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Schroder ISF[1] Global Gold Fund update

October 2021

Fund performance:

The fund posted a return of 12.75% for October. This compared to the FTSE Gold Mines Index benchmark return of 6.08%.

I shares gross

US$ %	Oct 2021	YTD	2020	2019	2018	2017	2016	Since Inception[1] Cumulative performance	Since Inception[1] Annualised performance
Fund	**12.75**	**-16.29**	**31.48**	**51.09**	**-13.90**	**11.28**	**-17.21**	**31.92**	**5.32**
Benchmark[2]	6.08	-14.80	24.95	42.68	-10.04	10.23	-23.13	15.77	2.78

Calendar year performance

US$ %	2016	2017	2018	2019	2020
Fund		**11.3**	**-13.9**	**51.1**	**31.5**
Benchmark[2]		10.2	-10.4	42.7	25.0

Past performance is not a reliable indicator of future results, prices of shares and the income from them may fall as well as rise and investors may not get the amount originally invested.
Source for performance: Bloomberg I shares gross USD. Performance is on a NAV to NAV basis. [1]Inception 29 June 2016. [2]FTSE Gold Mines Index. Typical ongoing charges for I shares are 1.07%.

Risk Considerations:

Performance risk: Investment objectives express an intended result but there is no guarantee that such a result will be achieved. Depending on market conditions and the macro economic environment, investment objectives may become more difficult to achieve. **Operational risk:** Operational processes, including those related to the safekeeping of assets, may fail. This may result in losses to the fund. **Market Risk:** The value of investments can go up and down and an investor may not get back the amount initially invested. **Liquidity risk:** In difficult market conditions, the fund may not be able to sell a security for full value or at all. This could affect performance and could cause the fund to defer or suspend redemptions of its shares. **IBOR Risk:** The transition of the financial markets away from the use of interbank offered rates (IBORs) to alternative reference rates may impact the valuation of certain holdings and disrupt liquidity in certain instruments. This may impact the investment performance of the fund. **Higher volatility risk:** The price of this fund may be volatile as it may take higher risks in search of higher rewards. **Emerging Markets and Frontier risk:** Emerging markets, and especially frontier markets, generally carry greater political, legal, counterparty, operational and liquidity risk than developed markets. **Derivatives risk – efficient portfolio management:** Derivatives may be used to manage the portfolio efficiently. A derivative may not perform as expected, may create losses greater than the cost of the derivative and may result in losses to the fund. **Currency risk:** The fund may lose value as a result of movements in foreign exchange rates. **Counterparty risk:** The fund may have contractual agreements with counterparties. If a counterparty is unable to fulfil their obligations, the sum that they owe to the fund may be lost in part or in whole.

[1]Schroder International Selection Fund is referred to as Schroder ISF throughout this document.

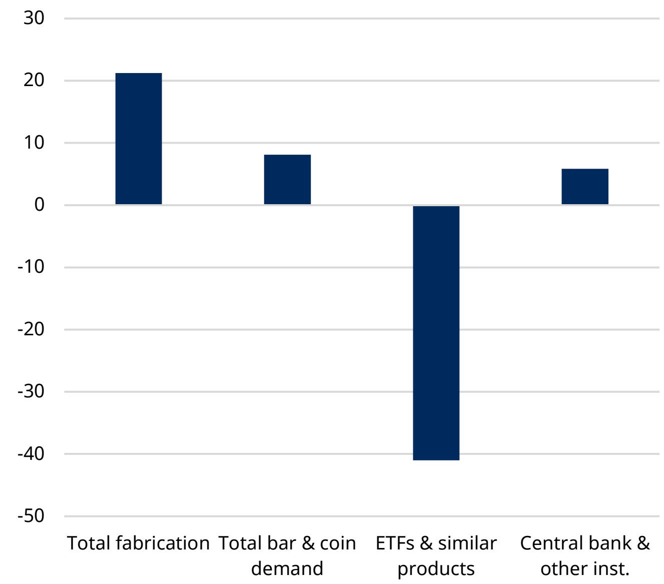
Current strategy and portfolio activity:

The fund continues to favour producers with cheap core valuations (Endeavour & Northern Star for example), clear paths to free cash inflections (Perseus for example) or other value surfacing optionality (Oceana / Eldorado / Goldfields for example). The fund re-enforced positions in Eldorado, B2 Gold, SSR mining and Northern Star through the month.

