Sprott | **Monthly Report**
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Gold Rally Strengthens on Rate Cut, Silver Follows

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Gold/Silver Respond to Fed Rate Cut, First in 11 Years

Events were positive for gold and silver bullion in July, culminating in the Federal Reserve's interest rate cut of 0.25% at its July 31 FOMC (Federal Open Market Committee) meeting, its first cut in 11 years. Any hope that this would be a "one and done" type rate hike has quickly been dashed with the latest trade war salvo. The long-term picture remains firmly intact. Gold continues its rise as the market adjusts to this new central bank easing cycle.

Since the end of July, metals have moved quickly. As of Wednesday's close, August 7, gold has climbed 17.06% YTD and silver 10.43% (both ahead of the S&P 500 YTD).

Month of July 2019

Indicator	7/31/19	6/30/19	Change	% Change	*Analysis*
Gold Bullion	**$1,414**	**$1,410**	**$3.54**	**0.3%**	**Consolidating in a bullish flag; heading higher.**
Silver Bullion	**$16.26**	**$15.31**	**$0.95**	**6.2%**	**Broke out of three-year trend; target ~$20.**
Gold Equities (SGDM)[1]	$23.05	$21.13	$1.92	9.09%	Outperforming GDX in 2019.
DXY US Dollar Index[2]	98.52	96.18	2.33	2.4%	Expecting range-bound trading activity.
U.S. Treasury 10 YR Yield	2.01%	2.01%	0.01%	0.5%	Heading lower; target 1.60%.
German Bund 10 YR Yield	(0.44)%	(0.33)%	(0.11)%	(33.3)%	Secular decline; target -1.00%.
CFTC Gold Non-Comm Net Position[3] and ETFs (Millions of Oz)	103.6	101.9	1.67	1.6%	Persistent accumulation; ETF holdings at all-time high.

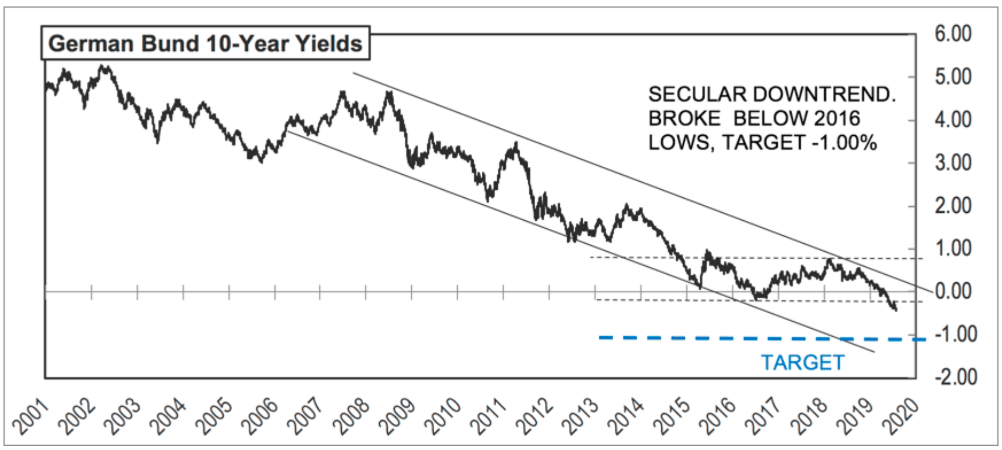
The ECB has already announced its intention to lower rates and signaled another new quantitative easing (QE) program as early as September. Thus far, the main economic weakness has been centered on manufacturing and trade which impacts Europe and China more so than the United States. European manufacturing activity has slowed to its lowest level in 11 years. China, at the epicenter of the trade war, saw its purchasing managers index (PMI)[4] fall below 50 in July (PMI readings above 50 indicate expansion, while those below 50 signal contraction). China's PMI has contracted for three straight months, despite the ambitious fiscal and monetary stimulus programs that have been in place since mid-2018. Most global economic indications continue to point to even more weakness in 2019's second half.

