

PALOS

CONTENTS

Weekly Commentary

Issue No. 15 | MARCH 30, 2020

Being Cautious on the Gold Producers	1
Palos Funds vs. Benchmarks (Total Returns)	3
Disclaimer & Contacts	4

By Charles Marleau, CIM

Being Cautious on the Gold Producers

Numerous analysts and market pundits are promoting gold producers as if they're the safest investment option as we work through the market turmoil. Many are advocating that investors should be adding gold equities to their portfolios. While I understand the thought process behind a flight to gold, I must question the wisdom.

What's important to consider is that gold miners are not essential businesses. What's happening now, is that a vast number of miners are being forced to halt or curtail production as companies are mandated by governments to follow emergency social distancing. For example, we've seen Agnico Eagle Mines Limited (TSX: AEM) taking action to shut down its Quebec mining operations. Normally, I would like the tactic of holding gold equities in volatile markets and particularly when the financial system is being stressed. What's key here, is that the current circumstances are very different from any prior financial crisis.

In the past, problems have usually started from the top (banks) and dwindled down to mainstreet. This time it's the reverse. The problem is not the world banking system, but the COVID-19 stress on mainstreet businesses. Hence the importance of the \$2 trillion USD stimulus from Washington and similar moves from Ottawa. The proactiveness of quantitative easing was an essential move as central banks were well ahead of the curve, having quickly assessed the impact of financial system stress that will result from mainstreet temporarily shutting down.

Because of this, the pricing behaviours of physical gold bullion and gold equities will very likely diverge. Given this thesis, I'm more positive on physical gold products like the iShares Gold Bullion Fund (TSX: CGL/C). I further believe that companies that produce copper, nickel, iron, lithium, and oil are more essential than gold producers. This is why I believe Franco-Nevada Corp. (TSX: FNV) is a superior investment than an individual producer. The advantage that FNV has is a continuous stream of royalties. This provides natural diversification on both a geographic and operational basis. Steering away from gold producers is a prudent strategy for the near term as the process of turning off/on a gold mine is not the same as flipping a light switch.

By Charles Marleau, CIM

Rather than following the crowd in an irrational rush to gold miners, I prefer to focus on opportunities in essential sectors like utilities, telcos, and consumer staples. The thesis here is that regardless of the impact on the economy, we are very likely to see continuous and possibly increased demand for energy, telecommunications and food.

Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$5.80	-31.84%
Palos Equity Income Fund - RRSP	PAL101	\$4.11	-28.16%
Palos Merchant Fund L.P. (Dec 31, 2019) ²	PAL500	\$1.71	20.15%
Palos WP Growth Fund - RRSP	PAL210	\$4.85	-36.61%
Palos-Mitchell Alpha Fund (Fund Initiated on Jan 29, 2019) ³	PAL300	\$5.93	-42.88%
S&P TSX Composite (Total Return with dividends reinvested)			-25.08%
S&P 500 (Total Return with dividends reinvested)			-20.96%
S&P TSX Venture (Total Return with dividends reinvested)			-32.68%
Chart 2: Market Data ¹			Value
US Government 10-Year			0.67%
Canadian Government 10-Year			0.74%
Crude Oil Spot			US \$21.51
Gold Spot			US \$1,625.00
US Gov't 10-Year/Moody BAA Corp. Spread			403 bps
USD/CAD Exchange Rate Spot			US \$0.7152

¹ Period ending March 27, 2020. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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