Sprott

Monthly Report

April 6, 2021

Paul Wong, CFA
Market Strategist

Gold Holds on to Support as Yields Rise

Authored by Paul Wong, CFA – Market Strategist; Paul has held several roles at Sprott, including Senior Portfolio Manager. He has more than 30 years of investment experience, specializing in investment analysis for natural resources investments. He is a trained geologist and CFA holder.

It was a difficult month and a mixed first quarter for the precious metals complex. Gold bullion lost 10.04% in Q1; silver declined 7.52%; platinum climbed 10.76% and palladium gained 7.30%. Gold mining equities pulled back in Q1 (-11.80%). Twelve-month returns as of March 31, 2021, paint a more positive picture: gold climbed 8.28%; silver gained 74.73%; platinum rose 64.22%; palladium returned 11.19%, and gold equities gained 35.16%.[1,4]

Month of March 2021

Indicator	3/31/2021	2/28/2021	Change	Mo % Change	YTD % Change	*Analysis*
Gold Bullion[2]	**$1,707.71**	**$1,734.04**	**($26.33)**	**(1.52)%**	**(10.04)%**	**Worst quarter since Q4 2016**
Silver Bullion[3]	**$24.42**	**$26.67**	**($2.25)**	**(8.44)%**	**(7.52)%**	**Above key support but below 200-daily moving average**
Gold Senior Equities (SOLGMCFT Index)[4]	**119.82**	**113.05**	**6.77**	**5.99%**	**(11.80)%**	**Held and bounced off key support**
Gold Equities (GDX)[5]	$32.50	$31.13	$1.37	4.40%	(9.77)%	(Same as above)
DXY US Dollar Index[6]	93.23	90.88	2.35	2.59%	3.66%	Now above 200-daily moving average
S&P 500 Index[7]	3,972.89	3,811.15	161.74	4.24%	5.77%	Monthly all-time high
U.S. Treasury Index	$2,450.55	$2,488.92	($38.37)	(1.54)%	(4.25)%	Worst quarter since Q3 1980, +40 years
U.S. Treasury 10 YR Yield	1.74%	1.40%	0.34%	23.88%	90.58%	4th largest quarterly increase in 30 years
U.S. Treasury 10 YR *Real* Yield	(0.64)%	(0.75)%	0.11%	(14.72)%	0.46%	5th largest quarterly yield increase in 30 years
Silver ETFs (Total Known Holdings ETSITOTL Index Bloomberg)	920.93	964.38	(43.45)	(4.51)%	3.76%	Most selling likely Reddit SLV holdings
Gold ETFs (Total Known Holdings ETFGTOTL Index Bloomberg)	99.84	104.18	(4.33)	(4.16)%	(6.47)%	Worst quarter since Q4 2016

One of the Largest Yield Increases in Decades

March gold prices finished at $1,707.71 per ounce, closing off a difficult quarter. Silver backed off to its rising 200-daily moving average as it appears the Reddit crowd has left the trade. The roll-out of COVID-19 vaccines in the U.S. encouraged market optimism which was reflected in rising U.S. Treasury yields and a strong U.S. dollar. Despite gold's pullback, larger-cap gold mining stocks recovered some of February's sell-off during the month, with larger-cap miners providing a positive offset to the more junior companies. Accumulation of gold mining equities was apparent even as gold fell, with notable rebounds in the equities after gold prices corrected. Investors recognized that despite a cheerier economic outlook, longer-term risks associated with trillions of dollars of economic stimulus are significant. Gold mining equity valuations have become more compelling as markets have over discounted the sector's favorable operating and financial conditions. That discount should close as miners continue to demonstrate that even in a lower gold price environment, they can generate solid cash flow to pay dividends, maintain capital discipline and keep healthy balance sheets.

> "Gold is driven by sentiment and tends to perform well during periods of systemic financial stress when volatility and emotions both run high."

