## Tariffs, Tightening, Trumponomics:

# Time to Reconsider Gold?

March 15, 2018

Sprott

# Featured Presenters

## Ed Coyne

Executive Vice President, National Sales
Sprott Asset Management USA

Mr. Coyne joined Sprott in January 2016 and has more than 25 years of investment management and sales experience. Previously, he was a Principal and Investment Specialist at Royce & Associates for over 18 years. Prior to that, Ed worked at Zweig mutual funds and Neuberger Berman as a Regional Sales Director.

## Trey Reik

Senior Portfolio Manager
Sprott Asset Management USA

Mr. Reik has dedicated the past thirteen years to comprehensive analysis of publicly traded gold-mining companies, developing significant perspective on their intrinsic values under a wide range of market conditions. Additionally, Trey is a renowned commentator on gold markets and monetary policy, including policies and actions of global central banks, global conditions for money and credit, and factors affecting supply/demand conditions for gold bullion.

# Sprott Asset Management

## An investor in the metals sector since 1981

- Sprott is a global asset manager providing investors with access to highly-differentiated precious metals and real assets investment strategies, backed by three decades of experience.

- Sprott manages more than $10 billion in precious metals and real assets, and offers best-in-class solutions:
  - Physical Gold (PHYS), Silver (PSLV) and Platinum & Palladium (SPPP) Trusts
  - Factor-based ETFs focusing on senior and junior precious metals equities (SGDM and SGDJ)
  - Public and private, equities and credit

- Sprott recently acquired the Central Fund of Canada (CEF), which adds a fourth physical solution allowing investors to own both gold and silver in a single investment. CEF began trading on NYSE on 1/16/18.

# Where Does the Gold Trade Stand in 2018?

- U.S. debt levels have decoupled from underlying productive output (GDP).
- An unprecedented era of low volatility for financial assets has ended.
- Ten-year treasury yields are breaking above their 35-year downtrend.
- Fed rate hikes are already causing tangible consumer stress.
- U.S. fiscal position is deteriorating rapidly.
- U.S. dollar remains in a pronounced downtrend.
- Trump tariffs threaten to destabilize global trade.
- New Fed Chair Jerome Powell is likely to be tested by markets (Greenspan parallels).

# Gold Investment Thesis: Default or Debase

## Annual Performance of Spot Gold in Nine Global Currencies (2001 - 2017)

| Year | US Dollar | Euro | Yuan | Rupee | Yen | Pound | CAD | AUD | CHF | Average |
|---|---|---|---|---|---|---|---|---|---|---|
| 2001 | 2.46% | 8.13% | 2.45% | 5.90% | 17.62% | 5.25% | 8.65% | 11.80% | 5.32% | 7.51% |
| 2002 | 24.78% | 5.76% | 24.78% | 24.08% | 12.64% | 12.67% | 23.48% | 13.85% | 3.87% | 16.21% |
| 2003 | 19.37% | -0.21% | 19.36% | 13.52% | 8.04% | 7.80% | -1.81% | -11.22% | 7.32% | 6.91% |
| 2004 | 5.54% | -2.19% | 5.54% | 0.54% | 0.66% | -1.76% | -2.19% | 1.40% | -3.10% | 0.49% |
| 2005 | 17.92% | 35.09% | 14.98% | 22.23% | 35.70% | 31.44% | 14.06% | 25.84% | 35.97% | 25.91% |
| 2006 | 23.16% | 10.51% | 19.11% | 21.00% | 24.32% | 8.17% | 23.46% | 14.61% | 14.24% | 17.62% |
| 2007 | 30.98% | 18.46% | 22.46% | 16.64% | 22.96% | 29.28% | 11.40% | 17.77% | 21.96% | 21.32% |
| 2008 | 5.78% | 10.55% | -1.07% | 30.62% | -14.10% | 43.89% | 29.91% | 31.59% | -4.90% | 14.70% |
| 2009 | 24.37% | 21.09% | 24.40% | 18.88% | 27.38% | 12.25% | 7.90% | -2.39% | 20.40% | 17.14% |
| 2010 | 29.52% | 38.88% | 25.02% | 24.45% | 12.75% | 34.15% | 21.95% | 13.66% | 16.91% | 24.14% |
| 2011 | 10.06% | 13.51% | 5.22% | 30.74% | 4.35% | 10.65% | 12.53% | 9.81% | 10.63% | 11.94% |
| 2012 | 7.14% | 5.22% | 6.04% | 10.54% | 20.84% | 2.31% | 4.86% | 5.82% | 4.39% | 7.46% |
| 2013 | -28.04% | -31.13% | -30.15% | -18.76% | -12.42% | -29.45% | -23.13% | -16.30% | -30.09% | -24.39% |
| 2014 | -1.72% | 11.99% | 0.79% | 0.45% | 11.81% | 4.48% | 7.40% | 7.44% | 9.92% | 5.84% |
| 2015 | -10.42% | -0.25% | -6.38% | -6.16% | -10.15% | -5.27% | 6.65% | 0.33% | -9.90% | -4.62% |
| 2016 | 8.56% | 11.85% | 16.13% | 11.42% | 5.35% | 29.57% | 5.60% | 9.66% | 10.46% | 12.07% |
| 2017 | 13.09% | -0.79% | 6.03% | 6.22% | 9.15% | 3.23% | 5.33% | 4.47% | 8.24% | 6.11% |

Source: Bloomberg.

