There's a terrific scene in Goldfinger, when the bad guy Aurich Goldfinger sets up shop by the pool, at Fontainebleau Miami Beach a la 1964. By the sounds of it, for a week straight, old Aurlich has been beating the wheels off his mark, in a game of high stakes cards. And hilariously, wearing an ear piece the size of an Air Conditioning unit, Aurich demands to sit in the same place, so his lady friend can read his marks cards. "You and your sun tan", the poor guy mumbles as he shuffles seats. It's business as usual until (the-GOAT-James-Bond) Sean Connery takes over the microphone… "**Now hear this Goldfinger. You're luck has just changed**".

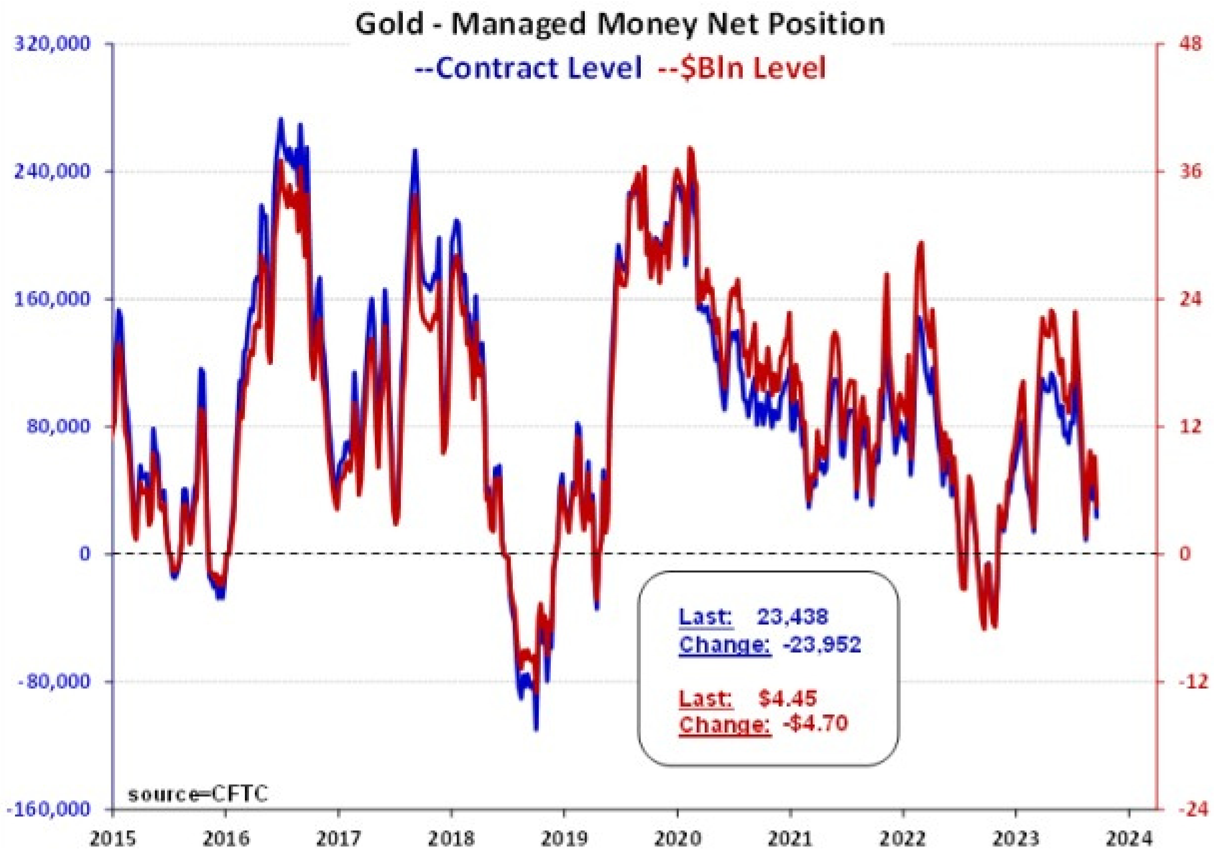
For as long as I've been in the business, as much as the sky is blue, when real interest rates go up, the gold price goes down. And vice versa. All of us investors assume the gold price and real interest rates are negatively correlated. And for good reason. Between 2007 and 2021, according to Bloomberg, the inverse correlation between the yield on 10-year TIPS and the price of gold registered 91%. And look at the divergence since. The correlation has totally broken. Given where real interest rates are, the gold price should be hundreds of dollars lower. Yet it isn't.

