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The Palos - Mitchell Report

APRIL 3, 2019

By William Mitchell, B Comm., CIM

Portfolio Manager and Equities Strategist

The Markets in March

On the heels of the Jan-Feb rally, we have seen a consolidation in the major indices. The Dow Jones Industrials have made several attempts to break through technical resistance around 26,190 and is less than 700 points from the all-time high that was established on October 3rd of last year. In similar fashion, the Dow Transports bounced within a tight range for the month and recently challenged the short-term peak made on February 22nd. The Dow Utilities Index, widely viewed as a leading indicator for the direction of interest rates, reached an all-time high on March 26th.

Like the U.S. indices, the TSX Composite Index has grinded higher and has gained roughly 18% since the December low. The Loonie traded in a range between .7430 and .7616 U.S. and will likely remain vulnerable to lower rates in Canada. NYMEX Crude Oil broke above the $58 level on March 13th and has continued to trend higher – touching $62.99 per barrel on April 3rd. Higher prices are a positive for Canadian exploration and producing companies. The differential between U.S. gulf prices and western Canadian heavy oil had tightened significantly – another positive.

Despite the negative headlines on Brexit and growth, European markets have held up well. The Pound Sterling has weakened relative to the EURO but considering the uncertainty with Brexit, this is not unexpected. Equity markets in China saw a boost at month end as speculation around a trade deal has attracted buyers.

We remain cautiously bullish on stocks as the overall trend remains higher. Impressive price action in the face of a plethora of negative news supports our view that significant buying strength is supporting equities. The path of least resistance is higher, and we will remain bullish until the trend shows us otherwise.

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A Gold; a Brief History

The use of gold as a store of value and for money exchange dates to 550 BC when the first coins were stuck on the order of King Croesus in what is now known as Turkey. For over twenty-five centuries, gold has served as a currency and as a protector of wealth.

From the late 19th century until the early 20th century, the *Classical Gold Standard* served to fix the supply of a country's paper, or fiat currency, to their gold reserves. Balance of payments between nations were essentially settled by an exchange of physical gold. A country having outflows would experience a reduction in its gold reserves and thus, a reduction in its ability to issue fiat currency. In 1933 when President Roosevelt recognized that enough gold-backed dollars could not be printed to stimulate the post-depression economy, he shocked Americans and the world by rendering any form of gold ownership illegal. Roosevelt actions forced all American citizens to either exchange their gold holdings for dollars or face the consequences of fines or imprisonment (gold prohibition wasn't ended until 1974).

Bretton Woods; the New Gold Standard

The Breton Woods conference of 1944 recognized that a new system would be needed to replace the Classical Gold Standard. As a result of Breton Woods, the price of gold was fixed at 35 U.S. dollars per ounce. Currencies of other nations would have an adjustable exchange rate fixed to the U.S. dollar. The complexities of Breton Woods created a major problem for the United States as growing trade deficits were a drain on gold reserves. In 1969, a two-tiered system was created that allowed gold to trade freely on world markets while official government transactions remained private. This ushered in unintended consequences of speculation against the U.S. dollar and a reluctance to accept dollars in lieu of gold. In 1971, President Nixon unilaterally pulled the U.S. from Breton Woods and as a result, the U.S. dollar would no longer be backed by gold. Gold prices were free to fluctuate based on supply and demand.

The Case for Gold

Gold is owned, exchanged, cherished, and hoarded globally by governments, financial institutions, investment pools and individuals. Throughout history, gold has been widely accepted as a store of value, recognized as an international currency, and safeguarded as a measure to protect wealth. While all the above are true, the real question should be why own gold?

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Below, I have highlighted four valid reasons why owning gold acts as both growth-enhancing and risk-mitigating strategies in a well-diversified portfolio.

1. ***U.S. dollar hedging:*** The U.S. dollar is globally recognized as the world's *'reserve currency'* and as such is also valued as the world's foremost *'safe haven'* currency. However, this does not imply that the U.S. dollar is risk-free and subject to perpetual strength. An argument can easily be made that with ballooning U.S. trade deficits and potential trade disruptions, the dollar could face future weakness if these issues are not addressed. History has showed us that dollar weakness often stimulates a flight to safety; potentially into gold.

2. ***Inflation***: History has also taught us that gold attracts buyers during periods of rising inflation. While inflation is certainly not a present threat, we cannot disregard the possibility that rising inflation will appear at some point in the future.

3. ***Geopolitics***: Gold prices usually rise in tandem with world crises, geopolitical threats, and economic uncertainty. In today's world, we are dealing with a plethora of global issues ranging from North Korean, Russian and Iranian nuclear proliferation, U.S. deficits out of control, China trade uncertainty, Russian meddling in U.S politics, European economic weakness, and cyber-espionage; just to name a few!

4. ***Central Bank Demand***: According to research from the World Gold Council (WGC), purchases of gold by central banks in 2018 reached the highest level since 1967. Central bank purchases were up by a whopping 74% from 2017 led by Russia. WGC reports that Russia has swapped out U.S. dollar treasury holdings for 274.3 tons of gold.

DISCLOSURE: The Palos-Mitchell Alpha Fund owns shares of gold miners Barrick Gold (ABX-TSX, GOLD-NYSE) and Agnico-Eagle Mines (AEM-TSX, AEM-NYSE)

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The Palos-Mitchell Alpha Fund

PAL 300 Net Asset Value (NAV) per unit (as of April 2, 2019) = $10.5443

PAL 300 - TOP 10 HOLDINGS

APRIL 3, 2019

Apple Inc. (AAPL)

Canadian Natural Resources Ltd. (CNQ)

Suncor Energy Inc. (SU)

Bank of Nova Scotia (BNS)

Walmart Inc. (WM)

Bristol-Myers Squibb Co. (BMY)

Interfor Corp. (IFP)

D.R. Horton Inc. (DHI) – recently added

Pfizer Inc. (PFE) – recently added

Qualcomm Inc. (QCOM)

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William Mitchell, B Comm., CIM

I am a portfolio manager at Palos Wealth Management based in Montreal, Quebec, Canada. My experience in the investment industry is extensive, having spent more than twenty-nine years analyzing, trading and investing in global financial markets.

At Palos, we are driven by our values. We believe in the principles of honesty, integrity and transparency. We subscribe to a strong work ethic and we have a passion for investing. The pursuit of excellence is our motivating force. We take our fiduciary duty to heart and we always act in the best interests of our clients.

If you have any questions about investing, our services, or becoming a client of Palos Wealth Management, please contact me at:

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