Gold market outlook:

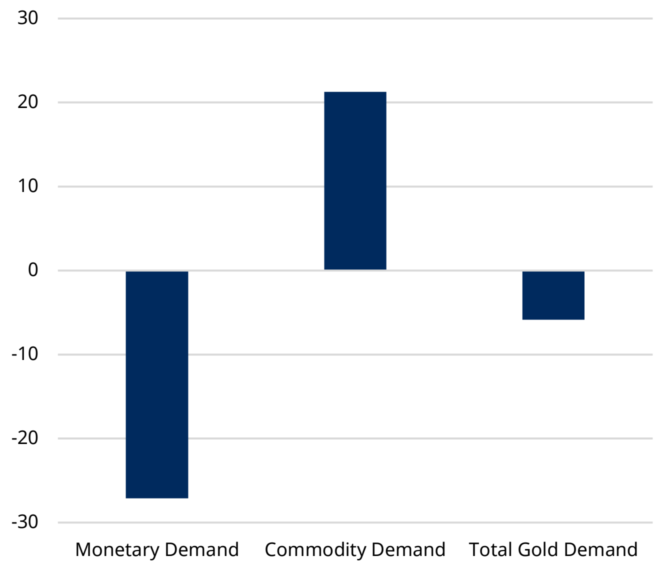
Gold prices closed October up 1.5% and are down 6.5% for the year. A lack of investor interest (in fact, notable liquidations) is what has caused gold to lag most other markets. While for the year to date global gold jewellery and fabrication demand is up over 50%, Central Bank purchases are up 70% and bar and coin demand is up over 35%, liquidations of investor ounces held in physical ETF products has kept total gold demand down YoY and stopped gold participating at all in the broader commodity market strength. **Chart 1** summarises these changes in Millions of oz terms, while **chart 2** aggregates the data into commodity (jewellery, industrial fabrication) and monetary (investment, Central Banks, Bar and Coin). In our minds it remains the case that where the sum of "monetary" gold demand goes, so the gold price goes. This has been the case since 2008, and 2021 so far is highlighting again that this remains the case.

Chart 1: 2021 YoY change in gold demand split by category (Million Oz)



Source: World Gold Council, Schroders

Chart 2: 2021 YoY gold demand change aggregated into Commodity and Monetary demand (Million Oz)



Source: World Gold Council, Schroders

As discussed in recent reports we think there is a good chance this investor apathy will start to shift. While discussion around crypto cannibalisation of gold investment is relevant, what continues to matter most is what macro scenario plays out over coming quarters / years. If we skew away from a path of broadly benign normalisation, investors are likely to once again turn to gold.

If we were to reduce this down, for discussion purposes, into three potential paths/scenarios they would be:

1. **Behind the curve:** Central Banks falling too far behind the curve of building inflationary pressure. Wages and rents pick up the inflationary baton and historically low supply chain inventories extend the manufacturing cycle. Long dated inflation expectations de-anchor and real interest rates move down. Positive for gold.
2. **Stagflation / growth disappointments:** A quicker than expected DM manufacturing to services switch and a prolonged painful downturn in China's gargantuan property market sharply impact global growth. Even moderate tapering / tightening proves too much for economies to bear. Elements of inflation prove sticky. Positive for gold.
3. **Goldilocks:** Inflation not too hot, growth not too cold. A benign market friendly normalisation overall continues. Gold continues to underperform/fall but likely averages much higher than recent historical troughs.

