ADRIAN DAY ASSET MANAGEMENT

PORTFOLIO REVIEW

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This was a difficult quarter for us, with overvalued stocks and sectors becoming even more overvalued, while gold unexpectedly languished. With many economies around the world beginning to re-open, and with central banks continuing to provide more-than sufficient liquidity, we expect equities to continue to move up, while gold should catch a bid soon. We discuss both of these expectations below. This flood of new credit has other ramifications as well, though, beyond those on the market, and they are less positive in the long run.

Most stocks markets up

Most stocks markets around the world were up this quarter just finished, though there were some losers, particularly in Asia. Brazil and Switzerland were the only two major markets in Europe and the Americas down on the quarter (in U.S. dollar terms), while in Asia, Japan, China, Korea, Malaysia and Indonesia all fell. Top performing markets were Singapore and Sweden. If there was a "theme" it was that generally, the top-performers last year were at the bottom of the list while the worst-performer rose to the top.

Most sectors, other than metals and mining, were also up, though there was some rotation from tech--the Nasdaq was the worst-performer of the major U.S. indices--into consumer stocks and value.

The S&P was up just over 6% (dividends reinvested), with the world outside the U.S. up less than 3%. Global funds rose just under 4.4% (per Bloomberg Index). Our accounts meaningfully under-performed with our mid-risk "global growth" accounts declining over 5%, while our conservative accounts were up 2%.* (All numbers are preliminary.)

The reasons for the underperformance this past quarter were two-fold. First, for the most part, we were not in the top performers, either markets or sectors and certainly not fully invested in the broad market. Second, our gold exposure, after boosting returns last year meaningfully, was a drag on performance this year. We are less concerned about the conservative account: 2% per quarter is still acceptable while we held a lot of cash. The performance in the mid-risk accounts will recover if gold turns around.

Commodities mixed with gold and silver down

As always, the commodities were mixed. The imperfect Bloomberg Index rose almost 8%, but that hides some diversity. Oil was the strongest performer, up over 20% on every benchmark. Other than copper, most of the other commodities up were less mainstream and less "tradeable": aluminum, steel, corn and soybeans. Worst performers, all negative, were precisely those with producers who trade: gold, silver and nickel.

Our resource accounts fell just under 9%; that's not as bad as gold, though our high exposure to gold and gold stocks obviously did not help us.

Gold fell almost precisely 10% for the quarter, virtually the same as the HUI (NYSE Arca Gold BUGS index), down 10.04%. It is unusual for gold stocks not to decline more than gold in a down market. The XAU fell over 5%, but that return is distorted by the inclusion of copper miner Freeport in that index;

Freeport was up nearly 27% in the quarter. The average gold fund was down 8.2% (per Bloomberg Precious Metals Funds Index), but that again is distorted by the inclusion of the Vanguard Global Capital Cycles Fund, which holds no gold stocks, and was the only fund in the index up on the quarter. Without that, gold funds were down almost 9.5% on the quarter.

Our gold funds fell 9.5%, a little less than gold and the HUI and a tad more than the average gold fund. Since we were more-or-less in line with the index and funds, there were no particular factors that drove divergence. If anything, a handful of stocks that had excellent returns last year gave back some this quarter. One of our top holdings, widely held, and a top performer last year--up 133%--fell nearly 30% this past quarter. Without that, clearly, our accounts would have done far better, but we are holding this--and other such companies--expecting them to outperform again when gold turns around.

■ High growth expected as economies re-open

Overall, the world should see strong growth this coming year, as economies re-open and travel and trade recover. Pent-up demand backed by accumulated savings enabled (by large-scale government cash distributions in many countries) could see a strong rebound in economic activity. Some analysts are drawing a parallel with the Roaring '20s, which saw massive consumer spending after four years of war and two years of the Spanish Flu. But we should not read too much into a few quarters of strong economic growth, as the comparisons will be with excessively low numbers.

