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Biden vs. Trump: Which metals will emerge as winners?

Speciality and Precious Metals Equities Update

Baker Steel Capital Managers LLP

Investment Manager of the BAKERSTEEL Electrum Fund and BAKERSTEEL Precious Metals Fund

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With American voters due to go to the polls in under a week, the results of one of the most divisive presidential contests in recent history will soon be clear. As investors eye the prospects for markets and the economy under a Biden administration compared with four more years of President Trump, Baker Steel's team of natural resources specialists is focused on the potential outcomes for the metals and mining sector.

Undoubtedly, the potential for vast levels of spending, whoever wins the election, will be a key driver for the sector. If Biden wins, much of this spending may be focussed on the development of green energy, while a second term for Trump will likewise see increased spending on metals intensive infrastructure and defence projects. Some metals would benefit from both trends, while different speciality metals would benefit more under one scenario rather than the other. Both candidates have also pledged to help bring domestic sources of "future facing" and strategic metals to market.

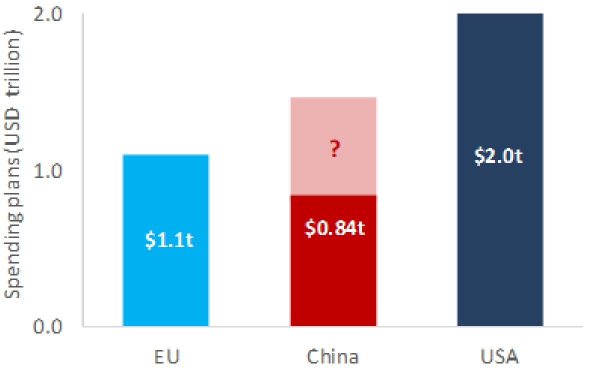
Both candidates will almost certainly preside over a period of rapid debt expansion and loose monetary policy in the wake of COVID-19, against a macroeconomic backdrop characterised by long-term low and negative real interest rates and eventually inflationary forces. These conditions have historically proven supportive of precious metals in their role as "real financial assets".

Key sector themes

As natural resources investment specialists, our team identifies two key long-term trends which will drive the mining sector in the months and years ahead.

1. The inexorable global movement towards decarbonisation and the implementation of green technology. Demand for speciality metals is forecast to surge amid potential supply shortages, as factors such as rising electric car production, increasing renewable energy usage, and the development and expansion of battery capacity require a significant increase in a number of strategic raw materials.
2. Fiscal and monetary imbalances are growing, including the build-up of inflationary pressure caused by years of loose monetary policy by central banks and the movement towards higher levels of government spending and rapid debt expansion. These trends have been exacerbated by the policy response to the COVID-19 crisis, which has seen vast stimulus packages planned by governments around the world.

Historic levels of economic stimulus are planned in response to COVID-19



Source: Bloomberg, SCMP, Baker Steel Capital Managers LLP.

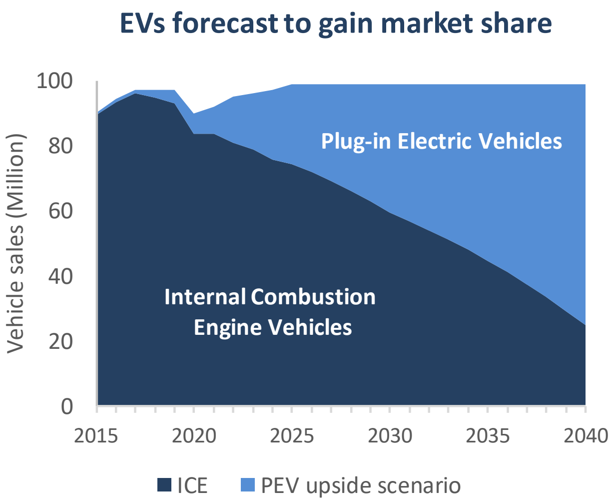
With a focus on speciality and precious metals equities, the **BAKERSTEEL Electrum Fund** ("Electrum Fund") is well-positioned to offer investors exposure to both trends. The **BAKERSTEEL Precious Metals Fund**, on the other hand, offers focussed participation in the second of these trends and provides a potential hedge against geopolitical and market risk.