So what is the explanation?

Who is our Mr. Bond, taking over Aurich Goldfingers microphone?

Let's start with who isn't.

Commercial contracts on gold are near their lows. This chart from Meridian Macro Research shows speculators net long futures have been more than cut in half over the last number of weeks. When these positions are near highs (~160,000 net long or higher), it's time to trim. And conversely, when it gets near zero, you buy. We are at zero.

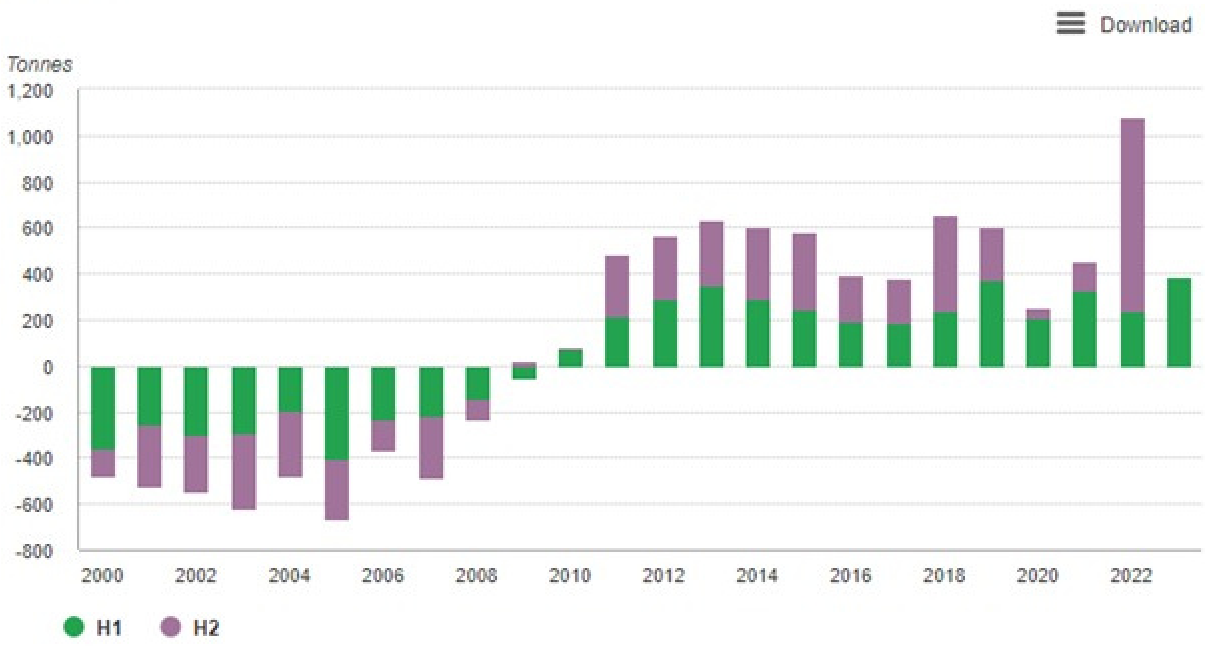


If sentiment is bad for gold itself, **the equity miners are far worse**. My colleague Grant Beasley, a card carrying gold bug (with the gout to prove it), pointed out the Gold Miners Bullish Percent Index is the lowest it's been since October 2022. Note that the peaks and the lows matchup almost perfectly with the CFTC Managed Money chart above.

So, who is our Mr. Bond?!

It is a shaken-and-stirred cast of Central Banks buying. **~~In the first half of 2023, central banks purchased a record net 387 tons, the highest such offtake according to World Gold Council data, which goes back to 2000~~** (link).

