

## Gold Resilient Despite Market Volatility

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### Volatility is Back

The calm of equity markets across the world was rudely interrupted in February by a sudden spike in volatility which impacted virtually every asset class. Volatility across equities, bonds, currencies and commodities rose sharply during the month and remained elevated into March. For the month of February, gold equities declined 10.10%, while gold bullion fell a modest 2.08%, as measured by GLD.<sup>1</sup> The metal's lack of volatility merits further discussion which we touch on below.

### Wake-Up Call for Markets?

Our perspective is that February's events provided a wake-up call for markets signaling that the period of historically low volatility has come to an abrupt end. Over the course of the past 15 months, investors had grown accustomed to the lack of volatility in equity markets. The chart on the following page illustrates the realized volatility of the S&P 500 Index. Realized volatility (using a 90-day running average) in the S&P 500 has averaged 13.4% since 2011. The December 2017 low of 5.49 was one for the history books; to put this into context, equities were acting as benignly as the high-quality investment grade bonds.

### Historical 90-Day Realized Volatility of the S&P 500 Index

(2011-2018)



Source: Bloomberg. Data as of 3/08/2018.

Since 2011, the widely followed CBOE VIX<sup>2</sup> index has averaged 16.3. As central banks begin to reduce their balance sheet holdings and raise short-term interest rates, risk premiums across asset classes should normalize and so should volatility. At the time of this writing (March 8), the VIX sits at 16.9. Volatility has simply reverted to its mean, indicating that the environment of exceptionally low volatility is likely behind us.

# Sprott Gold Report

March 12, 2018

## Gold Bullion Was an Exception Amid Volatility

At Sprott, we have long been proponents of holding precious metal bullion and equities as a portfolio hedge against general market volatility. The events which transpired in February underscore the validity of our investment thesis. Volatility across many asset classes, including North American equities, global equities, Treasuries and currencies rose in February and remain elevated today. Gold bullion was a singular exception, given that its spot volatility as measured by the CBOE/COMEX Gold Volatility Index moved up by just under 3% from the beginning of 2018 to end the of February. By contrast, other asset classes experienced massive volatility increases of as much as 235% in the same time frame.

## ...While Gold Miners Declined

Precious metal equities were influenced by the general equity volatility and sold off in February, as was to be expected. However, the profitability of precious metals equities is predicated by bullion prices and with bullion prices firm and maintaining their uptrend there has been no change in the fundamentals of gold equities. In fact, we have pointed out in our previous commentaries that while gold bullion has continued to climb, the vast majority of precious metals equities have lagged the yellow metal. Indeed, gold equity valuations sit at depressed levels that we have not seen in our careers, and we posit that it is just a matter of time that these valuations normalize.

As market volatility rises, investor complacency is likely to fall. Investors will once again begin to pay closer attention to developments that are likely to impact the economy and markets, both positive and negative. We would argue that the weight of negative factors which can lead to further market declines over the medium term continues to rise. My colleague Trey Reik just published a Sprott Gold Report titled, *Oopsie Daisy! Equity Markets Stumble in Early February*. I strongly encourage clients to read this report as it summarizes the build-up of factors which are negative for both the equity and bond markets: Rising consumer stress, equity market pressure from higher interest rates, and last, but not least, the ballooning U.S. fiscal debt.

## Favorable Tailwinds Support Gold Bullion

The declining U.S. dollar and rising inflationary pressures continue to provide favorable tailwinds for gold bullion. Gold's relative lack of volatility has not gone unnoticed by investors. While large ETFs such as SPY and EFA<sup>3</sup> have seen billions of dollars in outflows over the past several weeks, investment capital has begun flowing back into both gold bullion and equity ETFs. We would encourage others to look into the precious metals equities space. You would be surprised at how profitable some of these companies can be with gold prices above \$1,250/oz.

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<sup>1</sup> SPDR Gold Shares (GLD) is an exchange-traded fund and is used as a benchmark to measure gold bullion prices.

<sup>2</sup> The CBOE Volatility Index (VIX) is a popular measure of the stock market's expectation of volatility implied by S&P 500 index options, calculated and published by the Chicago Board Options Exchange (CBOE).

<sup>3</sup> The SPDR S&P 500 trust is an exchange-traded fund which trades on the NYSE Arca under the symbol SPY. EFA is the symbol for the iShares MSCI EAFE ETF.

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