Sprott | Gold Report
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# Gold Equities are Currently on Sale

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The month of November has traditionally been relatively uneventful for the gold complex (as shown in the chart below). For this reason, we entered the month with a slightly defensive bias in our active gold strategies. November witnessed several bullish developments for both traditional and contemporary assets, including progress on the U.S. tax bill, continued buoyancy of the U.S. equity markets and speculative bitcoin surpassing US$10,000. It is encouraging to us that gold equities remained stable in November amid such exuberant sentiment extremes.

## The Gold Miners Investment Opportunity: Inexpensive and Poised for Strong Earnings

Despite the strength in broad equity averages, spot gold has remained resilient throughout 2017, trading largely in a $100 range (between $1,200 and $1,300), and logging a year-to-date gain of 8.95% through 12/15/17. By contrast, gold equities have lagged the metal as demonstrated by the 5.11% gain for gold mining equities[1] and an actual ***decline*** of 0.29% for a junior gold mining equities.[2] This presents an opportunity for investors, as Trey Reik discussed last month (see Bridging the Performance Gap Between Gold and Miners).

The chart below also shows that the 2017 performance of spot gold (the gold line) has bucked the relatively recent trend favoring mid-December lows for the gold complex (red line represents past-five-year average). Should gold benefit in early 2018 from its traditional first quarter strength, we believe that high-quality gold miners are positioned for strong earnings performances.

### 2017 Cumulative Average Daily Change in Spot Gold versus Historical Time Frames from 1972-Present


Source: Nick Laird; Sharelynx. Data as of 12/13/2017. This chart uses the London PM Fix to calculate gold price returns.

## Volatility Should Benefit Miners

As we have communicated in the past, we believe volatility among traditional asset classes is likely to increase in the coming months. To us, valuations seem stretched for most U.S. financial assets. For example, U.S. equities have roughly tripled from their Q1 2009 lows. Between 3/31/09 and 11/30/2017, the S&P 500 Index (including reinvestment of dividends) generated a total return of 298.44%, with the Index rising from 797.87 to 2,647.58. During roughly the same span, the "free-cash-flow" of S&P 500 companies has only increased 27.68%, from $89.46 in calendar 2008 to an estimate of $114.22 in calendar 2017. More instructively, the free-cash-flow ***yield*** of the S&P 500 has plummeted from 11.21% at the end of Q1 2009 to 4.31% on 11/30/17. On the fixed-income side, credit spreads across the quality spectrum trade today near historically thin levels despite well-documented highs for every conceivable global debt measure.

Against this backdrop of stretched valuations for traditional financial assets, we are bullish about precious metal miners, among which 10% free-cash-flow yields and P/E multiples around 10x are increasingly common. In essence, gold shares resemble today the attractive valuations for high-quality companies available in the S&P 500 during the lows of 2009.

## The Attractive Risk-Reward Proposition of Miners

Among gold miners, we are especially optimistic about several companies in Australia, namely Kirkland Lake Gold, Dacian Resources and Northern Star Resources, which all posted strong results in November. Kirkland Lake Gold's exploration at the Fosterville operations continues to generate exceptionally high grades. Dacian Gold continues to execute well in the construction of its Mount Morgan project. Dacian Gold's pending emergence as Australia's newest mid-tier producer promises to continue its ongoing rerating. Northern Star Resources reported strong operating numbers at the end of October. Both Kirkland Resources and Northern Star Resources, remain in expensive in our view, with roughly 10% (2018) free-cash-flow yields at current prices.

Despite their inherent volatility, we remain especially optimistic about the risk-reward proposition of precious metal miners.

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[1] VanEck Vectors Gold Miners ETF (GDX) seeks to replicate the NYSE Arca Gold Miners Index (GDMNTR), which is intended to track the overall performance of companies involved in the gold mining industry.

[2] VanEck Vectors Junior Gold Miners ETF (GDXJ) seeks to replicate the MVIS Global Junior Gold Miners Index (MVGDXJTR), which is intended to track the overall performance of small-capitalization companies that are involved primarily in the mining for gold and/or silver.

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