

## Gold miners' profits are rising - but what's their long term outlook?

### Feedback from the 2019 Denver Gold Show

**Baker Steel Capital Managers LLP**

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As the gold sector approaches a seasonally strong period towards year-end, Baker Steel's award-winning investment team sees a multitude of opportunities in gold equities. Against a backdrop of higher gold prices and improving investor sentiment, the outlook for miners is more positive than for some time, while supportive macroeconomic factors such as low real interest rates, rising financial sector risk and the ongoing currency war provide potential catalysts for the next phase of the bull market for the gold sector.

Having returned last week from the Denver Gold Show in Colorado, one of the largest gatherings of gold producers, sector analysts and investors annually, fund managers Mark Burrige and David Baker see a resurgent sector, with companies emerging from a period of reform in the years since the bottom of the gold market in late-2015. Key current themes for gold miners include improved profitability backed by a rising gold price, a growing recognition of the importance of returns to shareholders increased investment in cost-saving technologies, and improved focus on ESG.

With the gold price having recently broken-out of its long-term trading range and currently trading at around \$1500/oz most gold producers are generating more cash. Yet the question remains, how much of this cash will be returned to shareholders? It remains clear that a substantial disparity exists between gold companies, in terms of profitability, management quality, capital discipline and attitude towards returns to shareholders.

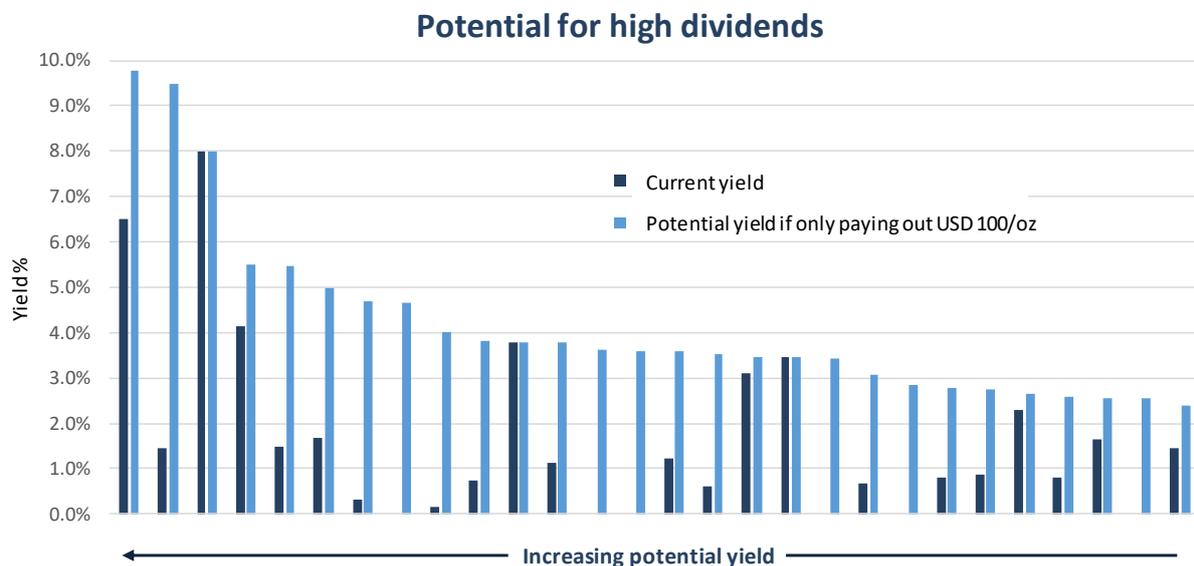


Source: Bloomberg. Data at 30 September 2019

Baker Steel targets superior risk adjusted returns relative to a passive holding in gold or gold equities. Our team favours companies with high quality assets, effective management teams and a proven commitment to shareholder returns.

As an active investment manager our team manages a concentrated portfolio with a value-driven approach, with the flexibility to benefit from current investment themes. In recent months those themes have included a focus on the gold majors on the back on constructive M&A, as well as an increased allocation to silver producers, given the relative undervaluation of these companies. A key theme for Baker Steel as active investment managers is the dividends paid by producers and the capacity for companies to expand these dividends as the sector’s profitability increases. Following the company meetings undertaken at the Denver conference our team feel cautiously optimistically that management teams are taking dividends more seriously.

While not known historically as a high dividend paying sector, a number of gold producers already pay sizable dividends, reflecting these companies’ status as cash-generative businesses, and importantly there is the potential for yields to rise significantly during this cycle as profitability recovers and companies seek a re-rating. The chart below illustrates the range of current yields paid by producers and highlights the potential yield if these companies were to pay out just USD 100/oz produced, an easily achievable target for most producers at current gold prices.



Source: Bloomberg, Baker Steel internal, company reports. Data at 30 September 2019  
 Note, based on a representative sample of gold producers.

**A supportive macroeconomic environment for gold’s bull market**

The gold sector has made encouraging gains year-to-date against an increasingly supportive macroeconomic environment. Low real interest rates globally are a key driver for higher gold prices, with the US Fed’s decision to begin cutting interest rates this year presents a major catalyst for the sector. Policymakers in developed economies are signalling a willingness to take drastic action to boost growth and stoke inflationary pressure if necessary in response to signs of slowing economic growth now visible in the US and Europe, backed by growing political support in these regions in for increased spending and fiscal stimulus. The acceleration of public and private debt levels appears a likely outcome of such policy direction, as does a continuation of confrontational trade policies and currency war between the US, China and the European Union.

Against this economic backdrop we anticipate that gold’s bull market will develop in the coming months and years as investors seek diversification from rising financial market risk, demand grows for safe-haven assets amid heightened geopolitical tension, and as investor sentiment towards this oversold sector recovers. Historically each new gold bull market cycle has seen the gold price take out its previous high. Of course, markets tend not to move in a straight line and it is our view that a

medium- to long-term view is most appropriate for investors, avoiding reaction to short-term moves in the sector. With the gold price today still some way of the c.\$1920/oz peak seen in 2011, the market appears to have substantial room to run during this long-term cycle. Likewise, the upside potential for gold equities appears sizable at this point in the cycle as investors show signs of returning to this relatively small and under-owned sector. Gold stocks typically offer operational leverage to a rising gold price, albeit with higher volatility and company risk, yet it is our firm view that an actively managed portfolio of gold equities, focused on the highest quality producers, best management teams and a commitment to shareholder returns, offers a superior risk/reward opportunity relative to passive exposure to the gold sector.

### **Sauren Golden Awards 2019: A recognition of Baker Steel's active management success**

For the fourth year running the Investment Team at Baker Steel Capital Managers LLP have received recognition from Sauren Fund Research, which has awarded two gold medals to fund managers David Baker and Mark Burridge. This is the highest rating of any gold equities fund manager rated by Sauren and represents a worthy recognition of the team's consistent alpha generation and value-based Investment approach.

The assets under management of BAKERSTEEL Precious Metals Fund have more than doubled over the past 12 months, highlighting the resurgence of interest in the gold equities sector, historically the highest returning portion of the precious metals sector during a gold price recovery phase.

Baker Steel Capital Managers LLP ("BSCM") is a specialist investment manager focused on the natural resources sector. BSCM manages the BAKERSTEEL Precious Metals Fund Baker Steel (UCITS long-only gold equities) and the BAKERSTEEL Electrum Fund (UCITS speciality and precious metals equities), as well as the Baker Steel Resources Trust (LSE: BSRT), an LSE-listed investment company which invests in pre-IPO opportunities within the mining sector.

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### **Important**

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