# Polling Question #1

What has the ratio of debt to GDP done since the financial crisis in the U.S.?

a) Increased

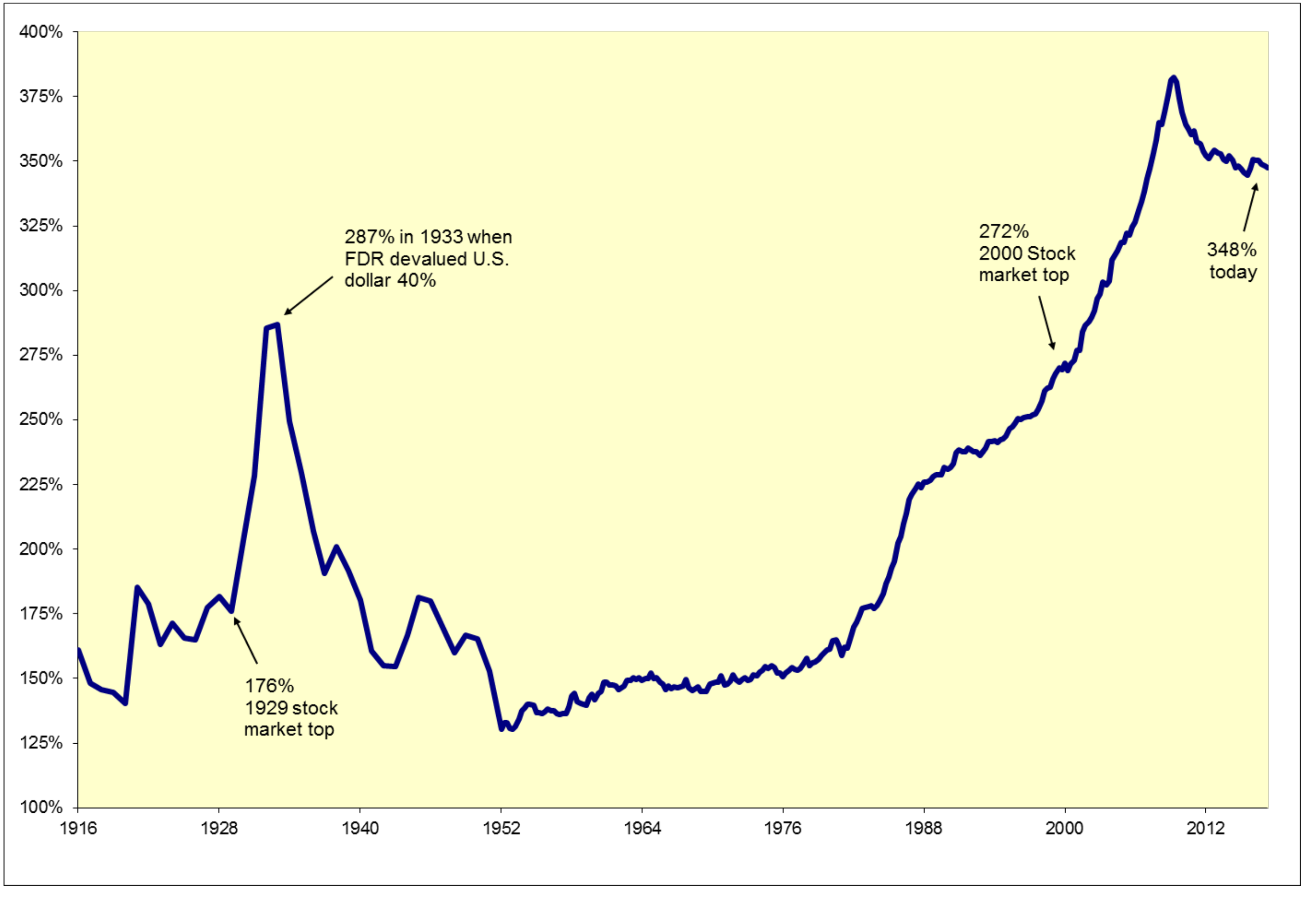
b) Decreased

c) Remained the Same

# Polling Results #1

# Gold Investment Thesis: Default or Debase

## Total U.S. Credit Market Debt as % of GDP (1916-2017)




Source: Federal Reserve Z.1 Report; BEA.

# Polling Question #2

In the new millennium (since 2001), gold bullion's cumulative return relative to the S&P 500 Index has been what?

