutual funds, First Eagle Gold Fund (SGGDX) and the Sprott Gold Equity Fund (SGDLX).

The cessation of world commerce would be cause enough for panic, but Covid-19 is wreaking havoc on financial structures already weakened by leverage and elevated valuations. Artificially cheap credit, such as that on offer for most of the past 10 years, produces fair-weather balance sheets. All's well when business activity hums and asset prices climb. Adversity is not in the business plan.

Confronting it, overextended people sell what they can to raise cash. "[A] significant chunk of clients were opting to sell their gold holdings, a contributing factor to the recent gyrations in the price of the precious metal," unnamed European wealth managers were quoted as saying in the weekend *Financial Times*. Perhaps leveraged hedge funds are doing the same. Missing, so far, are the monetarily informed buyers eager to take the other side of the trade.

The pandemic will pass—the world's brainpower is working overtime to see to it. But as to the debt-heavy American economy, someone must pay. That someone is conventionally the debtor. Alternatively, in case of default, the losing creditor bears the cost. There is a third candidate to foot the bill. The money-holding population is the sap when inflation erodes the purchasing power of the dollar.

Because gold earns nothing and yields nothing, its price is indeterminate (gold-price theories based on the money supply or real yields to the contrary notwithstanding). From ancient times to 1971, the value of gold was fixed by law, that being the nature of a gold standard. For the past half-century, Mr. Market has taken charge of the price, not infrequently outsourcing the work to his manic colleague, Ms. Momentum.

Mining shares slumped last week as they have slumped all year long (and as they sold off in the autumn of 2008). We bulls stare open-mouthed as gold—*gold*, for Pete's sake, nature's own hedge against the Ph.D. standard of monetary management—buckles in the face of one central-bank liquidity gusher after another.

A tip of the hat, here, to our friends the deflation-philes. Perhaps even the trillions of dollars on offer to liquefy panic-stricken markets will prove inadequate. Then, again, there's always more where they came from. And whether or not these prospective new billions, or trillions, enter the real economy or remain trapped in the financial one, they will make mischief somewhere. The mischief will prompt new interventions, each one calling forth another.

"[M]ost people," says John Hathaway, portfolio manager of the Sprott Gold Equity Fund (formerly the Tocqueville Gold Fund), alluding to the coronavirus, "think this is just a bad dream and it's going to go away in the markets, and gold therefore is just hyped-up for a very short period."

Markets make opinions, quoth the

sages. Interest rates have been falling since 1981. Until just the other day, stocks had been going up since 2009. As to gold, it peaked at $1,900 an ounce almost nine years ago. In 2019, when the gold price increased by 18.5% and the VanEck Vectors Gold Miners ETF (GDX on NYSE Arca) soared by 39.8%, the latter actually suffered net outflows.

A decade's worth of radical monetary methods provokes a cerebral reaction; you approve or disapprove. A decade's worth of rising stock prices (and almost four decades' worth of rising bond prices) provokes a very different, visceral kind of reaction; you probably cheer. It's therefore no wonder that the average investor is slow to renounce his faith in the false magic of modern central banking.

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The case for gold investments has a microeconomic dimension as well as a monetary one. "Oil coming off 25% is really good for these companies," a hedge-fund investor who prefers to remain anonymous reminds colleague Fabiano Santin. "Margins should be pretty good not only because gold prices are up, but because oil prices just took a huge whack. Remember, they are moving dirt. Very fuel-heavy, fuel-intensive. These companies, at these prices, can actually generate real money, and the companies are generating good cash flow these days."

"My take," says Hathaway, speaking of the mining companies in general, "is that they're all mispriced for current gold prices. I mean the cost of producing an ounce of gold globally is around $1,000—an all-in, sustaining-cost-type number. The margin has gone from $200 two years ago to nearly $400 last year. And maybe if we stay where we are [over $1,600, as he spoke], trading in a range, another $200 this year."

"Maybe" is the watchword, all right, and in the short run Ms. Momentum has the last word. In the long run? We trust, if that's the word, the politicians and the gold-bullish arc of evolution.

"You don't necessarily buy gold miners for the dividends," Santin observes, "but at least the majors today are very competitive on that front. For instance, Barrick, the world's largest gold miner, recently raised its cash distribution by 40% and now pays a quarterly rate of 7 cents per share for a 1.6% dividend yield, which absorbs only a quarter of Barrick's annual free cash flow."