Reason to Own Gold? Negative Yielding Bonds

Since the 2008 credit crisis, German Bund 10-year yields have been in a secular downtrend and did not experience a cyclical rally like U.S. Treasury 10-year yields. Eurozone 5y/5y inflation swaps (a great measure of growth expectations) also confirm the persistent downtrend in growth expectations. With the ECB (European Central Bank) about to lower rates and preparing for another QE program, German Bund 10-year yields look poised to move even lower. While the Eurozone accounts for the bulk of negative-yielding bonds, we expect the total amount of negative-yielding bonds globally to surge over the next few years. This is one of the primary reasons to own gold. If we use a target of -1.00% on German Bund 10-year yields and run a simple multiple regression analysis with other related variables, we get an R-square of 80% (great fit) and a forecast of $19.4 trillion of negative-yielding bonds (the current level is $13.6 trillion).

Figure 1. German Bund 10-Year Yields in a Secular Decline

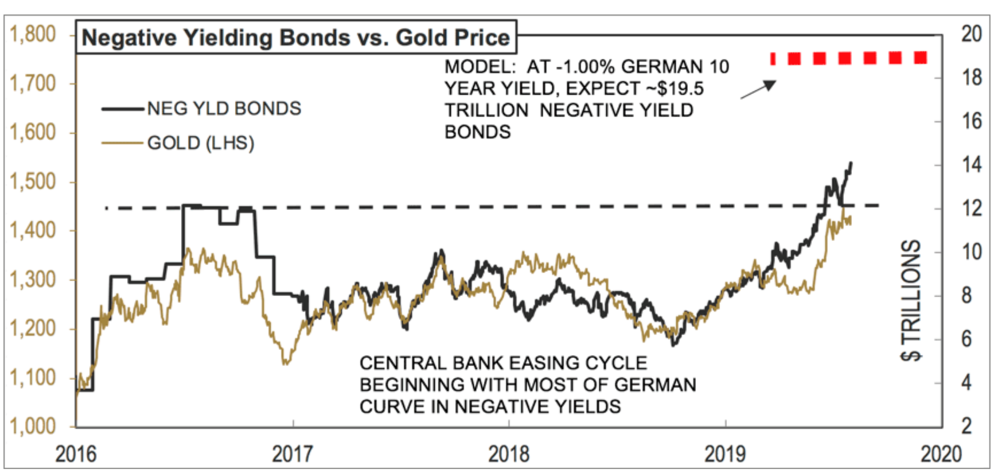
German Bund 10-year yields have been falling since the 2008 credit crisis, and we expect a break to approximately -1.00%, with scope for even lower levels.



Source: Bloomberg as of August 1, 2019.

Figure 2. Nearly $20 Trillion in Negative Yielding Debt

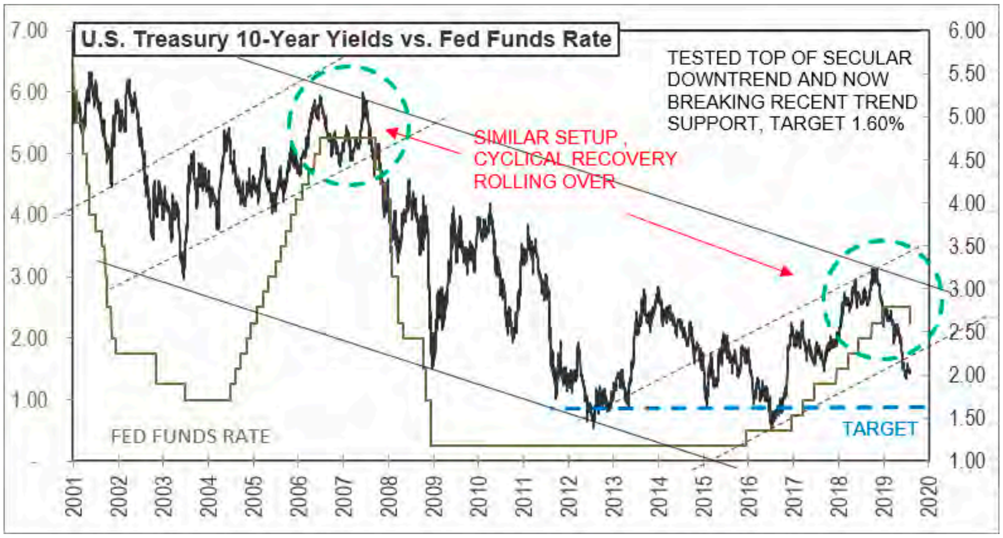
If German Bund 10-year yields decline to -1.00%, our multiple regression model indicates that approximately $19.5 trillion of negative-yielding debt will be reached.



