



## Gold, Mines & Natural resources... A mixed 2017

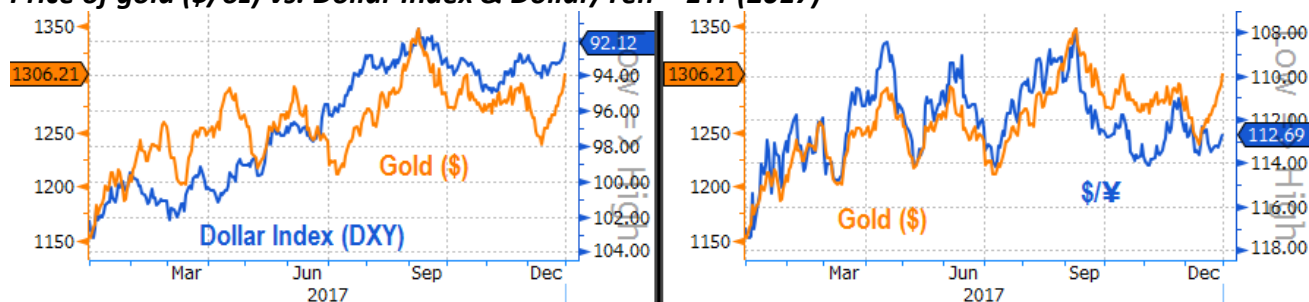
Arnaud du Plessis - Senior Portfolio Manager, Global Thematic Equities, Natural Resources / Gold & Precious Metals CPR AM

Although the year was positive for natural resources overall, their performance lagged the global markets. 2018 could offer better prospects, an uptick in inflation being perhaps the best scenario for the theme.

Gold prices ended 2017 above the \$1300/oz threshold, rising by around 13.3% (\$). The weak dollar (Dollar Index), which fell by around 10% against the main currencies, was the main support for the yellow metal. Investors' risk aversion, for its part, was fairly moderate, and was unable to offer a boost, in fact quite the opposite. US real interest rates had no significant impact, as they were flat over the period. There was a sharp positive change in inflation expectations, on the other hand, starting from mid-year, which could be the surprise for 2018.

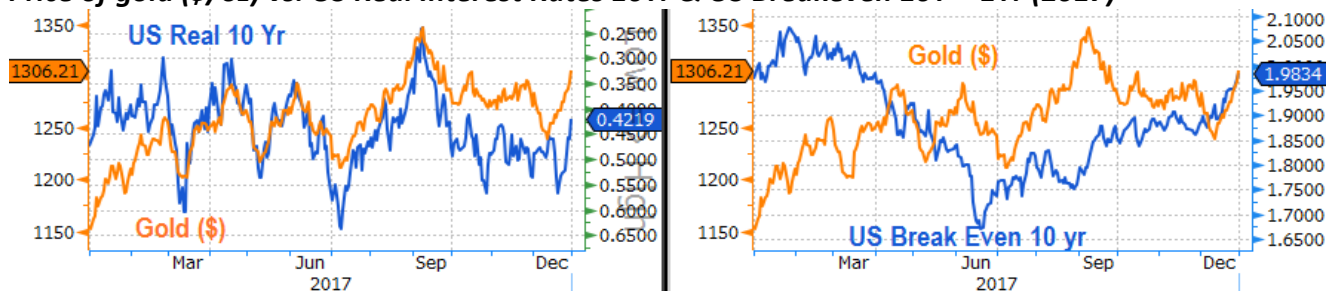
As predicted, the FED raised its policy rates at the last FOMC meeting of the year and, once this had taken effect, gold prices considerably rebounded, as in 2015 and 2016.

### Price of gold (\$/oz) vs. Dollar Index & Dollar/Yen – 1Yr (2017)



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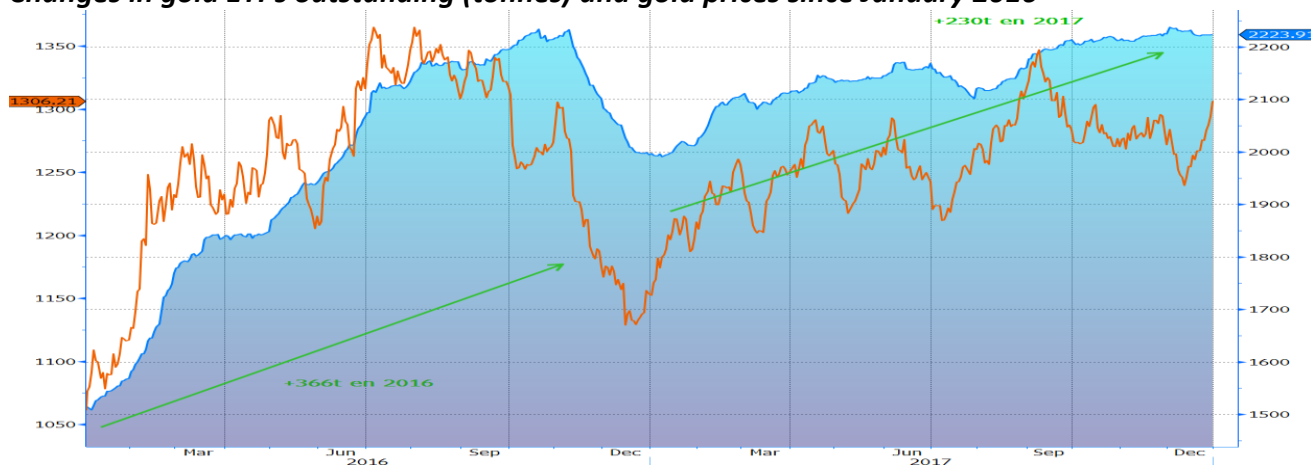
### Price of gold (\$/oz) vs. US Real Interest Rates 10Yr & US Breakeven 10Y – 1Yr (2017)



Source: Bloomberg

There was strong demand on the market for gold-backed ETPs in 2017, with outstandings up by 230 equivalent tonnes. For the 2nd year running, investors increased their positions, but global outstandings are still far from the record observed at the end of 2012 (2670 tonnes).