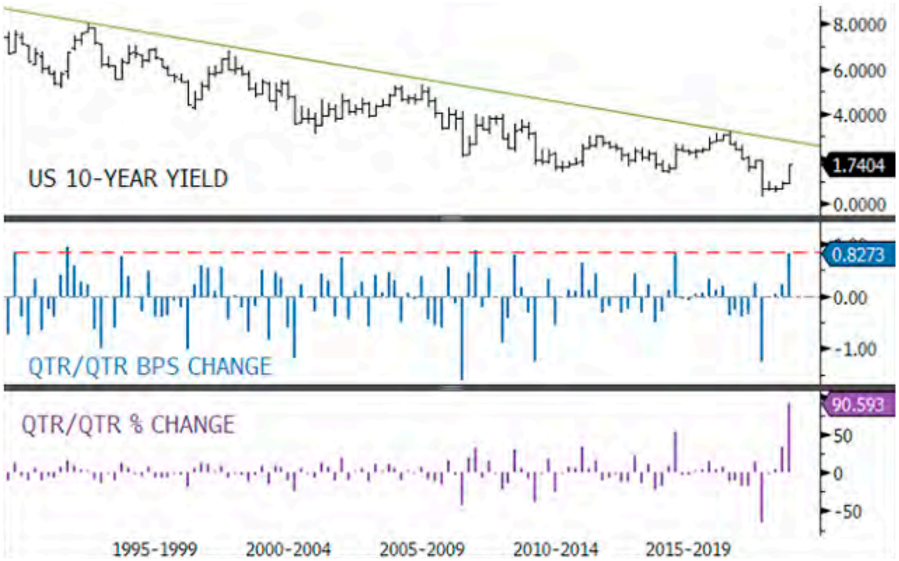
Rising yields continued into March, with the U.S. 10-year Treasury yield rising back to pre-COVID levels. In addition to robust economic numbers and the relative lack of pushback from the Federal Reserve ("Fed"), bonds have been under tremendous technical selling pressure. In addition to the usual quarter-end effects, there has been significant selling of U.S. Treasuries from Japan as it squares its balance sheets for fiscal year-end. There was also heavy Treasury selling from primary dealers due to the uncertainty regarding the SLR (supplementary leverage ratio) exemption status, which had relaxed the amount capital banks had to maintain against Treasuries and other holdings during the pandemic. This uncertainty likely accounted for the relatively thin liquidity in recent weeks, producing choppy trading in bonds.

Gold Contends with a Bear Steepener

The most remarkable driver for nearly all asset classes in Q1 was the bear steepener. U.S. 10-year Treasury yields had one of the largest quarterly increases in the past 30 years measured either by basis point increases or percentage changes (see Figure 1). Volatile bear steepeners typically reflect uncertainty and worry about policy (not knowing what to expect) and a general lack of conviction. Though the Fed has stated it will not conduct pre-emptive interest rate hikes, it also did not indicate what yield levels will prompt intervention, adding more uncertainty to the market.

Gold had to contend with the bear steepener, but it also had to deal with a taper tantrum[8] (earlier than expected rates hikes and QE [quantitative easing] reduction). Gold was not the only casualty of the bear steepener in March. There has been an accelerating unwind of a multi-year long duration/short cyclical positioning that began in early autumn. Long-term equity outperformers such as secular growth, mega-cap, minimum volatility and long-term momentum all were sold to re-allocate to cyclical and value equities.

Figure 1. U.S. 10-Year Treasury Yields, Quarterly Data (1995-2021)



Source: Bloomberg. Data as of 4/01/2021.

Markets Move Ahead of Future Fed Action

For gold, the first quarter of 2021 marked its worst performance quarter since Q4 of 2016. Gold fell $190.65 per ounce or 10.04% in Q1 2021. During Q4 2016, gold sold off for similar reasons: an expected rebound in economic growth driving yields higher. There were also echoes of the 2013 Taper Tantrum in the first quarter selling (which we wrote about last month). The U.S. bond market has priced in roughly three rate hikes about a year earlier than the Fed's outlook, along with a reduction in QE. However, the Fed remains adamant that it will not raise rates until inflation is well and consistently above 2% as measured by PCE (personal consumption expenditure) inflation.

Gold bullion is pricing in this early rate hike scenario despite the Fed's stance. Though many factors determine gold's value, for now, the market is squarely fixated on yields and a fear of a replay of the 2013 Taper Tantrum. It is important to note that the Fed initiated the 2013 Taper Tantrum. Today's tantrum is being driven by the bond market, a very significant difference — while the Fed has unlimited firepower, the bond market does not.