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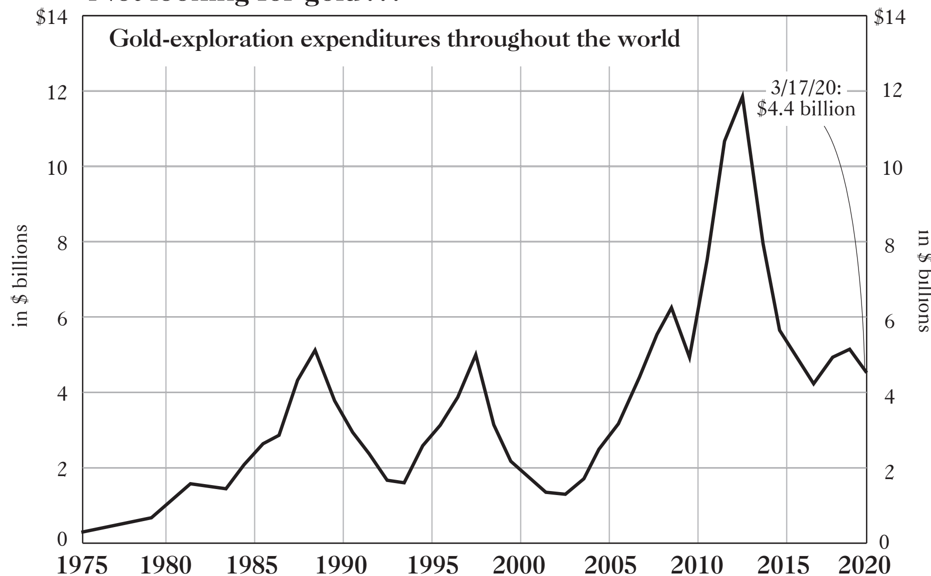
In 1995, before taking the helm of Barrick, Mark Bristow founded Randgold Resources. In 2018, he combined that creation with Barrick to build the world's largest gold company, and he has committed to new projects only if they yield an internal rate of return above 15% with an assumption of gold at $1,000 an ounce. "If anyone can teach an elephant to dance," comments John Doody, editor of the *Gold Stock Analyst*, "it's Bristow."

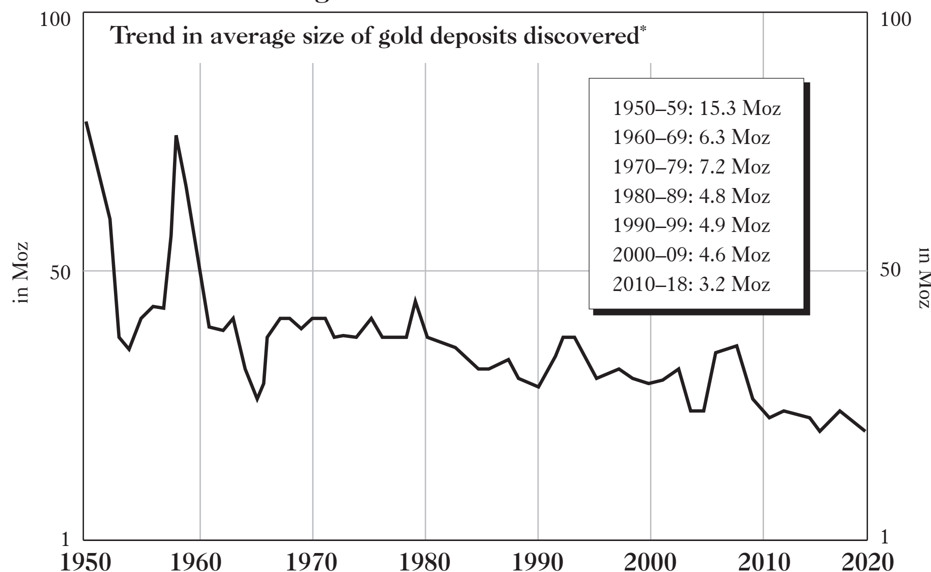
Last year, Barrick produced 5.4 million ounces of gold at an all-in sustaining cost of $894 per ounce. It owns 71 million in proven and probable reserves averaging 1.7 grams of gold per ton of ore. Aside from properties in the United

Not looking for gold . . .



source: MinEx Consulting estimates

. . . and not finding it



* Excluding deposits in which gold is a byproduct.

source: MinEx Consulting

States, Canada and Australia that contribute nearly half of total production, Barrick operates mines in the Dominican Republic, Argentina, Papua New Guinea, Tanzania, Mali, Congo and the Ivory Coast. In partnership with Novagold, it also shares 50% ownership in the Donlin gold project in Alaska.

Once a prisoner of its own encumbered balance sheet, Barrick has reduced financial leverage to 0.5 times trailing earnings before interest, taxes, depreciation and amortization from almost 9.0 times in 2012. The shares trade at 8.8 times 2020 Bloomberg consensus cash flow.

Discouraging words from the C-suite sent shares of longtime market darling Agnico Eagle reeling by 15.6% on St. Valentine's Day. Reduced management guidance featured a 4% decline in projected gold volume, to 1.875 million ounces, and a 20% bump up in the estimated cost per ounce, to $750. The market took solace in neither a 14% boost in the quarterly dividend nor in assurances that costs would decrease in 2021 and 2022 as gold production ramps up.

Slower-than-projected production growth at a pair of mines, Meadowbank and Meliadine, in the Nunavut Territory in northern Canada, was one difficulty. Greater-than-expected costs at the LaRonde mine in western Quebec was another.

LaRonde, Agnico's flagship property, was responsible for 403,000 ounces of gold produced last year, or nearly a quarter of companywide output, at a cost of $502 an ounce. Under management's watchful eye, production at Meadowbank, the smaller of the two northern problem children, is expected to rise to 415,000 ounces in 2022 from 245,000 ounces this year.