a) Better

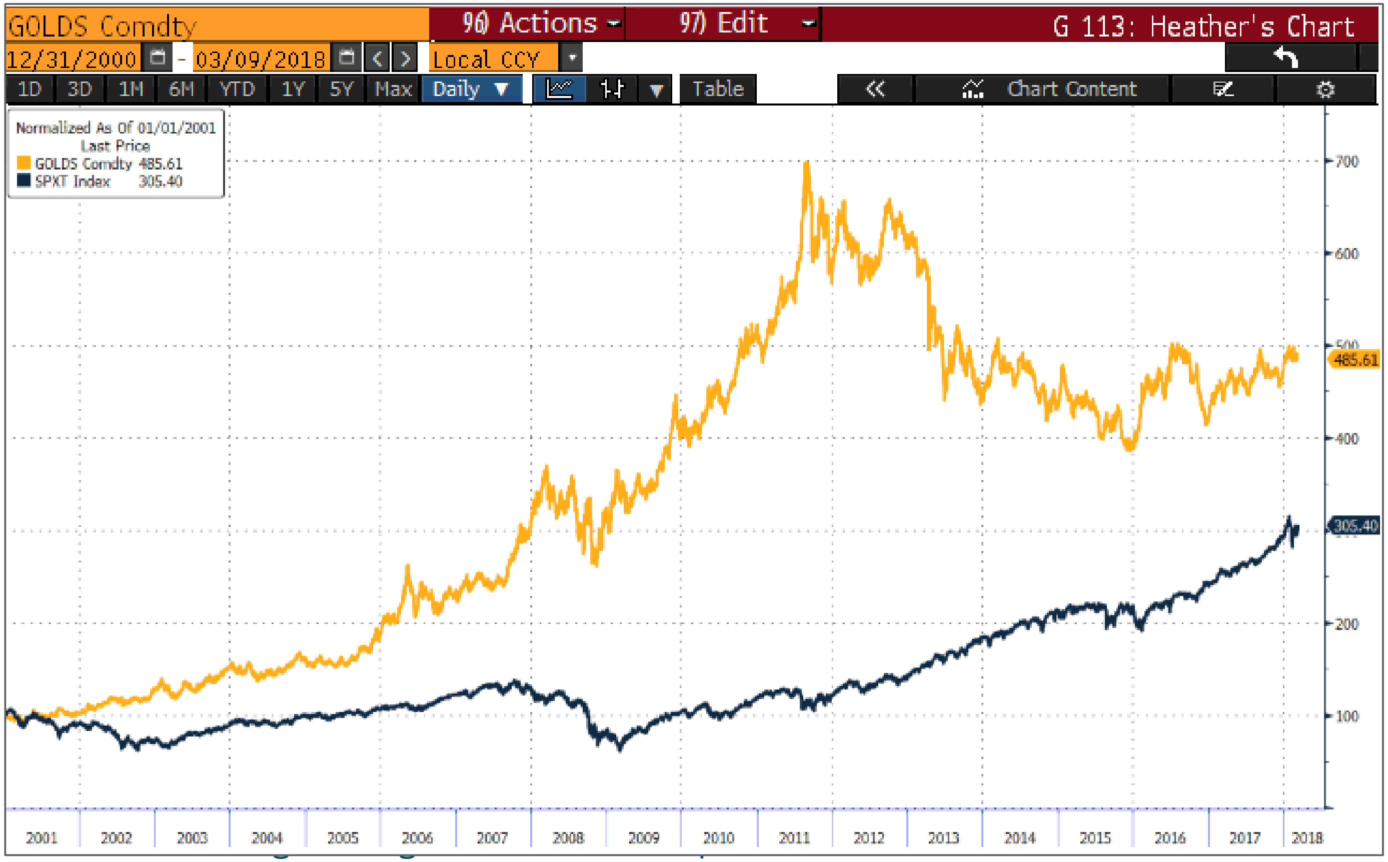
b) Worst

c) About the Same

# Polling Results #2

# Gold Investment Thesis: Default or Debase

## Cumulative Change for Spot Gold and S&P 500 Index (12/31/00-3/09/18)

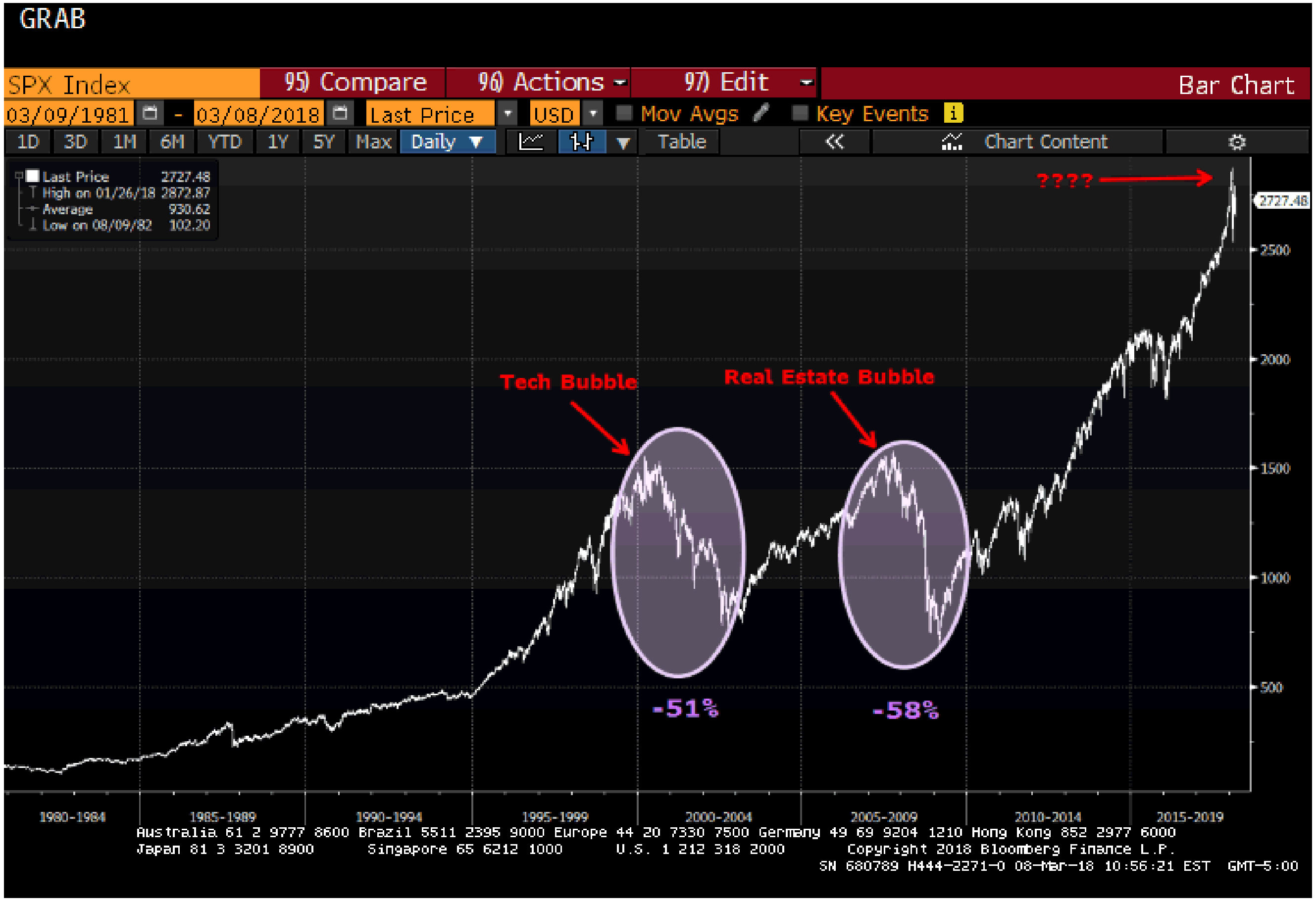



| Asset | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | CAGR |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Spot Gold (USD) | 2.46 | 24.78 | 19.37 | 5.54 | 17.92 | 23.16 | 30.98 | 5.78 | 24.37 | 29.52 | 10.06 | 7.14 | -28.04 | -1.72 | -10.42 | 8.56 | 13.09 | 9.65% |