Source: Bloomberg as of August 1, 2019.

Figure 3. U.S. Treasury 10-Year Yields are Heading Lower

Similar to the prior rate cycle, yields are breaking below a cyclical recovery channel as the fed funds rate is lowered. We expect a target of 1.60% before a bounce. Longer-term yields remain firmly in a secular downtrend.



Source: Bloomberg as of August 1, 2019.

"Paradigm Shifts" from Dalio

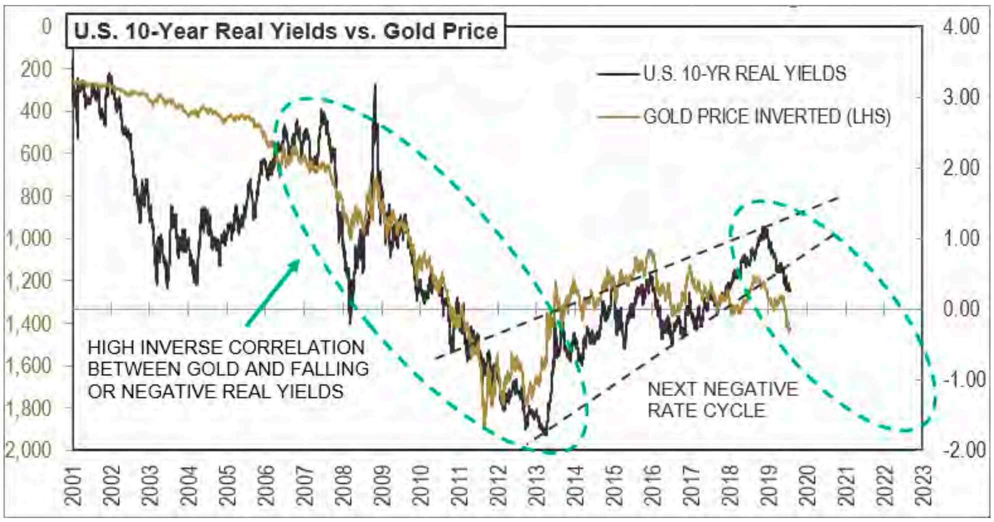
Ray Dalio published a great essay in July, "Paradigm Shifts." To quickly paraphrase Dalio's thesis, when the pressure of an unsustainable debt load becomes too great, central banks will favor debtors over creditors. The likeliest course of action is to bring real yields into negative territory in a persistent and determined manner. The last time we saw this was between 2007 to 2013 in the previous credit crisis, and it was only ended by the sheer size and scale of QE2, QE3 and LTRO (ECB long-term refinancing operations).

This time, it is highly unlikely that there is the same capability for that scale of QE and LTRO. At this point, it would seem to favor the odds of a longer and deeper negative rate environment. But the point remains that when central banks begin to favor debtors over creditors, real yields will decline and the inverse relationship to gold is obvious — and gold prices are likely to rise.

TINA: "There is No Alternative"

Figure 4. Gold's Inverse Relationship to Bonds

When central banks favor debtors over creditors, look for a persistent trend in real yields to go lower and into negative territory. When real and nominal yields go negative, there are very few alternatives. Hence, gold. In the next real yield downtrend, we expect gold to experience the same positive inverse correlation that occurred from 2007 to 2011.



Source: Bloomberg as of August 1, 2019.

