Adrian Day
ADRIAN DAY ASSET MANAGEMENT

PORTFOLIO REVIEW

PO Box 9024106, San Juan, PR 00902-4106 • 410.224.2037 Fourth Quarter January 2025

Jerome Powell and the Federal Reserve took away the punch bowl just as the party was getting out of control. In a year in which most asset classes and markets appreciated, most are ending the year on a negative note, down for the final quarter of the year. With a new administration in Washington, the year ahead suggests some rotation, independently of what the Fed decides to do. We could see the leaders of the past year or more—U.S. tech stocks among others—declining while laggards—international markets, particularly smaller ones, value stocks, and resource stocks, among others—come to the fore. With many global economies declining amid excessive debt loads and a new U.S. president, much remains uncertain, however.

■ Most stock markets give back some of earlier gains

The final quarter of the year, as I write with one market day remaining, sees global markets give back some of 2024's earlier gains. This is true for stocks, bonds, and resources; even Bitcoin is off its highs.

For the quarter, the U.S. market is the only major global stock market that is up (in dollar terms), with the S&P up 3.6%. Other markets that are in the green are pretty minor: Argentina on President Milei's dramatic reforms, and some smaller Eastern European and Asian markets such as Macedonia and Laos, hardly investable markets. In all, markets outside the U.S. (per MSCI World ex-U.S. index) fell over 8.3% in the quarter.

For the year, most of Europe's stock markets were up, as were many major markets in Asia, including Japan, Hong Kong and Singapore, but the U.S. markets were still the leaders. The S&P is up 25% for the year, while the runner-up, Hong Kong, is up 18%. International markets overall are up just 3.5% for the year. The top sector once again was tech, particularly anything to do with AI.

■ Global accounts beat global markets, but not U.S.

Our global accounts are all down for the quarter, anywhere from 4% for conservative to 5.5% for mid-risk growth accounts. (Account numbers are preliminary, as of December 27th.)* This is a loss only half or little more that of the global markets. The reason for the outperformance against global, and underperformance against the U.S. is our low exposure to the U.S., and none to the top sectors; but above-market exposure to the less-bad global markets, such as Singapore, Hong Kong and the U.K. Our exposure to gold, given our stock selection, also helped accounts beat the global markets.

For the year, our global accounts well outperformed the global markets, and lagged the U.S. only marginally, with our mid-risk growth account up 21%. (See disclosure*.) Again, low exposure to the U.S. and particularly the tech leaders hurt relative performance, while weighting to Hong Kong as well as gold stocks helped.

■ Resources down, but gold and silver up

The resources fell broadly in the fourth quarter with the complex down over 2%, with only oil (up 3.5%), natural gas (up 15%), and some agricultural commodities up. All of the metals fell; gold (down 0.5%) is the least bad. The gold stocks fell sharply, with the XAU Index down over 12% for the quarter.

For the year, the complex was down marginally, as most individual commodities fell, with oil down 1.5%. But natural gas rose (35%), as did some of the metals (aluminum, copper), led by gold and silver (up 27% and 23.5% respectively). The gold stocks (per the XAU) are up just over 12% for the year.

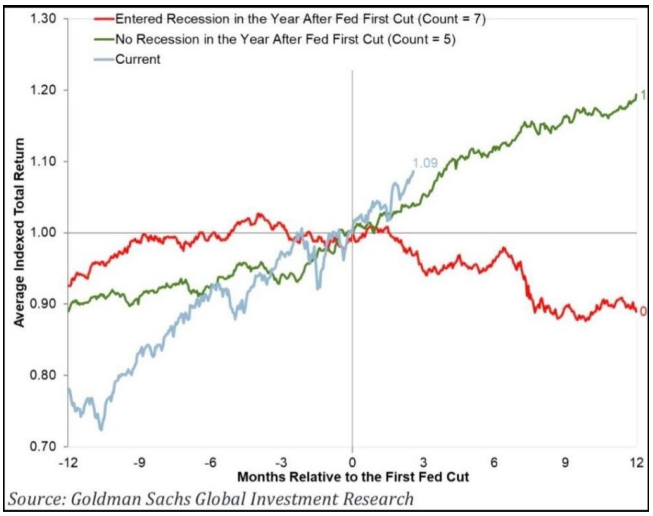
■ Gold and Resource accounts beat indices