H1’23 central bank demand is the highest first half total on record*



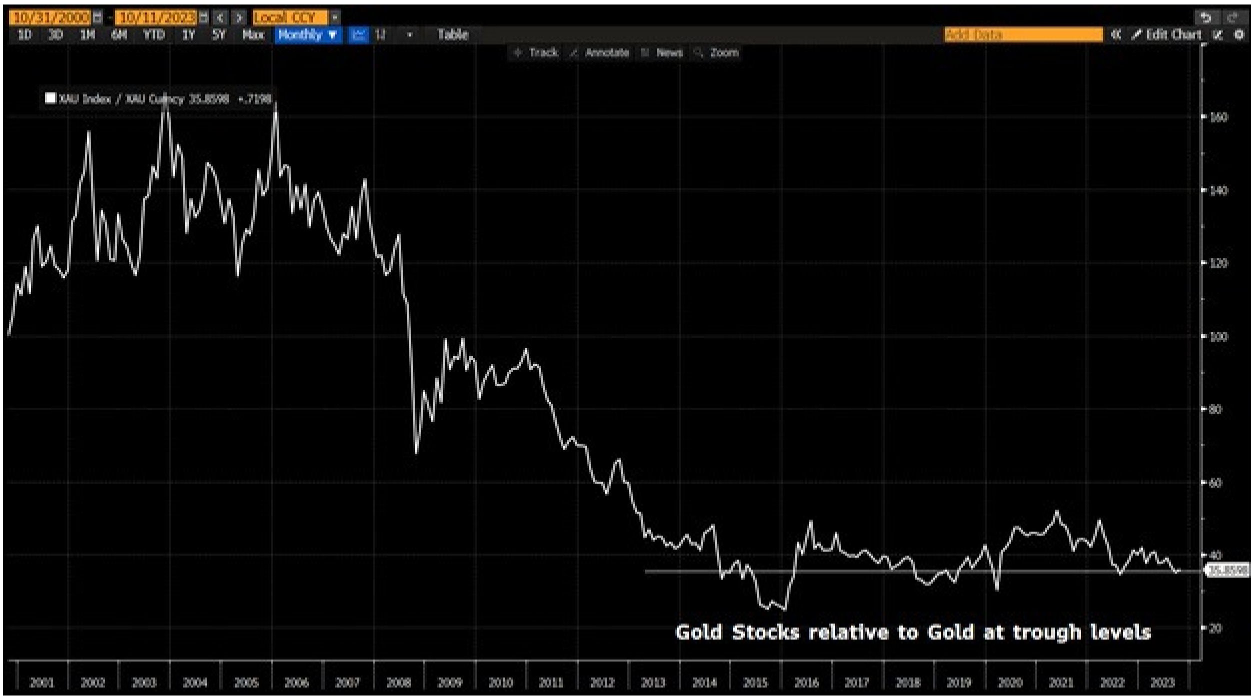
Sources: Metals Focus, Refinitiv GFMS, World Gold Council; Disclaimer

*Data as of 30 June 2023. Quarterly data available from Q1 2000.

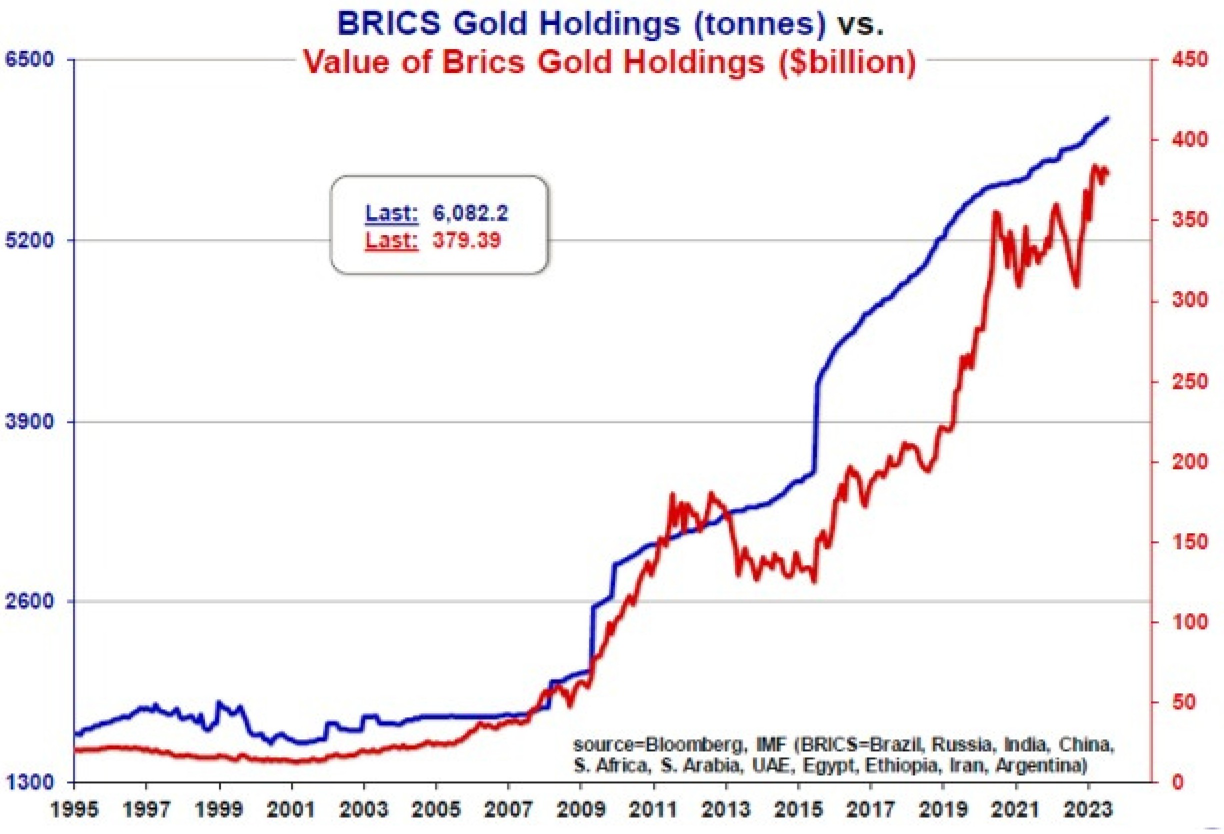
~~2000 was an important year~~, because it marked the start of the last big run in precious metals and related equities. And it lasted a decade. The Philadelphia Gold and Silver Index, which is a basket of the leading gold and silver miners was up ~400% from the start of 2000 to the highs in 2008.

