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Shownotes

Host Ed Coyne is joined by Ronnie Stoeferle from Incrementum, to discuss the 2022 *In Gold We Trust* report. Topics include gold's recent performance, inflation, Fed policy and how gold differs from commodities in general.

Podcast Transcript

Ed Coyne: Hello and welcome to Season 2, Episode #5, of Sprott Gold Talk Radio. I'm your host, Ed Coyne, Senior Managing Director at Sprott. It's the time of year again when we are lucky enough to be joined by Ronnie Stoeferle of Incremental. Ronnie, thanks for joining Sprott Gold Talk Radio today.

Ronnie Stoeferle: Thank you very much for having me, Ed. Always a pleasure talking to you.

Ed Coyne: In the precious metals world, as nerdy as this may sound, I always look forward to this time of year because one of my favorite reports is *In Gold We Trust*. And you guys do such a wonderful job to help crystallize what's happening in the world today and even more importantly, what's happened in the last twelve months relative to last year's report. Give us a little insight into your background and what makes your firm special. And frankly, how did *In Gold We Trust* even come to be?

Stoeferle: "Gold has done its job as a solid portfolio performer....I think it's now time to play defense. We are seeing turbulence in many markets and those crises start in the periphery and then move to the center."

Ronnie Stoeferle: I started as an analyst at a big Austrian bank and I don't know if it was a curse or a blessing, but I invested in a small-cap explorer called Osisko Exploration. I didn't know about gold or the mining business, but this was cool. I went to my boss and said I would like to research the topic of gold. And back then, I was analyzing Asian equities, and my boss said, gold is always good; go ahead and write a little special report. That was when I started writing and researching the topic of gold and publishing the *In Gold We Trust* report. Now in

2012 we received our first order. I quit my job and set up Incrementum with partners from Switzerland, very senior guys and a close friend of mine, Mark Valek, who was a very successful fund manager here in Austria. And I said I would love to continue writing the *In Gold We Trust* report because there is a lack of solid, serious, not doom and gloom research in the gold space. We want to cater and inform and educate institutional players and sophisticated investors and make a sober case for gold and not make the case for everything going to hell and for hyperinflation because there's already way too much of this kind of gold research out there.

Now we publish the report in four languages, and it's probably the most widely followed publication on gold. We posted it on May 24th and it's free of charge, which is also important for us thanks to our premium partners like Sprott, who make it possible for us to make this available for everybody all over the globe, free of charge. But primarily, we are asset managers; we are a boutique asset management company based in Lichtenstein. We manage six investment funds. We manage private accounts for high-net-worth individuals. We're very much focused on the commodities and the precious metals space.

Ed Coyne: That's a great download. I use your report throughout the year. It's sort of dog-eared and I have a little black folder that I carry around all my favorite stats when I'm traveling and doing meetings and this thing gets dog-eared and marked up all year long. Ronnie, we want to cover a lot of stuff. A lot has changed in the last twelve months and a lot has stayed the same. If you think about where the S&P 500 was this time last year versus today, as the Fed sort of puts pressure on balance sheets and starts to raise the cost of capital, we're certainly seeing some dislocations in the market from time to time. Yet gold's kind of marched along, right? It's continued to do its role of being a store of value. Walk us through that a little bit. What do you think about gold over the last year? How happy or dissatisfied are you with this performance and help our listeners think about that going forward as we continue to see some of this nagging volatility in the market?

Ronnie Stoeferle: If we take a step back, gold has done nothing. It has stayed to be gold for the last 5000 years and as far as I know, it's still in our vault. An ounce is an ounce. The purchasing power of currencies has fluctuated quite wildly. But I think that gold has done its job well as a solid defender in your portfolio. I think it's now really time to play defense. We are seeing lots of turbulence in many markets and those crises always start in the periphery and then move to the center. And we already saw last year that all those COVID memes stock started getting slaughtered. Now we are seeing darling stocks like Apple, Amazon and Tesla; all those tech stocks that did so well over the last couple of years are now down between 20% and 60%. We are seeing enormous turbulence in bond markets. I think Jim Bianco said it's the worst start of the year for bond markets, for U.S. Treasuries, in more than 100 years. We're seeing turbulence in many commodity markets. Everything basically except for energy. If you have a look at lumber prices, if you have a look at copper, if you have a look at aluminum, we are seeing lots of turbulence, obviously also in crypto markets.

The fact that gold in U.S. dollar terms has been flat, or it's even up slightly, is a positive sign. Again, in Euro terms, it's up 9%. I'm talking to private bankers over here in Europe. They are pretty nervous because they have to send out their quarterly statements to their clients in a couple of days, and already in the first quarter for so-called conservative balance portfolios, they were down between 8% to 12%. Now the second quarter is even worse. Clients are down, let's say 30, up to 35, 40% in conservative portfolios. And then on top of that, you've got inflation running at 8%. There's enormous wealth destruction happening, so I think we shouldn't get too greedy. I believe that gold did its job pretty well. I'm not super excited with the performance of gold, but I think given the turbulence that we're in, I think gold did quite okay.