Our gold and resource accounts well outperformed, both declining less in the fourth quarter (down around 6%), and well outperforming the indices for the year. Our resource accounts are up almost 24%, while our gold accounts are up almost 23%, nearly twice the returns of the XAU. Our low exposure to natural gas hurt the relative performance of the resource accounts, while stock selection and a few large winners account for the outperformance of the gold accounts.

As we look ahead, we expect the global markets in which we are most-heavily weighted to continue to drive performance, while new exposure to Mexico and Brazil may boost returns as those depressed markets recover. A decline in the U.S. markets, or at least sector rotation, will also help our relative performance. We expect gold exposure to continue to help all accounts.

■ The Fed turns cautious, on stubborn inflation

Although the Federal Reserve did cut interest rates again in their final meeting of the year for the third consecutive rate cut, it was the accompanying "dot plot" of individual members' forecasts and Powell's comments at the press conference following the meeting that set the tone. The forecasts in the dot plot went from a median of four rate cuts this coming year to just two, with the Fed concerned both that inflation remained stubborn while market speculation ran rampant. Powell emphasized several times how strong the economy was, indicating that it could withstand higher rates for longer. He stated, in what passes in FedSpeak for plain speaking, that the Fed could "now be more cautious in further adjustments to rates".



Source: Goldman Sachs Global Investment Research

We agree that inflation remains stubborn. Indeed, the CPI index has been trending higher for the past several months. But we disagree that the outlook for the economy is "pretty bright", with the jobs market "solid", as Powell asserted. For half the population, with high credit card and other debt, and wage increases below inflation over the past three years, there already is a recession. And when the majority of new jobs created are either government jobs or part time, the jobs market is not, in my view, "solid". New hires are very low. Consumer confidence has retreated from its post-election rally. Consumers and small businesses want to be optimistic about the economy with promises of lower taxes and fewer regulations, but realize that the current reality is not positive. Rate cuts do not guarantee that we will not see a recession, as the chart shows.

* Please note: **Past performance is no guarantee of future results.** For complete information on our past performance, including factors to be considered in viewing past performance and other disclosures, please contact our office. Specific stocks mentioned herein are intended solely as illustrative of strategies and types of stocks we are buying or selling, and are not intended as indicative of entire portfolios or of any individual client's portfolio. The numbers mentioned represent our composite averages. They represent all accounts that fall within the stated objectives which have the ability to buy and sell options; they exclude accounts under $25,000 and accounts with significant limitations or restrictions that would make them unrepresentative of the account type. Performance figures for composites reflect the deduction of administrative fees, but do not take into account any performance fee that may be charged for the period stated. The performance of any individual stock or stocks does not take into account fees. Performance numbers include dividends; dividends are not reinvested. Commissions charged may vary depending on the brokerage firm at which an individual account is held. All accounts are managed individually and are therefore different, even within the same broad objective. Factors such as an individual's circumstances, the size of the portfolio, and the time the account opened can affect specific buy and sell decisions. Factors such as price movements and security liquidity can affect whether any trade is made for all accounts. Global Strategic Management, an SEC-registered investment advisor, does business as Adrian Day Asset Management.