Here is the same chart, but this time relative to the price of gold. It shows that valuations have come in to levels you want to add, if the famous adage about past performance and future returns applies. And it makes sense. An RBC report covering this year's Gold Forum was titled: "You Could Hear a Pin Drop." The time to be concerned is when the conferences are packed and the mood is giddy. The gold development companies within our coverage universe are trading at an (extraordinarily low) adjusted average of 0.3x their NAV (net asset values). I was forwarded a note by Fred Hickey at the High-Tech Strategist and he had an interesting theory;

"The primary consumers of gold (China, India, Turkey, Middle East) have continued buying gold this year (keeping gold slightly up), while Western investors (North America, Europe) have sold. **However, it's Western investors that determine gold mining stock pricing. Thus, the disconnect between gold (holding up) and the miners (deeply depressed).**"

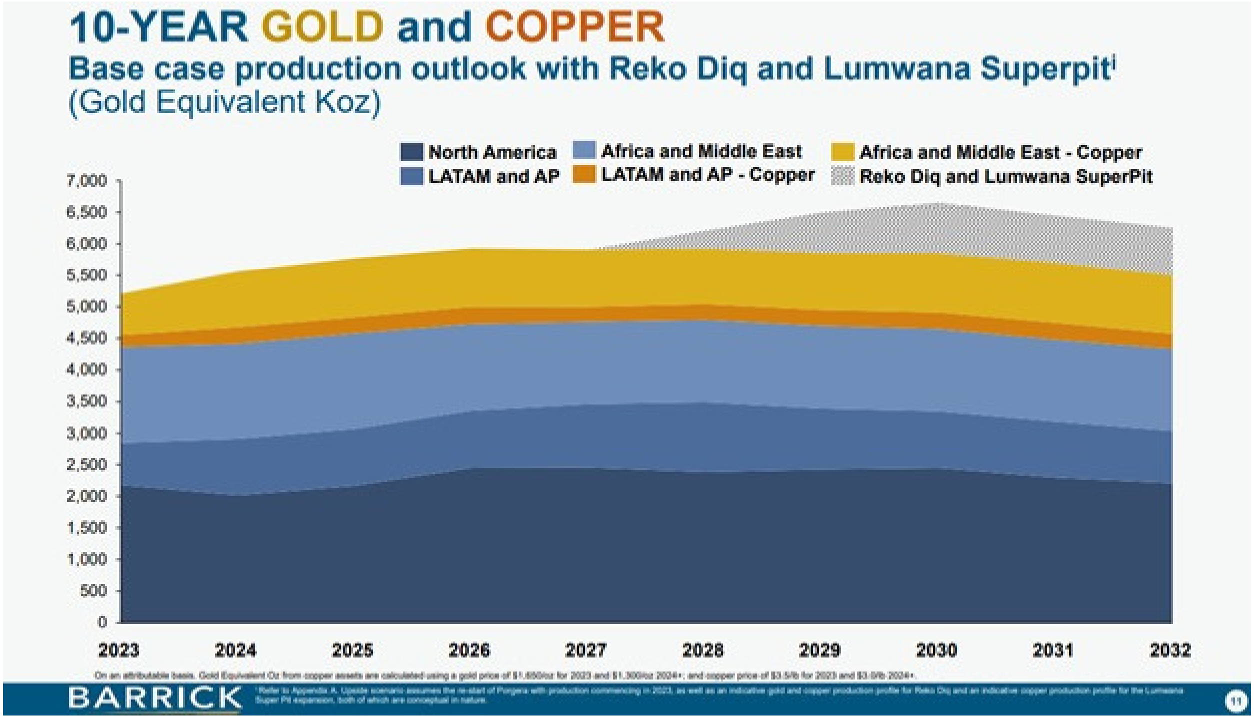


As for why Central Banks are buying, if you think about it; China is decoupling, they want off treasuries and dollars; the Japanese carry trade is done, they're the biggest holder of every foreign sovereign, they will be off treasuries; Saudi Arabia and China are discussing oil sales to China in yuan; and it didn't help that the EU froze €200bn in Russian central bank assets since Moscow invaded Ukraine. And what do Brazil, Russia, India, China and South Africa, the BRICS have in common? Well the FT's associate editor Janan Ganesh has a mischievous but plausible explanation: 'grievance: against western primacy, against past slights (link)...



So pay attention to our Mr. Bond… Central Banks buying. Russia getting zero'd on their FX reserves, means that gold has taken its own non-interest rates sensitive spot in the world. And it means I think all those charts with rates, that all the sell side analysts and economists talk to, need to be thrown out.

So if CFTC positioning is on the lows, the equities are as cheap as some of the great buying opportunities ever, and central banks are on the bid, then what do we buy? Well look at the gold companies that reported today; Barrick, miss. K92, miss. Torex, miss. Even Osisko Gold Royalties, who had a lot of positives in their production, even missed (not much they can do about a plummet in rough diamond prices). The number of significant discoveries has fallen off a cliff, exploration expenditures have too, grades are falling, permitting hurdles are rising, and delays + cost over runs are like building a house in 2020. Why?… available capital and flow of funds… here is Barrick's production for the next decade.



In a world where Barrick's growth chart is flatter than a pancake, yet Glencore is trying to buy Teck, Newmont is buying Newcrest, Exxon is buying Pioneer, it's clear the super majors are going to ignite one of the great M&A booms of our careers in natural resources. They can't grow otherwise. So we want to own smaller companies, with huge growth upside, which the market is pricing unreasonably cheap. Because, well, they haven't even looked.