| S&P 500 Index (w/divds.) | -11.92 | -22.1 | 28.66 | 10.88 | 4.91 | 15.78 | 5.57 | -37 | 26.45 | 15.06 | 2.11 | 15.99 | 32.37 | 13.68 | 1.37 | 11.95 | 21.82 | 6.32% |

Source: Bloomberg. SPXT Index represents the S&P 500 Total Return Index and reflects dividends reinvested.

# Prior S&P 500 Corrections Rationalized Bubble Peaks

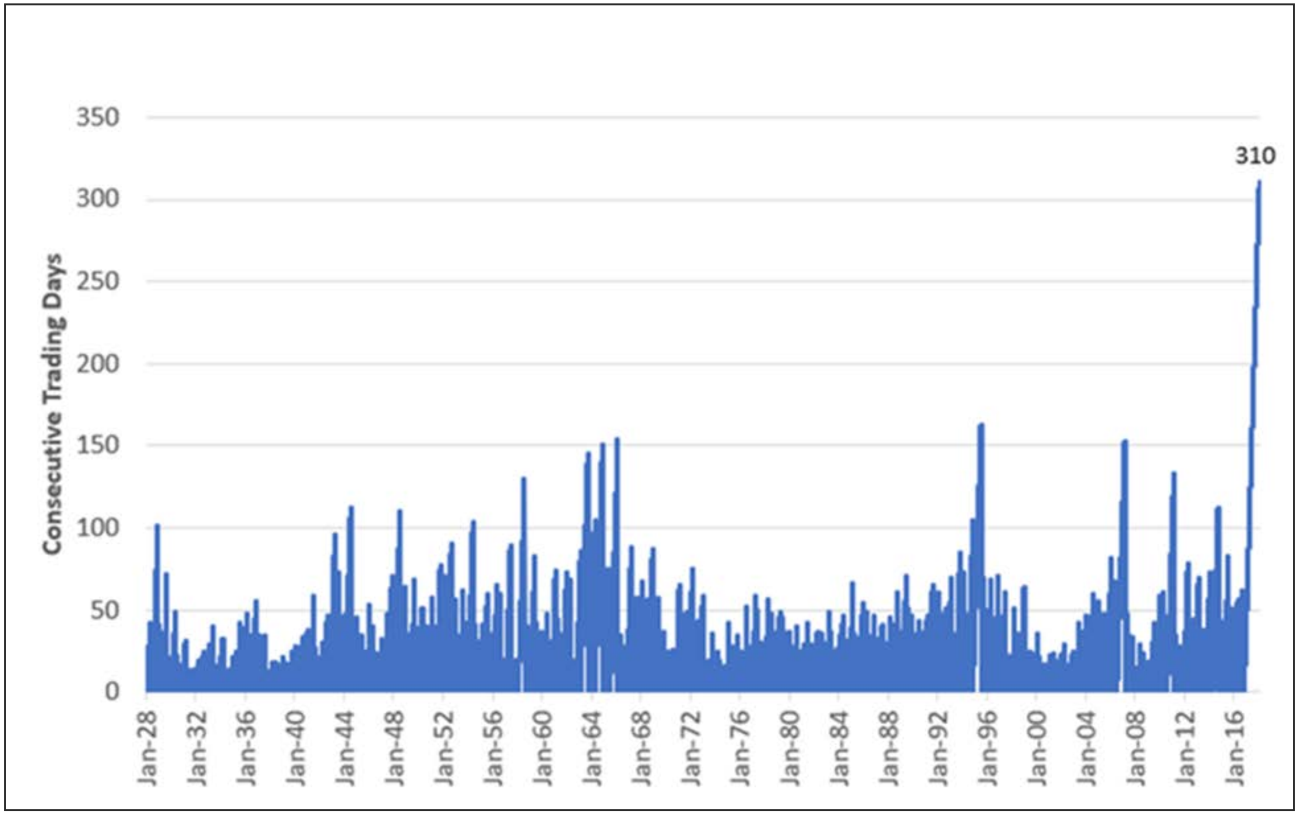
## S&P 500 Index (3/09/1981-3/08/2018)




Source: Bloomberg.