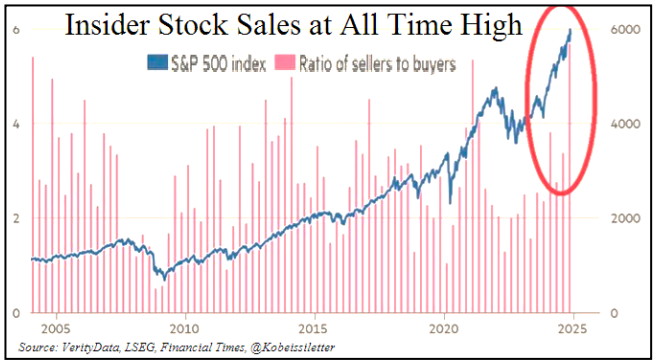
It is not only the Fed that has been cutting rates, down 100 basis points since September, but so are many other central banks around the world, some even more aggressively than the Fed, including the European Central Bank, the Bank of England, the Swiss National Bank, the Bank of Canada, and the Reserve Bank of Australia. As in the U.S., they are doing so before inflation is at the arbitrary 2% target. This clearly sets the scene for a stagflationary environment, where inflation remains stubborn and above mediocre growth.

■ Overvalued stocks vulnerable

Stocks in the U.S. are clearly overvalued on a fundamental basis, but as we know, overvaluation can continue for a long time and is no predictor of timing. However, there are indicators that should cause concern.

- Market analyst John Hussman says that, at the beginning of the month, the S&P was at its most extreme level of overvaluation ever.
- Before Christmas, there were 14 consecutive days of more declines than advances, for the first time since 2001. Market breadth is hitting new lows as the index price pushes higher.
- Insider selling has increased significantly in the last few months, as buying declines, leading to the highest ratio of selling to buying ever.
- Per Hussman, what defines a bubble is when investors drive stock prices higher without adjusting expectations for lower future returns, clearly the situation that exists today. Fund managers now have their lowest levels of cash ever, while margin in stock accounts is at a record high, at $900 billion, up from less than $800 billion just three months ago.

U.S. stocks are now trading at an extreme level relative to international stocks. Similarly, the gap between value and growth stocks is essentially back to its 2021 all-time record, while value stocks have been on their longest losing streak since 1995. Meanwhile, the growth rally itself is increasingly concentrated, led in the last couple of months by Tesla.



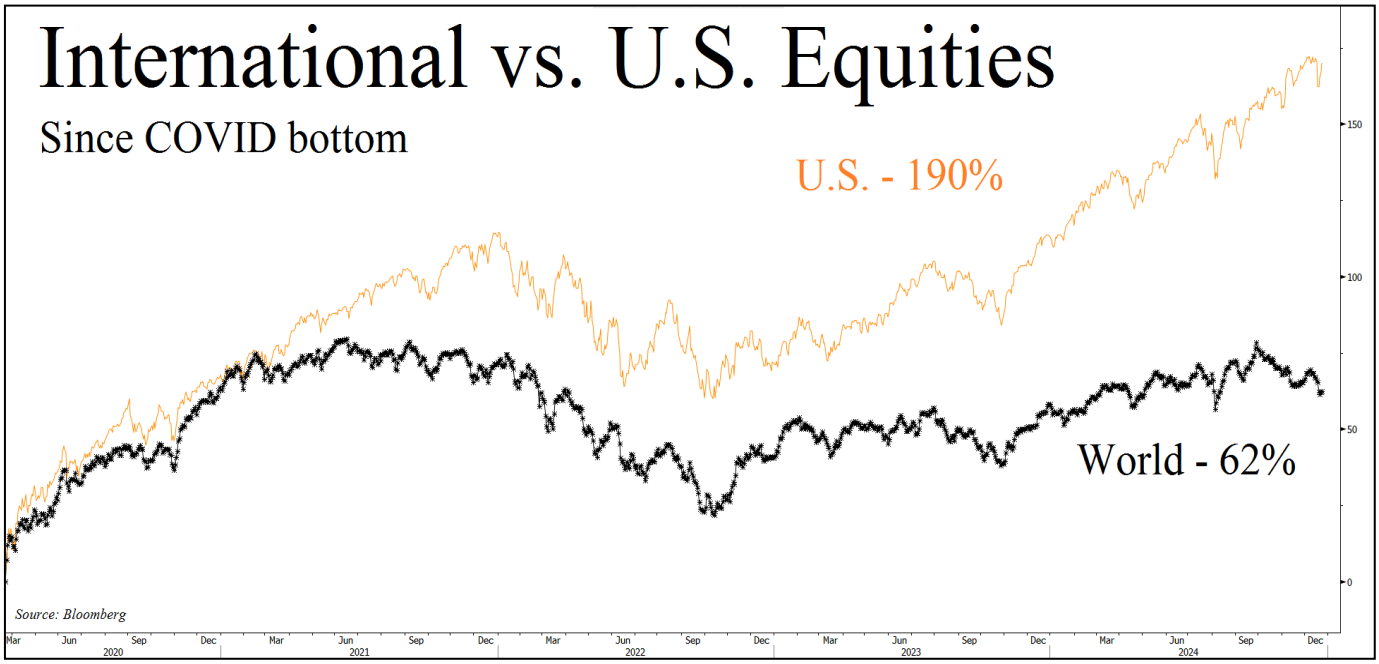
Stocks and relative valuations do not have to revert to the mean, and certainly do not have to do so in the near future. But the indicators would suggest that the over-extended market is reaching a turn, while the decline, particularly in the erstwhile high flyers, could be sudden and dramatic. Margin clerks are not known for their patience.