Of course the above is an oversimplification and potential scenarios / paths are myriad. A fourth scenario would obviously be that major Central Bank's quickly realise that they are behind the curve and act more aggressively to "normalise" policy (something that smaller DM CBs and EM CBs have already started to do). This would be short-term negative for gold as real rates rose sharply but, to our minds, any such assertive tightening would most likely itself trigger a sharp growth slowdown / financial asset instability and lead directly to more explicit stagflationary conditions – certainly recent ECB, BoE and Fed pronouncements suggest we really are a long way from this.

Empirically, if we are honest, the track record of economists and investors in forecasting precise macro paths even in "normal" times has been poor. The unprecedented abnormality of the post COVID world makes that task even more thankless. Overall, if we were to hang our hat on anything it would be that the probability of scenarios 1 and 2 unfolding have become much higher. As the exhibits below show generally those type of environments would be very constructive for gold markets (exhibits below are from Schroders Sean Markowicz and Citigroup's Matt King).

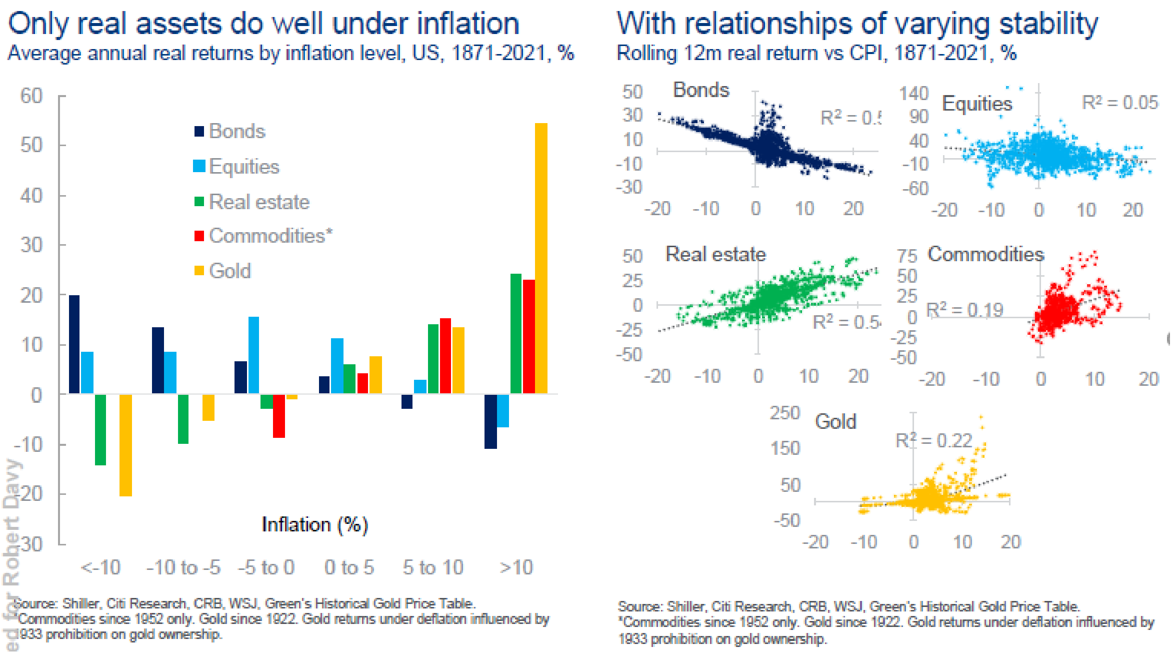
Exhibit 1: Table showing asset price returns in different inflation environments. Gold strongly outperforms in stagflationary environments and this is not simply a "1970s" effect. In the period post 1980 gold has also outperformed in periods of rising inflation and slowing growth.

Average real (inflation-adjusted) YoY total return since 1973, %

	US equities	US Treasuries	US T-Bills	Commodities	Gold	REITs
Goldilocks	16.1	4.3	0.8	0.4	-2.5	18.1
Disinflation	8.4	8.1	1.7	-5.6	1.3	3.5
Reflation	14.6	-2.0	0.0	21.0	-1.1	14.0
Stagflation	-1.5	0.6	0.4	15.0	22.1	6.5

Source: Source: Datastream Refinitiv and Schroders. Data to 30 September 2021. Notes: growth is proxied using US Chicago Board Leading Economic Index and inflation is US core CPI. Goldilocks = accelerating growth and falling inflation; disinflation = decelerating growth and inflation; reflation = accelerating growth and inflation; stagflation = decelerating growth and inflation above 10-year average.