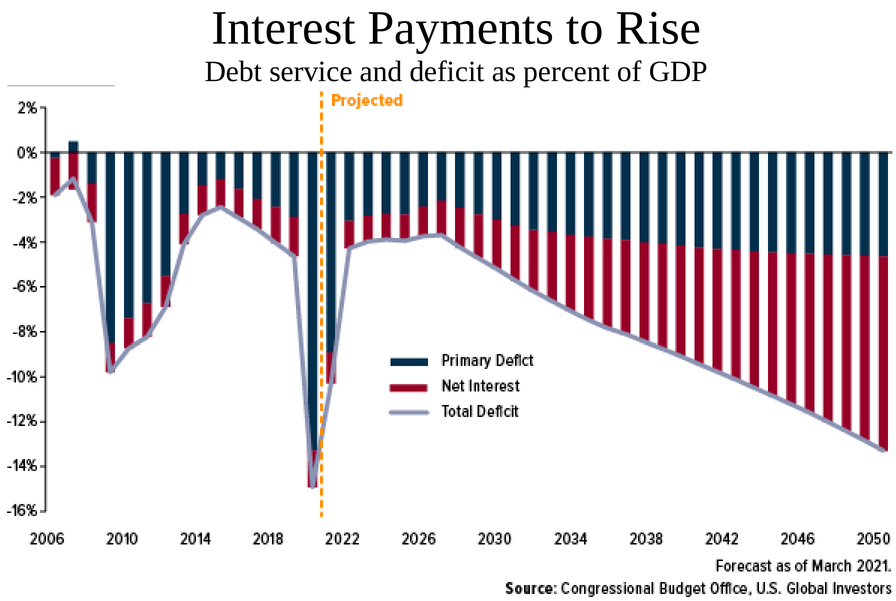
Two factors will hinder growth: demographics and debt. Most major economies around the world have very low population growth rates, with the U.S. around 1%--mostly from immigration--among the highest. Europe is close to zero (negative for "core" population), while Japan, without immigration, is also less than zero. Even some East Asian countries have growth of less than 1%.

■ Can we grow out of the debt?

The Federal Reserve--and most other major central banks--are pinning their hopes on getting out of the debt trap they have enabled on growth. But they have left it far too late to attempt to restore balance sheets "the old-fashioned way". Even they must realize that, however low rates are, we cannot have growth rapid enough to grow ourselves out of the debt load (especially with essentially zero population growth in developed countries). This is why the Fed and many others have stopped trying to control the money supply, and why they expect rates to remain ultra low for years to come. It has gone too far; they have lost, and they know it. They will keep it going as long as they can, but hence the discussion of "the great reset", involving swapping debt for ultra-long term or even perpetuals at current low rates.

Central bank policies (as we have discussed before), however, exacerbate the wealth gap, and as more and more people get left behind, the government takes care of them. Thus we have societies, in the U.S. and Europe in particular, where an ever-greater proportion of the population is dependent on the government, while wealth gets more and more concentrated. This is unhealthy for the economy, and exceedingly so for society. (The wealth gap in and of itself is not a negative, but crony capitalists at the top and a large and growing number of households dependent on the government at the bottom, is.)

Respected Swiss manager Felix Zulauf says that once central banks start debasing their currency and inflating the financial system constantly and chronically, then they can no longer stop, without risking a deflationary accident. We are at that point in the U.S. Non-discretionary spending is now 70% of the budget. These items, primarily social welfare of one form or another, will not be tackled under the new administration; indeed, as we have already experienced in just two months, new entitlements will be added, with the Fed willingly accommodating them.



Already we are seeing this in the U.S. government's latest "covid relief" measure, ostensibly intended to help people hurt by economic lockdowns and restrictions of the past year. Much more than that, the $1.9 trillion is going to fund pre-kindergarten schooling, free community college, child care, transportation, and more. Now, today as I write, we have a new $2.25 trillion spending package announced, with the promise of another "$1 trillion or more" to come in April. As debt piles up, the debt-service burden increases even at historically low interest rates, and despite old long-term debt maturities being replaced by new ultra-low yielding debt. Thus, governments cannot afford for rates to increase.

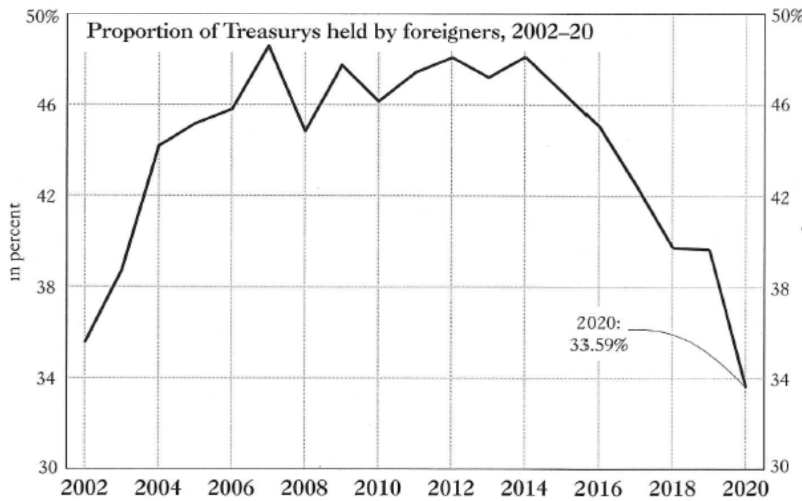
Looking at the numbers for the various indicators of money growth--money itself, whether M1 or M2, Fed credit, or the Fed's balance sheet--all show accelerated growth in the last three months to the previous quarter. Liquidity is being created at an even faster rate than during the last world war.

■ When will the Fed act?