> *Bubbles often burst when rank speculation spreads to a small sector. Today, the extreme speculation is most evident in the crypto market. Dogecoin has a value of $60 billion, more than the entire uranium sector or commodities trading giant Glencore, for example. Something called Chillguy, representing a meme of a cartoon dog with his hands in his pockets, is going viral on TikTok, and reached a value of almost $500 million in the two weeks after it was created. Pepe, referencing a comic frog character, has a market cap of $8.2 billion. "Speculation" is too dignified a word for this. As one New York manager put it, "We are deep in idiot land behavior." He added, "lookout".*

We suspect that when the U.S. leaders drop and the U.S. markets starts to roll over, we shall see a rotation both from the U.S. to foreign markets, and from growth to value. At the same time, given that the year's losers were sold off even more dramatically than usual in December, there could be trading opportunities in the big losers.

■ There is value abroad

Globally, most developed markets are expensive on a fundamental basis, but not so much as the U.S., while emerging and smaller markets offer the best opportunities. In this group are countries with solid fiscal positions and growing economies, companies with strong balance sheets and growth prospects, and stock selling at low valuations with decent dividend yields. We cannot be sure on the timing, and the new U.S. administration adds



uncertainty, but the risk-reward profile on both value and smaller global markets is certainly better than it is in the U.S. or most global developed markets.

■ Most commodities are weak

Commodities and particularly resources have had a soft year and a weak fourth quarter, with the exception of natural gas, and gold and silver. The primary reasons:

- A weak Chinese economy, where China is the largest buyer of most resources
- A strong dollar, where resources are priced in dollar terms
- Slowing demand for EVs, where many pinned hopes for higher prices on this demand
- The threat of across-the-board tariffs, where most resources are traded globally

China may see a recovery however, as many leaders and advisers urge increased stimulus to offset the effect of any tariffs from the incoming U.S. government. Very low inflation numbers may persuade the government and People's Bank that they can act without deleterious impact.

■ Tight supply is critical for copper and gas

For many resources, such as copper, however much demand from electrification, including EVs, may boost demand, the reality is that even without that demand, the supply of copper five years out will not be sufficient for demand at current prices. It will take more than a decade to bring a large copper project into production and so we can be reasonably sure of the potential supply five years out. We are very bullish on copper, and a recovery in China's demand profile will only see the looming deficit occur sooner.

Natural gas prices have risen dramatically off their extreme lows, up 35% this year, as U.S. production, particularly from the shales, is falling precipitously. We don't think the shale production can be turned around, though the promised easing of regulation and opening up of new areas under the incoming administration, may help other areas partly offset this decline.