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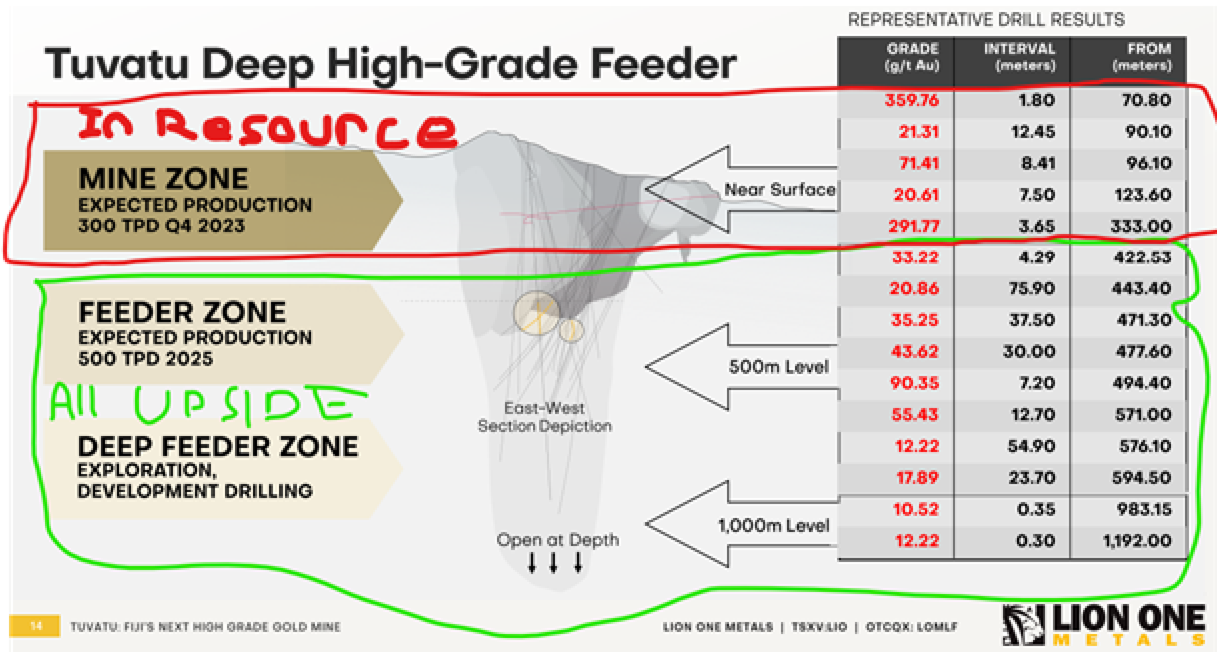
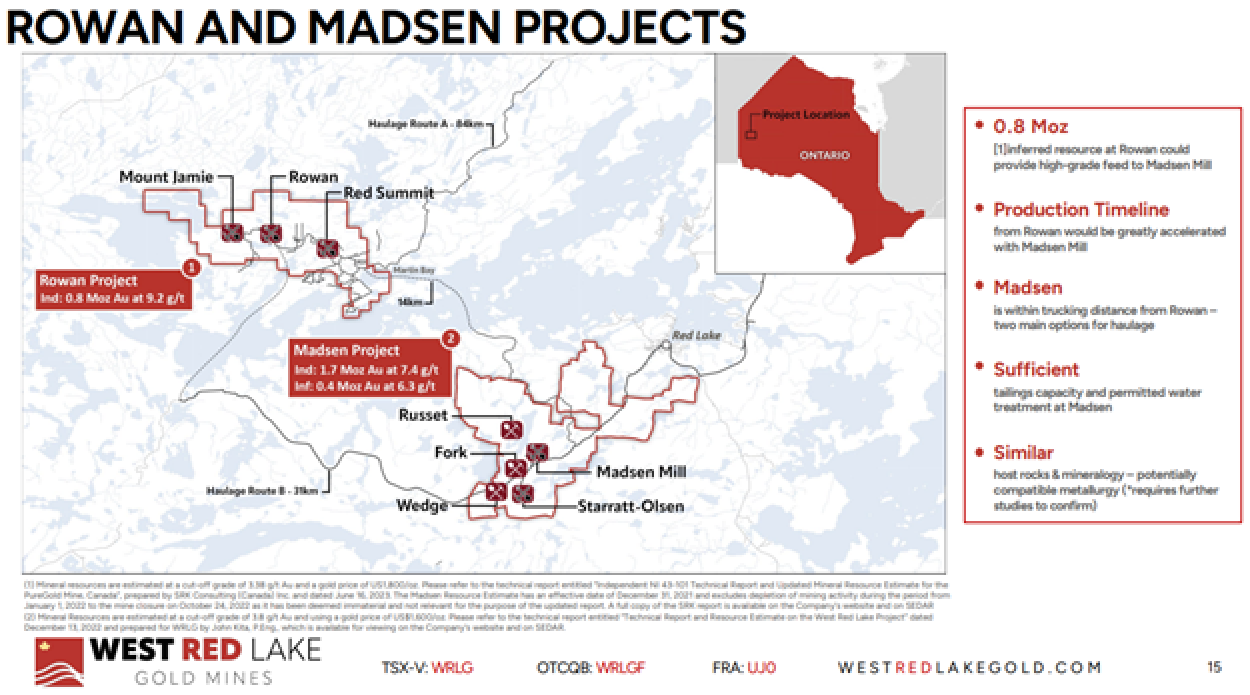


