F&A
FOSTER & ASSOCIATES

Why Gold, Why Now?

"Gold is money. Everything else is credit"
J.P. Morgan, 1912

Gold has held an esteemed place in society and commerce for centuries and its legitimacy as an investment is well-established. Still, gold pays no interest and offers no dividends, so in times when stock markets are booming and interest rates are high, gold loses its allure.

Unfortunately, we are not in such times. Financial markets are in disarray. In response to the COVID-19 pandemic, the United States has reduced interest rates to near-zero and have already committed to injecting over $8 trillion dollars into various markets, businesses and assets, amounting to some 37% of GDP. Globally, this number is approaching $18 trillion of liquidity injections and equals over 20% of Global GDP.

Global Monetary And Fiscal Stimulus To Fight COVID-19 Impact
2020 Feb to Apr (CSM)

	Central Bank Liquidity Injection		Govt Fiscal Stimulus		Central Bank Liquidity Injection and Govt Fiscal Stimulus	
	$ Tln	% GDP	$ Tln	% GDP	$ Tln	% GDP
U.S.	$4.80	22.4%	$3.27	15.2%	$8.07	37.6%
Eurozone	$1.10	8.3%	$2.83	21.2%	$3.93	29.5%
Japan	$0.20	3.9%	$0.99	19.2%	$1.19	23.1%
U.K.	$0.25	9.0%	$0.14	5.1%	$0.39	14.1%
China	$1.29	9.0%	$0.54	3.8%	$1.83	12.7%
Others*	$0.65		$1.85		$2.50	
Total	**$8.28**	**9.6%**	**$9.62**	**11.1%**	**$17.90**	**20.7%**

Credit: Nine Point Partners

While these numbers are staggering, the indication is that more stimulus will be provided as needed, and for as long as needed. How exactly this ends nobody knows. But clearly, injections of this magnitude will have unintended and unpredictable consequences. As unemployment soars and businesses struggle, deflation is not out of the question. Or perhaps the surge in liquidity and debt will stimulate inflation or hyper inflation; either way real, hard assets (gold and precious metals) will be in demand. The solution to debt is not more debt (albeit cheaper); and this is true for governments as much as individuals. History is littered with failed nations where the monetary printing presses ran wild and they should not be forgotten (Hungary 1945/46, Peru 1990, France 1795/6, Chile 1973).

This is a concern very much on the minds of the thousands of institutional investors that have been piling into physical gold ETFs, such as the SPDR Gold Shares ETF (NYSE: GLD)*. The fee is low, the safety and security of the bullion backing the ETF is considerable, and you can buy or sell it at any time the market is open.

The other option is gold stocks. For an investor less concerned about debauched currencies, but who believes the that gold will appreciate strongly anyway - just on the fear of this happening - gold stocks may be the way to go.

There is little debate that the most leverage to higher gold prices is found investing in the equities of gold miners, developers and exploration companies. We don't need to look back very far to find a great example of this. The 2008/2009 Global Financial Crisis saw the initiation of several fiscal and monetary stimulus programs - QE1, QE2 and TARP, amounting to about $2.6 trillion of liquidity injections. From October 2008 until September 2011 gold rose 2.7 times, from around $712 per oz ounce to just over $1900 per oz. Gold equities, on the other hand, more than quadrupled, as measured by the popular VanEck Vectors Gold Miners ETF (NYSE: GDX)*.

Unfortunately, there is a trade-off here. While gold equities offer more upside potential, if things get really, really, bad (including social breakdown, failing states), one would certainly appreciate owning bullion over individual gold mining companies.

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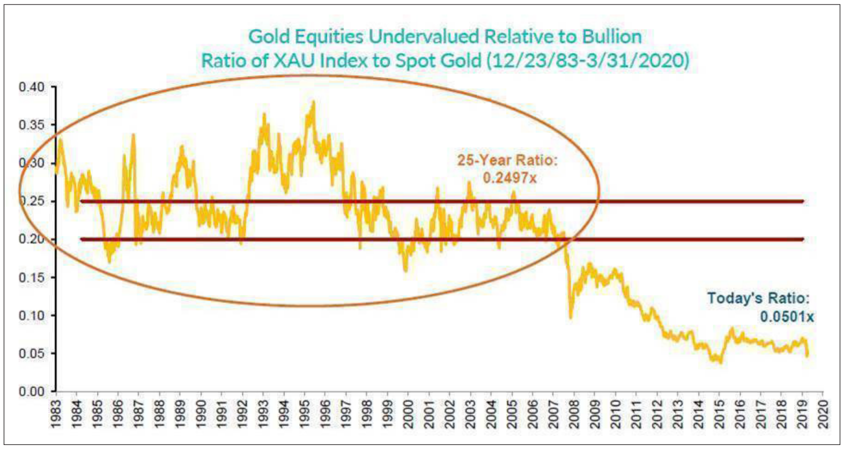

Credit: Nine Point Partners

As well, when considering investing directly in an individual mining company, there are multiple factors to be taken into consideration. The country in which the company operates, the political and tax regime, land rights, and environmental issues all need to be evaluated. Further, exploration and development costs, access to infrastructure and skilled labor, and hedging/sales of future production need to be accounted for. Lastly, company management – do they have a reputable track record of finding and developing gold projects, are they able to finance their projects, do they promote or hype the stock, and do they have significant ownership in their companies?

Despite these obstacles, gold shares deserve very serious attention. Investors are just starting to wake up to the possibly inflationary impact of governments' COVID-19 response. Mining companies are generating strong free cash flows at near-record margins, yet the share prices have only begun to reflect this new reality of an elevated gold price. As the major producers look to replace lost reserves, they will look to acquire junior producers and development projects – so mergers and acquisitions could provide an additional upside catalyst for smaller companies.

All this said, the bigger question is not how to invest in gold, it's whether one should. From our point of view, for clients with a multi-year investment horizon and some appetite for risk, we believe the time is now to consider a non-trivial exposure to gold and/or gold mining stocks.

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