NESTOR Gold
Quarterly Report 1/2021

Herisau, April 2021

Review

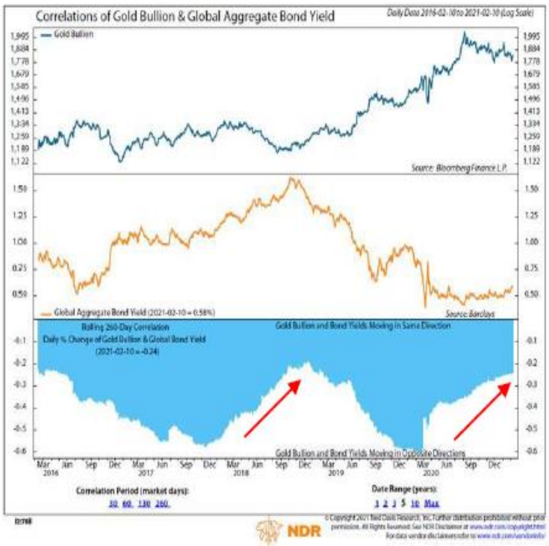
As of March 31st 2021, gold bullion closed at US$ 1'707.71/oz., a decrease of 9.9% in the reporting Quarter (Dec. 30th, 2020 to March 31st, 2021). The Philadelphia Stock Exchange Gold and Silver Index lost 8.7% (USD), resp. 4.5% (EUR) during the reporting quarter, while Nestor Gold Fund (-B- share class) decreased 11.5% (USD) resp. 7.4% (EUR). The fund's underperformance is due to fact that Freeport-Mc Moran, a copper company has a heavy weight (about 17% in the benchmark) and increased sharply in Q1, while gold miners consolidated. In addition, small and mid-cap producers suffered from intense investor selling (double representation in gold mining ETFs) and underperformed the two largest gold miners (Barrick and Newmont, about 30% of the benchmark) significantly.

The fund continued its disciplined value approach and reduced silver exposure into the Reddit-induced short-term exaggerations in late January/early February, reduced Newmont for valuation reasons and made some adjustments within the explorer/developer segment.

Economic optimism led to rising 10-year interest rates and slightly higher real rates. Gold continued its consolidation until mid-March. While physical gold demand in the two key markets (China and India) rose significantly, the gold price suffered from consistent outflows in gold ETFs. Gold miners published generally in-line Q4 results. Many companies announced further dividend hikes and some announced share buy-backs. The operating leverage and continued industry discipline bode well for the next quarters and we expect gold miners to continue to outperform physical gold in a stable or rising gold price environment. M&A started to increase with more willingness by the larger/medium-sized producers to do low-risk bolt-on acquisitions.

Gold and interest rates/real yields

Common sense is that rising yields are bad for gold. This thesis is based on the fact that 10-year yield and gold have had a somewhat negative correlation for most of the last 20 years. However, as can be seen below (chart left) that wasn't the case between 1970 and 2000. In addition, as can be seen on the right-hand chart below, the negative correlation has shrunken considerably during the last 12 months, as it did just before gold went from USD 1'300 to well over USD 2'000 in the period H2, 2018 to H2, 2020.



Source: Ned Davis

Correlations aren't stable over time and have often changed quickly, as seen above. Therefore, investors shouldn't put too much emphasis on the outlook for the 10-year rates.

More important is the strong correlation between gold and yield of the 10-year TIPS (treasury inflation protected securities), as shown below. Recently, while the TIPS-yield increased somewhat, gold did overreact to the downside and is oversold. In addition, the TIPS-yield will likely fall further in the mid to long term thanks to rising inflation expectations.

Source: Capitalight Research Inc.

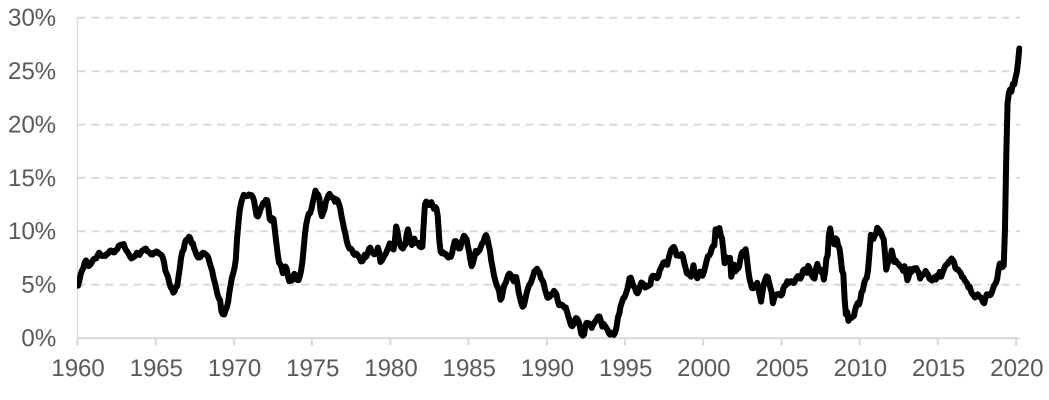
Inflation: expect it when it is declared dead!