### Changes in gold ETPs outstanding (tonnes) and gold prices since January 2016

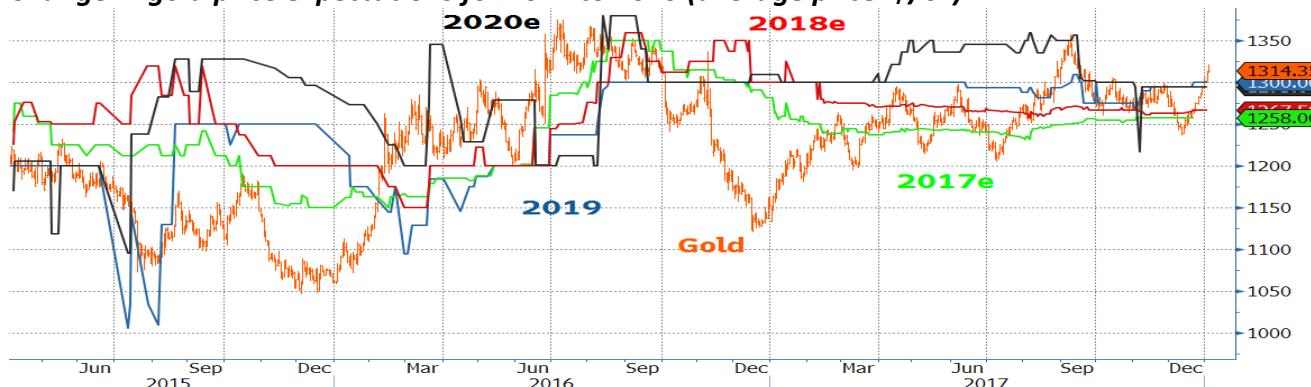


Source: Bloomberg

On the physical gold market, India made a big comeback, with gold imports (855 tonnes) up 67% year-on-year in 2017, as jewellers built up their inventories again on a huge scale as demand reawakened. The upswing in purchases in India, which is the 2nd largest market worldwide after China, is likely to maintain prices. The change in the US dollar and US real interest rates will be the other major indicators to follow to try to stay ahead of the trend.

In the meantime, the market's expectations for 2018 are still very modest at this stage, with a forecast average price for the year of \$1267/oz vs. \$1258/oz recorded in 2017 (vs. \$1281/oz expected at the start of the year).

### Change in gold price expectations for 2017 to 2020 (average price: \$/oz)

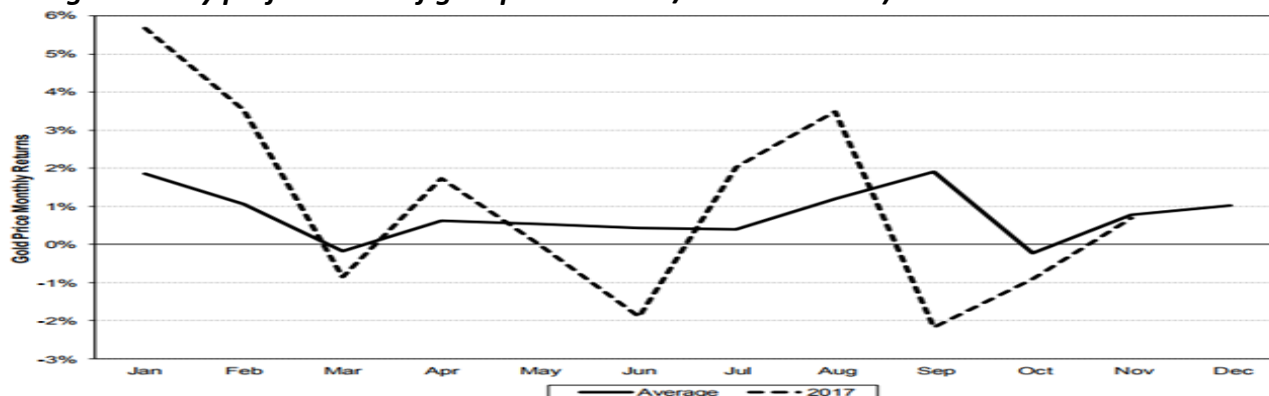


Source: Bloomberg

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Note that the seasonality of the gold market is traditionally quite positive at the start of the year, which is often the best time to invest in the theme, along with the summer period.

#### **Average monthly performance of gold prices – 1971/2016 and 2017)**



Source: Bloomberg – Scotia Bank GBM

As for gold mines, the last four years got off to a buoyant start, before tailing off. Will the pattern be repeated this year?