Exhibit 2: Chart looking back to 1871 and showing Table showing asset price returns in different inflation environments. To quote the source report: "Only real assets do well under inflation"



Source: Citigroup

At the same time, regardless of what rough path the global economy treads in coming quarters, as we have argued many times before, we are of the view that we are entering (not ending) an era of deeply negative real interest rates for an array of structural reasons including excessive debt levels, financial repression in response to those debt levels, changing attitudes to fiscal policy (partly to finance political commitment to climate change) as well as long-cycle demographic and geo-political shifts which are likely inflationary.

Gold equities:

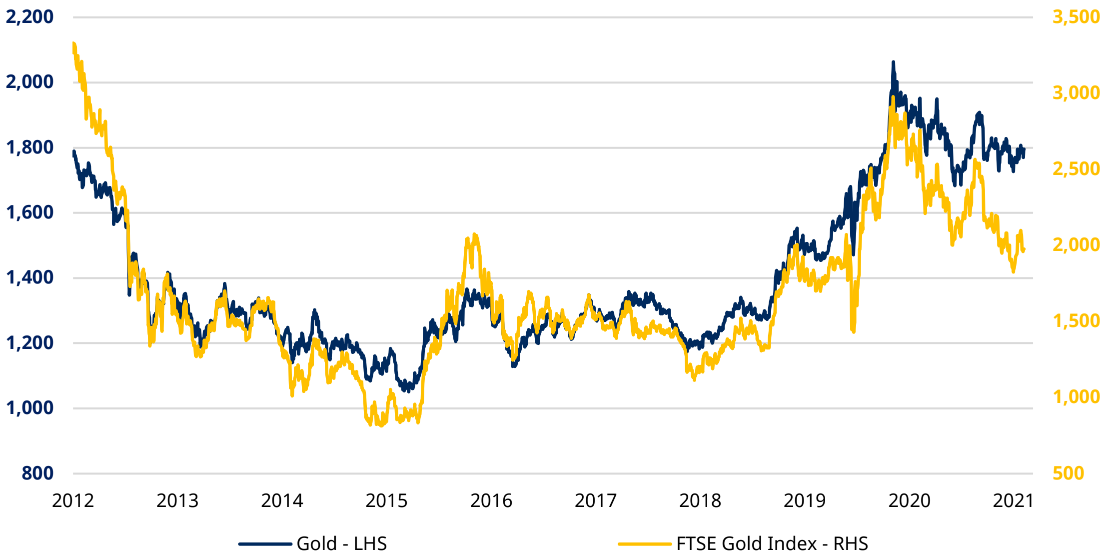
Gold equities moved 6% higher in October, correcting some of their underperformance for the YTD but remain down 15% for the year. We are currently moving through quarterly earnings season and will provide a fuller update on operational and cost performance next month.

So far results have been mixed with some producers hinting at ongoing cost inflation and struggling to meet guidance (Newmont) on the one hand to others actually being in a position to reduce cost guidance or increase production guidance due to operational strength and favourable producer currency environments SSR, Eldorado).

While early signs of warming sentiment towards gold bullion are apparent (and unsurprising given the stagflationary risks) a question we have had a few times is whether gold equities can really be viewed as a reliable proxy for simply holding gold bullion. We would make the following points in answer to that question:

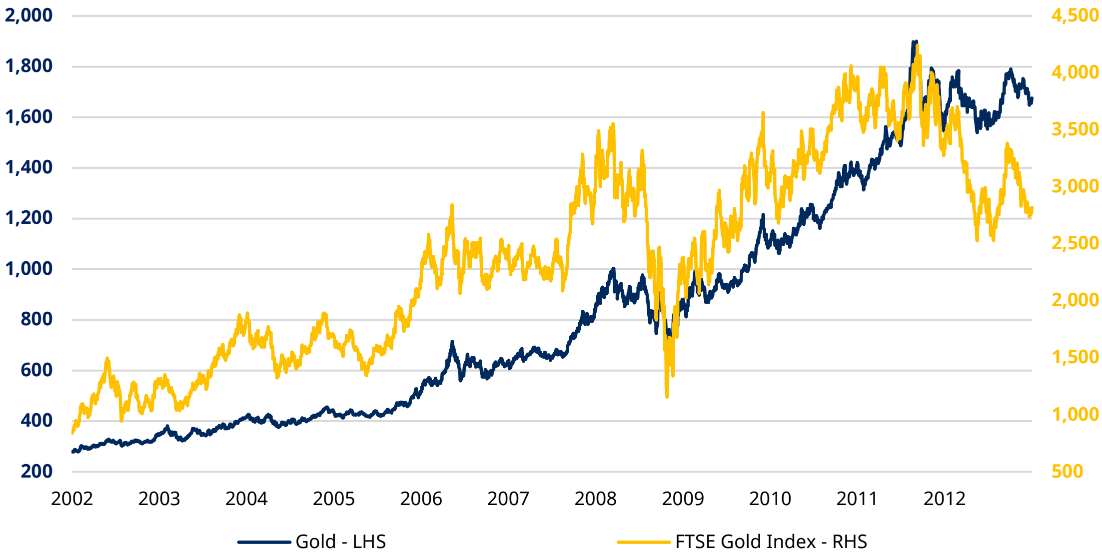
1. It is fair to say gold equities are broadly an extension of gold. Directionally they move in the same direction. **Chart 3 and 4** show that.
2. However, it is also the case that the beta of gold equities to gold has been far from constant. For example it is not even true to say that gold equities always outperform gold bullion in a rising gold environment.
3. **Chart 5** shows a good example of that. In the period from late 2005 to 2015 gold equities underperformed gold in both a bull market and bear market. We call that the "lost decade" – **chart 6.**
4. That might seem an odd thing to highlight. But to give a full picture **chart 7** shows why we think that happened by breaking the period up into three distinct periods:
    a. First the producers saw their margins eaten up by cost inflation (2005-2008).
    b. Second the producers all believed gold was going to 5k so levered up massively and went on an M&A binge. Maximum debt increases and equity issuance came in 2011… just as the cycle peaked the producers were all looking to the moon (2009-2011)
    c. That meant when prices fell the producers were levered, had huge capex commitments, and had let their operational discipline go (2012-2015)
    d. In short – an epic disaster. Investors have not forgotten and, very importantly, neither have management teams.
5. Key point: that disaster (75% underperformance vs. bullion in a decade) sowed the seeds of a much healthier industry which is now almost the polar opposite to that period in terms of operating and capital discipline and in terms of financial health. Industry financials and valuations have been transformed:
    a. Producers are pricing in significantly below spot gold prices.
    b. Gold equities are now on aggregate net cash – a huge change from the 2011-2015 period.
    c. Management discipline remains high.
    d. The sector is ripe for further consolidation.
6. That is why if you believe the environment is positive for gold then the producers are a very attractive prospect.
7. As we have pointed out recently, the all-in cost inflation we are seeing today is about 1/3rd of what we saw in prior periods.