Today's consensus and FED view is that the inflation increase is temporary. An overshooting will be tolerated and is even welcomed given inflation was below the FED's target for most of the last 20 years. The fact that the massive money printing after the Global Financial Crisis (GFC) hasn't led to inflation underpins the broad-based view that inflation is dead.

We disagree and point to the following key differences between now and the years following the GFC:

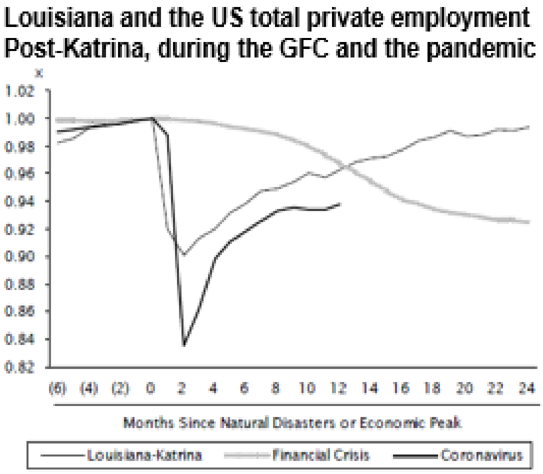
- During the GFC, the banking sector was the problem and all the money printed went to the banks and has not left the financial system. Unlike now, the money never went into the economy; a key difference. This is also seen in the massive rise of M1 and M2 , unlike what happened after the GFC, as shown below.

US broad money aggregate: M2 growth YoY



Source: Bloomberg, Konwave AG

- The disinflationary globalisation trend looks exhausted today. We also expect the trade war between the US and China to resume after the pandemic. Populism is at its highest level since the 1930s. This leads to protectionism and nationalism, both inflationary.
- The labour market is currently weak, but will recover much faster than expected as a pandemic should be compared to a natural disaster, not a traditional recession. During the pandemic (like natural disasters), employment falls much more quickly, but then recovers also much faster, as can be seen in the comparison to the hurricane Katrina (chart below). In addition, given the facts that most global labour markets were much tighter before the pandemic and the demographic situation looks much worse (many more retiring people and fewer younger people entering the labour market), this increases the likelihood as well that the labour market will tighten much more quickly (vs. expectations). This will create additional inflation pressures, also helped by the significant increases in the minimum wage in the US.

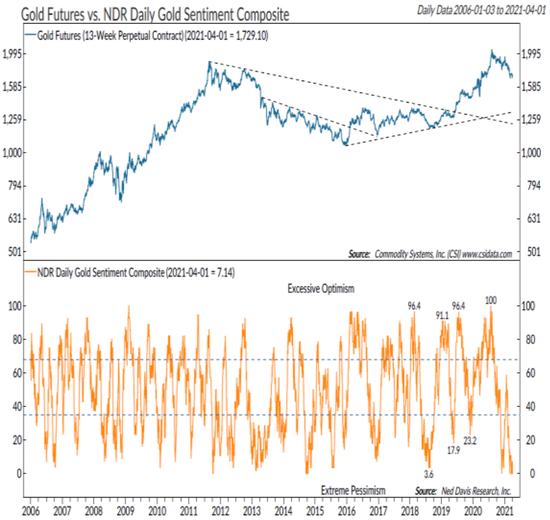


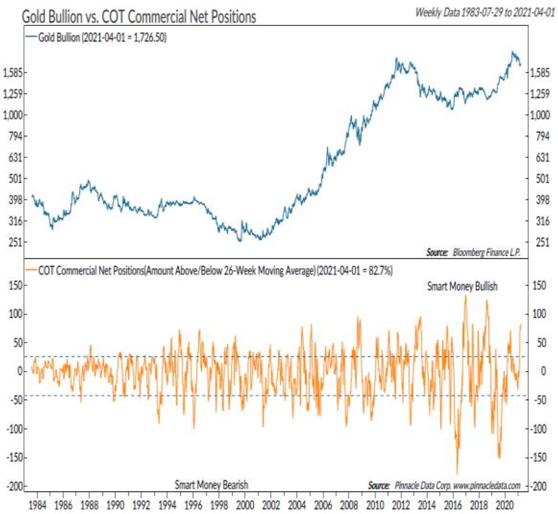
Source: Bureau of Labor Statistics, Empirical Research Partners Analysis

- After the GFC, most commodity prices peaked (2008) and entered a multi-year structural bear market. Now, due to significant underinvestment in the past 10+ years and major demand increase thanks to the energy transition and massive infrastructure programs, commodity prices have started to rise and entered what is most likely a super-cycle, leading to additional inflation pressure.