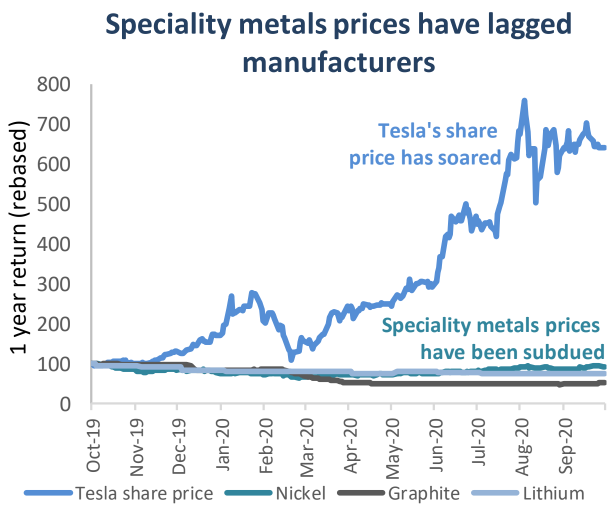
A "green recovery" would boost speciality metals producers

Decarbonisation is a long-term secular trend and globally the direction of travel for green technology implementation is clear. Trillions of dollars of funding has already been committed for more environmentally friendly projects and industries, as well as to climate mitigation jobs over the coming decades, alongside increasingly competitive pricing for renewables relative to fossil fuel energy sources. The coordinated European response to the COVID-19 crisis has largely focused on "building back better", with EUR 1 trillion having been directed or promised to a multitude of green energy initiatives over the coming decade. In China, a vast post-COVID-19 stimulus package, totalling around USD 800 billion, has largely been focused on creating jobs in low carbon industries, with the next five-year plan expected to only add more momentum in this area.

In the US, the winner of November's elections (presidential, congressional and particularly senate) will have a significant impact on the speed at which the world's largest economy transitions towards lower emissions, and the level of enthusiasm for green initiatives between Trump and Biden (and Republicans and Democrats generally) stands in stark contrast. Victory for the Democratic candidate could take the global tally for spending on a green recovery as high as USD 7 trillion. Regulatory guidelines on emissions that President Trump rolled back would return in more stringent form.

Biden's climate plan highlights some of the areas in which his administration would focus, including making power generation 100% carbon-free by 2035 and setting the US on a path to net zero emissions by 2050, while spending USD 2 trillion on new and upgraded infrastructure including power lines, trains and broadband networks. The implications of such policies for producers of the speciality metals and materials used in green technologies are far-reaching and highly positive. An accelerated pace of green technology adoption under Biden's plans would further boost the already high demand forecasts for critical raw materials, including lithium, nickel, platinum group metals, cobalt, vanadium, and copper.





Source: Bloomberg, Benchmark minerals, Baker Steel internal. Data at 27 October 2020.

In contrast to the overtly positive outlook for green technology under a Biden administration, the re-election of President Trump would likely result in lower overall spending and a slower transition towards a lower-carbon US economy. That said, green stimulus under Trump is still an impressive USD 1.71 trillion and growing (Source: Credit Suisse Group AG). Transport and infrastructure-related sectors have received over USD 300 billion, mostly towards electrification. A Trump administration is likely to focus on building retrofits as a key stimulus tool as it is estimated to generate 15 jobs per every million dollars of spending. Building retrofits have a significant impact on metal demand as building ventilation requires zinc, LED lighting uses copper, gallium and indium, wiring upgrades require copper, solar panels utilise copper and silver, and heat pumps need nickel and copper. At the same time, the potential for broader infrastructure stimulus and defence spending to continue under Trump would also continue to support selected metals.

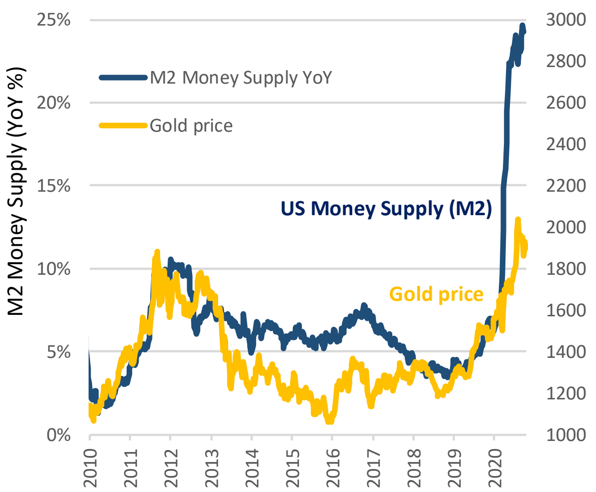
Ultimately it is our view that the global movement towards decarbonisation is unstoppable, whoever wins on Tuesday, as the rest of the world continues to move towards a "net zero" future much faster than we thought possible at the start of the year. Furthermore, a wave of stimulus spending that will benefit many metals is also likely, regardless of who wins.