Ed Coyne: We talked about this a little bit last year and I think it's worth revisiting. Often people talk about gold and the miners, gold and gold equities in the same sentence. Some look at it as simply a levered trade to the price of gold. Others look at it as two separate allocations, as we do at Sprott. We look at the physical market in general; whether it's gold, silver or other metals as a low-cost liquid way to hedge a portfolio, balance a portfolio, maybe complement bonds and cash in a portfolio. But mining stocks are stocks, right? There are opportunistic allocations. It is true that as the price of the metal expands the margins potentially expanding these companies. But how are you feeling, or what are you seeing in the mining market? Because the large-caps have held up quite well year to date. Small caps, not so much within the mining space, the seniors versus juniors. What are you seeing out there right now in the mining space from an opportunistic standpoint or an allocation standpoint?

Ronnie Stoeferle: I think you're right. We always differentiate between safety gold and, on the other hand, performance gold. And suppose you want to hedge against worst case scenarios, against high inflation, against currency reforms, whatever. In that case, you have to think about your gold allocation and minimize counterparty risk. I think this is crucial. But on the other hand, if you say it's kind of a nasty correction, but the world will continue to move on and we're close to the lows, then I think it also might make sense to consider performance gold, which could be futures and options on gold miners, and also the mining space itself. As you said, the large-cap miners are doing pretty well. Of course they have to deal with cost inflation, mostly energy, but also labor.

I'm seeing pristine balance sheets. I think the companies did a good job over the last couple of years, basically over the bear market to get their books to deleverage, decrease debt, and focus on creating shareholder value and creating free cash flow. I think it is a little bit too early to call the bottom.

And the reason is, from my point of view, we are already in a recession. The GDP indicator for the first quarter was already negative. The second quarter is basically at zero when I looked at it last week. It's already borderline official recession. At some point, the Federal Reserve will realize it went too far and have to make this U-turn or at least hit the pause button on rate hikes and quantitative tightening. They are way behind the curve; everybody knows that. I think this will be the point in time when gold, silver and mining stocks start taking off. I think now it's a little bit like dinner is prepared, but nobody did ring the bell yet and said, as they say in Italy, "a tavola. *Come to the table, we're having dinner now."* I think this is a nice setup. Coming back to the mining stocks, they are one of the few value picks out there. I'm seeing dividends between 3%to 6% for the large caps. I'm seeing an enormous amount of free cash flow. They are buying back shares. I see insider activity in many stocks. I think it's a great setup for a long-term investor. For a speculator, perhaps it might still be a little bit early. I think this is already kind of a positive sign because we are seeing so much bearishness despite the fact that gold is holding up so well.

Ed Coyne: We would agree with that. We've seen many larger institutions start to show interest, whether through RFPs or DDQs, that kind of thing. We're starting to see that as well. The appetite continues to grow. You mentioned something about the Fed and being behind the curve and maybe potentially taking a pause. Specifically, here in the U.S., we're focused on the elections in November and it'll be interesting to see the game of chicken that gets played there.

One of the things I think that keeps coming up is debt. Does it matter anymore? Do people care about it anymore? What does it look like on the balance sheet? In the abridged version, you have a great graph on page 15. It talks about central banks' balance sheets as a percentage of GDP in 2007 versus 2021. And it almost looks made up when you look at the drastic difference between what 2007 balance sheets look like and what 2021 balance sheets look like. I've got to believe as we raise the cost of capital to try to combat inflation, we're just going to crush ourselves because the level of debt we have is just insane - probably the best way to word it when you look at it.

Does that matter? And that's the biggest question. People are trying to figure out how destructive is debt, particularly when the cost of servicing that debt is going up. How destructive is that to the economy? And what does that mean for gold?

Ronnie Stoeferle: We wrote an entire book about that topic. It's called The Zero Rate Trap and we published it in 2019. I think it's still a very good read. And we made the case that the higher the debt, the greater the sensitivity to rising rates. People tend to forget that we're coming out of a two-year COVID crisis where it felt like governments are taking care of everything. *Dear taxpayer, you don't have to do anything. Just sit on your couch, order food and watch Netflix and we'll compensate for everything.* But at some point, those bills have to be paid. And now, after two years of an unprecedented COVID crisis, we're moving into the next crisis. People tend to forget that the servicing costs for debt are approaching levels that are impossible to cover anymore. And I think it would be extremely naive, and you probably have to be a Fed economist to say it doesn't have any impact. It has a huge impact on consumption. And I can tell you over here in Europe, inflation is the main topic. You're seeing it on the news.

