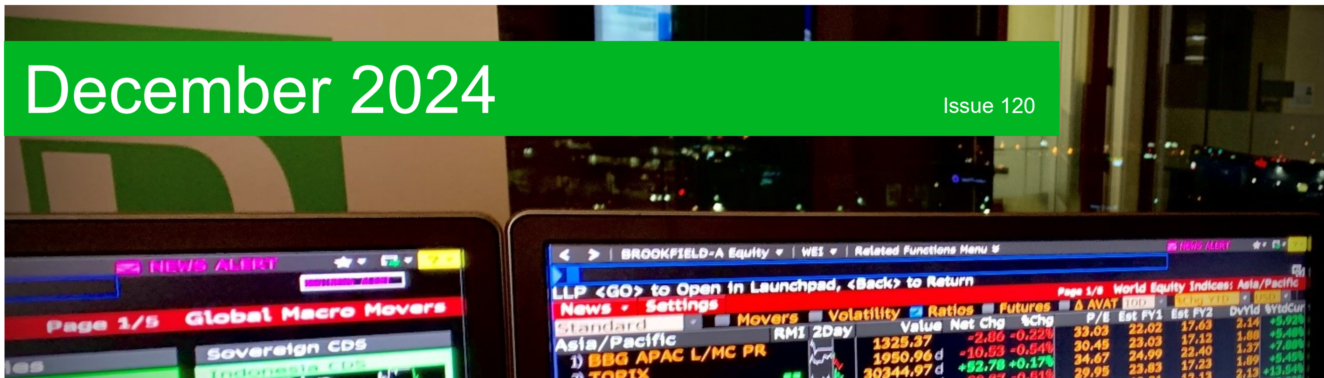
The Charter Group Monthly Letter



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Economic & Market Update

Monday Morning Gold Rush

In November I was in Western Australia for a week. While I was in Perth, I decided to take a side trip to a town named Kalgoorlie about 400 miles inland. It is in a region of the country called Goldfields, which gives a hint as to what drives the economy there.

Through doing due diligence on gold mining firms over the last few decades, Kalgoorlie was a town that I had heard of before. I had read stories of the "Super Pit" which is a gigantic hole in the ground, 1,800 feet deep, that buttresses right up against the eastern edge of the town. At one point in time, there had been five pits. But as they grew, they began to merge into one another as various mining firms agreed to consolidate.

A view of the Super Pit on approach to Kalgoorlie

Mark Jasayko

With the U.S. dollar price of bullion up over 28% so far this year, and my curiosity to see what a modern-day gold rush town looked like, I decided to make the trip.

Gold mining firms can have difficulty containing costs as all the firms rush to add equipment and staff at roughly the same time as gold bullion prices are rising.

This lesson was reinforced to me on a November trip to a gold mining region in Western Australia.

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Doing an 800-mile roundtrip in a rental car, and driving on the left side of the road, wasn't very appealing. Also, Kalgoorlie is about the only thing to see out there with not much to see or do along the way there or back. So, I decided to book a flight on Virgin Australia Airlines.

That's when things got interesting. Despite being the main low-cost carrier in the country, the airfare on Virgin Australia to Kalgoorlie was $788 in Canadian dollars. So, I checked Qantas, which was flying a 35-year-old rickety jet to the town. They wanted even more. But my mind was made up, so I bit the bullet and bought the seat on Virgin Australia.

When I got to the Perth airport on Monday morning, the terminal was overflowing with people in high-visibility orange clothing. There weren't there to work at the airport. They were there to catch flights to towns all around Western Australia, including Kalgoorlie.

My flight was almost full, with about 90% of the passengers wearing the orange clothing. I asked my seat mate what the deal was. He told me that those people in the terminal and on the flight were FIFO workers. I asked him what that meant. He further explained that they were Fly-in, Fly-out workers that would generally work for two weeks at a mine site, staying in barracks, and then spend two weeks back home in Perth. And, it wasn't just Mondays when the Perth airport was full of people in orange clothing. It was every weekday.

I noticed a BHP logo (a large mining company) on his orange outfit and asked if he worked at the Super Pit. He said that BHP didn't have any operations there. Instead, he worked at a BHP nickel smelter just south of town. He then said that BHP was shutting down operations there because the price of nickel was down in the dumps. Despite spikes in 2006 and 2022, the price of nickel is trading about where it was back in 2004.

I told him that I was sorry to hear that. And he replied, "Don't be, I already have another FIFO job lined up with a gold producer in Kalgoorlie for close to $200,000/year."

Two weeks on, two weeks off, and $200,000/year? Times are good in the gold sector.

Gold mining towns can experience very high prices for homes, hotels, everyday needs, and airfares during boom times.

But high wages and perks for workers can offset these challenges.