#### **Change in gold mining stock prices (NYSE Arca Gold Miners Index) – 2014/2017)**

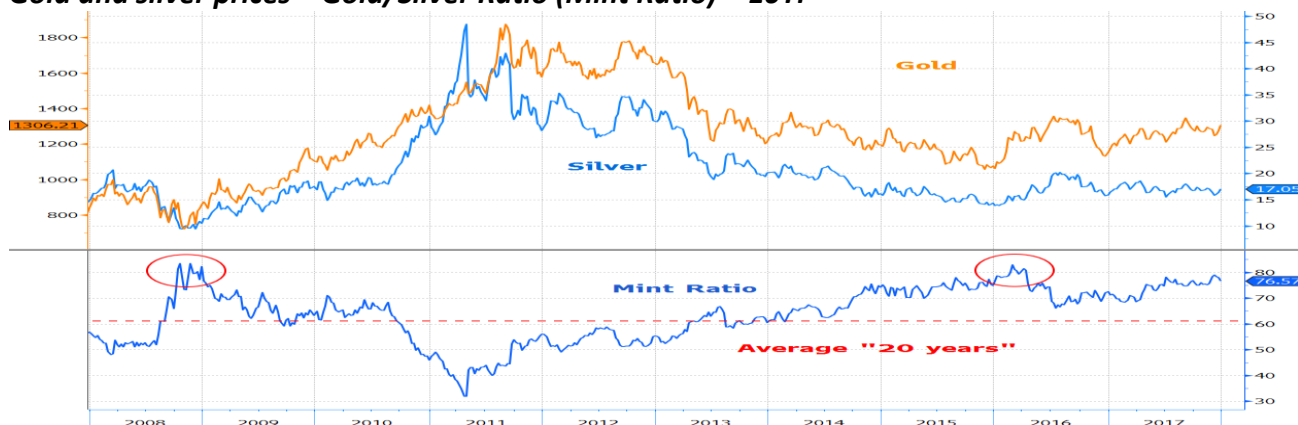


Source: Bloomberg

#### **Other precious metals**

Other precious metals had varied fortunes in 2017. Although they gained ground over the full year, the performance of silver was far from amplifying the performance of gold; quite the contrary, with a price rise of only 7.4% (\$) compared with 13.3% (\$) for gold. The mint ratio (gold/silver ratio) ended the year at around 76.5x, far above the averages seen over 10, 20 and 30 years, standing at 63.5x, 61.5x and 66.5x respectively, suggesting that a significant catch-up is possible.

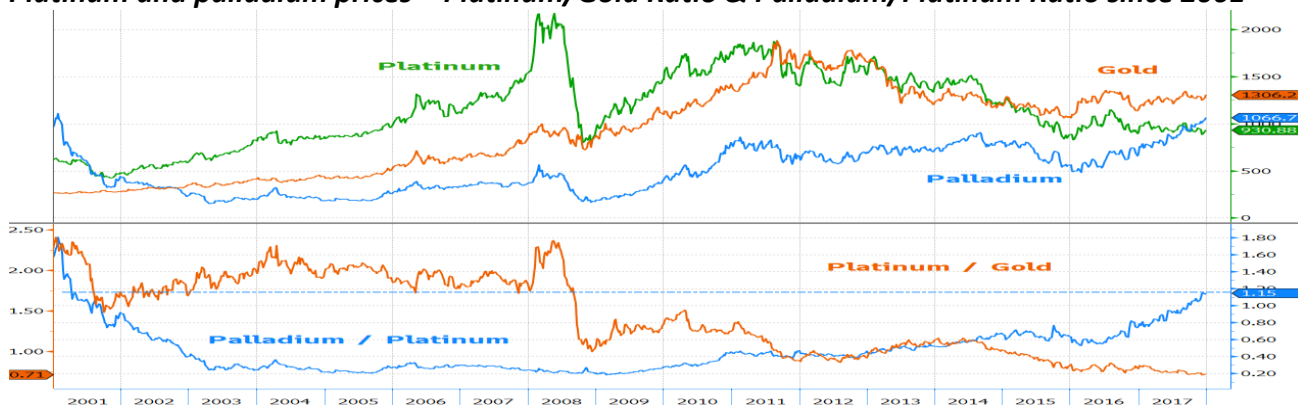
### Gold and silver prices – Gold/Silver Ratio (Mint Ratio) – 10Yr



Source: Bloomberg

Palladium, which gained more than 56% (\$) over the full year, was the undisputed star of 2017. Palladium prices ended the year above the \$1000/oz threshold, returning to their level in 2001 and largely exceeding platinum prices. Platinum was the poor relation, rising by only around 3% (\$) and ending the year at a record low relative to gold, with a platinum/gold ratio of only 0.71x, which is unheard of.

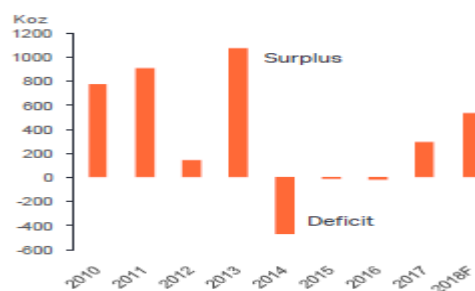
### Platinum and palladium prices – Platinum/Gold Ratio & Palladium/Platinum Ratio since 2001



Source: Bloomberg

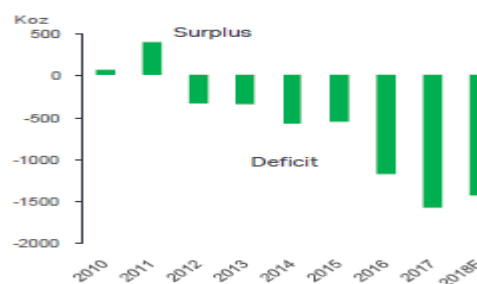
Given the unavoidable decline of diesel and the structure (supply/demand) of the platinum and palladium markets, palladium is set to retain its appeal over platinum.

