Adrian Day
ADRIAN DAY ASSET MANAGEMENT

PORTFOLIO REVIEW

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This year, if it has been marked by anything, it's uncertainty, and volatility. British politician Rab Butler famously said that "a week in politics is a long time," but it seems recently that a day is an eternity. Uncertainty leads to indecisive and rapidly changing decisions, whether in business or in investing. Bill Dunkelberg, Dean of the Business School at Temple University, puts it this way: "it's hard to steer a ship in the fog."

■ Everything up again

Nonetheless, virtually every major asset class, and nearly all markets, were up in the last quarter, the main exception being long-dated bonds. Some returns were marginal, however.

Returns in international stock markets matched those in the U.S., 10.9%, (per MSCI World ex-U.S. and S&P), though well outperforming for the year to date (16% against 5%). There were a handful of big winners, including Japan (up 14%) among the major markets. Most of Europe was up moderately, building on very strong first-quarter results, with a weaker dollar boosting returns measured in U.S. dollars. Several markets, such as the Swiss market, were negative in local currency, but up by a respectable amount when measured in U.S. dollars

Our global accounts outperformed the major indices, with our benchmark mid-risk global account up 16.5% for the quarter.* (Preliminary numbers.) Conservative accounts were up a little less (12.3%). The main reasons for our outperformance was exposure to Japan, and lack of exposure to the weakest markets, but the main reason was our large allocation to gold stocks (which beat all equity indices in the quarter just ending). Again, the mid-risk and more aggressive account had a higher exposure to gold than the conservative accounts, accounting for the relative performance among our global accounts.

Going forward, we expect gold stocks to help us again, while our overweighting in Asian markets will also likely boost relative returns, as well as absolute. We are also increasingly concerned about the U.S. stock market, and our low exposure will also boost relative returns.

■ Commodities mixed as gold stocks catch a bid

The commodity complex, as always, was mixed, with the Bloomberg Index down over 4% for the quarter. Oil and natural gas fell, while the metals were mixed, with copper and the precious metals up marginally, iron ore and nickel down. Gold was up just over 6% in the quarter, being essentially flat after a strong early quarter move, while silver was up 3.7% for the quarter, though up strongly after an early April drop. The gold and silver stocks, however, exhibited their traditional leverage to the metals, with the senior stocks up 16.5% (per the XAU).

Our gold and resource accounts outperformed, each up over 18% (gold up nearly 19%)* (Numbers are preliminary.) Our resource accounts outperformed due to an underweighting to oil and an overweighting to gold, while the gold accounts outperformed as the juniors finally started to exhibit signs of life, with a handful of strong outperformers among stocks we hold.

Going forward, we expect the junior and exploration stocks to continue to play catch up as North American investors finally begin to return to the space, and that will reward our accounts.

■ The U.S. economy is slowing, as jobs stagnate

One reason we are cautious on the U.S., and other developed equity markets, is that the economies are slowing. The U.S. economy—and many other parts of the global economy—are sliding into recession, notwithstanding numerous economic reports, the Pollyanna media reporting, and the wishful thinking from the Federal Reserve's Jerome Powell. The reality is not as positive as the headlines suggest.

The jobs market is a good example. The last nonfarm payroll report was better than expected, at least from a headline perspective. But look just a little deeper, and it was not such a positive report, with almost as many jobs revised lower from the last couple of months as were claimed to have been created.

Other factors, some of which we have discussed before, add to the impression of a softer-than-proclaimed labor market. The private ADP report is consistently reporting lower jobs numbers (net 37,000) than is the Bureau of Labor Statistics (139,000). Some of the difference is new government jobs included in the BLS numbers. Small businesses in aggregate lost jobs. The unemployment rate last month remains static, but only because of a large decline in the labor force. The number of people working part time because they cannot find a full-time job is high and increasing (to the highest in over six years). Initial jobless claims are at two-year highs, while continuing claims moved up sharply to the highest since the end of 2021, when the economy was coming off the covid lockdowns; the numbers are higher than pre-covid, reflecting difficulty in finding new work. Historically, back to at least the 1960s, a rise in continuing claims such as we have seen over the past three years signifies that a recession is underway or about to start.