Chart 3: Gold vs. gold equities – 2012 to today



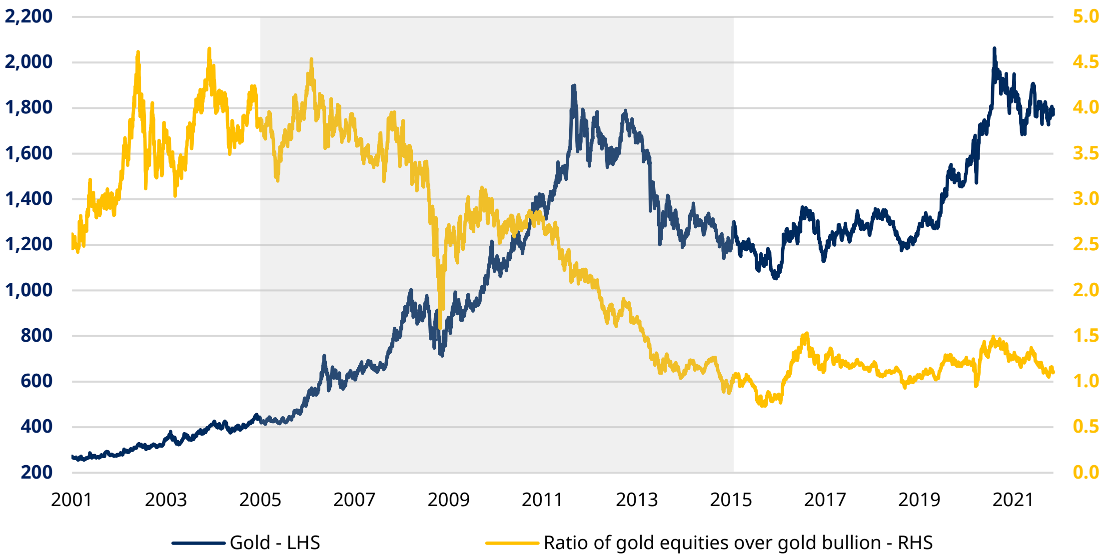
Source: Bloomberg.

Chart 4: Gold vs. gold equities - 2002 – 2012



Source: Bloomberg.

Chart 5: Gold vs. the ratio of gold against gold equities highlighting that in the period from late 2005 to 2015 gold equities underperformed gold in both a bull market and bear market.

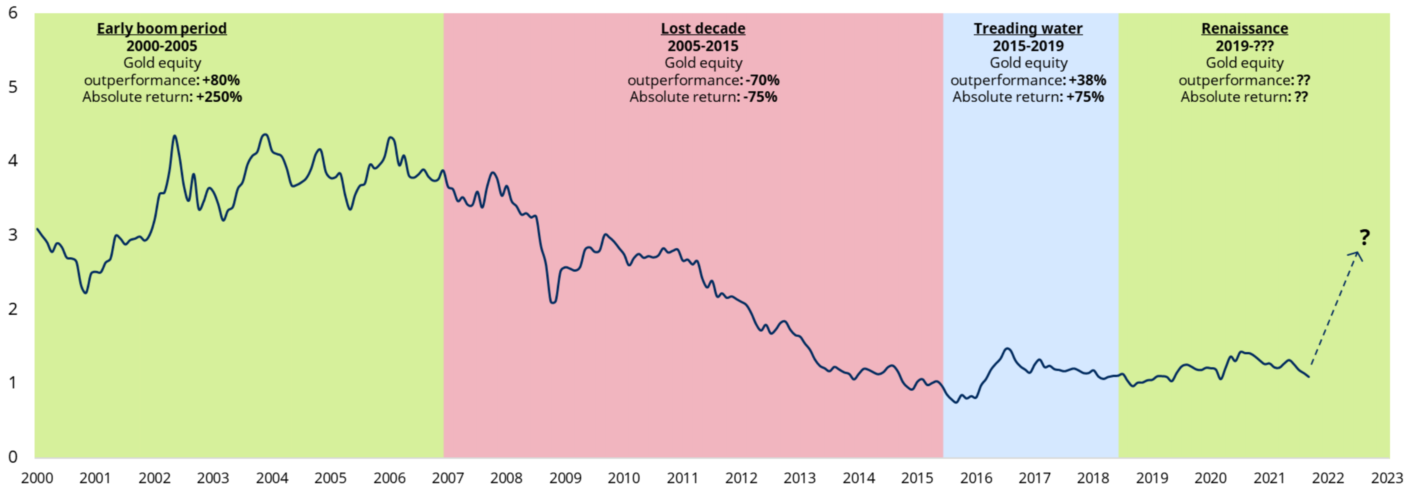


Source: Bloomberg.