WRLG CN – West Red Lake Gold Mines – I've never written this one up before but am very intrigued after marketing with CEO Shane Williams this week. Most people hear "turnaround story of the old Pure Gold Madsen Mine" and stop you there. I'm not going to lie, I thought the same, until I actually spent some time and called around. My good friend Duncan Middlemiss (former CEO of WDO CN) is on the board and I know he wouldn't put his name on anything for a few shares, and he is a turnaround specialist, so that got my attention. Duncan was brought into fix Eagle by an activist S/H at WDO and if you recall it was a very similar asset situation to Pure Gold at Eagle, where WDO was putting indicated into the mill, think 20 meters spacing's, basing a lot of information, on a miniscule amount of samples, no shocker it didn't work. Interestingly Tony Makuch is on the board too and he turned around Lakeshore Gold which was taken out by Tahoe, and then again a similar mine at Macassa under the Kirkland banner. So these are very wealthy guys, who don't need a few shares, putting their name on helping advise a turnaround here, and have done it before. Shane Williams I should add too is no slouch himself, was COO at Skeena, and Eldorado before that running mines in Greece and Turkey. He is an operator hence why Frank Giustra and his team recruited Shane when they picked up the asset.

The story here is a long and winding one, but bottom line it never had the right kind of attention or money spent on it. Talking to the old operators, they leased all their equipment, to get capex down, which just pushes everything into opex (leasing a crusher is crazy, it just adds into your monthly burn). Because spacing was so wide, which doesn't work on a high grade narrow vein UG mine, they didn't have the detailed information required to do a credible mining plan. I'm sure the Oxygen guys had the best of intentions but without that info you are flying blind. Think about it, you go into a stope with no holes above your head, for all you know, you are taking a big scab of waste to the mill and it kills your economics. Which is crazy when you think about it because you've got the asset, and the mill is in a good spot and you have all your stuff ready, you're at the 5 yard line, and then you don't get gold because you don't know where it is. Sprott was the lender, which became a loan to own, they own 24% of the company today, and some covenants forced Pure Gold to press ahead, despite a lack of knowledge. And then Covid hit so if Pure Gold had any shot, that was the nail in the coffin, labor issues, parts sourcing, but it was WRLG's gain picking up the Madsen project with $350mm of investment, for C$6.5mm and Sprott's shares + a 1% NSR.

For that WRLG got a brand new 800 tpd processing facilities and ramp access to underground. The Flagship asset commanded over $1bn mkt cap at its peak, despite not really having any handle on it. This could be a 100k oz pa with existing infrastructure. The second project Rowan is turning out to be a sleeper, 850k ounces of high grade inferred on its way to a +1m oz deposit. It's early days to guess amount 50k oz pa to 70k oz pa over time. They need to drill the heck out of Madsen and do this right, but with Frank Giustra and co. I have no doubt they will. I really would recommend spending some time on hearing the story. It could be one of the biggest winners in time .



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In closing, this weekend my friend Kevin Muir wrote a note entitled 'The Fed Just Paused' (link). Kev has been a bit quieter than normal, on making a bold macro call. And he is VERY good. So when he came out and said, more or less, "now, I am pretty sure, this equity risk premium (meaning that bonds weigh on stocks) will be a big deal", it kind of made my ears perk up. Since the Fed's September 20th meeting where they hammered home their "high for longer message", the 30-year US treasury yield has risen from 4.35% to 5%.

Listen, I can't tell you where rates, or inflation, or the economy is going any more than the next guy. But perhaps those aren't the questions we should be asking. We should be focusing on who Mr. Bond is? And why he is doing what he is doing. Because clearly that is driving price more than anything else. And as for Gold, despite the relentless pace of higher yields in the short and long end of the curve, Gold is still up year to date (albeit small). I think the setup for Gold is so good at this level. And the miners could be the stuff of legend.