Federal Reserve chairman Jerome Powell calls this a "solid" labor market, and the reason he is not in any hurry to cut interest rates. I beg to differ; this is anything but solid.

Other areas of the economy are also showing weakness, again despite headline numbers. Consumer spending dropped again, but modestly. More significant, though, are the large drops in discretionary items, including durables and services (notably airfare and hotels). This means that more money is being spent on essentials, in an economy where many consumers are tapped out on credit. Powell says the consumer is "resilient" and the economy "solid". Again, I beg to differ.

* 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.

The Fed is taking its time

Powell sees no reason to lower rates because of this apparent strength in the economy, and prefers to wait and see the inflationary impact of tariffs. But tariffs are not inflationary. On the contrary, by increasing prices, they tend to reduce spending and are disinflationary, even recessionary. Both theoretically and empirically the conclusion is the same. Tariffs alone would be a reason to cut rates not to hold them high. He is rightly concerned about a tick-up in inflation, but the risk of a near-term slowdown is more significant, in my view.

Fed members, according to their latest "dot-plot", are still expecting an average of two and a half rate cuts this year, and it seems almost certain that we shall see lower rates before the end of the year. Another Fed policy of monetary easing might be even more significant, and that is a new round of Quantitative Easing. Whereas lower rates fight economic weakness, QE will aim to fight the government's debt problems.

Funding the debt will lead to policy change

A U.S. debt funding crisis lies ahead. J.P. Morgan CEO Jamie Dimon has warned that if the U.S. doesn't take action to address the spiraling national debt, "you are going to see a crack in the bond market" (though he added that he doesn't know when). I believe we shall have a foretaste later this year, probably by the end of summer. This is not just me saying that; Treasury Secretary Scott Bessent has said as much. It will be significant, for the economy and markets.

At nearly $37 trillion, the national debt stands at over 120% of GDP (and nearly $280,000 for every household). That number does not include the off-balance sheet liabilities that any private company would have to include. Add those in, and estimates for the total debt range anywhere from $130 trillion to $200 trillion. Over the last half century, U.S. GDP has increased by over 2,000%, while government debt has increased by some 8,500%. That interest on the debt has increased by "only" 5,600%, is because rates were declining for most of this period (1980 to 2022). Interest rates fell from over 15% in 1980s to zero lower bound in 2016 before moving back up to 4.5% today, helping to reduce interest payments even as the total debt increased.

However, debt service as a share of GDP has been increasing for the last several years, after rates moved up, and are now back up to just over 3%, almost at the record level they were in 1980, when interest rates were four times what they are today.

Higher rates mean higher debt service

As the shorter-term five-and seven-year Treasuries issued at far lower rates mature, they have to be rolled over at higher rates today, ensuring that the interest payments, in both absolute and relative terms, increase. Debt service is estimated to be 17% of next year's budget, larger than the defense budget, or Social Security, or Medicare, indeed the largest single item in the federal budget.

Recall, the federal government fiscal year starts at October 1st. After the November 4th election, the Biden administration set about, deliberately and knowingly, spending as much of the full-year appropriation as they could, effectively leaving the cupboard bare for the incoming administration. Indeed, in an interview the Friday evening before Trump was sworn in, then-Treasury Secretary Janet Yellen proclaimed that the U.S. would hit the debt ceiling on Tuesday, Trump's first full day in office.

Without a debt ceiling increase, the government is legally prohibited from raising more money. This year to date, there has been no new net debt issuance; all the Treasury auctions have been limited to replacing funds from maturing Treasuries. Bessent is using all the normal accounting tricks and devices, juggling to pay the government's bills while staying within the debt ceiling requirement.