### Platinum Physical Surplus/Deficit



Source: Metals Focus

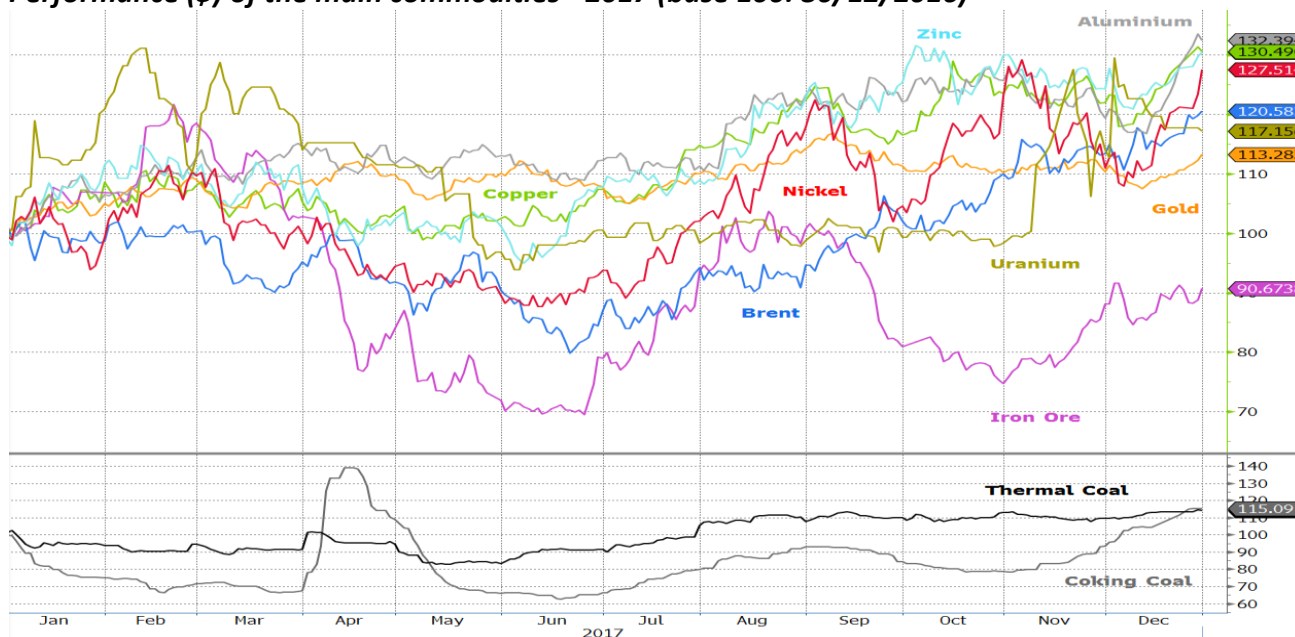
### Palladium Physical Surplus/Deficit



### What about other commodities?

It was a boom year for industrial metals, with rises of more than 30% (\$) for aluminium, copper and zinc, closely followed by nickel (+27% - \$). Even uranium and thermal coal, whose uses are so heavily criticised, ended the year up 15%/17% (\$). Only iron ore, which is always very volatile, finished on a low (-9.6% - \$). After such a movement, combined with an already positive 2016, we might legitimately wonder about the potential for the future. Note, however, that in spite of the rise observed, the majority of metals are very far from making up the ground lost from mid-February 2011 until the end of 2015. Only zinc prices are above their level in 2011 (+35% - \$). Aluminium, copper, iron ore and nickel prices are still down, by 9%, 28%, 48% and 56% (\$) respectively. Meanwhile, the economic outlook, especially for China, is still sound, with the publication of a manufacturing PMI (Markit) at 54.5 in December, its highest level since the start of 2011.

### ***Performance (\$) of the main commodities - 2017 (base 100: 30/12/2016)***



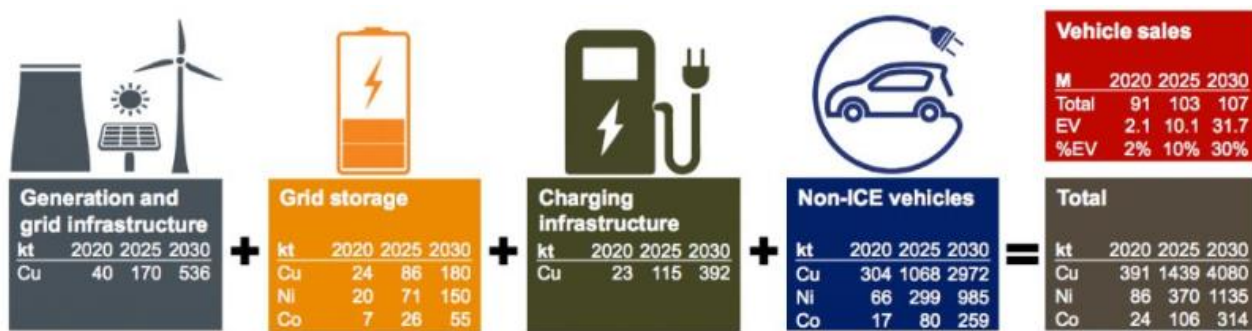
Source: Bloomberg

The upcoming development of electric cars will continue to substantially affect trends. The London-based business intelligence firm CRU reached the following conclusions, taking into account the relatively modest market shares to be gained by electric vehicles by 2020 and 2030:

According to their analyses, although electric vehicles should account for only 2% by 2020, the impact on the demand for certain metals should already be very considerable, including a need for an additional 390,000 tonnes of copper, 85,000 tonnes of nickel and 24,000 tonnes of cobalt. With 32% of sales forecast for 2030, the extra demand should therefore amount to 4.1m tonnes of copper (around 20% of the quantity produced in 2016), 1.1m tonnes of nickel (around 56% of the quantity produced in 2016) and 314,000 tonnes of cobalt!