However, these wages and perks become significant costs for gold mining firms.

Expected profit margins during boom times may not materialize, disappointing the shareholders.

My thoughts then went back to when I first read about the Super Pit. I held Barrick Gold Corp. in the client portfolios from early 2005 to the beginning of 2010 when they had a 50% ownership of the Super Pit. The decision to purchase Barrick was based on a desire to increase the exposure to gold. I had bought bullion the year before and was relatively happy with the results and thought that the miners could potentially be an even better way of adding return if the bullion trend continued. After doing the research, I concluded that the miners had good operational leverage (owning the mines and equipment to produce gold in theory should produce more profit than just buying and holding gold bars). In addition to Barrick, I also bought the iShares S&P/TSX Global Gold ETF which was a passive amalgamation of four dozen gold miners.

Then, the real education began.

The Barrick stock price had trouble keeping up with the gains in bullion throughout the entire period. Ill-timed decisions to hedge their gold production added to their woes. As the price of bullion rose it would have been better for Barrick not to hedge.

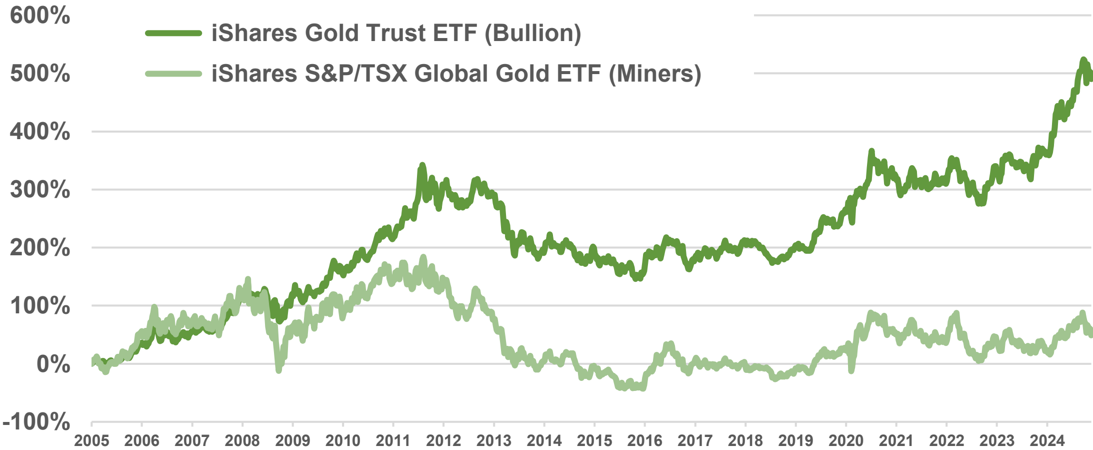
Less than expected profit margins can suppress the share prices of gold mining firms.

The price of gold itself has far outdistanced the share prices of gold mining firms as a whole over the last two decades.

The iShares S&P/TSX Global Gold ETF performed well initially, perhaps an indication that the other mining firms weren't hedging as much as Barrick was. Then, following the historic stock market selloff of 2008 and into 2009, the price of bullion held steady but Barrick and the ETF did not. And that was the beginning of a stretch that continues to this day where gold mining firms have significantly underperformed bullion.

Chart 1:

Gold Bullion versus Gold Miners (in U.S. dollars)



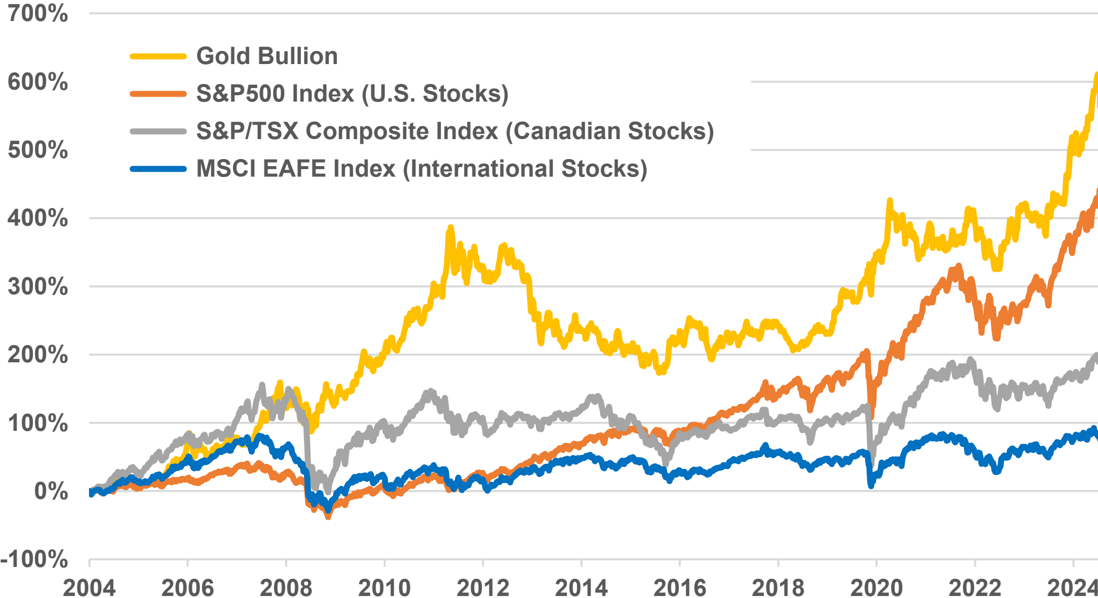
Source: Bloomberg Finance L.P. as of December 18, 2024