Who will buy new Treasuries?

But even when the debt ceiling is raised, there remains the question of who will buy all the bonds, and at what price. The later in the fiscal year this occurs, then the shorter the period available to raise funds before the next fiscal year begins. There will be a significant "catch-up" problem. Assuming the debt ceiling is raised later this month, the Treasury will need to issue about $1.6 trillion, which is about 66% more than in the same period last year.

Thus, the supply of Treasuries over a given period will be higher than normal at the same time that buyers are scarce. It is well known that fewer of the traditional buyers of long-term Treasuries will be stepping up, not willingly at any rate. The large foreign holders, including Japan and China, are net sellers. A declining dollar plus an antagonistic U.S. administration will not likely cause more countries to be more eager buyers. Nor does Moody's recent downgrade of the U.S. credit rating, the last of the major rating agencies to do so, help. Many foreign institutions, including Hong Kong pension fund managers, have restrictions on holding bonds not rated Triple A.

Other traditional buyers are more reticent than previously, for one reason or another. The Federal Reserve, which had been the largest buyer of Treasury bonds, has been a seller in recent years after it instituted Quantitative Tightening three years ago. Bond funds saw $11 billion of withdrawals in the second quarter, the largest withdrawal since the depths of the covid crisis; this number includes corporates as well as Treasuries, but it shows the sentiment towards longer-term bonds. Of course, when the debt ceiling is raised, most of the issuance will continue to be at the shorter end of the curve. There is still plenty of demand for 4.5% on short-term Treasuries; there are few places to get higher yields with relative safety.

A mixed bag of tricks to conjure up new buyers

So the question remains: who will buy all those bonds when the debt ceiling is lifted? It will come from a variety of sources, including some buyers dragged to trough. The large banks are faced with a carrot-and-stick approach over the Supplementary Leverage Ratio ("SLR"). They are being told that they do not need to place so much money in reserves on deposit at the Fed—oh, and by the way, we won't be paying interest on reserves any longer (reverting to the long-term practice before the 2008 financial crisis)—"but we'd like you to buy some Treasury bonds at auction instead". This could be a significant source of new buying (though J.P. Morgan's Jamie Dimon has said that he does not expect his bank to increase Treasury purchases).

The so-called Genius Act encourages the issuance of "stablecoins" fully backed by U.S. Treasuries, creating new demand. Perhaps some countries, such as the U.K., will step up to the wicket (or the plate) as a quid pro quo for the trade deal. And so on.

The Fed will pivot to QE

But all these buyers are little more than scraps relative to the total issuance, for this year at any rate. (Changes in the SLR, for example, require a 60-day notice period before implementation.) Here is where the Fed rides to the rescue. For the past three years, the Fed has reduced its bloated balance sheet in a program of Quantitative Tightening, but this year, that program has been reduced, from $35 billion a month, to $25 billion a month, to just $5 billion a month, a rounding error for a balance sheet of almost $7 trillion. Indeed, the Fed has been a net seller in the past two weeks. QT has effectively ended, and once the Treasury resumes issuing new bonds, there is little doubt that the Fed will resume QE, creating credit to mop up the Treasuries.

Remember, though, that most debt issuance this year will be at the short end—in truth the administration has little choice given the squeeze it is in—so the Fed's contribution may not be so much for the balance of this year as it will be in future years.

A resumption of QE would be likely bullish for stocks, negative for the dollar, and wildly bullish for gold.

The dollar has seen its peak

The dollar fell sharply this past quarter, down nearly 8% per DXY Index, to its lowest level in more than three years. This is partly the result of deliberate policies by the administration, but also a reflection of growing concern on the part of international trading partners about the fiscal situation in the U.S., exacerbated by the tariff imbroglio. The fact that the dollar has been falling despite sporting the highest interest rates of any major (and most minor) countries, is striking. What will happen when U.S. rates start to fall again?

