PRECIOUS METALS Q&A

Gold Prices Can Keep Rallying, This Investing Pro Says. Here Are Her Picks.

Imaru Casanova, a portfolio manager at VanEck, also likes the outlook for mining stocks and precious-metals royalty and streaming companies.

By Jack Denton Follow

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John Maynard Keynes called the gold standard a barbarous relic, but the yellow metal recently has outshone far more modern assets.

The price of gold is up 15% this year to a recent $2,409, and has gained 22% since the Federal Reserve began raising interest rates in March 2022, a move that typically batters bullion. That's because higher bond yields present competition for gold, which has no yield.

Yet, gold's unorthodox rally is just one anomaly of late in the metals market, says Imaru Casanova, a portfolio manager specializing in gold and precious metals at VanEck. The firm offers exposure to gold through exchange-traded funds including the VanEck Merk Gold Trust (ticker: OUNZ), which gives investors the option to take physical delivery of gold in exchange for shares; the VanEck Gold Miners ETF (GDX); and the VanEck Junior Gold Miners ETF (GDXJ). It also offers precious-metals mutual funds.

A native of Venezuela and a mechanical engineer by training, Casanova joined VanEck in 2011 and became a deputy portfolio manager in 2014. Last year, she took over as manager of the firm's actively managed gold equity investment strategy, which includes the

VanEck International Investors Gold fund (INIVX). The fund returned 9.7% in 2023, putting it in the top quartile of its equity precious-metals category, according to Morningstar, which currently ranks it four stars. This year, it is underperforming most peers, with a 5.24% total return.

Barron's spoke with Casanova on April 11 about the drivers of the current gold rally, and why she is bullish about gold, silver, and mining stocks. An edited version of the conversation follows.

***Barron's*: Gold has enjoyed a thunderous rally this year. How do current trends in the gold market compare with history?**

Imaru Casanova: The historical drivers of gold have been lacking in the recent rally. Since the October 2022 lows, strong performance hasn't come from the traditional centers of demand. For as long as I have been covering the sector, we have studied investment demand and tracked what gold-backed bullion ETF holdings are doing. Yet, investment demand and ETF holdings have been in persistent decline since April 2022. Previously, if you plotted ETF holdings versus the gold price, there would have been an almost perfect correlation.

So, what is driving gold prices higher, if not investment demand?

As investment demand declines, it has been more than offset by strong demand from central banks, which have been buying gold at unprecedented levels since 2022. Mostly, we're talking about emerging market banks: China, and then places like India and Turkey.

China has been buying gold as it reduces U.S. dollar exposure. It isn't a coincidence that the strength in gold began in 2022, when Russia invaded Ukraine. We know what happened to the rest of Russia's assets, but the country had about 22% of its reserves in gold. Other central banks were paying attention.

Asian consumers have also been buyers. We have seen zero interest in gold or gold equities from the West as the S&P 500 index has been making new highs. But in China, the economy is weak, and investors have clung to gold in physical form as a shelter.

Why are central banks and other investors buying gold right now?

Protection against inflation, volatility, and geopolitical risks. Heightened geopolitical risk has always been and continues to be supportive of gold. There is also a de-dollarization theme, and central banks are diversifying.

Western investors are still on the sidelines. When these investors come back, that's when the rally [in gold] will accelerate.
— Imaru Casanova

Another driver has been the Federal Reserve. For the past couple of years, investors said, "Why would we be looking at gold if the Fed is embarking on a tightening program and raising interest rates? Higher rates tend to be negative for gold." In fact, well before the Fed paused interest-rate hikes, gold took off in anticipation of eventual rate cuts.

How can gold prices be so high in this environment of generationally high interest rates?

A rise in the gold price while rates are rising is a disconnect in the usual relationship, and the key factor is inflation. Let's not forget that inflation reached almost double digits in 2022, and the recently released consumer price index report for March showed an uptick in inflation. Gold historically does well during inflationary periods.

What is your gold-price outlook

One reason we are so positive is because the historical driver of prices has been absent. Geopolitical risk is increasing, the Fed is still expected to cut rates, and Western investors are going to start looking to hedge their portfolios. When investors look to add protection and diversification, we expect gold and gold equities to benefit. Gold is at peak prices, yet investment demand isn't even close to peak levels. If that demand comes back, we can easily justify a price of $2,600. That makes me really bullish.

If inflation persists but Fed rate cuts are seen as coming eventually, and ETF holdings are historically trailing, maybe the real rally hasn't started yet?