Upon studying Barrick and the various companies in the ETF after the 2008-09 selloff, a theme started to emerge: gold mining operations were a very difficult thing to manage.

Specifically, senior executives had a hard time containing costs which would eat into the expected profit margins. As the price of bullion rose, all the mining companies would scramble to buy equipment and hire staff at generally the same time, significantly increasing the demand for that equipment and staff. There is not much choice but to pay a higher price for those inputs if one wants to increase the output to take advantage of rising bullion prices.

I now think back to my seat mate on that Virgin Australia flight to Kalgoorlie. There, sitting next to me was living anecdotal evidence of the challenges that the mining firms face.

Chart 2:
Gold Bullion versus Stock Market Indices



Source: Bloomberg Finance L.P. as of December 18, 2024

Investors in gold bullion have not only generally done better than gold mining firms, but they have also done better than most of the other major asset classes over the last 20 years.

In the last 15 years, I have not held any gold mining firms in the model portfolios for clients. But I have maintained a sizable position in gold bullion throughout that stretch. And, going all the way back to when I first added gold bullion, its return has not only outdistanced the miners, but it has also handily beaten most major stock market indices.

Model Portfolio Update[1]

The Charter Group Balanced Portfolio
(A Pension-Style Portfolio)

	Target Allocation %	Change
Equities:		
Canadian Equities	12.0	None
U.S. Equities	38.0	None
International Equities	8.0	None
Fixed Income:		
Canadian Bonds	22.0	None
U.S. Bonds	6.0	None
Alternative Investments:		
Gold	8.0	None
Silver	1.0	None
Commodities & Agriculture	3.0	None
Cash	2.0	None

No portfolio changes during November.

No changes were made to the asset allocations or the securities in the model portfolios in November.

Post-U.S. election, stocks were the star performers.

Investors hoping for tax cuts and less regulation.

U.S. and Canadian stocks were the most significant contributors during the November, rising immediately after the U.S. election and then slowly adding to those gains during the rest of the month. Clearly, enough investors thought the economic and regulatory environment under President-elect Donald Trump and a Republican-controlled Congress would be conducive to rising prices for stocks.

But often hope doesn't equate to reality.

On the surface, it may well look that way. But, because of the multitude of variables involved and the potential for unforeseen second-order effects, proposed economic policies are like trying to nail Jell-O to the wall in terms of generating the desired outcomes.

[1] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of December 18, 2024. The asset allocations of individual clients invested in this Portfolio may differ because of the relative performance of the asset classes since the last rebalancing and because of differences in the timing of deposits and withdrawals. The Balanced Model Portfolio is part of a sequence of five portfolios ranging from conservative to aggressive: Conservative, Balanced Income, Balanced, Balanced Growth, and Growth.

One prominent aspect of the expected policies is for the U.S. to apply tariffs on the imports from countries such as China, Mexico & Canada, among others (proposed tariffs on Canada hit the Canadian dollar which actually helped amplify the returns of the U.S. positions in the model portfolios during the month). This may protect American businesses which could be a positive for the U.S. economy, but generally adds to the prices of goods that American consumers must pay. And, rising prices were, by some accounts, a deciding factor in the U.S. elections. So, it's tough to reconcile all that at this point.

Proposed U.S. tariffs hurt the Canadian dollar, which helped the U.S. positions in the model portfolios.

Will tariffs be inflationary? It will be wait and see.

What seems to have been overlooked during the last few months is the U.S. budget deficit and its contribution to the growing U.S. federal debt which now stands at $36 trillion. Neither of the two main U.S. parties addressed this dilemma. It may not be a problem tomorrow. But, over time, I would expect it to play havoc with stocks, especially those that rely on low-cost debt to fuel their growth, or those that need customers to borrow in order to buy their products.

The U.S. debt and deficit have not gotten much attention from political leaders despite a concerning amount of growth during 2024.