Though it is probably oversold in the near term—and the lack of a major currency that can act as a competitor will aid a recovery—we suspect the dollar will weaken over the medium- and longer-terms. This will boost U.S. dollar returns of foreign markets, and be a positive for commodities, in particular gold. It may help some U.S. exporters, but hurt companies relying on foreign-sourced raw materials.

Stocks remains expensive amid higher risk

Stocks in the U.S. and most developed markets around the world continue to be expensive. In the U.S., market breadth, though not at the extremes as of year end, remains poor, while the insider sales have ramped up. Although corporate earnings have held up, the estimates for future earnings have come down significantly, and a slowing economy amid tariff wars, will certainly have an impact on earnings. As we have said before, none of this means that stocks must fall any time soon, but the risk has certainly increased meaningfully.

We are also cautious on other markets amid high valuations and global uncertainty, though new tariff agreements could certainly see sharp rallies in affected markets. Overall we do see a continuation of money flows out of the U.S. into foreign markets, both from U.S. and international investors, so international markets are likely to continue to outperform the U.S. for the period ahead. We continue to focus on bottom-up opportunities, however, and are finding them in various markets and sectors.

Resources mixed amid policy uncertainty

As mentioned above, the commodity complex has seen quite disparate returns over the past quarter. Copper, after a sharp decline early this quarter on concerns for economic growth after the tariffs were first announced (so-called Liberation Day), a decline that wiped out all of the first-quarter gains and more, has now recouped most of those losses.

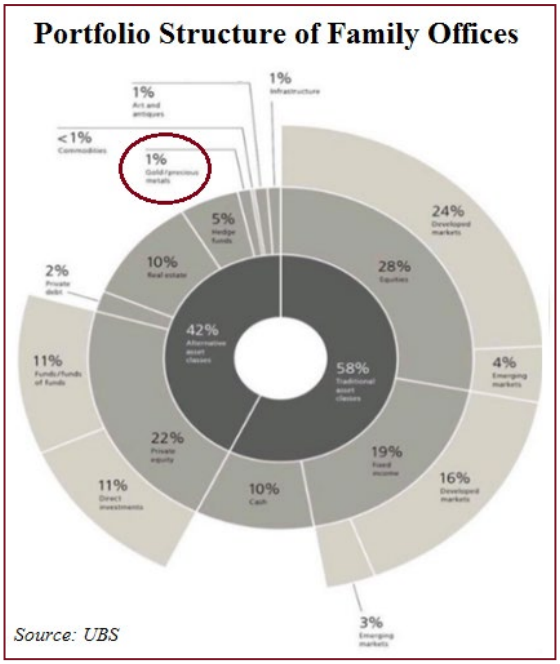
The medium- and longer-term supply/demand outlook for copper remains very positive, with a scarcity of major new deposits coming on line amid rising demand from AI, crypto, and electrification on top of traditional infrastructure demand. Even if the demand expectations from these new sources are overstated, there will still be insufficient copper five years from now. However, a global slowdown, and particularly economic weakness in China coming at the end of a massive infrastructure spend, is a near-term risk.

Gold continues to be strong, as new buyers enter market

The monetary metals, particularly gold, do not face that risk. Other factors are in play. So gold has the best risk/reward outlook in the resource sector right now. Gold is trading just below its all-time highs, demonstrating remarkable resilience. Although the pace of central bank selling has slowed in the last few months at the same time as non-official Chinese buying has ground to a halt, gold's pullbacks have been shallow and short-lived as other buyers take up the slack.

The reasons for the gold buying over the past three years has not gone away: central banks wanting diversification in their reserves amid dollar weaponization; Chinese investors concerned about the possible

yuan devaluation; and wealthy families in the Middle East and Asia wanting protection amid fiscal deficits and easing monetary policies. Though buying from any particular group will ebb and flow, nothing suggests that this buying will end any time soon.