Many central banks around the world, including those of Japan, Korea, Australia and most recently Europe, are taking action to combat the rise in long yields. The Federal Reserve however, it would seem, refuses even to acknowledge it, and hopes that continual repetition of the mantra that "rates will stay low for the foreseeable future" will do the trick. Following the recent excessively dovish Fed policy meeting and statement, bonds continued to drop (that is, yields continued to rise). Eventually, the Fed will have to act, and they are quite prepared to. They prefer "jaw-jaw" to "war-war", wanting to avoid having to loosen monetary policy further, but they can quite easily use newly created credit to buy long-dated bonds and push yields down. It might come in the form of another "Operation Twist", attempting to flatten the yield curve, or it could simply be additional outright purchases of long-dated bonds. In the new world of Modern Monetary Theory, with a democratic-controlled Congress and uber-dove Janet Yellen at the Treasury, there is no constraint.

The Fed, despite forecasting 6.5% economic growth for this year, wants further "substantial progress" on employment and inflation (more of it) before thinking about tightening. That is clearly well into the future, with the majority of the Fed's members expecting interest rates to remain close to zero for the next three years. The bond vigilantes, who have returned with a vengeance, won't like that however. We saw mediocre demand in recent treasury auctions; the latest seven-year auction was the fourth-worst ever. The bond vigilantes demand more than 1.7% to lend to the government for 10 years, especially with inflation inching up and the dollar weaker.

Foreigners holding fewer U.S. Treasuries



source: SIFMA, Treasury International Capital

What is different from the last time the vigilantes were active and had their way is that today, the Fed can buy all the long-term government bonds it wants. It needs neither foreign investors--whose demand for Treasuries has dropped from almost 50% of all Treasuries in 2014 to just one-third last year--nor even private investors. Government entities of various sizes and shapes, including the Federal Reserve, are in aggregate the largest holders of government debt today. (If you think there is something circular about that process, then you are paying attention!) Higher yields, however, will begin to be evidenced in private debt, especially in "junk-bonds", where the yield gap with Treasuries is now at ridiculously low levels.

■ Will the recovery last?

The U.S. economy will experience strong aggregate growth, boosted by fiscal stimulus. But it will be an uneven recovery, and may not be sustainable. A little less than 20% of all companies in the U.S. are Zombie companies, where profits are less than interest payment. (In the EU, it's a little over 20%.) They are kept alive only by government money and ultra-low interest rates. When businesses that are currently closed or operating at half pace reopen, there will be many bills to be paid, including rent and suppliers that had been postponed over the past year. Many of these companies will not be able to survive once the government handouts and the suppliers and landlord forbearance ends.

Other sectors that have been doing well may experience a slowdown, perhaps due to cost inflation. Housing, for example, has experienced very strong growth and higher prices over the past year, but starts and permits are both down recently, suggesting a slowing in the period ahead, as lumber prices skyrocket and mortgage rates move up.

■ Increased risk of inflation

The economic growth may also be accompanied by rising inflation. Already, many sectors, mostly commodities including food, are seeing higher prices. Food prices were up almost 4% on average in 2020 and they are expected to increase again. The CEO of General Mills commented on its recent results conference call, "inflation is broad based and global." Kimberly-Clark just announced higher prices across most of its lines to counter higher input prices. Across the board, input prices are rising as demand returns, aggravated by supply shortages in some sectors. Once we see a full reopening of the economy, we may see pent-up demand return more rapidly than additional supply, especially where some supply chains have been broken, driving prices up. Consumers know that inflation numbers are understated. But even the Fed's preferred gauge, PCE, up 1.4% for the past year, rose 0.2% month-on-month in the latest month, rebounding consistently from last March's low.

The Fed is continuing to downplay inflation, saying its 2% target is now an average to be achieved. Just how high will the Fed be prepared to see inflation before being prepared to take action? The danger is that once it takes hold, it may accelerate rapidly. Depending on the speed of demand recovery and supply bottlenecks, it could be strong, while the Fed seems determined to delay any tightening to clamp down on incipient inflation as long as possible.

■ Rest of world lagging

Globally, economies are recovering in alignment with how they are reopening based largely on the vaccination rollout. China and most of East Asia had a head start; Britain has a phased opening plan based on one of the higher per-capita vaccination rates; the European Union is stumbling; while most of Latin America, Africa, and southern Asia are lagging.

China's economy is now virtually back to pre-covid levels of growth, with exports recovering as different economies pick up. This is likely to continue. Although the People's Bank had not been overly aggressive on fiscal spending--with more targeted than widespread stimulus--they are now reining in a little. (Perhaps they are more able to do so precisely because they did not go overboard with stimulus measures.)

On economic issues, China has been gradually moving towards accommodation with the U.S., though certainly it neither wants to take orders from abroad nor be perceived as doing so. In its more aggressive stands, however, the U.S. is increasingly alone. Most countries are generally less inclined to interfere in other countries' affairs than is the U.S. But also, increasingly, China is overtaking the U.S. as a source of trade, and, particularly in Asia, Africa, and much of Latin America, as a source of foreign direct investment.

