Fund performance

For the month of November the fund posted a return of -1.97%. This compared to the FTSE Gold Mines Index benchmark return of 0.47%.

Year-to-date the fund has returned 6.01%. This compared to the FTSE Gold Mines Index benchmark return of 5.07%.

Since inception (29 June 2016) to end September 2017 the fund has returned -8.77%. This compares to the FTSE Gold Mines Index benchmark return of -13.96%.

Source for performance: Bloomberg I Accumulation shares USD gross. Performance is on a NAV to NAV basis.

Gold and broader market commentary

Throughout the last few weeks rising US real yields, rising equity markets (all driven by the US tax “reform”) have provided headwinds to gold and gold equities.

Global equity markets have now added close to US$9.5tn in market capitalisation over the course of the year. While global consensus 2018 inflation forecasts have been revised down, consensus global growth forecasts have been revised up. Against this backdrop, the fact that gold has traded in a narrow US$30/oz range for most of the month, with implied volatility at close to all time lows, is relatively impressive.

The impact of tax reform is a key issue...If accelerating US real growth and strong real interest rate increases were the likely result we would share this view. However, in a recent survey, only 35% of US S&P 500 CEO’s suggested they would increase capital spending (the rest would pay down debt or increase buybacks) our group’s belief is that the impact on growth will be less aggressive. As we have highlighted before, it is also noteworthy that a rising US twin deficit (which the tax bill will almost certainly help drive) tend to correspond with periods of a weak US dollar.

These recent announcements have kept broad market investors euphoric, but in the event that global equity and growth euphoria weakens, gold stands to benefit significantly. With the Federal Reserve set to raise rates on the 12 December it is worth recalling that Fed rate hikes have marked the low for precious metal markets in three of the last four instances (refer to Chart I below).

Chart 1 – US dollar gold spot prices with Federal Reserve interest rate hikes marked

Source: Bloomberg – December 2017.

¹Schroder International Selection Fund is referred to as Schroder ISF throughout this document.
For investors looking to hedge their diverse portfolios with some precious exposure, it is the longer term that matters.

Here the outlook for gold (and silver) prices remains very strong. As we often repeat, several key drivers are converging:

1. The need for global real interest rates to remain negative amid record debt levels;
2. Broad equity valuations are extremely high and complacency stalks financial markets;
3. The dollar is potentially entering a bear market;
4. Global geo-political uncertainty is profound, and increasing.

Cryptocurrencies are a theme we have been asked for our opinion on more and more.

We cannot claim to be Bitcoin, or any other cryptocurrency, experts. However we are happy to share some of our views.

**Gold and Bitcoin**

Perhaps we are simply financial dinosaurs, unable to grasp that the world has moved on, and that cryptocurrencies have become the currency of last resort for the Digital Age.

Maybe. Or maybe Bitcoin and the cryptocurrency craze is simply another frenzied bubble, coming at the end of the longest period of liquidity creation, record low interest rates, and consequent yield seeking behaviour in modern financial history.

In terms of extreme financial events the cryptocurrency frenzy may come to be seen as just one example of a 2017 crescendo (see exhibit I below).

**Exhibit I – 2017 has seen a further surge in extreme financial behaviour**

- A painting (which may be fake) sold at auction for $450 million.
- Bitcoin, which does not physically exist, rose from $952 to over $11,000, surpassing the market capitalisation of Royal Dutch Shell
- The Bank of Japan and the European Central Bank have bought nearly $2 trillion of assets.
- Global debt has risen further: now above $225 trillion or ~32% of global GDP.
- US corporations sold a record $1.75 trillion in bonds.
- European high-yield bonds traded at a yield under 2%.
- Argentina, which has defaulted twice since 1980, sold 100-year bonds in an oversubscribed offer.
- Illinois, a U.S. state which is close to insolvency, sold 3.75% bonds to bondholders who were desperate for allocations.
- Global stock market capitalization increased by $15 trillion to over $85 trillion and a record 113% of global GDP.
- S&P 500 volatility dropped to 50-year lows and Treasury volatility to 30-year lows.
- Tesla Inc. sold 5% bonds with no covenants while it burned $4+ billion in free cash flow and again pushed back its Model 3 production timeline.