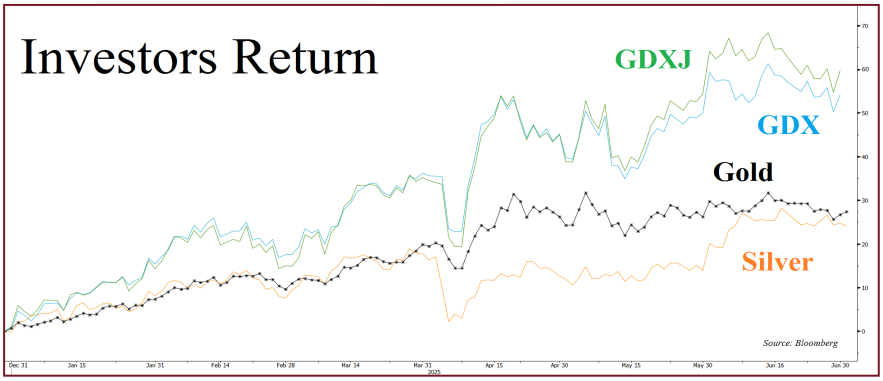
To emphasize that point, a survey of global central banks from the World Gold Council reports that nearly half of respondents (73 banks in all) indicate that their gold reserves will increase over the next 12 months, with none anticipating a decline. The main reason given for increasing gold reserves was de-dollarisation.

An easing of Iran tensions saw a pullback in gold, but it had not really gained much when the conflict started. Geopolitical tensions will see gold respond, but they are not the main driver. In the near term, we see gold responding to resumed monetary easing around the world, including the U.S.; a stagflationary environment in the face of ongoing tariff disruption; and concern about possible devaluations in China and elsewhere in Asia.

■ Is this a crowded trade? Far from it!

Interesting, in the Bank of America's survey of global fund managers, "long gold" has been ranked the most crowded trade for three straight months, with over 40% of managers naming it so. Yet there is a massive disconnect between what these managers think and what they do, with nearly 80% of all advisors having less than 1% exposure to gold, a number that has barely moved over the past five years. Family office has a small 1% exposure to gold. That is not a crowded trade.

There are signs, however, that investors are returning to the space. This quarter, silver performed as well as gold—outperforming in the last couple of months—while the junior stocks have outperformed the seniors (GDXJ vs GDX), again particularly in the last few months. And most importantly, the gold stocks are finally exhibiting some of the leverage to bullion one expects, with the GDX doubling the returns from gold this year. These are indications of investor interest, though not yet showing up in large inflows to gold funds.



Despite this outperformance, the gold stocks remain undervalued. Given the dramatic margin expansion over the past year, and higher gold price, cash flow multiples as well as NAVs have increased faster than the share prices.

Silver appears to have found a new floor, definitely at $30, and possibly just under $33, as the physical deficit seems set to continue. Solar demand is continuing, with demand for relatively cheap and clean energy overcoming concerns about China trade, and that is a main driver for silver. A period of efficiency in solar and photovoltaics, using less silver per usage, may be slowing. As investors return to the sector, there are no significant stockpiles to meet demand. We are not looking for a huge spike to $50 let alone $100 in the near

term; profit taking has come in at current levels about $36, but a new floor does appear to have been found. Again, though we are positive on silver, gold remains our top choice with better risk/reward metrics.

Overall, we remain cautious on the U.S. and major market financial assets, both stocks and bonds, though finding attractive opportunities in diverse sectors and markets. Increasingly, we are finding better opportunities in foreign, and particularly, smaller markets. We continue to be overweight resources, particularly gold, trimming positions to raise cash as prices move up, but maintaining our high allocation. On balance, we expect cash to increase in accounts as assets appreciate and uncertainty increases, and this will see us in a good position when markets have their inevitable pullbacks.