■ U.S.-China tensions increase

Two sources of friction are growing. First, the Biden administration is aggressively expanding President Trump's more targeted attacks on Chinese companies, which banned U.S. persons from owning a group of companies purportedly with ties to the Chinese military. Under Biden, the attack has now expanded requiring Chinese companies listed on U.S. exchanges to open their books to U.S. auditors. In truth, the fault lies years ago in first exempting Chinese companies from the rules. But taking action now appears like yet another onslaught against the country. China is not going to want U.S. auditing firms rummaging through the books of local companies any more than the U.S. government would allow Chinese auditors to examine U.S. corporate accounts. This may result in most Chinese companies being de-listed from U.S. exchanges, but there is nothing to suggest U.S. persons will not be allowed to hold these stocks.

More intractable are the issues involving internal Chinese affairs, such as the treatment of the Uighurs, and those perceived by China as internal affairs affecting sovereignty, such as disputes over Hong Kong, Taiwan and the South China Sea. If the U.S. and the West are willing to allow China to ignore the treaty it signed over Hong Kong (albeit with some noise), any threat to Taiwan's independence would likely be treated differently by the U.S. Behind much of this, however, is the view in the U.S. of China as a growing competitor, economically and militarily, which the U.S. sees as an existential challenge that must be stopped. The U.S. believes it has the moral right as well as the power to stop China from overtaking the U.S.; China views its rise as an inevitable process of resuming its leading position in the world. These issues, unlike the trade and investment ones, put the two countries on a collision course.

■ Mostly slow re-opening

Other regions are far behind China in re-opening their economies. Japan, ever-wary of outside influences, is being very cautious in re-opening, while the European Union is fumbling its vaccine rollout amid third-waves and new on-off lockdowns. Its unseemly verbal attacks on Britain over vaccine access--first prohibiting the AstraZeneca vaccine (funded by British tax money) for alleged safety reasons, then complaining that Britain was taking too much of it--looks like jealousy; the U.K. has now vaccinated over half the population, while the EU is at around 15 persons per 100.

Europe is also hurt more by higher oil prices than other regions (not that the period of low prices seemed to give it much competitive advantage). So these factors suggest a deferred and slower recovery for the EU than elsewhere, including Britain, where phased re-openings are now underway.

Canada has been a surprising failure, despite very strict lockdowns and restrictions on travel, even within the country.

■ Emerging markets, hurt more, may recover faster

There is wide divergence among emerging markets, with some, particularly in East Asia, seeing slow but steady recoveries, while others are hit with new covid waves among mostly very low vaccination rates, and not a few others likely under-counting covid cases. There are wide differences even within regions; in Latin America, Chile is one of the top-six countries in the world for per-capita vaccination, though just recently hit with a new outbreak resulting in a lockdown of Santiago, while Brazil is failing seemingly without a plan. Generally, however, with an average age far lower than in North America, Europe and Japan, emerging markets may recover from covid faster once they turn the corner. And the lower dollar is a positive for these economies.

Most countries are following the fiscal stimulus route, though at different stages. In the U.K., it is now "pay-back" time as numerous tax increases are planned to pay for the unprecedented (and grossly excessive) spending, continued well past its "sell-by" date. Canada has started to cut back on some direct spending. To some extent or another, most countries which initiated unfunded fiscal spending over the past year risk inflation, though the biggest threat is in the U.S. Other central banks may be more willing to clamp down on inflation sooner, though the risk, particularly in Japan and Europe, is less.

■ Brief rally in dollar before further declines

With the U.S. economy further down the road to recovery than most countries, we can expect the dollar to strengthen, particularly since the global yield differential is now even more in favor of the dollar than it was last year. However, the massive credit creation--greater in the U.S. than most other countries--the huge budget deficits; and the trade deficit set to widen with increased U.S. demand, all indicate a lower dollar ahead, so this move will be only a counter-trend rally. Indeed, the dollar rally this year--from 89.4 on the DXY index to 92.8--the peak will probably be behind us.

■ The odds favor higher stock prices for now

Excess money, low interest rates, an economic recovery and improved corporate earnings together represent a positive environment for equities. The most important factor is the continued excess money creation by the Fed, because, as discussed previously, excess money must go somewhere and much of it is likely to continue to move into stocks, regardless of valuations or even of economic conditions. Fedhead Jerome Powell downplays the Fed's role in blowing the bubble.