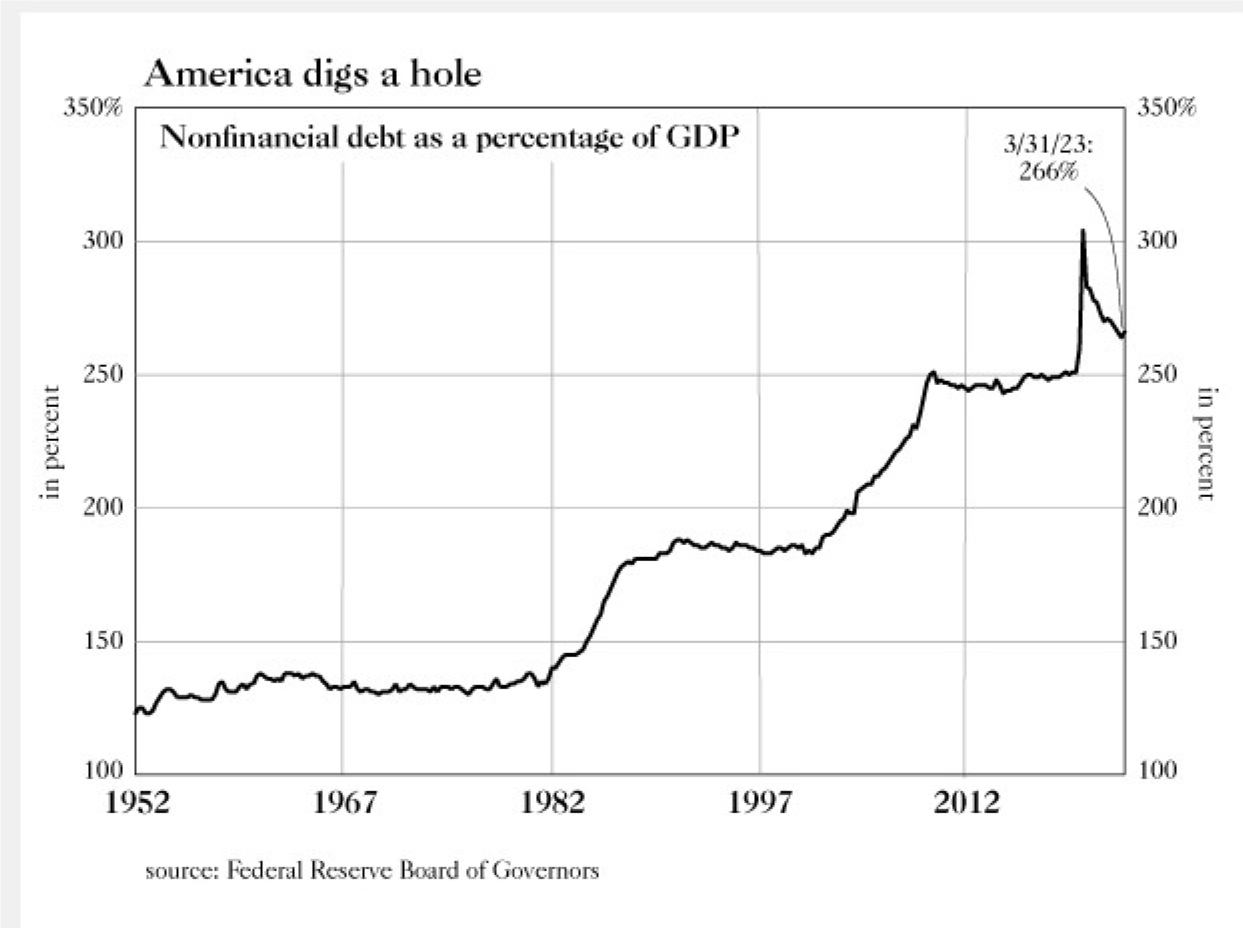
A veteran client of mine (shout out to Frank Peters) said that for 30 years, you've only had bad relative, strength in gold flip to positive 3 times. THREE. And when cumulative money flow flipped from negative to positive, the small cap equities massively outperformed the commodity.

Imagine if the BRICs decide what bonds them is a currency, likely backed by gold. That wouldn't mean anything good for the dollar.
Then there's the Japan carry trades unwinding, which will force rates up, as treasuries are sold. That alone is huge, the Japanese have done something they said they would not do, for a long time.
Then there is China is decoupling. They don't want UST's, look at their holdings chart below for the last decade+.

So the biggest buyers of UST's, don't want them.

On the flip side, China's Central Bank hasn't bought gold for almost a decade… until 2023…

And all of this is in the face of an already huge, peacetime I'll add, deficit. The financial archivist extraordinaire James Grant recently wrote on the matter… "*As long as interest rates were falling and the government's credit was held to be sound, Treasury securities could dominate the market in financial safety. In a new bond bear market, gold may lay claim to a bigger share of the safety franchise*"…



It’s proverbial that there are lots of reasons to sell (houses, cars, divorce, G wagons etc. lol), but only one to buy. So if the Fed has to step in, because everyone else is selling for their own reason, that is yield curve control, which will absolutely hurt the dollar.

So gold has a real window here, in the next 1-3 years.

There is no institutional memory that the miners can perform. But that’s no different from 1996 when Bre-x broke the sectors back. The sector did nothing for 5 years, then bang. It can happen.

Pour yourself a drink Aurich, we are in for a ride....

Your Pal,

Winston Miles

Principal, Head of Institutional Equity Sales

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