Review of Individual Accounts

Global Accounts

We continue to employ a mostly bottom-up approach to looking for opportunities in the global accounts, and, notwithstanding our cautious approach to the U.S. and most developed equity markets, we continue to find good opportunities, quality companies selling at low valuations. Thus, our cash exposure remains low, though up from the end of the first quarter. In mid-risk accounts, we hold just over 2% of accounts in cash, over 13% in conservative ones. Our largest exposures by market continue to be Hong Kong and Singapore, and by sector, gold and the Business Development Companies.

We raised cash mostly by trimming holdings on rallies, in global markets and in BDCs. We exited one stock, a Hong Kong exporter after a strong rally despite tariff concerns.

On the buy side, we had no new holdings, but did add across the board to quality companies whose stocks fell on what appear to be temporary factors.

Going forward, we expect cash levels to increase again, if only modestly, as we continue to trim overvalued stocks, always looking for quality stocks with low valuations. We will continue to hold a high weighting to gold stocks, again looking for opportunities to trim in global accounts in order to raise cash.

Gold Accounts

Gold accounts continue to be essentially fully invested. The increase in cash to 1.6% reflects new accounts opened that are not yet fully invested, and the timing of a couple of sales, rather than any shift in outlook.

There was a shift in relative weightings among sub-groups however, all fairly modest. Senior miners and royalties declined to just over one-quarter of accounts, while silver and other resources, and juniors and exploration, each increased to just over one-third, with the balance in intermediates. The first was the result of trimming positions in some stocks on rallies. The intermediate and resource categories increased through additions, while the juniors increased their weighting because of greater appreciation.

Two new long-term positions added

We exited only one position, that is in a large, undeveloped project after a rally; we tend to use this stock as a trading vehicle since it is sensitive to the price of gold. We added two new positions: one a developmental story that was transformed with the purchase of an operating mine in Ontario; and a new junior royalty company run by a team that has successfully built and sold in the space before. We anticipate building positions in these two companies and holding for the long term.

Looking forward, we expect to remain fully invested. We also anticipate a continuation of the trend towards the juniors seeing outperformance, driven mainly by strong performance in a few stocks, rather than a broad increase in the sector. With a mix of the top royalty companies as a foundation, the better quality major producers, as well as smaller companies and explorers, we are well positioned for growth at moderate risk.

■ Resource Accounts

Our resource accounts also continue to be fully invested; most of the increase in cash is set aside for possible exercise of put options. Although gold, copper and silver continue to be our largest exposures, we did meaningfully reduce the weighting to senior gold stocks, both because of relative performance but also because we trimmed positions to raise cash for other buys.

Several new companies added

We exited no positions this past quarter, but did add some. We are buying a company with a polymetallic deposit in Minnesota; well funded with strong management and shareholders, there are expectations that permits may move faster under the new administration. We also bought two new private placements, in small rounds, one with a polymetallic deposit in Canada and the other with a copper deposit in Peru. Once these go public, we intend buying more (depending on price, of course). Lastly, though our exposure to oil & gas remains very low, we did add a high-quality Canadian name on a tariff-induced price decline.

Most of our buying however has been adding to existing holdings, including a copper name in Arizona, moving rapidly through development; a company with a copper deposit in Brazil up for sale; and a large phosphate deposit in Ontario which recently brought in a large (unnamed) strategic investor.

Looking ahead, we expect to remain fully invested, and expect gold, copper and silver to remain our top holdings. We are adding to copper as well as to uranium names, opportunistically, while we expect our oil exposure to remain underweight for the near term. Apart from the precious metals, our focus is on good deposits with top management in resources where supply is constrained.

In sum, increased uncertainty and with it volatility, amid slowing economies, has increased our caution on financial assets in major markets. There remains the possibility for sudden crises, including on Treasury debt funding and the Fed's response. Although we expect cash levels to increase in our global accounts, we continue to find opportunities in uncorrelated markets and assets, including smaller Asian stock markets and the commodities.

Adrian Day, July 1, 2025

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