However, there are some near-term worrying signs. First, if yields were to continue to rise, then growth stocks in particular would be hurt. We have seen this in recent weeks, as different indices have been going in different directions. Indeed, there have been massive drops in the last week in former market favorites, including tech and media, as well as Asia big tech (for example, there were a couple of big-cap, well-known U.S. companies down over 50% in a few days last week, occasioned by liquidations of massive positions held on margin. (We are not naming names since we are actually buying them; see "Global Accounts" discussion below.) Such selling feeds on itself. Larry McDonald, editor of The Bear

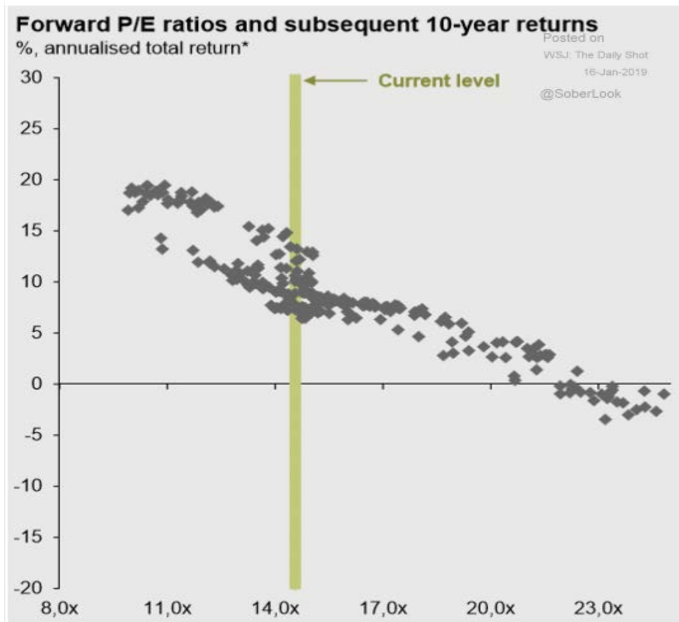
Traps Report, quotes a client, a larger trader: “there is a lot of carnage for a market on the doorstep (of) new highs.” Such carnage rarely comes and goes in a couple of days, and we can expect some fall out and follow-through as heavily margined investors get ahead of pending calls.

A bubble can keep getting bigger

There had been signs of a bubble all around: the Reddit-induced short squeezes, the speculative call buying in small sizes; the 100% bullish reading at the American Association of Individual Investors, and more. One day in mid-January, just six penny stocks accounted for 18% of domestic equity turnover. We are already seeing some of the worst excesses dissipate. The economy re-opening probably means less spending on stocks than while people are stuck at home and bored, and more spending on going out (inflation replaces a bubble!). Already, speculative call buying has declined.

Higher the Valuation, Lower the Return

%annualized return from P/E levels



One can never time the top of the bubble, but as we have commented before, in a bubble, risk increases and declines are likely to be deeper and more rapid; there is simply more room to fall. In addition, if one buys when stocks are overvalued, the anticipated returns are so much less. At today’s price-to-earnings ratio, the anticipated 10-year return is negative.

I do not think, on balance, that the equity markets, here or abroad, are entering a new bear market, or that a market collapse is imminent. The Fed would likely step in to prevent a deep, broad market decline. Typically, bubbles are pricked by monetary tightening (gold in 1980, the Nikkei at the end of the 1980s and so on), and there are no indications of that anytime soon. A market decline triggered by an external event, such as the arrival of covid last March, is unusual, and such are usually short-lived.

Is 1987 a good analogy for an overvalued market?

Some analysts are now looking to 1987 as a possible analogy to the current situation (or potential situation later this year): bond yields up (the first incarnation of bond vigilantes), and inflation rising, against a background of easy money. The difference is that in 1987, the Fed actually increased rates several times over the course of the year; the Fed Funds rate stood at 5.7% in October 1986 (how long ago that sounds), to 6.8% at the end of August and 7.42% at the end of September. It was these rate hikes that were the proximate cause of the market decline. This Federal Reserve is most unlikely to drive rates higher in like manner; perhaps the market will do it all for them. It is worth noting that after the October 1987 crash, stocks were back at new highs within a year.

There is greater potential for a decline in the second-half, perhaps if the economic recovery splutters and runs out of steam. Massive corporate tax increases will not help the economy. That could see equities decline, but rather than a new bear market, I would expect a relatively quick market recovery and market rotation. If yields continue to rally, then growth stocks in particular will be hurt and so-called “long-duration Assets”, companies that can achieve revenue and earnings growth over many environments, will be positive.

There are pockets of value around the world

Chinese stocks listed in the U.S. markets will likely be weak while the accounting story plays out (see above). But since U.S. investors likely will not be prohibited from owning the shares, the declines will likely be relatively short lived, even if companies are de-listed from the New York and Nasdaq. Institutional investors will buy the stocks on overseas markets instead.

We see some value in disparate markets. In Japan, the export oriented companies and the financials are reasonably good value. The index, being price weighted, can distort valuations and make the market appear more expensive than most individual stocks are. Many Japanese companies have rock solid balance sheets which provides some downside protection.

U.K. stocks, which have lagged the world since the vote to leave the EU in 2016, can now start to recover. With the final departure from Europe, much uncertainty is removed. The economy is re-opening. And finally, valuations are reasonable.

