Ninepoint Gold & Precious Minerals Fund

Q3 2021 Commentary

Investment Team

Ninepoint / Sprott,
Sub Advised by Sprott Asset Management (SAM)

Performance Summary

The Ninepoint Gold and Precious Minerals Fund, Series F declined 9.77% in Q3 2021 as precious metal equities struggled against the backdrop of a strengthening US Dollar and credit concerns emanating out of China. Over this period, the GDX and GDXJ declined 13.27% and 17.99% respectively. Our portfolio strategy, which is overweight high-quality small and mid-sized miners helped generate alpha against the precious metal indices. Curiously, gold bullion held firm during this quarter, with the GLD ETF experiencing a comparatively small decline of 0.85%. The relative strength of gold bullion was helped by the re-emergence of physical demand out of India and China, which combined with strong operating results from our portfolio companies gives us a strong signal that the correction in precious metal equities may be nearing its end. With valuation multiples for precious metal equities at or near historic lows, we continue to see potential for outsized returns in the precious metal sector.

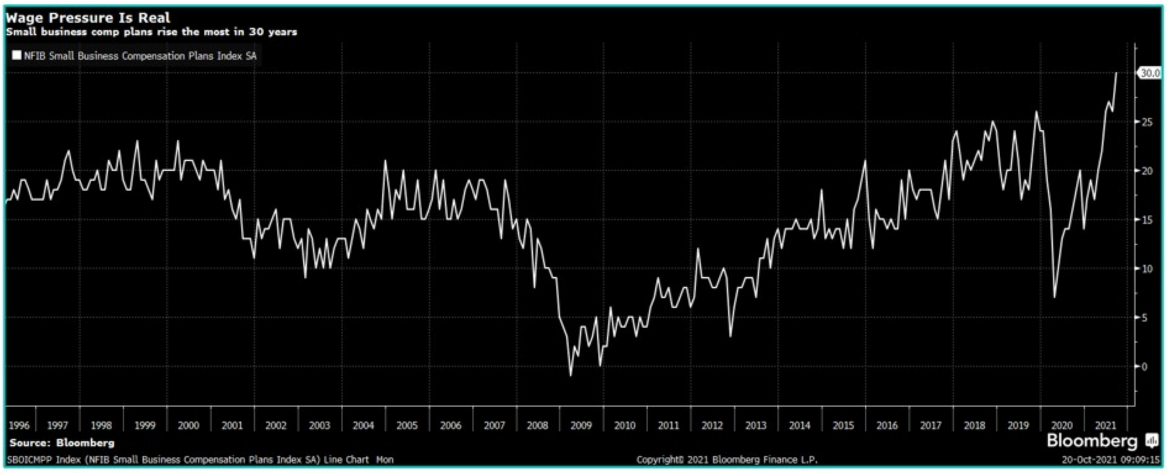
In our previous commentaries, we had pointed to the divergence between inflation and the economy. This trend continued to diverge further through Q3 2021. The "reopening" trade has experienced several speedbumps along the way as a result of a persistent pandemic and languishing logistic chains. In particular, the challenges on the supply side of the equation have been substantial. Shortage of parts needed in automobiles have led to assembly lines being idled, while worker shortages have forced service industries into a difficult position. Social distancing measures amid the pandemic have slowed ports down to a crawl as a result of which shipping rates have skyrocketed. Shortages of skilled workers are commonplace in nearly every sector of the economy. Prices have been marched rapidly higher, in part to adjust for the curtailed output and in part due to rising commodity prices. This has put the global economy in a very difficult position. Inflation, which was previously viewed as "transitory" by pundits is now transitioning to "persisting" and "frustrating". At the same time, GDP growth has underwhelmed in many parts of the world.

Source: Bloomberg

Closer to home, positive economic surprises are now difficult to find because the long awaited economic rebound has also been more muted than anticipated. The widely followed Atlanta Fed GDP Nowcast Index has the GDP growth trending around 0.5% which is wildly different from the 4-5% number that is baked into consensus.