Western investors are still on the sidelines. When these investors come back, that's when the rally is going to accelerate. You also wonder how price-sensitive central banks are, and what we have seen is that they aren't. That said, we're prepared for things to pull back a little and settle down until another catalyst emerges. The most obvious one would be the return of Western investors, but it could also be a black swan event. Gold historically responds to global events that threaten financial stability.

What will drive Western investors back to gold?

How high do prices have to get? We have seen markets pay more attention, but it's going to take a real pullback in the broader equity market to drive investors to gold. We need to see investors feel the pain of lacking diversification. The Fed's announcement of a rate cut could also be a catalyst, but that would be perceived as positive for the broader market, as well.

How should gold fit into a portfolio, and how do you approach allocation, both in terms of size and different types of exposure?

Investors shouldn't try to time the market. They should make gold a core component of their portfolio because gold has historically offered improved risk-adjusted returns. It is hard to talk about the benefits of gold if you have a portfolio allocation of much less than 5%. Your allocation probably shouldn't be more than 10%, but it depends on your profile.

The next layer is how you get exposure. Investors should consider not just gold bullion but also equities. On the bullion side, if you really sleep better at night having gold in a vault, go ahead. But I believe that bullion-backed ETFs serve you just as well.

On the equities side, investors need to understand that gold equities are a leveraged play. When gold is up 1%, you'll see stocks up 3% to 5%, and that works in reverse on the way down. The stocks are volatile and have risks that gold doesn't—geopolitical, technical, geological, financial. Expected excess returns come with higher risk. Investors might want a blend of bullion and equities.

Gold-mining stocks have been dead money in recent years. What is the bullish case?

We have been flagging the lag between the metal and the equities for some time now. We expect things to mean-revert, and that's what we are starting to see. In March, gold was up 10% and the stocks were up about 20%. Gold is well above its prior peak. The stocks peaked around 2011. They would have to double from here to get to their prior peak. That shows how undervalued this sector is.

How confident are you in the miners as businesses?

Valuations are so low that we have a lot of ground to cover, but these companies are also in good shape. Balance sheets are strong. Hedge books are almost nonexistent. Costs to produce gold are about $1,400 an ounce. Costs have increased significantly, and that has affected sentiment. With gold potentially much higher from here, we might get a 3% to 5% increase in costs in 2024, but that will be more than made up for by the strength in gold prices.

These companies are generating a lot of free cash flow, and we don't expect costs to blow out. These companies are well managed and should see significant margin expansion. And where does all of that cash go? Some of it gets returned to investors, and some gets put to work in growth and acquisitions. In the previous gold bull market, companies destroyed a lot of value by not caring about costs in acquisitions. Now we are encouraged by their discipline.

What are some mining stocks you like?

Alamos Gold is a top holding and has been a good example of discipline, delivering growth and value accretion. We also like the royalty and streaming companies. It's a brilliant business model. [Royalty and streaming companies fund mines in exchange for future payouts.] Within that category, our top names are Wheaton Precious

Metals, Royal Gold, Osisko Gold Royalties, and Franco-Nevada. Wheaton also has silver exposure.

Other precious metals have also rallied, especially silver. What is your outlook?

Silver is like gold and has historically traded based on the same fundamentals. It has been lagging behind gold over the past couple of years, which makes me bullish because it has the potential to catch up, and it has started to do that. What makes silver unique is that it also has an industrial component that is a pretty big chunk of total demand. Silver is used in solar cells, and the growth of that industry is a bullish story for silver, but there are a lot of applications. If the global economy picks up, silver will feel it and could have downside protection compared with gold. Usually a strong economy isn't the best environment for gold, but it could support silver.

Some investors might consider Bitcoin a store of value to rival gold. Do you see a competitive threat?

Emerging markets with younger investors seem to be a lot more attracted to Bitcoin than developed nations and older demographics, which seem to see more appeal in gold. We always get asked if Bitcoin is stealing demand from gold, and there probably is some of that.

I suppose younger investors might consider Bitcoin instead of gold, but I struggle to think there is much of an overlap. It is probably a different investor base, and gold as an asset class historically has had a well-understood and defined role and track record. Bitcoin offers an alternative that makes it similar to gold as an asset class, but it's young. It also doesn't have the track record to compete with gold as a haven, an inflation hedge, and a geopolitical hedge.

Thank you, Imaru.

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