We also see some value in some emerging markets. Above all, however, we are looking at individual companies with a bottom-up approach.

Commodities mixed

Commodities were mixed this past quarter, with even the stronger ones pulling back from highs over the past month. The index was up around 7.8% for the quarter, with oil (up 22%) and copper (up 13%) among the winners, and the precious metals lagging, with both gold and silver in the negative column. A higher dollar and rise in long-term interest rates weighed on the complex in the last month.

Agriculture is a major component of commodity indices and a compelling, if volatile (because of the weather) asset for the years ahead. There are fewer farms in the U.S. and around the world, and they need to produce more food for a population that continues to grow, if at a slower pace than in the past. There are relatively few direct ways to invest in agriculture (other than purveyors of processed food), but we hold land owners, a direct way to be exposed.

The oil price continued to appreciate, closing over $62/bbl, up from under $38 on the last day of October (basis WTI crude future). It can continue to move higher, but spare capacity in OPEC is at record levels, so there is no shortage of potential supply if prices move much higher on a sustained basis, thus limiting the move. The oil stocks have mostly had very good runs and are no longer undervalued, absent much higher oil prices.

Uranium has near-term risk

Nuclear energy is suddenly popular again, with one Democratic senator saying he will haul CEOs before Congressional hearings to explain themselves if they plan to wind down plants.
The longer-term outlook for the industry, and therefore for uranium, is positive. Nuclear, despite a handful of accidents (at older plants), is a safe, clean and reliable form of energy. The number of plants under construction ensures rising demand for uranium for years into the future, while there will likely be a resurgence of the industry in the U.S. and other countries. At the same time, there are not many large-scale mines on the drawing board. Being an essential component and a relatively small part of the overall cost structure, uranium is price-inelastic, meaning higher prices do not curtail demand very much.

During 2020, uranium demand remained relatively stable while supply was disrupted. Spot volumes moved to record highs, but the price is languishing around $30/lb, actually down from mid-year before large producer Cameco announced the restart of its Cigar Lake mine, a surprise after a series of closures earlier in year (including Canada's only production facility, and across-the-board cuts at all Kazatomprom's mines. These cuts had seen the spot uranium price jump from $24 to $34.

Demand has grown steadily in recent years as new reactors have been started around the world, and demand now exceeds the annual levels that existed prior to Japan shutting down all its nuclear units following the 2011 Fukushima nuclear incident. At the end of 2020, there were 436 nuclear reactors operating in 31 countries; there are a further 58 reactors under construction.

Given the demand side of the equation, the price might come as a surprise. It is estimated that last year just two-thirds of demand came from current production, with the remainder from inventories, government (particularly Russian) stockpiles, and reprocessing of spent rods. The last will remain stable while government and private stockpiles are shrouded in secrecy, but best estimates are that these will decline sharply but perhaps not for another decade. In the meantime, any sustained and significant increase in the price of uranium may be met with the restart of shuttered mines, both Cameco's huge McArthur River (the world's largest) as well as those in Kazakhstan.

Given the current uranium price as well as the ready source of increased supply, the shares of uranium producers and explorers have moved far too fast, too soon, in my opinion. We want to gain exposure but not at these prices.

■ Coal and base metals: waiting for opportunities

Other energy sources may see sooner price moves, including met coal, which is still used in coal-fired plants for generating electricity, as well as for making the steel required for proposed infrastructure spends. Coal may be on its way out, but it is not imminent. Some of the coal companies, devastated in the last couple of years, are undervalued and under-owned, and could see good moves as coal demand picks up, even moderately, from these levels.

Most of the base metals continued to move higher in the quarter, though came back in the last month. Copper, for example, rose 22% in the first two months of this year (up 50% from October), before easing to end the quarter up 14%. In addition to a strong dollar (which affects U.S.-dollar prices), and higher interest rates, there are signs of reduced Chinese end-demand as inventories there in copper, zinc and other metals have been rising. For reasons we have discussed before--increased demand for electrification and infrastructure and lack of large mines in the development stage--we are bullish on the copper price over the next few years. The current pause will be relatively shallow and short-lived.

But stocks of base metals miners and explorers for the most part have moved too far too fast. We will look for pullbacks to renew our positions. In the meantime, we have exposure through gold miners with significant by-product production, as well as royalty companies.

■ Gold has unusually weak start to year

Gold saw its worst start to a year in three decades, reportedly reacting to a higher dollar, higher interest rates, and a purported switch from gold to Bitcoin. All this comes against a background of expectations of an economic recovery ahead. For the quarter, gold fell 10% and silver 7.5%, unusual for what is traditionally a seasonally strong period.