# 2017 Equity Market Complacency was Unprecedented

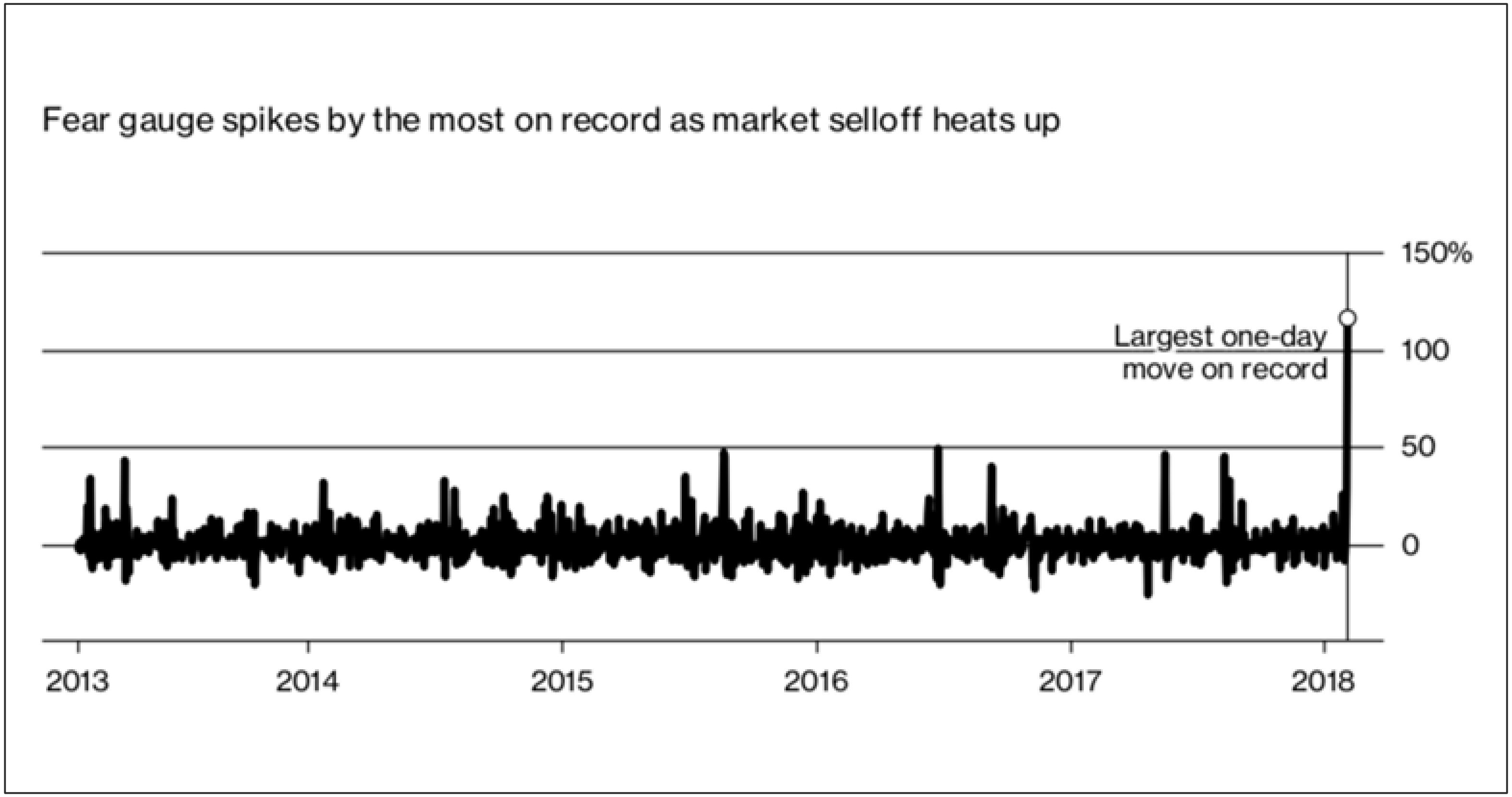
## S&P 500 Index Streak of Trading Days Without Back-to-Back 0.50%+ Declines (1928-1/30/2018)




Source: Bespoke Investment Group; CNBC.

# "Stored Force" of Short-Volatility Trade Erupted in Early February

## CBOE Volatility Index (VIX) One-Day Percentage Change (2013-2/05/2018)




Source: Bloomberg; Businessweek.

# Polling Question #3

Having rising U.S. Treasury yields been historically positive or negative for the overall market?

a) Positive

b) Negative

c) Not Sure

# Polling Results #3

# Treasury Yields Broke 35-Year Downtrend in Mid-January

10-Year U.S. Treasury Yields with Financial Crises Highlighted (1973-3/08/2018)


Source: MacroMavens.

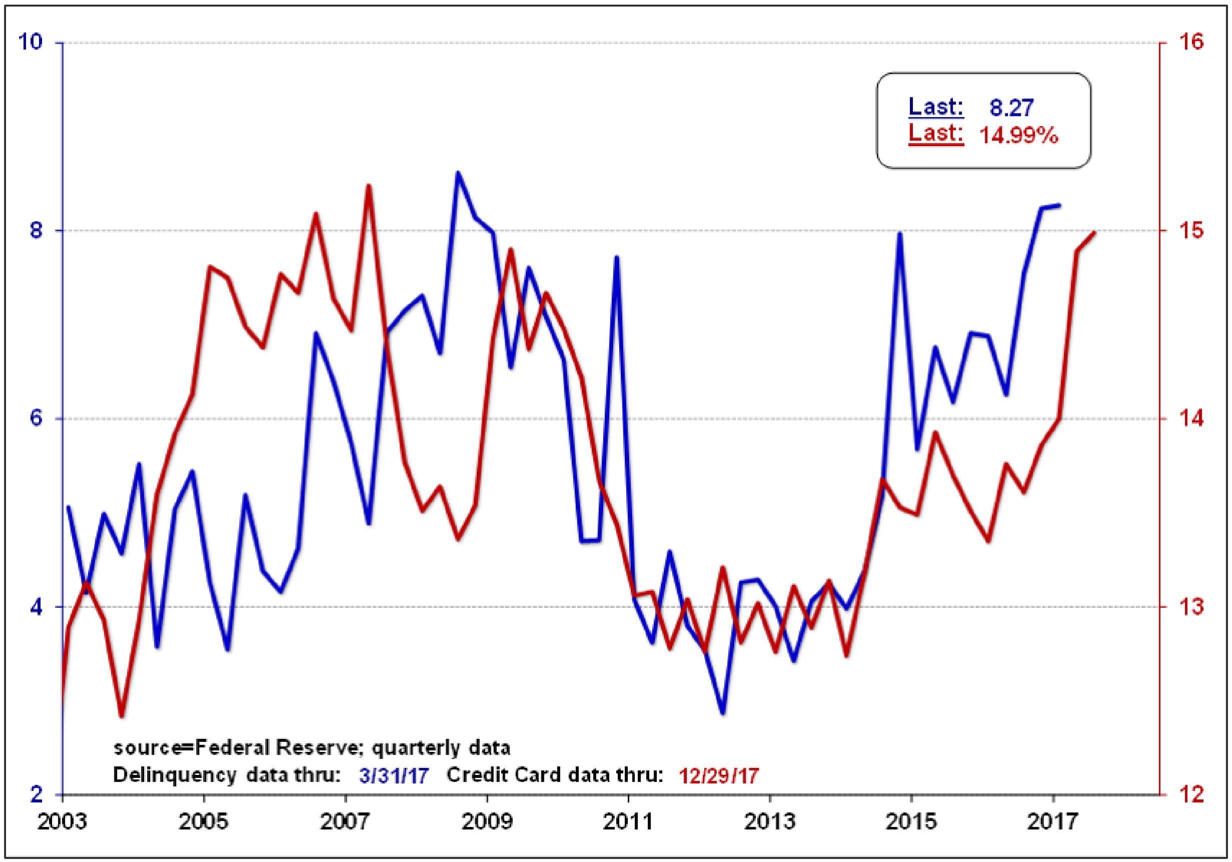
# Fed Rate Hikes are Already Ratcheting Up Consumer Stress…