Source: Bloomberg

Most importantly, inflation is now soaking into wages. Wage inflation, unlike commodity prices is much more sticky. Compensation paid by small businesses hit a new high earlier in October. Higher wages directly increase consumer spending power and make the current inflationary environment even more difficult to tame.



Source: Bloomberg

Inflation has resulted in rising yields, especially on the long end of the yield curve. Against this backdrop, the market continues to believe that the rate of inflation will cool significantly over time. Despite persistent inflation showing up in the CPI and PPI numbers, the US 5 and 10-year breakeven rates have gone sideways over the past six months and real yields have actually increased. This development has been an important detractor for the underperformance of gold and silver so far this year.

The chart below shows the relationship between real yields that have been inverted and the price of gold. It is easy to see the connection between the price of gold and real yields. Gold tends to do best when real yields are in decline, either as a result of declining rates or rising inflation. We saw this coming out of the global financial crisis in a period between 2008 and 2011 and again between late 2018 to mid-2020.

Source: Bloomberg

Real yields rose between 2012 and 2014 as the US economy recovered leading to a drop in gold. Back in 2012, inflation was muted and labor was plentiful, the exact opposite of the environment we find ourselves in today. Today, inflation is soaking into virtually every part of the economy – from rent to raw materials to real estate. Furthermore, as we have pointed to in our previous commentaries, the US and EU are in a bind when it comes to their debt loads. Inflation can be tamed by increasing benchmark interest rates. However, most developed countries are cornered when it comes to interest rates since the cost of servicing their onerous debts becomes increasingly unpalatable if rates are allowed to rise. The path of least resistance for real yields is lower, advantaging asset classes such as gold, silver and other stores of value.

While gold has continued to generally hold its own following the March 2021 bottom, gold and silver equities have not. The sentiment towards precious metal equities is at levels we have rarely seen before.

The companies in our portfolio continue to deliver strong profits with gold and silver trading near $1800 and $24 respectively. The divergence between the operating performance and share price performance for these companies has become a sore spot for the miners of late. Many are responding by buying back shares, raising their dividends and while being acutely focused on maintaining their per share profits.

As Q3 2021 drew to a close, there were exactly zero stocks in the GDX index that were trading above their 200 day exponential moving average. Over the past four years, we have seen this occur twice before and in both instances, significant rallies and handsome gains followed.

Source: StockCharts.com

Multiple companies in our portfolio are trading at free cash flow yields in excess of 15% and EV/EBITDA valuations under 4x. A broad swath of producers in our benchmark are pricing in $1400 gold and the GDM index pays a dividend yield that is over 60% higher than that of the S&P 500. By any measure, these are tough valuations. And if history is a guide, valuations tend to be mean reverting.

Source: Bloomberg

The precious metal space is currently unloved and under-owned while the underlying fundamentals continue to improve daily. While timing bottoms is always difficult, buying equities that are trading at the bottom of their valuations has historically generated substantial rewards. By our work, precious metal equities continue to offer significant upside with valuations trading near generational lows.

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Sub- Advisor to the Ninepoint Gold & Precious Minerals Fund

NINEPOINT GOLD & PRECIOUS MINERALS FUND - COMPOUNDED RETURNS[1] AS OF SEPTEMBER 30, 2021 (SERIES F NPP300) | Inception Date - October 12, 2004

	1M	YTD	3M	6M	1YR	3YR	5YR	10YR	15YR	INCEPTION
Fund	-9.8%	-21.8%	-11.9%	-6.7%	-22.6%	19.4%	1.9%	-2.6%	0.7%	3.2%
Index	-9.1%	-14.9%	-9.9%	-6.5%	-26.1%	21.2%	3.3%	-2.8%	0.6%	2.3%

[1] All returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at September 30, 2021; e) 2001 annual returns are from 11/15/01 to 12/31/01. The index is 100% S&P/TSX Global Gold Total Return Index and is computed by Ninepoint Partners LP based on publicly available index information.

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