However, in the short-term, we are heading into one of the best seasonal stretches for stocks. My sense is that we might have to wait until past the inauguration to assess whether the recent gains in stocks are justified.

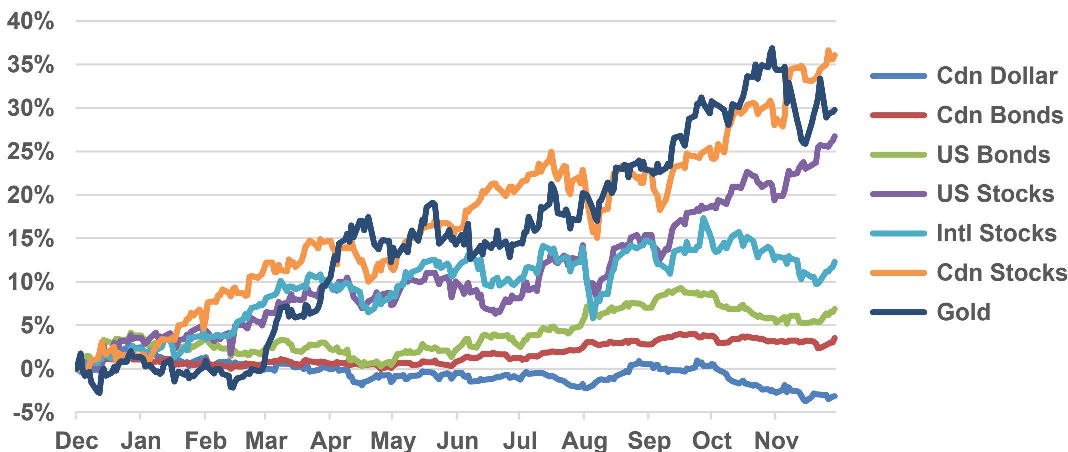
Seasonally, the stock markets are often in a good mood this time of year.

The focus will be on how long this mood can last beyond inauguration day in January.

Below is the 12-month performance of the asset classes that we have used in the construction of The Charter Group's model portfolios. (**Chart 3**).[2]

Chart 3:

12-Month Performance of the Asset Classes (in Canadian dollars)



Source: Bloomberg Finance L.P. for the interval from December 1, 2023 to November 30, 2024

[2] Source: Bloomberg Finance L.P. – The Canadian dollar rate is the CAD/USD cross rate which is the amount of Canadian dollars per one U.S. dollar; Canadian bonds are represented by the current 3-year Government of Canada Bond; US bonds are represented by Barclays US Aggregate Bond Index; U.S. stocks are represented by the S&P 500 Index; International stocks are represented by the MSCI EAFE Index; Canadian stocks are represented by the S&P/TSX 60 Composite Index; Gold is represented by the Gold to US Dollar spot price.

Top Investment Issues[3]

Issue	Importance	Potential Impact
1. Global Geopolitics	Significant	Negative
2. Canadian Federal Industrial Policy	Moderate	Negative
5. Inflation (Portfolio Impact)	Moderate	Positive
3. China's Economic Growth	Moderate	Negative
4. Canadian Dollar Decline	Moderate	Positive
7. Short-term U.S. Interest Rates	Medium	Negative
6. U.S. Fiscal Spending Stimulus	Medium	Positive
8. Long-term U.S. Interest Rates	Medium	Negative
9. Global Trade Wars	Medium	Negative
10. Canada's Economic Growth	Light	Positive

[3] This is a list of the issues that we currently deem to be the ten most important with respect to the potential impact on our model portfolios over the next 12 months. This is only a ranking of importance and potential impact and *not* an explicit forecast. The list is to illustrate where our attention is focused at the present time. If you would like an in-depth discussion as to the potential magnitude and direction of the issues potentially affecting the model portfolios, I encourage you to email me at mark.jasayko@td.com or call me directly on my mobile at 778-995-8872.

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Accountability is further enhanced by the fact that we commit our own investable wealth to the same model portfolios in which our clients are invested.

The information contained herein is current as of December 18, 2024.

The information contained herein has been provided by Mark Jasayko, Senior Portfolio Manager and Senior Investment Advisor, TD Wealth Private Investment Advice, and is for information purposes only. The information has been drawn from sources believed to be reliable. Graphs and charts are used for illustrative purposes only and do not reflect future values or future performance of any investment. The information does not provide financial, legal, tax or investment advice. Particular investment, tax, or trading strategies should be evaluated relative to each individual's objectives and risk tolerance.

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Thank you from The Charter Group at TD Wealth

Thank you to our clients and community for voting The Charter Group, your favorite for Investment Management and Financial Planning in Langley for the fifth year in a row.

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