Gold is still holding onto support (see Figure 2) despite these challenges: 1) one of the most considerable back up in yields in decades; 2) a market discounting earlier than expected rate hikes; and 3) one of the most significant rotations in several years. Ideally, we would like to see gold trade above the $1,765 level to trigger a small double bottom and stabilize the price action.

Figure 2. Gold Remains at Support Levels

Source: Bloomberg. Data as of 4/01/2021. Spot gold is measured by the Bloomberg GOLDS Comdty Index. RSI is the Relative Strength Index, a popular technical indicator.[11]

Reflation or Inflation?

The main eye-catching signs of inflation are coming from manufacturing data, which are indicating shortages of raw materials, record supply chain delays, steep increases in input prices and sharp rises in new orders. However, manufacturing's portion of GDP (gross domestic product) has declined over the decades to about 12% currently. Commodity prices have also staged a dramatic rebound in pricing as well. But the linkage between commodity inflation and service inflation has weakened significantly in the past 20 years as the U.S. economy has become more technology-driven.

Technology has also reduced inflation effects by raising productivity. The large slack in labor is another major factor limiting inflation. For these reasons and other entrenched deflationary forces such as demographics and, ironically, high levels of debt, the Fed views any near-term inflation signs as transitory. The Fed also believes that it has the tools to address inflation risks if they were to become a problem. The main risk the Fed sees is workforce scarring due to prolonged unemployment. For now, the Fed is focusing on where inflation is, not where it will be.

Is the Fed Behind the Curve? No, But It's Trying

The market concern is that the unprecedented amount of fiscal stimulus coinciding with pent-up consumer demand will catalyze an inflation overshoot faster than the Fed can react. The bond market is pricing in rate hikes about one year earlier than indicated by the Fed. That is a major disconnect between the Fed and the U.S. bond market. The whole point of AIT (average inflation targeting) is to get behind the curve and allow inflation and the U.S. economy to run hot. After 20 years of kneecapping inflation at 2% preemptively, the economic shock of COVID brought forward the risk of the Fed's policy leading to the deflationary trap that Japan has been in for well over two decades.

In one year, $5 trillion of fiscal spending has been announced (the $2.2 trillion CARES Act in April 2020, the $900 billion COVID-19 Relief in December 2020 and the $1.9 trillion American Rescue Plan in March 2021). More stimulus is expected in the coming years, including Biden's proposed ~$4 trillion infrastructure spending plan. This level of spending has upended conventional wisdom of what is possible. The U.S. is on the path of unprecedented spending, to a scale not seen since the New Deal of the 1930s. However, the market is currently focused only on the near-term economic boost in spending on growth and yield levels. There will be consequences down the road, intended and otherwise.

There is a shortage of historical examples of countries spending their way to nirvana. Moreover, the market is assuming the Fed will react or behave as it has in the past decades — being proactive in heading off any signs of inflation by increasing interest rates. Intuitively, this makes little sense: launch unprecedented spending and then shortly slam on the brakes?

The Definition of "Debasement"

The $5 trillion of announced spending will be almost all deficit spending. U.S. debt-to-GDP for fiscal 2021 is estimated to be ~109%, the highest since World War II. U.S. M2[10] money supply will grow by this spending amount in time. The Fed's goal to manage the debt is by a debasement process via inflationary means (AIT) and ZIRP (zero interest rate policy) to maintain a low-interest expense to handle the massive debt load.