Seriously Delinquent Auto Loan Balance ($bln)

vs.

Consumer Credit Card Assessed Interest Rate

(2003-Present)




Source: Federal Reserve; Meridian Macro.

# Polling Question #4

As interest rates rise, what do personal savings rates do?

a) Increase

b) Decrease

c) Stay About the Same

# Polling Results #4

# …And Pressuring the Personal Savings Rate

## Personal Savings as Percentage of Disposable Income (2000-1/31/2018)


Source: BEA, Meridian Macro.

# U.S. Fiscal Position Now Deteriorating Rapidly

- After initial market-sentiment surges, Trumponomics is now taking its toll.
- “Cost” of Dec. 2017 *Tax Cuts and Jobs Act* now estimated at $1.5 trillion (10 years).
- January 2018 budget bill included $300 billion in increased spending (2 years).
- Federal debt ceiling suspended through March 2019.
- OMB now estimates Treasury issuance will surge from $519 billion in fiscal 2017 to $955 billion in fiscal 2018, and then ***average*** $1.1 trillion for each of next ***five years***.
- PBOC officials floated in early January that China might curtail or halt its Treasury purchases.
- In a case of near priceless timing, the Fed still plans to be downsizing its balance sheet at an annual rate of $600 billion by year-end 2018 ($420 billion for the year).

# U.S. Dollar Has Been the Canary in the Coal Mine

DXY Dollar Index (1/02/2013-3/06/2018)


Source: Bloomberg.

# Polling Question #5

How did gold respond to the last two Fed rate-hike cycles (2004-2006 and 2015-present)?