Gold Bullion: As Sentiment Improves, Investor Base Widens

There are at least two primary drivers for gold for the next few years. **The first and most immediate is lower yields**, especially lower negative yields, and the growing amount of negative-yielding bonds. In the last credit crisis, there was essentially no negative-yielding bonds. This will be an essential and new driver of gold in this cycle. **The second driver is likely to occur in the next year or two and involves building financial stress** that causes central banks to push real yields lower and into negative territory. This will be the second leg of the current gold bull market. There is also a **third consideration, the Macaulay duration of bonds** (which represents the weighted average term to maturity of the cash flows from a bond). Duration levels have now hit an all-time high, which means that those bonds are now even more sensitive to changes in interest rates. This will have significant consequences for volatility targeting strategies in that investors (especially large quant fund managers) will need to manage their volatility exposures while maintaining investments to ever lower yields. Gold makes sense as an alternative, given its high inverse correlation to lower yields (both real and negative nominal yields), its role as a historical store of value in negative-yielding environments, and its lower overall volatility and lower correlation to other asset classes.

Since gold bullion first broke out of its multi-year major base pattern in late May, it has been consolidating in a very bullish manner. There are much higher target numbers but breaking out past $1,450/$1,460 is the first immediate resistance. After that, $1,580 becomes open and will become the next meaningful resistance level. Over the past several weeks we have seen Commodity Futures Trading Commission's (CFTC) Gold Non-Commercial Net Positions, ETF and options gold bullion positions being added to in a consistent manner. Known ETF gold holdings have now reached an all-time high signaling meaningful broader participation beyond quant-type funds into a more extensive investor base.

Figure 5. The Gold Bullion Rally

After the significant breakout through $1,380, we expect gold bullion to move in a series of sharp impulsive up legs followed by short consolidation patterns before another impulsive up leg. This trading pattern is consistent with prior major bull market trading patterns for gold bullion.

Source: Bloomberg as of August 1, 2019.

Silver Bullion: On the Heels of Gold

Silver made a speculative blow-off top back in April 2011 ticking above $50/oz on an intraday basis. Since then, silver collapsed to a closing low of $13.68 in December 2015. From the 2016 rally peak of $20.63, silver had been in a steady down channel until breaking out a few weeks ago. Gold bullion broke out a while ago convincingly when it pushed through the $1,380 level. The silver price equivalent of the gold $1,380/$1,400 breakout level is about $20.50 to $21.00. Given silver's close of ~$16.50 yesterday (August 5), there is still considerable resistance to work through to achieve a similar silver breakout. The gold-to-silver ratio has hit a recent high of 93:1, the highest since 1990. Given the magnitude of the gold drivers, silver is very likely to play catch up as the cycle progresses.

Gold buying in the past year has been likely quantitative ("quant") fund driven. Speculative buying (non-industrial) in silver is mainly retail-driven and lacks the liquidity that large quant funds need. We are now just starting to see gold buying broaden out to retail, individual investor level. By all historical measures, we should see silver play a phenomenal catch-up trade to gold in the next few months.

Figure 6. Silver Plays Catch-Up to Gold

Silver, after completing a major speculative blow-off type top, looks to be bottoming near its post-crash lows.

Source: Bloomberg as of August 1, 2019.

Figure 7. Silver Breaks Out of its Three-Year Downtrend

Looking at a shorter-term daily chart, silver has broken out of its downward trend since 2016. Target is the 2016 high of $21. There are several layers of resistance until the 2016 high. Trading action at these resistance levels will be a good indication as to the strength of this silver rally.

Source: Bloomberg as of August 1, 2019.