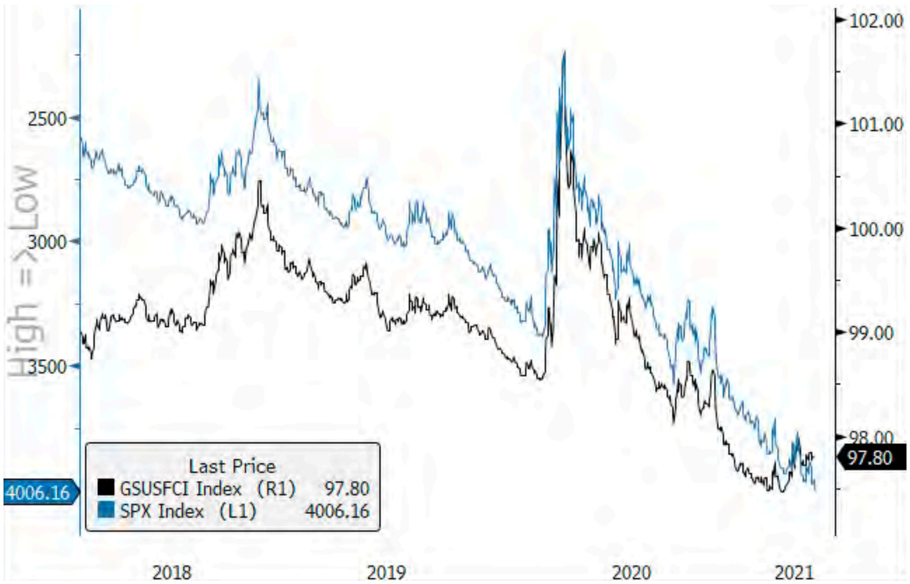
Raising rates and tapering QE in the face of such current and future spending is near impossible until the economy is at full capacity (if that). A Fed policy targeting 2% average inflation while maintaining ZIRP ensures deep and prolonged negative rates and a weak U.S. dollar (USD). That is literally the definition of debasement. Despite the short-term price action of gold, the long-term picture for gold continues to improve with each announced government spending plan. As a reminder, the 50-year R-squared[9] of gold and M2 is 82% and there is a reason why the U.S. dollar in gold terms has lost ~97.7% of its value in 50 years.

There is a Limit to Higher Yields

Though the Fed has been remarkably quiet regarding the increase in yields, especially compared to the European Central Bank (ECB) and the Bank of Japan (BoJ), there is a risk of tightening financial conditions. U.S. 10-year Treasury yields versus German 10-year government bond yields have widened as the ECB has pushed back hard against yields rising. The U.S. is now outperforming the European Union in the battle against COVID. The EU is being hit hard with a third infection wave leading to more shutdowns. Combined with much higher U.S. fiscal stimulus levels, GDP expectations have increased significantly for the U.S. while declining for the EU, which adds to USD strength.

A strengthening USD and rising real rates will tighten conditions quickly. Figure 3 shows the relationship between U.S. equity markets (as measured by the SPX Index) and financial conditions (measured by the Goldman Sachs U.S. Financial Conditions Index). Over the past several years, this relationship has increased as Fed policies became more entwined with the equity markets. The R-squared is about 85%, which is very high. With ever-higher spending and debt issuances, the market will want to see some form of coordination between WAM (weighted average maturity)/Twist[12] and the fiscal stimulus flow to prevent recurring bond volatility. Though the Fed may not react to a near-term inflation overshoot, it will likely intervene to address market functioning and liquidity issues.

Figure 3. A Tight Relationship: U.S. Financial Conditions and U.S. Equity Markets



Source: Bloomberg. Data as of 4/01/2021. SPX represents the S&P 500 Total Return Index. GSUSFCI is the Goldman Sachs U.S. Financial Conditions Index.

To keep long-term interest rates from becoming unruly and to tighten financial conditions (making them less accommodative), the Fed has many options. A "twist operation" would involve selling the front end and buying the curve's long end. The net effect would pull up front-end rates and stabilize back-end rates in a reserve-neutral way. Along with WAM extension and adjustment to QE, there are already market strategists forecasting the Fed will implement YCC (yield curve control) in due time to prevent the long end of the curve from impairing market function and liquidity. The super expansionary policy will stay in place until policymakers are forced to reverse course, but it won't be due to bond vigilantes.

Gold Bullion Sentiment Weakens

Gold, perhaps more than most asset classes, is driven by sentiment. Gold tends to perform well during periods of systemic financial stress when volatility and emotion both tend to be high. Over the decades, we have seen gold overshoot to the upside and overshoot to the downside. With that in mind, we built a proprietary sentiment index to gauge the extreme movements in gold (see Figure 4). We created the index with a view towards flows, positioning and momentum to reflect market activity, not market perception or opinion. In other words, the Sprott Gold Bullion Sentiment Index measures what investors are doing, not what they are saying.

The Sprott Gold Bullion Sentiment Index includes several inputs based on options activity (e.g., open interest, call buying, put/call ratios), flows (gold purchases) and technical indicators (e.g., trend following, momentum, dispersion). The various models are combined and normalized over a rolling two-year period and expressed as an Index ranging from 0 to 100. We believe this approach has several advantages over a single-input sentiment type index. The most pertinent would be that different input variables can drive gold, and the magnitude can fluctuate over time. This methodology should minimize "false extremes" due to normalizing the data and the multiple models used. Figure 4 highlights the +/-2 standard deviation lines where a +2 standard deviation reading represents extreme bullishness and a -2 standard deviation is extreme bearishness.