a) Positively

b) Negatively

c) Was Flat

# Polling Results #5

# Fed Rate Hikes are Not Inherently Threatening to Gold

## June 2004-June 2006 Tightening Cycle

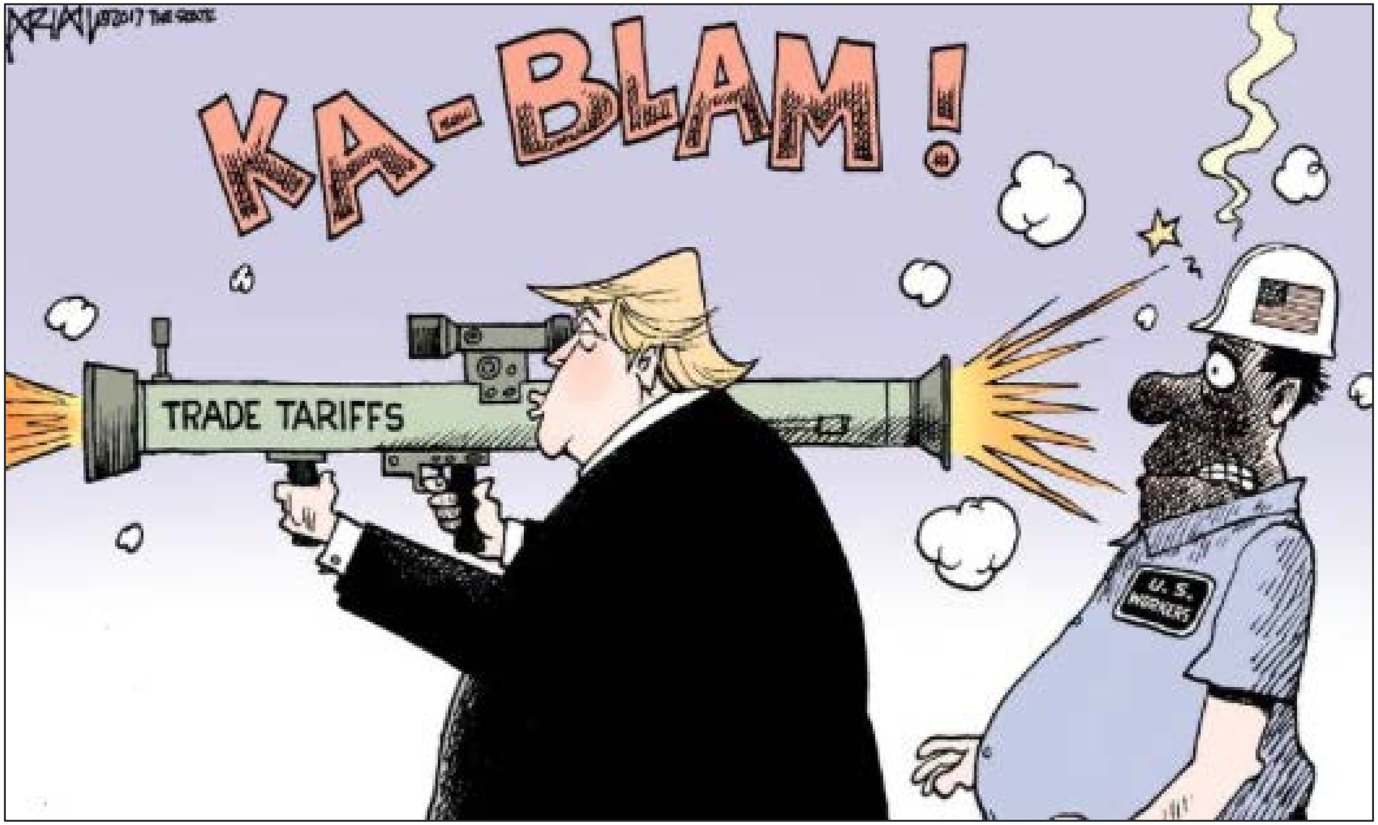

Spot Gold vs. Upper Bound of Fed Funds Target Rate
(7/04/03-3/01/07)

## December 2015-Present Tightening Cycle


Spot Gold vs. Upper Bound of Fed Funds Target Rate
(1/01/15-3/09/18)

Source: Bloomberg.

# Will Trump Tariffs be the Final Straw?



# New Fed Chairman is Just the Latest 1987 Parallel

Federal Reserve Chairmen Swearing-In Ceremonies:

Jerome Powell (2/5/18) and Alan Greenspan (8/11/87)

Source: Associated Press; Reagan Library.

# Polling Question #6

Can an allocation to gold improve risk-adjusted portfolio returns?

a) Yes

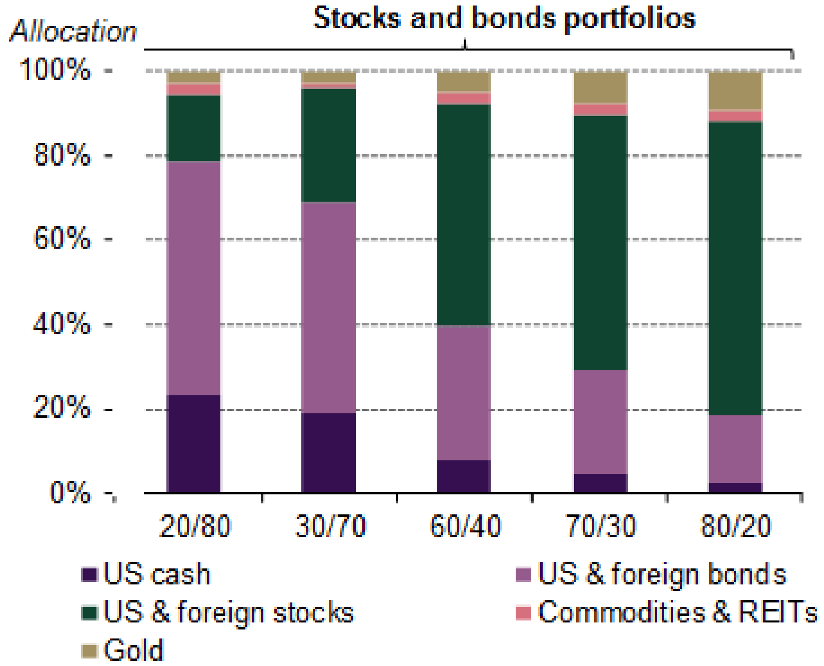
b) No

c) Not Sure

# Polling Results #6

# Gold Optimizes Risk-Adjusted Returns for Any Risk Tolerance

## Optimal Gold Weightings in Basic Stock/Bond Portfolios at Five Risk Tolerance Levels

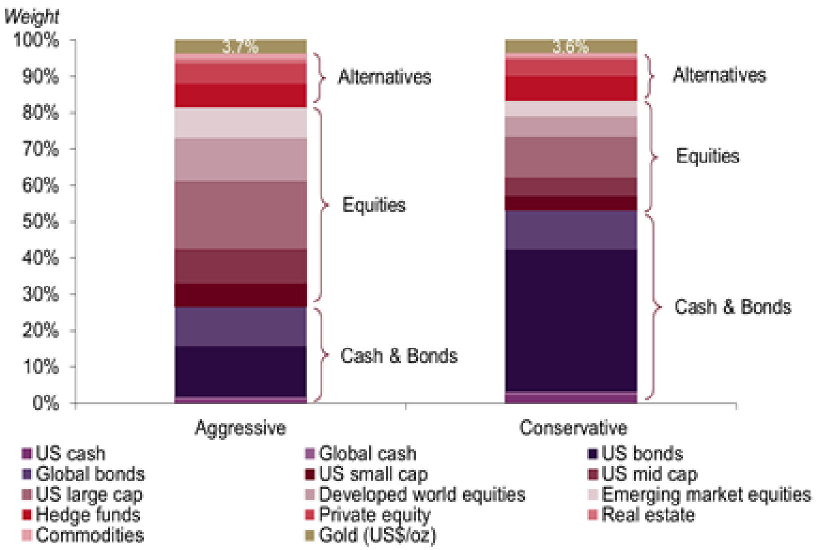



| Scenario | 20/80 | 30/70 | 60/40 | 70/30 | 80/20 |
|---|---|---|---|---|---|
| U.S. Cash | 24% | 19% | 8% | 5% | 3% |
| U.S. & Foreign Bonds | 55% | 50% | 32% | 25% | 16% |
| U.S. & Foreign Stocks | 16% | 27% | 53% | 60% | 69% |
| Commodities & REIT's | 3% | 1% | 3% | 3% | 3% |
| **Gold** | **2%** | **3%** | **5%** | **8%** | **9%** |
| | 21%/79% | 31%/69% | 61%/40% | 71%/30% | 81%/19% |

Source: Based on Michaud & Michaud RE Optimization; World Gold Council.