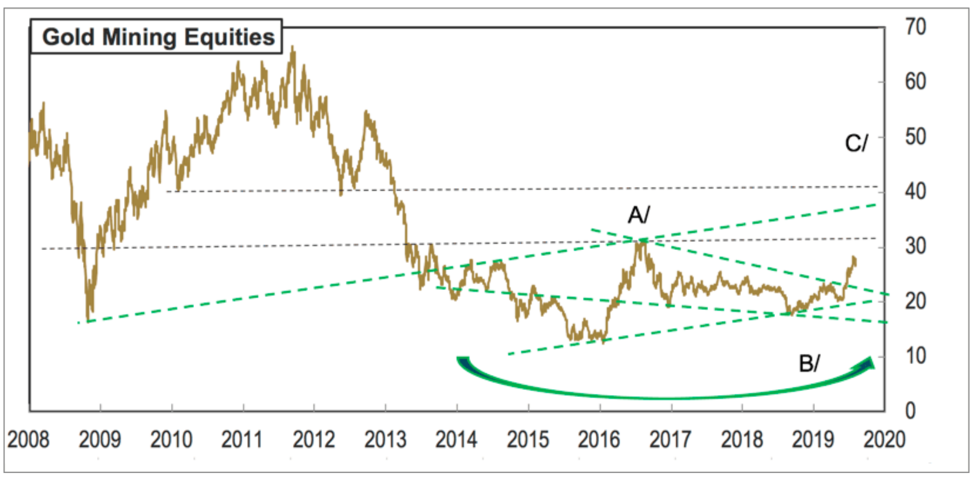
Gold Equities Show Enormous Opportunity

Gold equities continue to trade at near multi-decade valuation lows (price to cash flow, price to gold, etc.). In the past several years, gold equities have sold off more than 80% and endured a number of selling capitulation events. It's safe to say that gold equities are not being priced to any degree of bullishness. We believe that it is one of the more under-owned equity groups relative to the macro outlook.

GDX[5] peaked out at $66.63 in September of 2011 and bottomed out almost five years later at $12.47 in January 2016, a drop of -81.2%. Since then, GDX has been developing in a clear A-B-C formation. Like the low in Jan 2016, the B-leg low in August of 2018 was also made on a capitulation selling (2018 saw massive fund redemptions). We are likely in the early stages of this C-leg advance. GDX is still below the 2016 peak of $31.32 despite gold bullion well above the 2016 highs. Once GDX passes the 2016 highs, a large base pattern will be in place. The initial target will be in the $37 range the upper end of the A-B-C channel (see green dash channel in Figure 8). Depending on the underlying fundamentals, there is scope to the $40 range as there is very little resistance between $31.32 and $40.00. We continue to track breadth measures and money flow data and it is consistent with the buying thrust we saw back in 2016.

Figure 8. Gold Equities Have a Long Way to Go

Gold equities appear to be following other major crash type patterns (i.e., the technology sector post 1999). After a drop of more than 80%, there is a long multi-year basing pattern with numerous capitulation selling events. Sentiment is negative and bullishness is reluctant until it isn't. GDX above $31 would be the major inflection point for this shift in sentiment from reluctant bullish to outright bullish.



Source: Bloomberg as of August 1, 2019.

About Sprott

Sprott is a global alternative asset manager with a defining focus on precious metals and real assets investments. Through our subsidiaries in Canada, the U.S. and Asia, Sprott is dedicated to providing investors with world-class investment strategies that include exchange-listed products, active equity strategies and highly-specialized real asset investments. Our deep sector expertise creates investment and financing solutions unparalleled in the industry. For more information, please visit **sprott.com**

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[1] Sprott Gold Miners Exchange Traded Fund (NYSE: SGDM) seeks to deliver exposure to the Sprott Zacks Gold Miners Index (NYSE: ZAXSGDM). The Index aims to track the performance of large- to mid-capitalization gold companies whose stocks are listed on major U.S. exchanges.

[2] The U.S. Dollar Index (USDX, DXY, DX) is an index (or measure) of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies.

[3] Commodity Futures Trading Commission's (CFTC) Gold Non-Commercial Net Positions weekly report reflects the difference between the total volume of long and short gold positions existing in the market and opened by non-commercial (speculative) traders. The report only includes U.S. futures markets (Chicago and New York Exchanges). The indicator is a net volume of long gold positions in the United States.

[4] The Purchasing Managers Index (PMI) is a measure of the prevailing direction of economic trends in manufacturing. The purpose of the PMI is to provide information about current and future business conditions to company decision makers, analysts, and investors.

[5] 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.

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