When the Sprott Gold Bullion Sentiment Index hits a -2 standard deviation reading (extreme bearishness), the average one-year return on gold bullion is +20%. Not only is gold bullion currently very oversold, but any weak holders (i.e., those who even thought about selling, have sold) are now gone. This extreme bearishness has only occurred four times over the past seven years and has generally marked the lows. Any positive gold event will have a significant effect due to the low base effect.

Figure 4. Sprott Gold Bullion Sentiment Index at Lows (2014-2021)

Source: Sprott Asset Management. Data as of 4/01/2021.

We have also created a sentiment index for gold equities using a similar construct (see Figure 5). The Sprott Gold Equity Sentiment Index has also nearly hit the -2 standard deviation level. Historically, the one-year return on gold equities after the Sentiment Index touches the -2 standard deviation is about +100%.

Figure 5. Sprott Gold Equity Sentiment Index (2014-2021)

Source: Sprott Asset Management. Data as of 4/01/2021.

Gold Equities: Sentiment Washed Out, Back to Major Support, Valuation at 15-Year Lows

The Sprott Gold Equity Sentiment Index is now washed out — positions have essentially been eliminated, and technical readings are at the lows. Gold equity prices have also technically retraced back to the breakout level of the large multi-year base pattern (top panel of Figure 6). This level is the critical level to determine the longer-term bull market narrative. In terms of valuation, gold equities are also at the 6x EV/EBITDA[13] range which has consistently marked the low valuation range for the past 15 years (lower panel, Figure 6).

Figure 6. Gold Equities at the Critical Support Level and 15-Year Low Range of EV/EBITDA

Source: Bloomberg. Data as of 4/01/2021.

This is Only a Correction in a Long-Term Bull Market

We have moved into a period of big government spending on a scale not seen since the New Deal (1933-1939), almost 90 years ago. The vast majority of this expenditure will be via deficit spending, with the long-term plan of U.S. dollar debasement eroding the debt. The short-term focus of the market is the growth aspect. The equity market has moved to a state of euphoria and near-record levels of risk appetite with the view that any pullback is a buying opportunity since risk has been eliminated. Meanwhile, gold bullion and gold equities are priced as if they are going back into the ground. Both scenarios are unlikely sustainable in the long term. We believe that the long-term precious metals bull market will regain its momentum.

About Sprott

Sprott is a global asset manager providing investors with access to highly-differentiated precious metals strategies. We are specialists. Our in-depth knowledge, experience and relationships separate us from the generalists. Sprott's specialized investment products include innovative physical bullion trusts, managed equities, mining ETFs, as well as private equity and debt strategies. We also partner with natural resource companies to help meet their capital needs through our brokerage and resource lending activities. Sprott is a global asset manager with offices in Toronto, New York and London. Sprott's common shares are listed on the New York Stock Exchange and the Toronto Stock Exchange under the symbol "SII".