# Gold Optimizes Risk-Adjusted Returns in Diversified Asset Portfolios

## Optimal Gold Weightings in Diversified Asset Portfolios at Two Risk Tolerance Levels




| Asset | Aggressive | Conservative |
|---|---|---|
| U.S. Cash | 0.8% | 2.4% |
| Global Cash | 0.8% | 0.7% |
| U.S. Bonds | 14.1% | 39.2% |
| Global Bonds | 10.9% | 10.8% |
| U.S. Small Cap | 6.5% | 4.0% |
| U.S. Mid Cap | 9.5% | 5.2% |
| U.S. Large Cap | 18.7% | 11.2% |
| DW Global Equties | 11.9% | 5.6% |
| EM Equities | 8.4% | 4.1% |
| Hedge Funds | 6.5% | 6.9% |
| Private Equity | 5.6% | 4.5% |
| Real Estate | 1.3% | 0.8% |
| Commodities | 1.4% | 1.1% |
| **Gold** | **3.7%** | **3.6%** |

Source: Based on Michaud & Michaud RE Optimization; World Gold Council.

# Sprott Precious Metals Solutions

We offer a full suite of physical and mining solutions

- **Sprott Physical Bullion Trusts**

  Gold and Silver Trust (NYSE Arca: CEF)

  Physical Gold (NYSE Arca: PHYS)

  Silver (NYSE Arca: PSLV)

  Platinum & Palladium (NYSE Arca: SPPP)

- **Sprott Factor-Based ETFs**

  Sprott Gold Miners ETF (NYSE, Arca: SGDM)

  Sprott Junior Gold Miners ERF (NYSE, Arca: SGDJ)

# Sprott Precious Metals Solutions

| Sprott Physical Gold and Silver Trust | Sprott Physical Gold Trust | Sprott Physical Silver Trust | Sprott Physical Platinum and Palladium Trust |
|---|---|---|---|
| NYSE Arca: CEF | NYSE Arca: PHYS | NYSE Arca: PSLV | NYSE Arca: SPPP |

Fully Allocated Precious Metals • Redeemable for Metals • Trustworthy Storage
Potential Tax Advantages • Easy to Buy, Sell & Own • A Liquid Investment

# Sprott Gold Miners Solutions

**Sprott ETFs** NYSE ARCA: SGDM and SGDJ


# Sprott Gold Miners Solutions

Sprott factor-based gold miners ETFs provide investors with access to innovative and unique gold miners indexes that are designed to outperform passive market cap-weighted offerings.

Sprott Gold Miners ETF (SGDM) Factors

- Revenue growth
- Long-term debt to equity
- Reconstituted quarterly

Sprott Junior Gold Miners ETF (SGDJ) Factors

- Revenue growth
- Price momentum
- Reconstituted semi-annually

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Sprott | Gold Report
February 28, 2018

**Oopsie Daisy! Equity Markets Stumble in Early February**

Authored by Trey Reik, Senior Portfolio Manager, Sprott Asset Management USA, Inc.

On the heels of historic 2017 complacency in broad equity averages, U.S. financial markets were jolted in the first week of February. The S&P 500 Index[1] ended its record-setting streak of 404 trading days unblemished by a 5% correction with a startling two-week pullback measuring 10.16%. Like a Rorschach inkblot, market observers have branded February's dislocation to fit their fancy. The bullish precis suggests the short-gamma of a tiny group of inverse-VIX ETFs mauled equity markets with bursts of compulsory selling, but these funds' quick demise has freed equity averages to resume their upward slopes. Echoes of Chairman Bernanke's March 2007 proclamation that subprime "seems contained" reverberate through recent FOMC characterizations of short-VIX equity declines as "small potatoes" with "virtually no consequence" (Dudley 2/8), "the most predicted selloff of all times" (Bullard 2/6), and ominously, "more volatility in markets can be a healthy thing" (Kaplan 2/7).

**Fed Rate Hikes Inflict Damage on Financial Assets**

As non-consensus as our gold thesis remains, early 2018 events have only served to validate our contention that in the context of excessive U.S. debt levels, **any increase in domestic rate structures (short or long) will inflict damage across the broad spectrum of financial assets.** Originally on the short end, the Fed's initial December 2015 rate hike almost unhinged the global financial system (China was forced to devalue and 2016 U.S. GDP growth slumped to 1.85%). It took **12 months** for the Fed to condition markets sufficiently to withstand a second baby step from the zero bound, a telling state of affairs for any legitimate tightening cycle. In our view, only the sentiment surges from President Trump's surprise election and December tax bill have provided sufficient cover for the Fed to eke out incremental fed fund hikes to their still historically insignificant 1.50%.

**Rising Consumer Stress?**

After initial corporate bankruptcies in over-levered industries such as retail (Q1 2017), it has taken a bit longer than we would have expected for Fed rate hikes to sour broad credit pools, but that fermentation is now brewing. The big four U.S. banks (JPM, WFC, BofA, Citi) experienced a 19% jump in credit card losses during 2017 (to $12.5 billion). As shown in Figure 1, the Fed's three rate hikes between December 2016 and June 2017 quickly translated into rising credit card interest rates and **a lockstep surge in seriously delinquent auto loans** (all credit scores). By late 2017, 9.7% of **sub-prime** auto loans originated by auto finance companies were more than 90-days delinquent, just below their crisis peak of 10.9%.

## [Oopsie Daisy! Equity Markets Stumble in Early February](#)

February 28, 2018
By Trey Reik

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