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The golden book end to the TB Amati Strategic Metals Fund

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By design, the evergreen nature of the Amati Strategic Metals Fund retains a focussed exposure to battery metals (54% portfolio weighting) but has 45% precious metals weighting. We outline why we still hold a high weighting in Gold for our investors.

The gold price weakness is largely due to the dollar's unforgiving march higher on Fed hawkishness. Federal Reserve officials gave their clearest signal yet that they're willing to tolerate a recession as the necessary trade-off for regaining control of inflation. Policy makers, criticized for being too late to realize the scale of the US inflation problem, are moving aggressively to catch up. They raised interest rates by 0.75% in September for the third time in a row and forecast a further 1.25% of tightening before year end, this is the trade.

• Gold initially jumped 1.67% on J Powell's announcement of a 0.75% Fed hike but has since reversed gains to settle around the $1,660/oz mark.
• The gold price has extended its decline in parallel to the dollar's strength against alternative major currencies.
• The dollar index has jumped another 1.62% to near 2002 highs.
• 2-year Treasury yields slid from 4.1% to 3.99% providing some respite, however such high 'risk-free' yields provide little incentive to prospective gold buyers.
• The strong dollar and soaring treasury yields have been propelled by the Fed's commitment to tame inflation with aggressive rate hikes, despite increasing the risk of recession.
• A decline to $1,650/oz would qualify gold prices for 'bear market' labels.
• ETFs continue to slash gold holdings, hovering around the lowest level since Jan. 2020.
• We expect an eventual dollar reversal, alongside a Fed pivot, currently priced in for May 2023, to trigger a continuation of gold's previous upwards momentum.

However, a fourth 0.75% hike in a row at the November FOMC meeting, followed by a 0.50% hike at the December FOMC meeting, would bring the target range for the federal funds rate to 4.25% to 4.5% at the end of this year. Powell signals that r**ecession may be the price for crushing inflation.**

Any hope of a pivot trade, (market indicator to buy equities) is difficult to see in the short term. The bar for the Fed to come riding to the rescue of the market (i.e., 2019) is a lot higher given the inflation backdrop hence losses for equities should continue near term as we correct. We believe the key takeaways are:

1. the probability that the fed will tip the US into recession. In this scenario the most mispriced pocket of the market is cyclicals and consumer discretionary sectors with the aforementioned pullback in back-end rates and a lower growth backdrop perhaps offering some support to defensives and quality growth such as mega cap tech. It was interesting that this was how US sector/thematic performance played out following the post-announcement Q&A.

2. if the Fed does slow rate hikes, then we are looking at severe losses for economy and thus the equity markets given how restrictive the dot plot is. However, given that employment is a lagging indicator there is a real risk that significant damage is done in the meantime before job openings and wage inflation start to moderate.

Gold warrants some attention here given the increasing likelihood we are heading for a more severe slowdown with rates close to topping out. It will be hard to fully commit prior to an economic / market pivot but averaging in as the data deteriorates make sense. It is important to stress that in only 3 out of the last 20 Fed rate hike cycles since 1915 did the US economy not end in a recession. It could be argued the Fed is already tightening in a recession?

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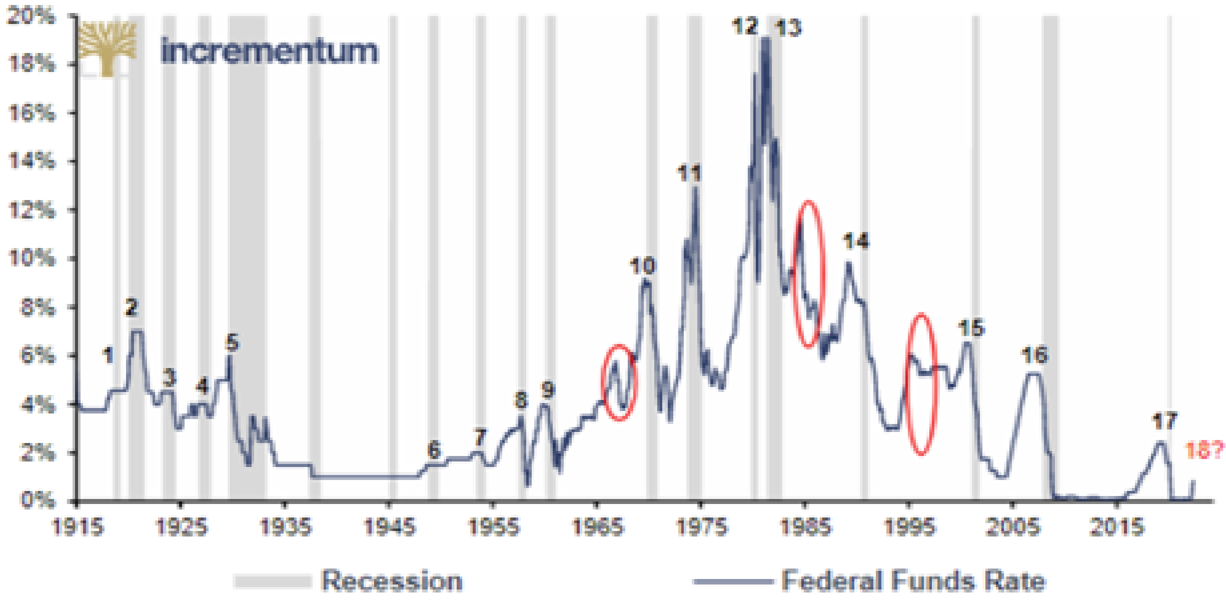
Figure 1 – A track record of recessionary cycles post rate hikes