## Change in the expected demand for the main metals attributable to electric vehicles

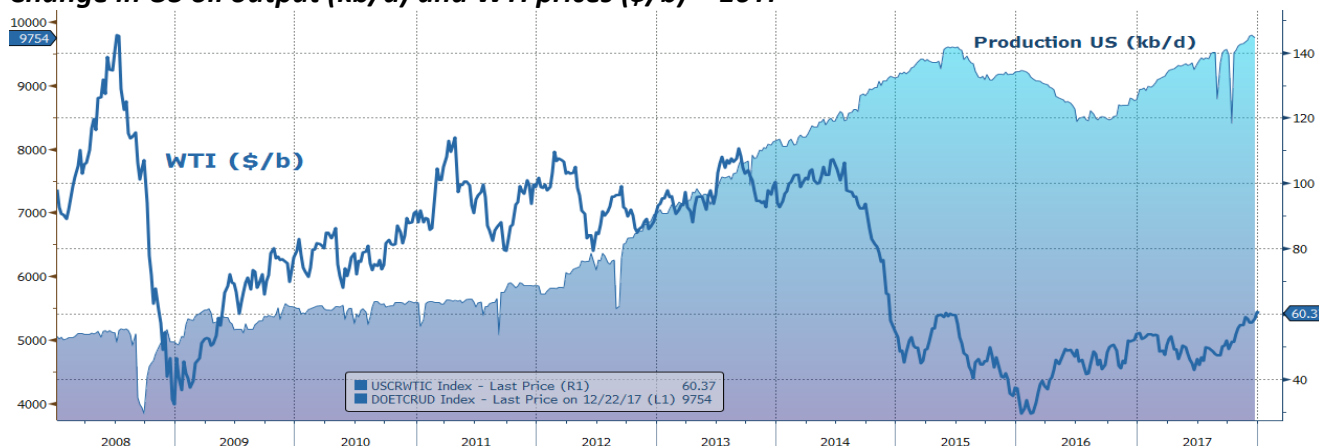


Source: CRU "Mobility and Energy Future - Perspectives towards 2035", prepared for Glencore by CRU Consulting - "Green" Scenario. See slide 26 for more detail on modelling framework. (1) The Electric Vehicles Initiative is a multi-government policy forum comprising Canada, China, Finland, France, Germany, India, Japan, Korea, Mexico, Netherlands, Norway, Portugal, South Africa, Sweden, UK and USA. <http://www.cleanenergyministers.org/News/new-cem-campaign-aims-for-goal-of-30-new-electric-vehicle-sales-by-2030-85068>.

Source: Glencore

The rebound in oil prices continued in 2017, as they returned to their level of May 2015, while still being far from the levels reached in 2011/2014 of around \$100/125/b. The decision made by OPEC and certain other countries, such as Russia, to maintain their output cuts, clearly offset the rise in US output, which exceeded its previous 2014 peak before falling.

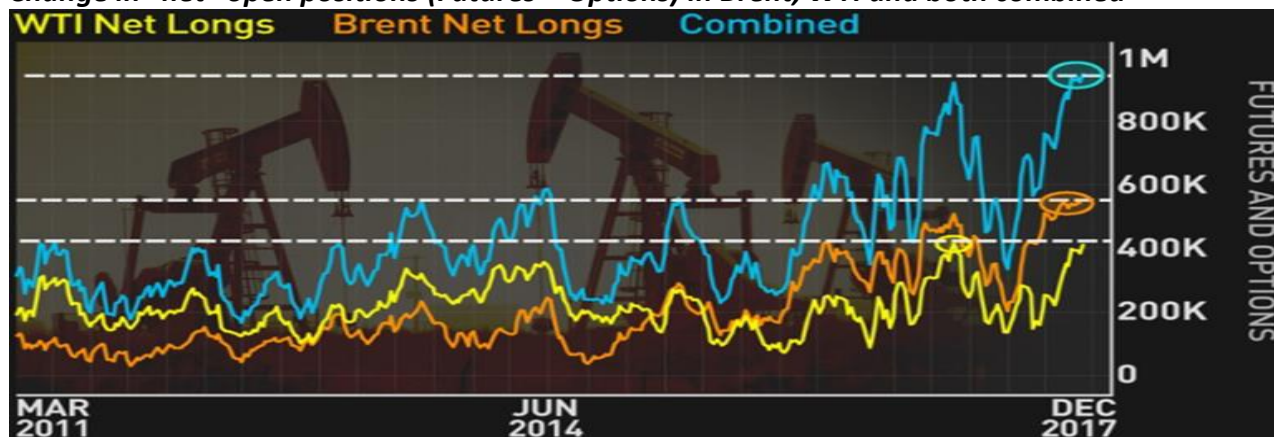
## Change in US oil output (kb/d) and WTI prices (\$/b) – 10Yr



Source: Bloomberg

With regard to the market, hedge funds have never been so optimistic if we believe the positions taken on the futures and options markets, which are at historic highs. Is this a worrying indicator?

## Change in "net" open positions (Futures – Options) in Brent, WTI and both combined



Source: Bloomberg

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The market's expectations for 2018 have changed very little in recent months and seem very low considering the rise seen in the last few months. After an average of \$54/b observed in 2017, investors are now forecasting an average price of only \$58/b for 2018 and \$63/b in 2020.