Source: LCM; Schroders.

There are many areas we could focus on in terms of comparing gold and cryptocurrencies. History, volatility and storability stand out (all in gold’s favour). Perhaps we will do so in a future monthly commentary.

We are not experts on cryptocurrencies, but we would highlight one of Bitcoin’s (used interchangeably with “cryptocurrency” below) selling points: that it exists independently from any issuing authority or sovereign government. Cryptocurrency generating algorithms* cannot be interfered with by Central bankers or governments. If that is what you believe, then best of luck. The reality is risks around the use, regulation, access to, and taxation of cryptocurrencies are large.

For us two regulatory “triggers” stand out...

Firstly, any perceived threat to financial stability can trigger aggressive government interference. The attractiveness of cryptocurrencies as a vehicle for capital outflows (be those flows sourced from legal or illegal enterprise) means that the point at which the scale of flows comes to pose a (real or perceived) risk to the currency stability of any sovereign nation, action becomes likely.

If the funds “risked” in cryptocurrencies become large enough to present a risk to financial stability then regulation will follow. The People’s Bank of China banning Bitcoin trading is a clear example though recent comments from regulators (UK, India, South Korea, Holland to name a few) show how quickly this scrutiny can increase. Perhaps, irrationally, fear of looming restrictions is driving current frenzied FOMO (fear of missing out) buying. The higher the market capitalisations of cryptocurrency vehicles, the closer broad restrictions come.

The second perspective from which cryptocurrencies appear to have a very large regulatory bulls-eye painted on them is environmental. Estimates suggest that the energy footprint of Bitcoin mining is roughly 31.3TWh per year (with a further 11TWh from Ethereum mining alone*). That is higher than the power consumption of numerous mid-sized countries including Ireland and New Zealand. It is ~10% of total French annual power consumption. These figures have risen rapidly: the power required to produce Bitcoin unit’s increases with the price as the complexity of problems needed to be solved increased. One commentator, admittedly an environmentalist, has argued that on current trajectory bitcoin mining would need as much power as is currently consumed by the entire US economy (592TWh in 2016).

² [https://digiconomist.net/bitcoin-energy-consumption](https://digiconomist.net/bitcoin-energy-consumption)
We are aware of one gold fund manager recently announcing that he has allocated 5-10% of his gold fund to Bitcoin. Just to be clear, we will stick to investing in gold and precious metals miners and we will not gamble with our investors' money.

One area which does look interesting and which we will re-visit is the emergence of gold-backed monetary schemes such as Glint [https://glintpay.com](https://glintpay.com), bitgold, or the micro gold scheme currently being rapidly expanded by China’s Tencent (backed by ICBC, China’s largest commercial bank). All have significant potential.

**Equity sub sector performance and positioning**

The Australian gold equities (ASX Gold Mining Index) increased by 3.0% in USD terms during November. At month end, the fund had around 16.2% exposure to Australian listed gold equities. This compared to the benchmark weight of 15.3%.

The South African gold equities (JSE Gold Mining Index) increased by 8.9% in USD terms in November. At month end, the fund had 6.8% exposure to South African gold equities. This compared to the benchmark weight of 7.1%.

The North American gold equities (S&P/TSX Gold Index) decreased 1.98% in November in USD terms. At month end, the fund had 62.8% exposure to North American gold and precious metals producers. This compared to the benchmark weight of 61.9%.

**Performance attribution and portfolio activity**

Overall fund attribution was slightly negative in November. Our overweight positions in Oceana and Westgold, two very well managed and strong free cash generative companies provided around 80bps of negative attribution. In contrast our overweight position in Wheaton partially offset this negative attribution.

**Monthly chart pack**

**Chart 1: Spot gold prices expressed in various currencies**

![Spot gold prices in various currencies](image1)

**Chart 2: Consumer price index (CPI) for major economies**

![Consumer price index for major economies](image2)

**Chart 3: US core personal consumption expenditures (PCE) vs civilian worker wage costs**

![PCE vs civilian worker wage costs](image3)

**Chart 4: Total ETF gold holdings vs spot gold price**

![Total ETF gold holdings vs spot gold price](image4)
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