Sprott

sprott.com

1 Gold bullion is measured by the Bloomberg GOLDS Comdty Index; silver bullion is measured by Bloomberg Silver (XAG Curncy) U.S. dollar spot rate; palladium is measured Bloomberg XPD Curncy U.S. dollar spot rate; platinum is measured by Bloomberg XPT Curncy U.S. dollar spot rate.
2 Gold bullion is measured by the Bloomberg GOLDS Comdty Index.
3 Spot silver is measured by Bloomberg Silver (XAG) Spot Rate.
4 The Solactive Gold Miners Custom Factors Index (Index Ticker: SOLGMCFT) aims to track the performance of larger-sized gold mining companies whose stocks are listed on Canadian and major U.S. exchanges.
5 VanEck Vectors® Gold Miners ETF (GDX®) seeks to replicate as closely as possible, before fees and expenses, the price and yield performance of the NYSE Arca Gold Miners Index (GDMNTR), which is intended to track the overall performance of companies involved in the gold mining industry. The SPDR Gold Shares ETF (GLD) is one of the largest gold ETFs.
6 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.
7 The S&P 500 or Standard & Poor's 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies. (TR indicates total return and reflects the reinvestment of any dividends).
8 "Taper tantrum" refers to the 2013 collective reactionary panic that triggered a spike in U.S. Treasury yields after investors learned that the Federal Reserve was slowly putting the breaks on its quantitative easing (QE) program. Source: Investopedia.
9 R-squared values are commonly stated as percentages from 0% to 100%. An R-squared of 100% means that all movements of a security (or another dependent variable) are completely explained by movements in the index (or the independent variable(s) you are interested in. Source Investopedia.
10 M2 is a measure of the money supply that includes cash, checking deposits and easily convertible near money. M2 is a broader measure of the money supply than M1, including cash and checking deposits. Source: Investopedia.
11 The relative strength index (RSI) is a momentum indicator used in technical analysis that measures the magnitude of recent price changes to evaluate overbought or oversold conditions in the price of a stock or other asset.
12 The mechanics of a "Twist" involve selling shorter-dated government notes and buying about the same dollar amount in longer-duration securities. The objective is to nudge up shorter-term rates and drive down those at the longer end, thus flattening the yield curve.
13 The EV/EBITDA ratio is a popular metric used as a valuation tool to compare a company's value, debt included, to the company's cash earnings less non-cash expenses.

Investments, commentary and statements are unique and may not be reflective of investments and commentary in other strategies managed by Sprott Asset Management USA, Inc., Sprott Asset Management LP, Sprott Inc., or any other Sprott entity or affiliate. Opinions expressed in this presentation are those of the presenter and may vary widely from opinions of other Sprott affiliated Portfolio Managers or investment professionals.

Sprott Asset Management LP is the investment manager to the Sprott Physical Bullion Trusts (the "Trusts"). Important information about the Trusts, including the investment objectives and strategies, purchase options, applicable management fees, and expenses, is contained in the prospectus. Please read the document carefully before investing. Investment funds are not guaranteed, their values change frequently and past performance may not be repeated. This communication does not constitute an offer to sell or solicitation to purchase securities of the Trusts.

The risks associated with investing in a Trust depend on the securities and assets in which the Trust invests, based upon the Trust's particular objectives. There is no assurance that any Trust will achieve its investment objective, and its net asset value, yield and investment return will fluctuate from time to time with market conditions. There is no guarantee that the full amount of your original investment in a Trust will be returned to you. The Trusts are not insured by the Canada Deposit Insurance Corporation or any other government deposit insurer. Please read a Trust's prospectus before investing.

The information contained herein does not constitute an offer or solicitation to anyone in the United States or in any other jurisdiction in which such an offer or solicitation is not authorized or to any person to whom it is unlawful to make such an offer or solicitation. Prospective investors who are not resident in Canada or the United States should contact their financial advisor to determine whether securities of the Funds may be lawfully sold in their jurisdiction.

The information provided is general in nature and is provided with the understanding that it may not be relied upon as, nor considered to be, the rendering or tax, legal, accounting or professional advice. Readers should consult with their own accountants and/or lawyers for advice on the specific circumstances before taking any action.

This article may not be reproduced in any form, or referred to in any other publication, without acknowledgement that it was produced by Sprott Asset Management LP and a reference to www.sprott.com. The opinions, estimates and projections ("information") contained within this report are solely those of Sprott Asset Management LP ("SAM LP") and are subject to change without notice. SAM LP makes every effort to ensure that the information has been derived from sources believed to be reliable and accurate. However, SAM LP assumes no responsibility for any losses or damages, whether direct or indirect, which arise out of the use of this information. SAM LP is not under any obligation to update or keep current the information contained herein. The information should not be regarded by recipients as a substitute for the exercise of their own judgment. Please contact your own personal advisor on your particular circumstances. Views expressed regarding a particular company, security, industry or market sector should not be considered an indication of trading intent of any investment funds managed by Sprott Asset Management LP. These views are not to be considered as investment advice nor should they be considered a recommendation to buy or sell. SAM LP and/or its affiliates may collectively beneficially own/control 1% or more of any class of the equity securities of the issuers mentioned in this report. SAM LP and/or its affiliates may hold short position in any class of the equity securities of the issuers mentioned in this report. During the preceding 12 months, SAM LP and/or its affiliates may have received remuneration other than normal course investment advisory or trade execution services from the issuers mentioned in this report.

0321858 03/21_ART_SMR