This should be put in context. The gold price is back to where it was last June, and remains up a reasonably healthy 13% since the beginning of last year. Some of the factors suppressing gold are overdone, in my mind. The widely touted dollar rally has recovered about two-thirds of the decline since Biden was elected president. As discussed above, the dollar could rally more in the near term, though will likely be lower over the course of the year. As for the move in interest rates, while yields at the long end have indeed moved up, tripling to 1.7% on the 10-year Treasury, they remain down at the short end, and, of course, real yields, after inflation, which is what matters for gold, remain negative. Yields are rising as inflation expectations begin--finally--to move up, and that is also positive for gold. As discussed above, the Fed will follow other central banks around the world and suppress long-term rates if they move up too far.

As for Bitcoin, there is no doubt it has soared on the back of strong inflows, nor that there have been outflows from gold ETFs, but the extent to which these are related rather than coincident is not clear. Other than a few high-profile instances, there is no evidence of a mass move out of gold to cryptocurrencies. Now, relative strength indicators on Bitcoin have turned lower even as the price moves up, a sign of a pending top.

■ Easy money will drive gold

At the same time, the central factor that drives gold, global liquidity, remains very strong with no indication of any reversal in the foreseeable future; quite the opposite! I think we are simply seeing normal market action. After an incredibly strong move in the first half of last year--over 40% from the low in March to early August--gold is simply taking time to consolidate. The more dynamic the move, the longer the correction. In fact, I would argue that gold holding above $1,700 in the face of dollar strength and rising yields, is actually quite positive and a sign of a slow shift in sentiment and coming turn in the gold price. The negative sentiment, evidenced by the outflows from gold ETFs, means that gold increasingly is held in strong hands. When the move comes, it could be a strong rebound.

■ Silver has advantages over gold

Silver, which initially fell with gold after the early-August peak, reversed and started to move back up, well before the Reddit-inspired squeeze that took the price to eight-year highs. Since its late September low, it has trended up, despite the recent pull back. Though down over the last quarter, it remains up 8% since that low. Silver has several things going for it, not all of which apply to gold.

- Like gold, it is a monetary metal, responding to excess global liquidity.
- It tends to respond even more than gold to inflation, and more more later in bull markets.
- It is an industrial metal, and will benefit from an economic recovery.
- It is a “green metal” with growing demand from electrification and other “green” sources.
- Finally, there is a shortage of the physical metal, with low stockpiles.

Of course, any physical shortage is taken care of by higher prices. But it is worth noting that, in a widely reported move, the largest silver ETF, the iShares Silver Trust, updated its prospectus to state that it may suspend or restrict the issuance of shares because it may be unable to acquire enough of the metal.

■ Gold stocks decline with gold

The gold and silver stocks for the most part have overreacted to the metals’ slide. Already soft, they have fallen another 10% this year. This year, therefore, the decline equals that of gold, though over six and 12 months, the stocks have declined far more. They are at valuations that are, in many cases, in the lowest historical quartile. They are very under-owned by generalists. When the metals turn, the potential for a leveraged return from the stocks is very real. The fact that over the past quarter, the stocks fell in line with gold, no more, suggests accumulation.

We are fully invested in gold and silver stocks, both in our dedicated accounts as well as in global accounts. We are continually looking to top up, or upgrade the portfolio as opportunities arise. We have exposure to other resources, mostly through diversified companies, but are looking to get back in to the base metals having taken profits in many sectors last year.

Overall, despite market indices at extreme levels, we continue to find reasonable values in different markets, different sectors and individual stocks. The monetary environment remains favorable for equities, so while the risk increases as the valuations get more stretched, we are buying for the most part more defensive stocks that will hold up better, and also being quicker to take profits or cut losses given the overall risk. We remain fully invested in gold and gold stocks.

Review of Individual Accounts

Global Accounts

We have increased buying in the global accounts, much of it through the sale of puts. Unrestricted cash levels have declined to a little over 2%, down from 5% at the beginning of the year, while exposure to broad markets in the U.S. and globally have both increased. Cash levels depend partly on the level of risk in an individual account. Cash in conservative accounts has increased to 18% on average.

Exposure to gold and other resources remains high, while high-yielding Business Development Companies have also increased their allocation, despite steady trimming of positions, as the prices continue to move up.

There are still good buys around

Notwithstanding our cautious view on global markets, and recognition of increased risk as valuations get more extreme, there are many areas of value, including regions, sectors, and individual stocks. We discuss this in our market commentary above.

These include defensive dividend payers in the U.S. Globally, we have focused on the U.K. where the leading companies are often not only relatively undervalued, but represent good value on their own terms. Again, for the most part, we look for companies that pay decent dividends.

Buy when blood is in the streets

We have also jumped in on a couple of large-cap U.S. names that had been demolished by margin liquidations. When the margin clerks take over, price becomes less of a consideration than getting the position off, and there were some spectacular stock collapses last week. As prices and volume stabilized, we grabbed the opportunity.

Where possible, in all these trades, we sell puts instead of buying outright. The premiums on put selling are quite high now, and since we are not necessarily looking to own these names for the long term, the “risk” of not buying (and just pocketing the premium) is not so great.