On a consolidated basis, Agnico delivered 1.8 million ounces of gold in 2019 and reported an all-in sustaining cost of $938 an ounce. Company-owned reserves at the end of December reached 21.6 million ounces averaging 2.8 grams per ton. About three-quarters of last year's production came from Canada, with the balance from Mexico (16%) and Finland (10%).

Debt on the Agnico Eagle balance sheet summed to $1.7 billion at the end of 2019, or 1.3 times adjusted Ebitda. The stock trades at 11.3 times 2020 operating cash flow and is priced to yield 1.9%.

Kirkland Lake's stock has been by far the best in the past many years among most gold miners (up 98% in the last two versus 20.4% for the GDX), but it has lately tumbled with Agnico. Each is down 34% and 32% this year, respectively, versus a total return of about -4% for Barrick.

On Feb. 3, Kirkland Lake completed the acquisition of Detour Gold Corp., which starred in the June 29, 2018 edition of *Grant's* (in the subsequent 19 months, the value of those shares has risen by 94%—*advt.*).

Detour, which will lift Kirkland's gold production by 60% to 1.6 million ounces in 2020, will also change the acquirer's operational profile. Although Detour's reserves of 14.8 million ounces would seem to overawe Kirkland's 5.7 million ounces, Detour's ore is relatively low-grade (0.99 grams per ton versus no fewer than 21 grams per ton for Kirkland's Fosterville flagship mine in Australia). You can see the difference in the respective units' projected 2020 cash costs: $720 an ounce for Detour, less than $150 an ounce for Fosterville.

If all goes according to plan, Detour will reduce costs and boost output under the new Kirkland management. The wobbly Kirkland share price is testament to fears that the opulent Fosterville ore will support high-grade production only through 2022. As with so many gold producers, an ascendant bullion price would go far to allay concerns.

Last year, Kirkland produced 975,000 ounces of gold at an average of 18.5 grams per ton and all-in sustained costs of $564 an ounce. Other than Fosterville and Detour, the company owns the Macassa and Holt Complex mines in Ontario.

Kirkland owed zero debt and carried $707 million in cash at the end of December. Its stock, which trades at 5.6 times 2020 cash flow, yields 1.9%.

The late Michael Harkins, a sometime investor in gold mines, had a rule that the mining company you own will be the one to succumb to fire, flood or some other act of God. Hence the appeal of the portfolio approach.

The GDX exchange-traded fund, with year-end assets of $11.2 billion, offers a low-cost (52-basis-point) way to track the NYSE Arca Gold Miners index. Top names on Dec. 31 included Newmont Corp., Barrick, Franco-Nevada Corp., Wheaton Precious Metals Corp., and Kirkland Lake. Total return has averaged 4.9% in the past 5 years, but *minus* 3.0% annually since inception in May 2006 (when gold traded at $656—a vivid illustration of how overvalued and under-managed gold-mining companies can be). For comparison, the FTSE Gold Mines index has returned 8.5% annually in the past five years and minus 1.9% since May 2006.

One alternative is the First Eagle Gold Fund, which charges a 1.29% management fee to look after $1.25 billion of assets. At the end of February, aside from gold bullion (18.5% of net assets), the fund owned shares of Newmont (10.8%), Barrick (10.5%), Wheaton Precious Metals (6.7%) and B2Gold Corp. (4.5%). It has seen an average return of 6.8% in the five years ended Dec. 31, 2019 and 5.5% since its founding on Aug. 31, 1993. Compare this to the 11.4% and 0.08% returns for the FTSE Gold Mines index over the same time periods.

"We always try to think of downside risk, what could go wrong," Thomas Kertsos, co-portfolio manager at First Eagle Gold Fund, tells Santin. "We use gold [bullion] as a potential hedge not because the gold price may rally in the next 6–12 months, but as a strategic position for all the known-unknowns but also all the unknown-unknowns that can impact the market. As such, we focus on resilience and we also try to look at what can really go wrong in the gold-mining companies that we own and try to cover the downside and let the potential upside take care of itself."

"Apart from valuation," Kertsos goes on, "We look at growth, resilience, duration, which means that we look at growth in gold production and gold reserves per share, the balance-sheet strength, the cost structure, the quality and the depth of the management team and the overall sustainability practices of the company. We know the space very well and have a very concentrated gold fund, about 21 securities, including gold bullion. We are not benchmarked to any index. We have low turnover, and we have historically been more resilient in downturns."

Another alternative is the Sprott Gold Equity Fund, which charges a 1.47% fee to manage $1.1 billion of bullion and shares. As of Dec. 31, gold itself accounted for 15.3% of net assets. Top mining names included Detour (7.9%), Pan American Silver (5.2%),

Franco-Nevada (5.1%), and MAG Silver Corp. (4.7%). Sprott returned an average of 5.4% in the five years ended Dec. 31, 2019, and 9.5% since its inception on June 29, 1998. Compare this to the 12.7% and 3.9% annual returns, respectively, for the FTSE Gold Mines index.

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