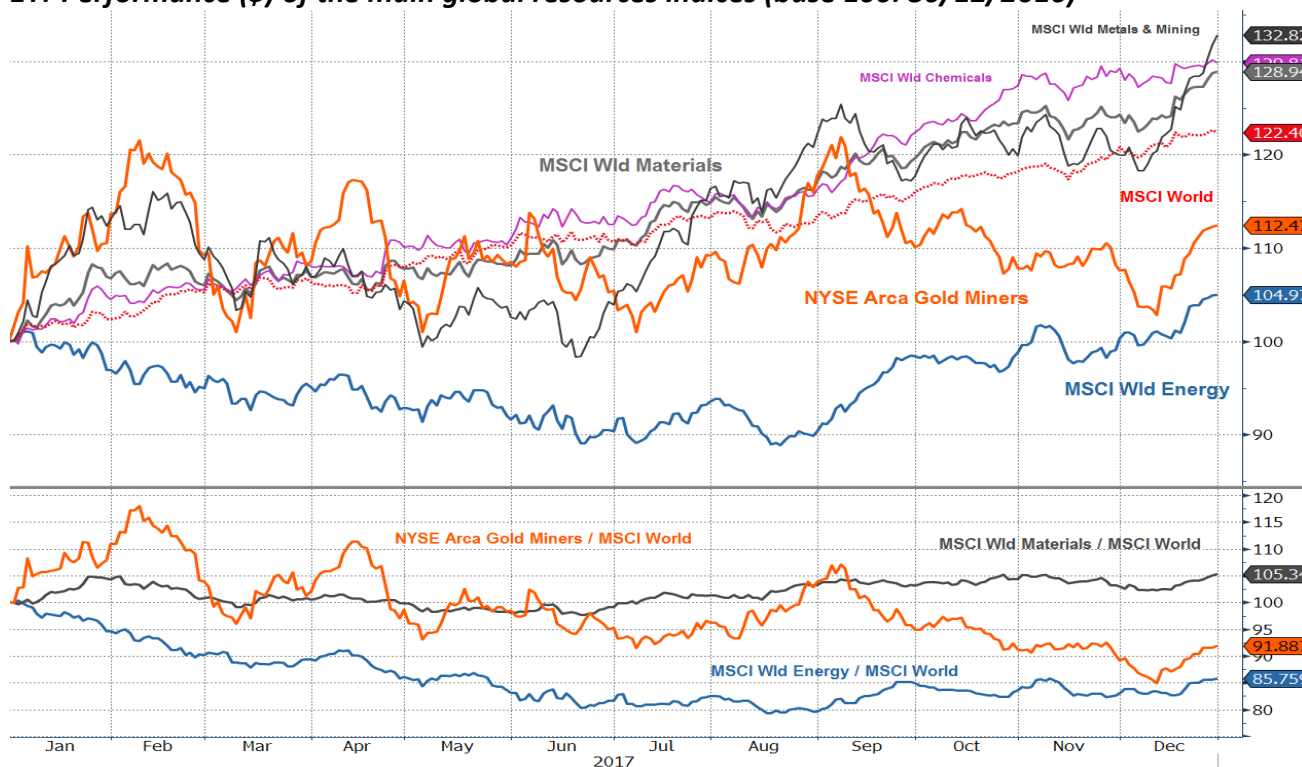
### ***Change in Brent price expectations for 2017 to 2020 (average price: \$/b)***



Source: Bloomberg

**Stock market overview** – The natural resources theme as a whole ultimately ended the year on a positive note. The performance gap between the different segments, in excess of 25%, is significant, however. Industrial mining stocks were the big winners, performing particularly well, in line with metals. Chemical companies also made a large contribution to the excellent performance of materials in general, throughout the year. The energy sector, on the other hand, was very disappointing in 2017, despite the rebound in crude prices. Gold mining stocks finished the year mid-league table.

### ***1Yr Performance (\$) of the main global resources indices (base 100: 30/12/2016)***



Source: Bloomberg

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The rebound in crude prices from mid-June ended the oil sector's counter-performance compared with global equities. Oil companies are far from having caught up on the lag in their performance, however, contrary to similar situations observed in the past. Whereas Brent prices surged by nearly 50% (\$) from their low point in June, the sector's performance relative to global equities was only positive by 5%, leaving room for considerable revaluation potential.

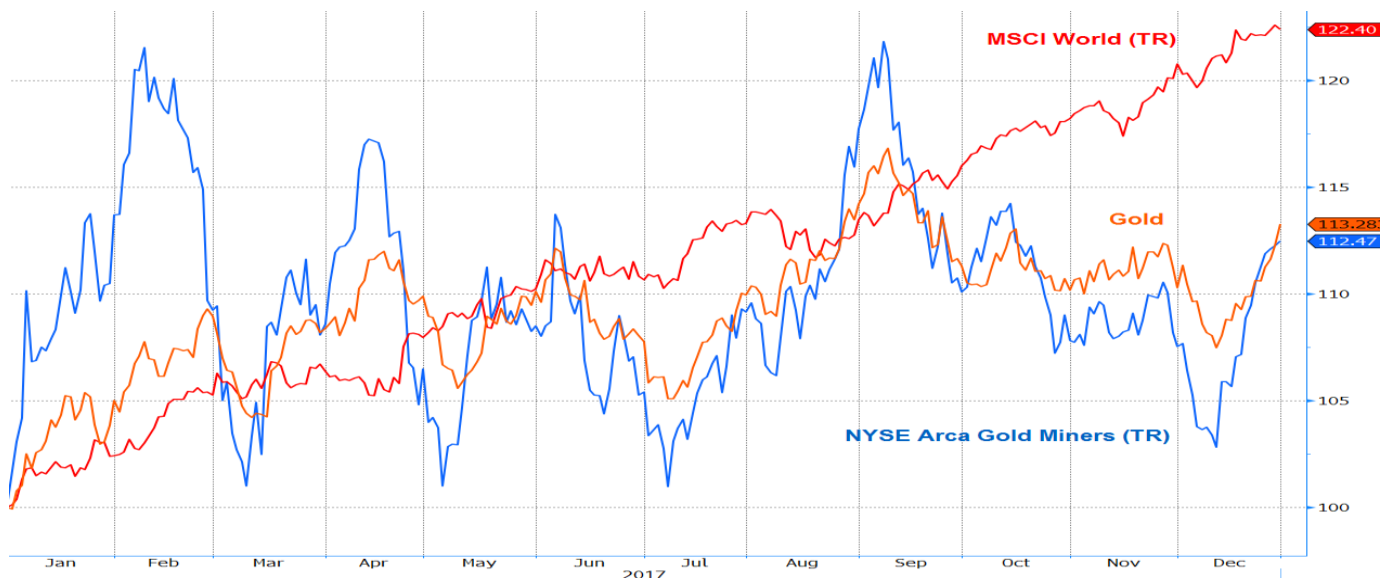
### **Relative performance of MSCI World Energy vs. MSCI World (\$) & Brent – 5Yr**