Some incidents of crisis, however, demand caution. Because of the increased tension with China, including moves against U.S.-listed Chinese companies (see above), we have been cautious on buying Chinese or Hong Kong companies recently.

Increasingly, we are being more short-term oriented with global equities, trimming on quick profits where available and cutting losses quickly in most cases. At the same time, we are slowly building a portfolio of defensive, dividend paying stocks around the world, at least for the next several months.

BDCs continue to perform well

The BDC group continues to move up; they are stand-out yielders in the current low-yield environment--the entire group yields around 9%--and companies with exposure to a recovering economy. In the last quarter, the number of overdue loans declined rapidly to around 3% (and I suspect it will be lower today) from third-quarter high of 4.5%. Of course, the non-accrual and yield vary by company. The group has also seen some buying from funds following the overturning of a rule which deterred funds from owning companies like BDCs.

We have been trimming as the sector moves up, selling add-on positions we bought this time last year, and also selling some stocks priced well above NAV, a warning sign for equity raises ahead. Nonetheless, because of strong stock moves, the sector allocation increased, to 6.5% for mid-risk accounts, over 12% for conservative ones.

Looking ahead, we expect to continue to find buys, opportunistically, and frequently for short-term trades, including selling of puts where able. Our focus continues to be on companies that can pay a sustainable dividend. We will continue to hold a high allocation to gold stocks, since they are undervalued, offer high potential, and can act as a hedge on the rest of the portfolio.

■ Gold Accounts

Gold had a weak start to the year, rounded off with a sharp decline at quarter end. We remain fully invested however for the reasons discussed above. Cash stands at around 2% of accounts, with most of that set aside for open orders. Following more buying, the major royalty and mining companies comprise almost one-quarter of portfolios, up from under 20% at year end. That low figure was due to the seniors sliding more than the juniors. Exposure to resources, mostly silver, rose to 27% from 22%, due to some buying and also better relative performance.

Trimming and adding to favorites

Gold accounts tend to be more active than global accounts, though we did not see the frantic activity of the previous quarter. Buying was primarily adding to our favorite major miners on depressed prices. We also bought a couple of new exploration companies, based on strong management teams we have known for a while, as well as new junior royalty companies.

We raised cash by trimming positions selectively where we had good short-term gains, as well as selling some laggards. Some clients who had participated in private placements also trimmed those positions and exercised some in-the-money warrants to raise cash.

Going forward, we anticipate continuing to be fully invested, always looking for opportunities to raise cash for future buys. When prices are weak, we typically add more to major companies which tend to be the first to move as well as surer movers when gold turns. That buying preference will likely continue in the months ahead.

■ Resource Accounts

Likewise, our resource accounts remain fully invested, with less than 1% in cash. Although that is down from 4% at the end of the year, that number was simply the result of timing of sales and buys. Major and intermediate gold companies remain our largest single exposure, up a little to 37%, the result of additional buys. We added to silver companies, but because of relative price movements, that remains at 11% of accounts. The rest is spread among various resources including oil and gas.

We look for opportunities to buy back

Having sold most of our copper mining companies, our exposure to that metal now comes from diversified miners and royalty companies. This is true for many of the base metals.

We are also alert to by-product production, so we may emphasize gold companies with a heavy copper production; or silver companies with zinc. One of our major companies classified as “gold” is also the fourth largest silver mining company in the world. With royalties, Royal and Osisko have heavy silver exposure, Franco oil revenue, while Altius is well diversified across the spectrum, with everything from potash to coal and renewables.

New buy: coal

In the last quarter, in addition to adding to existing favorites, we also bought a large U.S. met coal producer; though coal is a dirty word to many, in fact, it is essential for electricity generation and infrastructure build. You can’t “go green” without it, right now. On the sell side, apart from exiting some base metals producers because of valuations, we also have lightened our oil exposure after a good run. As discussed above, the near term carries risk of additional output from OPEC.

Looking ahead, we anticipate remaining fully invested, and though gold and silver will likely continue to be the largest segments, we are looking for opportunities to add across the entire resource spectrum, including copper, nickel, uranium, oil and coal, either idiosyncratically or on a correction in the sector.

In sum, if the federal Reserve and other major central banks continue their loose monetary policy, the odds suggest equity markets will continue to move up. As valuations become stretched, the risk increases and we see the possibility of a correction later in the year. In the meantime, we are avoiding broad exposure to the market as well as high-flyers, but are finding good value both in the U.S. and globally, in overlooked gems, depressed stocks, or laggard markets. The bias is towards dividend-paying defensive stocks. We continue to hold a high allocation to Business Development Companies, as well as to gold. Despite low cash levels, at least in more aggressive global accounts, we are alert to opportunities to sell and expect cash levels to be higher by the end of the quarter, in global if not gold and resource accounts.

Adrian Day, March 31st, 2021