Sentiment and COMEX – more reasons to be positive

The following charts show the capitulation of sentiment. Unlike in August 2020 (100% short-term bulls), now the gold bulls have disappeared, while smart money has started to position itself for the next major gold price increase. Both are among the most reliable indicators of gold over the last 20+ years and both show very, very constructive readings!

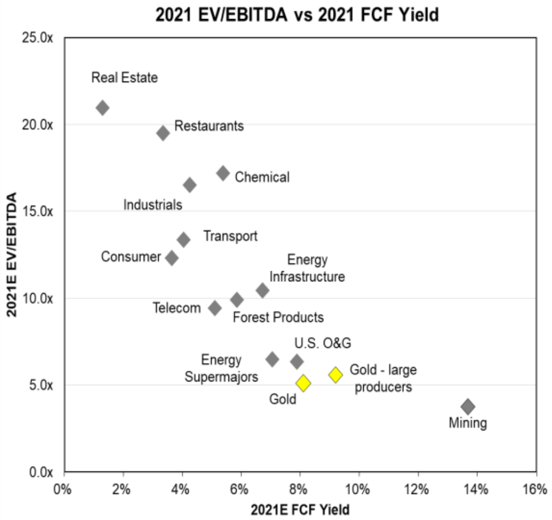


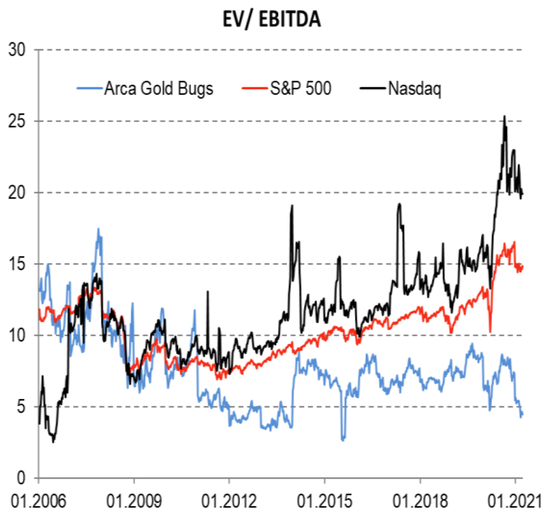


Source: Ned Davis

Gold miners are one of very few remaining bargains

While many equity indices are valued at historic highs, gold miners are valued close to historic lows. The fundamentals look terrific. Gold miners have very high free cash flow yields, no net debt (unlike many of the hyped or financially engineered other sectors/themes) and continue to increase the dividend yields. The huge valuation opportunity relative to other sectors is shown in the charts below. In addition, gold miners currently discount a gold price that is around 15% below the spot gold price: one of the biggest undervaluations in the last 20 years!





Sources: BMO Capital Market, Konwave AG

Conclusion

Unlike last August, no one speaks about the debt escalation or the irresponsible monetary policies of global central banks, and investors are worried about rising 10-year yields and rising real rates. The fact that further interest rate increases will soon be a major problem for the real estate, global equity and debt markets, cannot or should not be ignored. The FED is well aware of the very important wealth effect for the US economy and will therefore do everything to avoid big drops in asset prices with respect to the next economic crisis, which would force the FED into even more extreme monetary tools.

To avoid such a crisis, we consider it a natural evolution that the ECB and the FED will also start to talk more and more about the introduction of yield curve control during the next few months. This tool, used by Japan (since two years ago), and Australia (Q1, 2021), combats the rise of long-term yields, a necessity given the unprecedented global debt situation. The recent comments by the ECB say that rising interest rates need to be countered with all measures pointing that way. The fixing of the yield curve combined with higher inflation will allow the debtors (government and the private sector) to de-lever the stretched and unsustainable indebtedness through even more negative real rates.

This will likely trigger the next major upward move in gold miners, for which the Nestor Gold Fund is perfectly positioned. As the pandemic is vanishing and herd immunity is likely reached in H2, 2021, physical due diligence has started to become much easier again. This will allow the larger gold producers to address their rather empty project pipelines, which will likely result in much more M&A, especially the low-risk bolt-on acquisitions. The well-above-average exposure of the exploration and development companies is a key differentiating factor of the Nestor Gold Fund relative to active and passive peer products.

Sentiment, COMEX positioning and the technical situation are also pointing to an end of the correction, historically very reliable indicators.

We therefore consider the recent correction as a very attractive entry point into the Nestor Gold Fund.

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