Only Mr. Putin is being blamed for high inflation rates; it's not the money printing, not the fiscal largesse, it's only the Russians. That was kind of the icing on the cake. But people tend to forget that inflation rates and energy prices rose significantly before Russia invaded Ukraine. And the problem with inflation is, if you talk to people from Turkey, for example, if you speak to people from emerging markets in general, I think it's the inflation psychology. Once we've got this inflationary mindset in our heads as consumers, business owners and investors, it's really hard to return to a normal, moderate inflation environment. Real estate markets and other illiquid investments will be the next pockets that will become nervous. If you talk to private equity guys, they fear big redemptions in a market where nobody is interested in buying risky stuff. I think we are already in a recession. It will become a nasty recession. And at some point, central banks will have to reverse. And the big question is, can they do it without completely losing their face and losing trust in financial markets?

Ed Coyne: I think those two keywords, trust and confidence, are everything, right? You're seeing the lack of trust in the markets. You're seeing the lack of believability and the Fed's ability to soft land this. It'll be interesting to see how that plays out over time. And once again, it looks like the gold side of the allocation seems to be doing its job, which is great to see.

The commodities in general, right - so often when people say oh, I've got my gold exposure, I have a commodity fund, or when they talk about commodities, they lump gold in with that. But gold has its personality. Gold, I like to say, is more of a monetary metal where all the other metals are more consumer or used or consumed. There are some things you can use gold for outside of pure store of value or protection or diversification. But generally, it's viewed as a monetary metal even though it is a commodity. Talk about that a little bit because so often people think commodities are commodities, I just going to own a basket and I'm going to get the benefit of that basket. But so often, in a commodity fund per se, gold is such a small piece of it. I like to say gold is the original alternative investment. But how would you frame that? How should people invest or consider gold when looking at how to protect their portfolios going forward? How can I continue to invest in the markets knowing I have to invest in a safe, secure way and diversify? Or how do I stay invested if I have a fixed pool of assets and I'm drawing it down for income purposes in retirement? How do I stay invested? Talk a bit about how you see gold relative to the other commodities in the world today.

Ronnie Stoeferle: That's a pretty complex question and one of the funds that Mark and I manage, we've got a very active commodity exposure. But I think it's, as you rightly say, it's important to differentiate between commodities and gold, which I regard as a currency, as money, as a competitor to the US dollar, to the Japanese yen, to the euro, whatever. I think the main reason for that is the so called stock-to-flow ratio. Gold has a tremendously high stock-to-flow ratio, meaning that over the last, let's say 5,000 years, we accumulated an enormous amount of gold, more than 200,000 tons. And as the value of gold is not being created by destroying it, by burning it like it is with fossil fuels, for example, with oil, with net gas and so on, people tend to hoard gold. And therefore, gold has a very high stock-to-flow ratio. While copper, for example, the warehouses are full for four or five months. We're seeing it now in the energy space that there are very few reserves out there, that even the national reserves have to be tapped, that there's very little spare capacity.

If you have issues on the supply side, it has a much higher impact on a commodity with a low stock-to-flow ratio because there isn't too much stock out there. This is the main difference that I would regard when it comes to making the case for commodities themselves. I think it's worth having a very close look at the 1970s, a stagflationary decade where I see many similarities and differences between now and the 1970s. But I think many of the root causes of the 1970s explanation obviously can be found in the 1960s, like many of the root causes for the troubles we are having can be found previously. I think people tend to forget that we saw an enormous amount of underinvestment in the commodity space throughout the bear market. At the moment, we roughly, and this is based on a great GMO paper, consume approximately 40% more commodities than 15 years ago.

For example, net gas, iron ore, and copper and it's somewhat surprising that CAPEX levels are at a 15-year low at the moment. I think the capital intensity of commodity production has risen substantially recently. We're seeing it in the oil space; we're seeing it in the gold space. I wouldn't call it peak oil or peak gold, but I would rather call it peak cheap gold and peak cheap oil. It's just significantly more expensive to get it out of the ground. There's still enough out there and obviously, technology moves very fast. But when it comes to commodities, I think this under investment, this lack of CAPEX is one of the main drivers and it's just not so easy with now having higher demand saying let's bring a copper mine online and start producing more copper. There are huge time lags involved. And I think we should not forget the ESG component, The Zero Banking Alliance, for example. It's bringing together the big banks worldwide. It's representing roughly 40% of global banking assets. All the big names, Morgan Stanley, JP Morgan, Bank of America, and Goldman, are all in and they kind of signed a commitment to reinforce and accelerate the implementation of decarbonization strategies.