Source: Incrementum

So how does gold perform in a recession? – well certainly better than other asset classes.

Figure 2 - % change in the nominal gold price during recessionary cycles

Recession year	Length (months)	% change in nominal gold price
1973	16	87%
1980	6	-5.1%
1981	16	1.6%
1990	8	0.1%
2001	8	5.0%
2007	18	16.3%
2020	2	5.6%
2022/23??	**??**	**??**

Source:Amati Global Investors

For more recent economic crises, the trend is more evident for gold's role as a wealth store.

Figure 3 – Gold versus the broader market

Crisis Period	Year	S&P 500 TR Index	U.S. Treasuries	Gold Bullion
COVID-19 Pandemic	*2020*	18.40%	8.00%	**25.12%**
Fed Hike/U.S. China Trade War	2018	-19.34%	2.45%	**5.14%**
China Yuan Devaluation	2015	-11.85%	3.50%	**11.54%**
U.S. Sovereign Debt Downgrade	2011	-12.27%	3.64%	**7.86%**
Eurozone Crisis/Flash Crash	2010	-14.53%	4.47%	**5.44%**
Global Financial Crisis	2008	-54.46%	15.80%	**25.61%**
Average Return		**-15.68%**	**6.31%**	**13.45%**

Source: World Gold Council

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For the wolf and bear scenario commentators, stagflation is good for gold too. Since 1970 the average return (during stagflation periods) for gold was 7.7%, Silver 3.4% and gold equities 33%. Given this historical performance of gold as an asset class, it is surprising there is still very little interest in investing precious metal equities.

Some investors are turning to precious metals as a store of value. While on the operational side – the threat of margin compression due to cost inflation is growing, and investors have been concerned about capital cost inflation for companies building new mines or expanding existing operations. We expect to see a continued trend of investors preferring capital returns over growth, a sentiment that is not aided by inflation, which is perceived to increase the risk associated with capital-heavy growth projects.

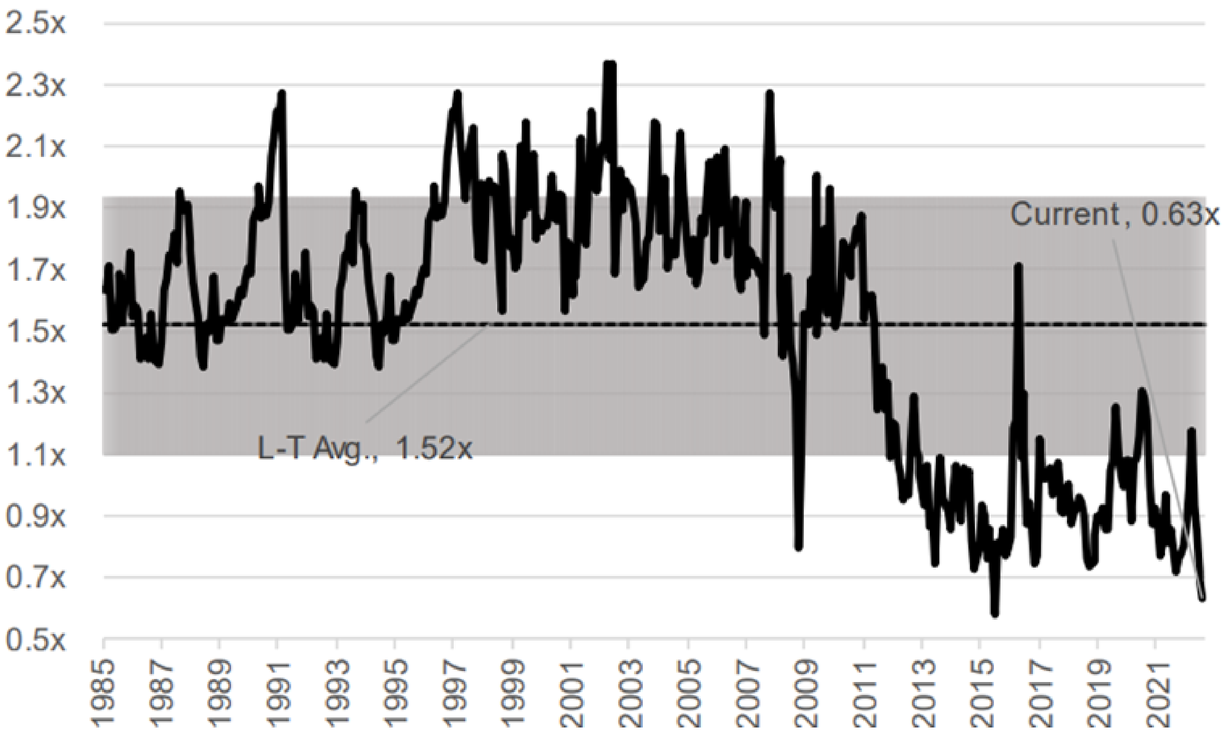
We also continue to see investors shift their focus towards royalty and streaming companies that are more insulated from inflation than their mine-operating counterparts.