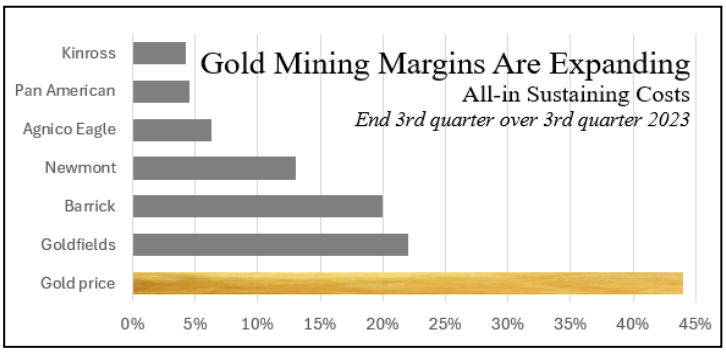
■ Reasons to buy gold remain

The outlook for gold is very powerful. We know why gold has gone up over the past two years, more than the S&P from the bottom two years ago.

- Central banks have been buying to diversify their reserve assets in the face of increasing weaponization of the dollar.
- Chinese consumers have been buying out of concern for the loss of purchasing power and vulnerability of the banking system.
- Large, sophisticated buyers in Europe, Asia, and the Middle East as well as North America, have been buying over concern of global fiscal deficits and systemic financial risks.
- Investors in North American and Europe have started buying over concern that inflation remains stubborn even as central banks ease monetary policy.

None of these concerns have gone away, and indeed some may accelerate with the new U.S. administration. The need to buy gold remains among all these groups. Indeed, in the latest report from the World Gold Council on central bank buying, October saw an increase, led by India, Turkey and Poland, making it the top month this year.

Chinese consumers are still concerned about the loss of purchasing power and the fragility of their banking system. Sophisticated investors worldwide are concerned about debt. And in Europe and North America, there are growing concerns about the possibility of a stagflationary environment, with stubborn inflation and mediocre economic growth, as central banks ease monetary policy before inflation is fully tamed.



If gold has declined on dollar strength brought on by optimism about the incoming U.S. administration, that optimism will evaporate as the policies face obstacles, and, in any event, as it becomes obvious that the rewards will take time to surface.

■ Gold stocks undervalued even as margins expand

Gold stocks, while positive for the year, remain ignored and undervalued. As the broad market rolls over, investors will look at the group that has delivered increasing cash flow each quarter this year while the stocks languish at long-term valuation lows. As the chart shows, gold prices are increasing faster than costs, so margins are expanding.

Overall, we are cautious about the U.S. and European economies; nervous about stubborn global inflation; and concerned about overvaluation in major markets. We see value in smaller global markets (such as Hong Kong and Singapore); in defensive stocks in the U.S. (such as business development companies); and in diverse bottom-up opportunities in markets as diverse as the U.K. and Mexico. Some of these opportunities may be short-term trades rather than long-term holdings. And we remain increasingly positive on gold stocks, unloved and undervalued as the cash flows increase amid higher gold prices.

Review of Individual Accounts

■ Global Accounts

Allocations to U.S. income stocks and to global markets remain pretty much the same at quarter end as they were at the end of last quarter. Hong Kong, Singapore, and the U.K. continue to dominate the global markets, though many are bottom-up selections rather than top-down by country. Cash increased, nearly doubling to 3.7% for mid-

risk accounts, though it declined somewhat for more conservative accounts to a still reasonably high 12%. Some of this cash is in foreign currencies, while some is set aside for the exercise of puts.

We had a few sells during the quarter on valuation concerns, including a global tobacco company, a Canadian holding company, and a Chinese real estate developer. We also trimmed moderately our exposure to Business

Development Companies in the U.S. again on valuation concerns, selling down a couple on rallies, and buying a couple on declines. The sector continues to be a large weighting for both income and dividend growth.

Diverse new buys in many markets

With the proceeds, we added several new companies. These were a diverse group of companies, all picked on a bottom-up basis, often after sharp declines for what we see as temporary issues. In some cases, such as in Mexico and Brazil, there were also macro issues that drove prices down.