The return of inflation and monetary debasement signals a strong outlook for precious metals

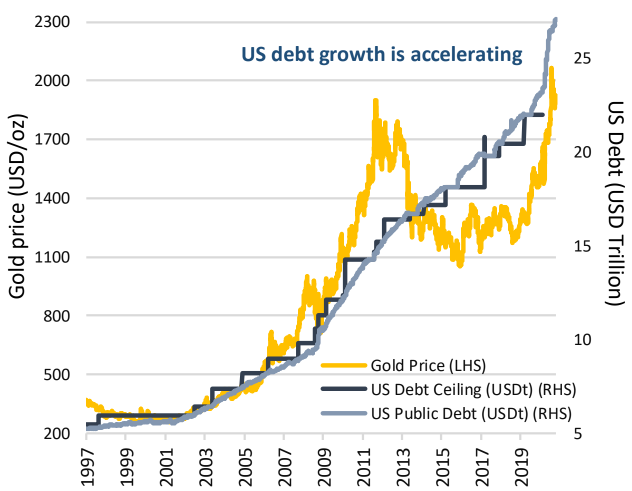
Returning to our second major theme for natural resources investors, we consider the current macroeconomic environment to be highly supportive of precious metals, for several reasons. Persistent low real interest rates, rising debt levels and heightened economic uncertainty have been supportive factors for the gold price for several years, but the onset of the COVID-19 pandemic and the policy response to the ensuing economic crisis has accelerated these macroeconomic trends. Historic levels of economic stimulus, zero or negative interest rate policies and other potentially inflationary initiatives have been implemented by policymakers globally, creating an environment highly conducive to higher gold prices.

Whichever candidate emerges victorious from the 2020 election, they will have to deal with deteriorating national finances and challenging fiscal conditions in the wake of COVID-19. Trump and Biden are divided on many things, however their positions on economic management share common themes. Both will support vast stimulus packages to drive economic recovery in the wake of the pandemic. Neither shows the inclination to oppose rapid debt expansion. Trade tension, a hallmark of Trump's presidency, is unlikely to disappear under either candidate and, if anything, may well increase given the turmoil inflicted on economies by COVID-19. Similarly, partisan domestic politics and social tension seem unlikely to fade, regardless of the winner, given the divisive nature of the 2020 presidential contest. In any event, US dollar volatility is likely in the weeks ahead, particularly in the event of a close result.

Gold tends to rise as money supply increases



Rising debt is supportive of higher gold prices



Source: Bloomberg, Baker Steel Capital Manager LLP. Data at 26 October 2020.

The conclusion we reach is that a win by either candidate is unlikely to alter the supportive macroeconomic conditions for the gold sector. This reinforces our view that all investors should have some exposure to gold in their portfolio; physical as insurance and for portfolio diversification, and gold equities to gain exposure to the significant margin expansion underway in the sector at present (as detailed in Baker Steel's previous commentaries, please contact our team for more information).

A key feature of the precious metals sector currently, is how-well positioned miners are in general to take advantage of a gold price recovery. The industry has fundamentally restructured itself to focus on expanding margins and generating investor returns but is still trading at very low valuations.

Amid a clouded economic outlook, selected speciality and precious metals producers are poised to thrive

Alongside the opportunities we identify in the mining sector when considering the potential outcomes of the 2020 election, we also see risks. With regard to investment in US-listed miners and those with US operations, comments by Biden last week indicate strong support for the development of domestic greenfield strategic metals mines. However, the permitting process for mineral operations is likely to become more protracted at the same time. Corporate taxes are also likely to rise under a Biden administration, negatively impacting domestic miners although given the low effective tax rates for many, any repeal of the "earned depletion" tax rules would likely be more significant if those rules became a focus of congress over time. Perhaps the two factors most difficult to quantify would be the market reaction to a significant increase in the capital gains tax rate and the implementation of a carbon tax. That said, the imposition of any carbon tax also creates opportunities for active investors in this sector, who can identify opportunities relating to Electric Arc Furnaces (EAF) to name one specific example and recycling operations more broadly.

The Electrum Fund maintains a permanent weighting to the gold and speciality metals sectors in its portfolio and actively adjusts the relative exposure. This flexibility offers a significant advantage in volatile markets, such as we have seen in 2020. Importantly all stock selection is determined by value-driven fundamental research, backed by our team's technical experience in the mining sector and multi-cycle investment experience. It is this active management approach which has allowed our team to generate consistently superior risk-adjusted returns over the long-term. Whatever the outcome of the US election we believe that Baker Steel's Funds are well-positioned to benefit from the long-term trends of green technology development on the one hand, while providing exposure to the supportive economic environment for precious metals on the other.

Important

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