Chart 6: Similar chart to above but highlighting the "lost decade" and related relative performance in numbers.

The "lost decade" of underperformance still haunts investors (and management)

FTSE Gold miners index plotted against gold prices (shown as a ratio)



Source: Bloomberg – 30 September 2021. For illustrative purposes only and should not be viewed as a recommendation to buy or sell gold equities.

Chart 7: it is important to understand why gold equities were so awful

Three distinct (though arbitrary) periods make up the 'lost decade'

2005-2008 Costs Explode

- Broad cash cost inflation as commodities and emerging market currencies boom alongside gold.
- Cross industry competition for miners, engineers, geologists + capital equipment pressures both opex and capex.
- M&A more focused on base metals than Precious metals in this period. Yamana an exception.

2008-2011 Massive hubris

- Introduction of QE stokes inflation fears.
- "new paradigm" mentality and aggressive gold price forecasts.
- Industry response: "borrow more, buy more, spend more, assume higher prices".
- Project capital peaks in 11/12/13 (+>100% vs. 05/06/07).
- Exuberant M&A epitomised by Red Back Mining and Equinox acquisitions in 2011.

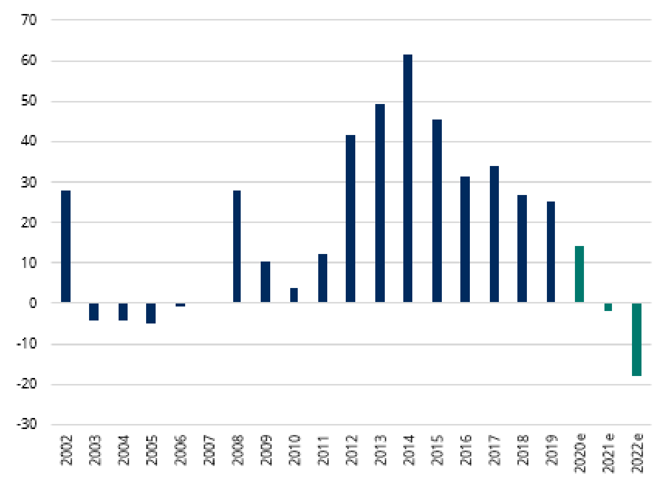
2011-2015 Hangover

- Peak gold prices coincide with peak debt on balance sheets.
- 85% of pre 2011 M&A transaction subsequently written down.
- Industry 2P reserves fall 25% to 2007 levels.
- Return on capital deeply negative.
- CEO compensation, particularly in North America, remains extremely high.
- Share prices drop 80% peak to trough.

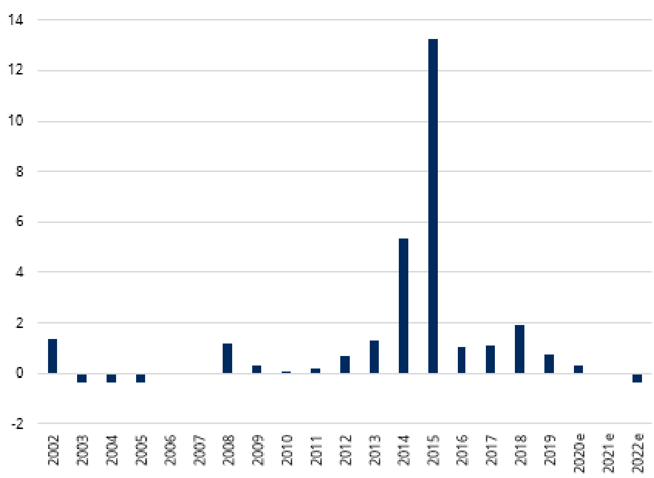
Chart 8: Just one example of a transformed industry – sector aggregate balance sheet rapidly moving towards net cash.