These new stocks include a large U.S. chip maker; a growing money transfer company based in the U.K.; a stable Mexican consumer goods company; two telecoms, in Japan and Austria; a Korean electronics manufacturer, down after the coup attempt; a London property agency, potentially a merger candidate; a growing supermarket chain in the southeast, with valuable real estate; and a Brazilian bank, depressed because of the country's fiscal crisis. Not all clients own all of these. Apart from client objectives—some are more appropriate only for more aggressive clients—much depends on other holdings and cash availability when we are buying. We continue to be buyers of several of the above, some of which are intended as short-term trades, while some we expect to hold for the medium term.

Looking ahead, we expect to continue to reduce exposure to the U.S. and into global markets, particularly smaller ones, though most buying will likely continue to be opportunistic, as it has been in recent months. We expect to maintain a high weighting to the Business Development Companies, whose high dividends provide some returns throughout market gyrations. And we are maintaining our high exposure to gold stocks, which served us well last year, and, we expect, will do so in the coming year. Cash may increase depending on the opportunities we see at any time.

■ Gold Accounts

The allocation among seniors, intermediates, juniors, and silver stocks remains more-or-less as it was at the beginning of the quarter, with about one-quarter in the large miners and royalty companies; a third each in juniors (and exploration) and silver and diversified companies; with the balance in intermediates. Cash increased a little, but only because of set-asides for a large private placement we are undertaking shortly.

We did not exit any stocks during the quarter, though trimmed many large and small on rallies in individual stocks.

Some new buys, including acquisition targets

We have started to add small positions in a few companies, including a developer of a large project in British Columbia which may be involved in M&A shortly; the developer of a large gold and copper project in the Yukon, with a new respected CEO and now making steady progress on multiple fronts; the developer of a strategically located Ontario project that is garnering attention from larger companies in the area; a Nevada explorer taking another look at a prospective project; and a small prospect generator that has transitioned from Mexico to western North America and is selling for less than its cash.

Again, these are largely small companies so we are buying selectively, based on risk-tolerance and cash availability.

Looking ahead, we expect to remain fully invested, trimming as stocks rally ahead of themselves to put cash into accounts. We expect to continue to hold large cap, juniors and silver in broadly equal weightings, adding to positions opportunistically, as well as constantly searching out new opportunities.

■ Resource Accounts

Our resource accounts also remain fully invested, with highest exposure continuing to be to gold, copper, and silver, though we have increased our energy holdings. As always, we get some exposure through diversified companies: Barrick Gold gives us copper exposure, Franco-Nevada oil and gas; lithium through Midland Exploration; potash through Altius, and so on.

We had two exits this quarter, one a small lithium explorer with disappointing performance (to which we may return); and a gas-dominant E&P company that was acquired. We also generated cash, as always, by trimming various positions as they seemingly got ahead of themselves.

Oil and gas explorers and service companies stand to benefit

With the proceeds from the gas acquisition, we added to existing oil and gas companies, including a high-quality LP; and two large independent E&P companies, one gas-heavy. We also purchased a large global oil driller. If the new administration unleashes the domestic oil and gas sector, it may lead to increased supplies and therefore potentially lower prices, but will be positive for the companies, particularly exploration and service outfits.

We have also started buying in small allocations a new royalty company, dedicated to silver. This is thinly traded so we are accumulating positions slowly. We also have raised funds for a new investment in an idled steel plant with strong returns potential on a restart.

Looking ahead, we expect to continue to be fully invested, with gold as our largest sector exposure. However, we expect to continue to increase exposure to oil and gas, as well as, opportunistically, to copper and uranium. We are focused on sectors that have the ability to do well even if the global macro environment, and particularly China, keeps demand subdued.

In sum, even though we continue to be concerned about, and reduce exposure to the U.S. and major European equity markets, we continue to search for opportunities, whether beaten-up recovery plays or hidden value investments, and we are finding them more-often-than-not in smaller global markets. We will continue to have a high weighting to gold stocks, both as a hedge on the overall portfolios and for return potential in their own right, trimming on rallies for more conservative investors. Across the investments, we are emphasizing companies with solid dividends.

Adrian Day, December 29th, 2024

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