I talked to many of those bankers and for them touching everything that has to do with commodities doesn't feel so well because it's kind of a bad reputation for whatever reason. When it comes to the whole ESG topic, the learning curve is steep, and we're seeing this kind of renewed green demand in the commodity space. We're seeing it in lithium, we're seeing it with cobalt, obviously, but I think when it comes to energy but also when it comes to copper, when it comes to gold, I think we are seeing the cost of capital rising significantly which from my point of view will lead to higher commodity prices. I think those are two topics, lack of CAPEX but also ESG, increasing the cost of capital. I think those are two really important drivers that many market commentators tend to forget, and they are very long-term drivers.

Ed Coyne: Just hearing you say that makes me think that one of the most established investments out there, gold been around the longest, on the brink of going out of favor when people weren't thinking about it a decade ago. And it's probably more relevant today than in decades, even in the face of cryptocurrencies. And I'd be remiss not to bring up cryptocurrencies just with the volatility we've seen in the last couple of weeks or months, but for the longest time, people often talked about cryptos as modern gold or a replacement for gold. And what we're seeing just from a pure volatility and a trading pattern standpoint is probably one of the more opportunistic trades you can make out there and it's almost a polar opposite of what gold represents and what gold has done in a portfolio. Talk just a little about how gold continues to do what it's done relative to the perception or reality of cryptocurrencies in the market today. What's your view on that?

Ronnie Stoeferle: I have to say that regarding crypto, or let's say Bitcoin in particular, we are not that negative. We're pragmatic and opportunistic investors. I bought my first Bitcoin, I think, in 2012. I sold most of it way too early, as my wife often reminds me. I believe there are 20,000 cryptocurrencies out there and there are 170 fiat currencies out there. It would be naive to think that all of them will survive. And 99.9% of all the cryptocurrencies out there are rubbish and won't probably survive this bear market. But when it comes to Bitcoin, I think from my point of view, it's quite binary.

I think in the gold space we should welcome competition. We are free-market people. I think it's good to have competition in currency markets. As I said, it makes the product one of the most important things, money, which is a storage facility for life energy.

I think monetary technologies have to be solid. Gold has made the case over the last 5,000 years that it's a pretty good monetary technology. Bitcoin has been around obviously for a way shorter time. We should, as gold guys - let's put it that way, I think we should be open to it and say let's discuss money. And this is what I love about the discussion going on, even though I have to say sometimes it bugs me on Twitter that there's the gold camp and the Bitcoin camp. And I said we should stick together and say those are two opportunities and two ways to hedge against the monetary insanity that we are currently experiencing. I don't think gold is the enemy of Bitcoin, and Bitcoin is the enemy of gold. I think they're kind of related parties. They're like cousins. But the real competitor probably is fiat currencies. And I don't see a way that in 2, 5, 10 years, the purchasing power of the euro, the U.S. dollar, etc., will rise significantly, especially measured in gold terms.

Ed Coyne: I think you hit it right on the head. For years, particularly when I started at Sprott over half a decade ago, it was gold versus Bitcoin. And you're right. And you can kind of throw out a lot of the other cryptocurrencies out there, right? They're just sort of chasing the car down the street. But it seems like there has been a gradual shift of gold versus Bitcoin to gold and Bitcoin and viewing it as money, as currencies, as alternative ways to allocate away from the market. We're even seeing it within some of the private families we work with; they're using gold to complement or hedge their crypto or risk on trades in general, and they have them in separate buckets or pools of assets. I really appreciate your insight on that because I think that's something continuing to evolve in a relatively short time. And I think those two roles and how they work together will continue to evolve as we move forward.

Ed Coyne: Ronnie, we took a lot of your time. We appreciate your words of wisdom. I think there's a lot of great stuff in your *In Gold We Trust* report every year. For our listeners who want to find this, download it, read it, use it, and understand it. How do they do that?

Ronnie Stoeferle: It's fairly easy. We've got our webpage ingoldwetrust.report, and there you can download it free of charge, as I've said, thanks to our premium partners, Sprott being one of them for many years now. It's free of charge in German, English, Mandarin and Spanish. There's the compact version, but there's also the triple X version for your vacation, roughly 400 pages. We do have a monthly gold chart book that we also send out for free. We've got special chart books. We've got In Gold We Trust nuggets. Everything is available free of charge. You don't have to give us your email address or register for anything. You can just download it. And if you want to look at our products, our company is called Incrementum. Incrementum.li, which stands for Lichtenstein. And I'm pretty active on Twitter and my handle is @RonStoeferle.

Ed Coyne: Fantastic, Ronnie. Thanks again for your time. You're listening to Sprott Gold Talk Radio and I'm your host, Ed Coin. Thank you.

Ronnie Stoeferle: Thank you very much. All the best.