Despite these inflationary headwinds, we have a positive outlook for the sector – the gold price remains conducive to strong Free Cash Flow (FCF) generation, and we expect that any growth foregone today in the name of capital returns will be made up for in the future as investor appetite for new projects increases. This is where the Amati Strategic Metals fund is positioned.

Equity Valuations

If we use the North American gold producers as a proxy, they are currently trading at an average 0.79x P/NAV (excluding internationals [0.57x P/NAV] and royalties [1.75x P/NAV]). Senior and intermediate producers are trading at a P/NAV of 0.82x and 0.28x, respectively. Based on Scotia Banks's 2022 estimates, the stocks are trading at an average 16.0x EPS, 6.8x CFPS, 4.5% FCF yield, and 5.6x EV/EBITDA (excluding royalties and internationals). The group is trading at an average $339/oz of reserves, and $140/oz of resources.

Figure 4 – Gold equity valuations



Source: Scotia Bank

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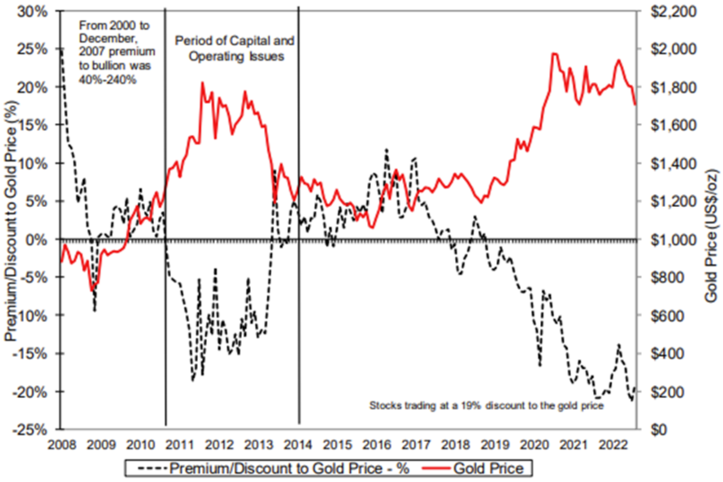
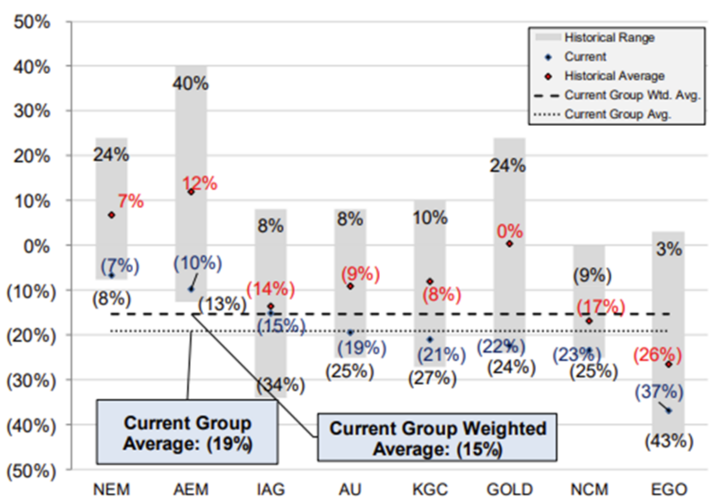
Another way to evaluate the gold equities is to estimate what gold price the gold equities are pricing in to their share prices. The producing companies are discounting 19%, while the developers are discounting 44%. Surprisingly we are at 10 year lows, and as value investors this piques our interest. We just need a Fed pivot to catalyse this sector.

Figure 5 - Gold equity premium/discount to gold



Source: Scotia Bank

Figure 6 - Discount/Premium to Bullion History (2013 – present): Senior Gold Producers



Source: Scotia Bank

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