Total net debt for the NYSE ARCA Gold Bugs Index

(US$bn)



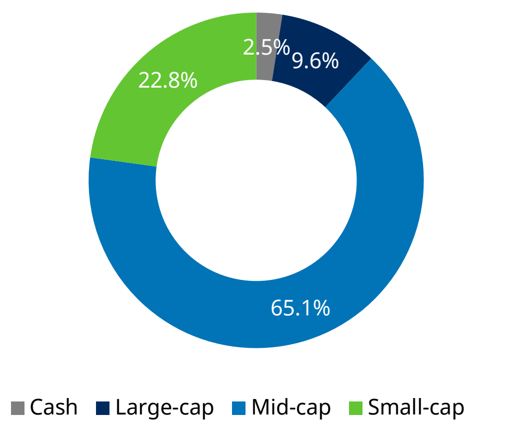
Net debt / trailing 12m ebitda (x) for the NYSE ARCA Gold Bugs Index



Performance attribution:

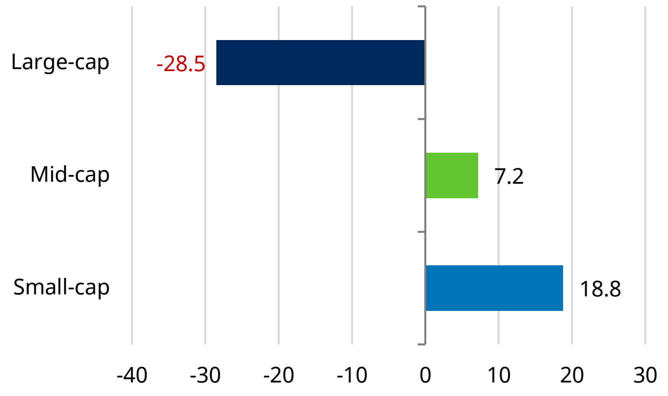
Overweight positions in Eldorado, Oceana, Goldfields and Golden Star contributed strongly to fund performance in November. An active underweight in Newmont also contributed.

Market cap (%)



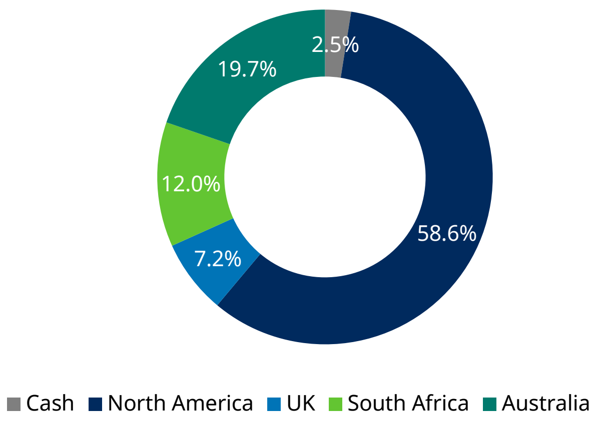
Source: Schroders, Bloomberg – October 2021.

Market cap over/underweight (%)



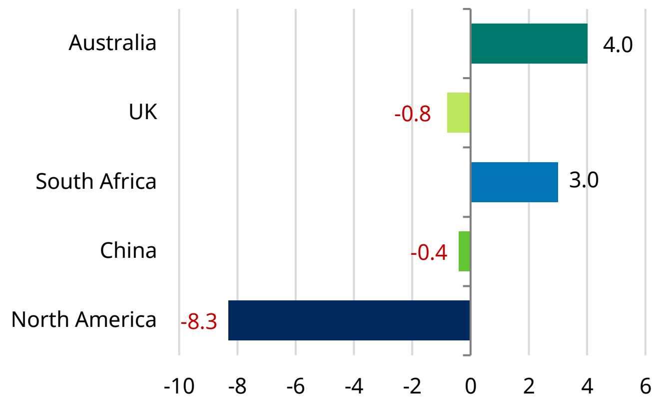
Source: Schroders, Bloomberg –October 2021.

Regional (%)



Source: Schroders, Bloomberg –October 2021.

Regional over/underweight (%)



Source: Schroders, Bloomberg –October 2021.

Important Information