Source: Bloomberg

Gold mines ended 2017 with a performance very similar to physical gold, although, unsurprisingly, it was more volatile in line with the fairly significant back and forth movements throughout the year. In detail, performances were very mixed, even for major stocks, with rises of close to 175% (\$) and falls of more than 50% (\$), underscoring the highly specific nature of this industry and making investment an especially difficult exercise.

### **1Yr Performance (\$) of gold, gold mines and global equities (2017) – base 100: 30 December 2016**

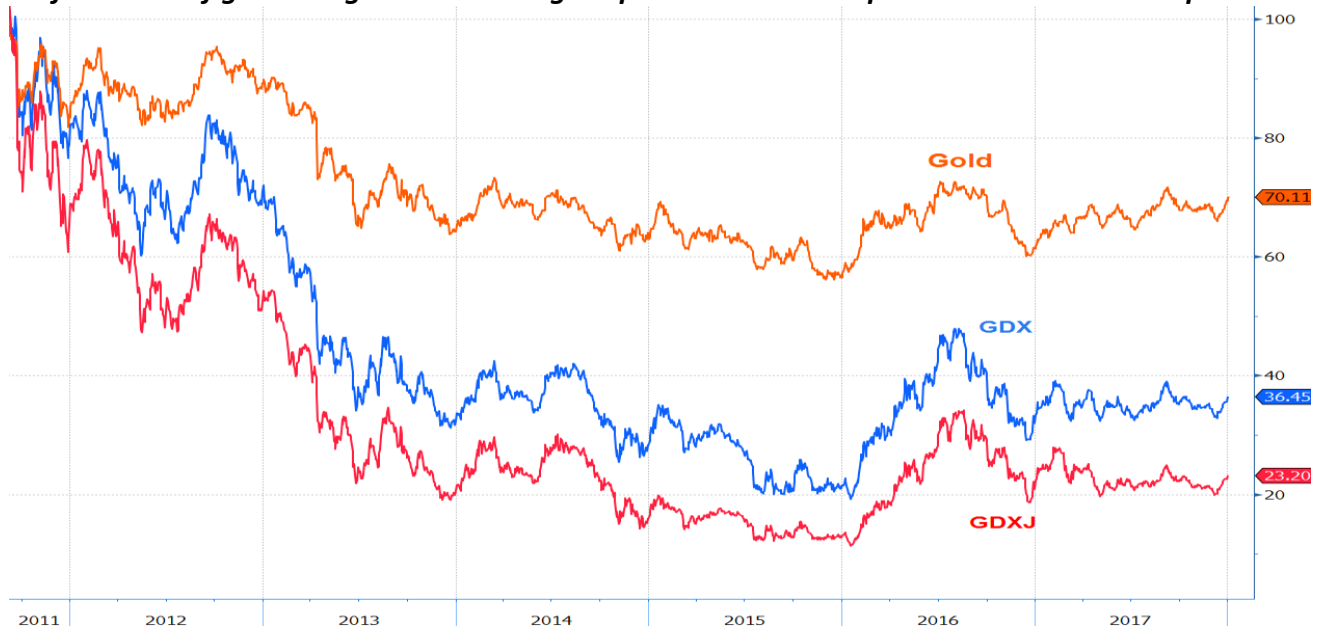


Source: Bloomberg



Since the peak reached in September 2011, and in spite of the rebound seen since the start of 2016, gold mines are still recording very substantial falls, ranging from 77% for small caps to 64% for the largest caps, greatly exceeding the 30% fall in gold prices over the same period. The crossing of the \$1350/1375 threshold would offer a very significant source of earnings and returns for the sector.

***Performance of gold and gold mines - large caps: GDX - & mid-caps: GDXJ since the 2011 peak***



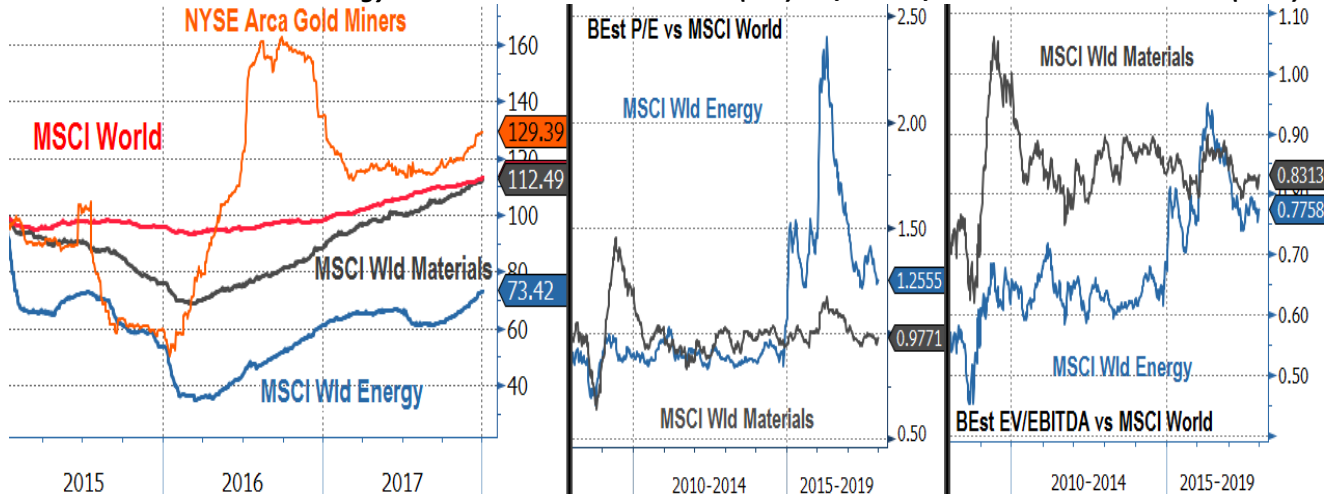
Source: Bloomberg

**Valuation of Natural Resources** – With the exception of gold mining companies, whose expected earnings for 2017 were revised down by 5% for the full year – after reaching a low of -17% in March, energy and material stocks were largely revised up, and particularly those benefiting from forecasts that beat their January 2017 level by more than 26%. Earnings revisions were less stable in the energy sector. They fell back to zero in mid-July, one month after oil prices troughed, before picking up in the wake of crude prices, ending the year up 20% on January.

Over three years, since the fall that began in September 2014 and continued until March 2016, earnings revisions in the energy sector are still in considerable decline. Gold mining stocks, for their part, have retained their lead, but this is due to the very low base (12-month earnings forecasts are still down by more than 75% on their level 5 years ago!). Materials have completely caught up with global equities, however.

On the valuation side, based on the earnings forecasts for the next 12 months, the energy sector is continuing to normalize, but its valuation remains relatively high, which may partly explain the sector's under-performance compared with oil. The current valuation of materials is close to its historic average.

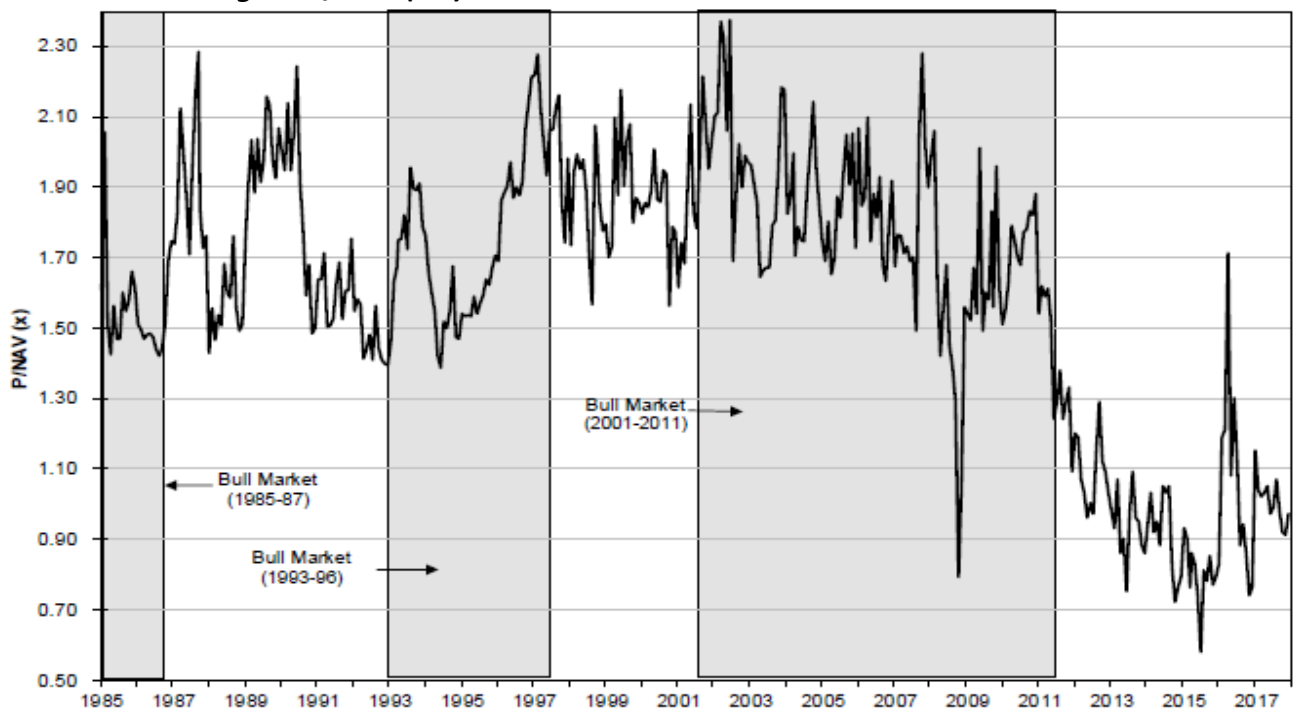
### Gold mines – MSCI World Energy & Materials: EPS Momentum (3Yr) – P/E & EV/EBITDA vs. MSCI World – (10Yr)



Source: Bloomberg

There has been no real change for gold mines according to the net asset value approach (P/NAV). Note, however, that given its valuation multiple of less than 1x, the market still doesn't believe in the gold sector's ability to increase the valuation of its mining assets. To be continued...

### Gold mines – Change in P/NAV (5%) since 1985



Source: Scotiabank GBM estimates - Company reports

Written on 4 January 2018

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