Ninepoint Silver Equities Class

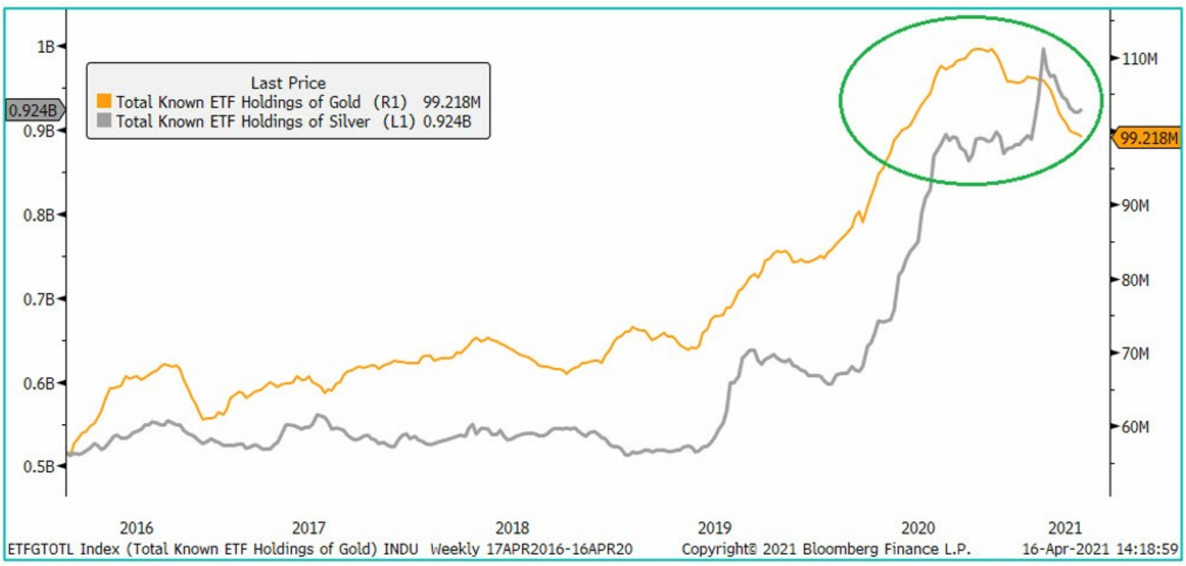
Q1 2021 Commentary

Investment Team

Ninepoint / Sprott,
Sub Advised by Sprott Asset Management (SAM)

The Ninepoint Silver Equities Class declined 15.28% for Class F in Q1 2021 as precious metal equities struggled against a backdrop of soft gold and silver bullion prices. Through Q1 2021, the fund's tilt towards small exploration companies and mid-cap miners created a small drag in its performance relative to the benchmark. Despite the Strategy's recent underperformance, our attraction towards the small and mid-sized operators in this sector remains unchanged.
Over the years, our fund has been able to uncover substantial alpha within the small and mid-cap miners. By our work, we see continue to find fertile opportunities capable of generating prolific returns.

Since our last commentary, governments around the world have continued to binge on debt. The US Federal Reserve, the ECB and other major monetary authorities have maintained their foot on the pedal when it has come to asset purchases meant to stimulate risk-taking. Investors in the Western hemisphere responded to this by buying gold and silver through the first three quarters of 2020. In doing so, investors pushed the price of gold to a record high and silver to its highest close since 2013. High expectations and euphoric sentiment typically lead to short-term consolidation and that is precisely what we have experienced of late. The performance of gold and silver over the past six months has produced more frustration than euphoria. When the typical seasonal strength in precious metals we see around January and February failed to materialize we saw short-term traders exit their positions. Negative capital flows were apparent in gold and silver ETPs (Exchange Traded Products). We must note that the quantum of this move was modest versus the 2020 inflows.



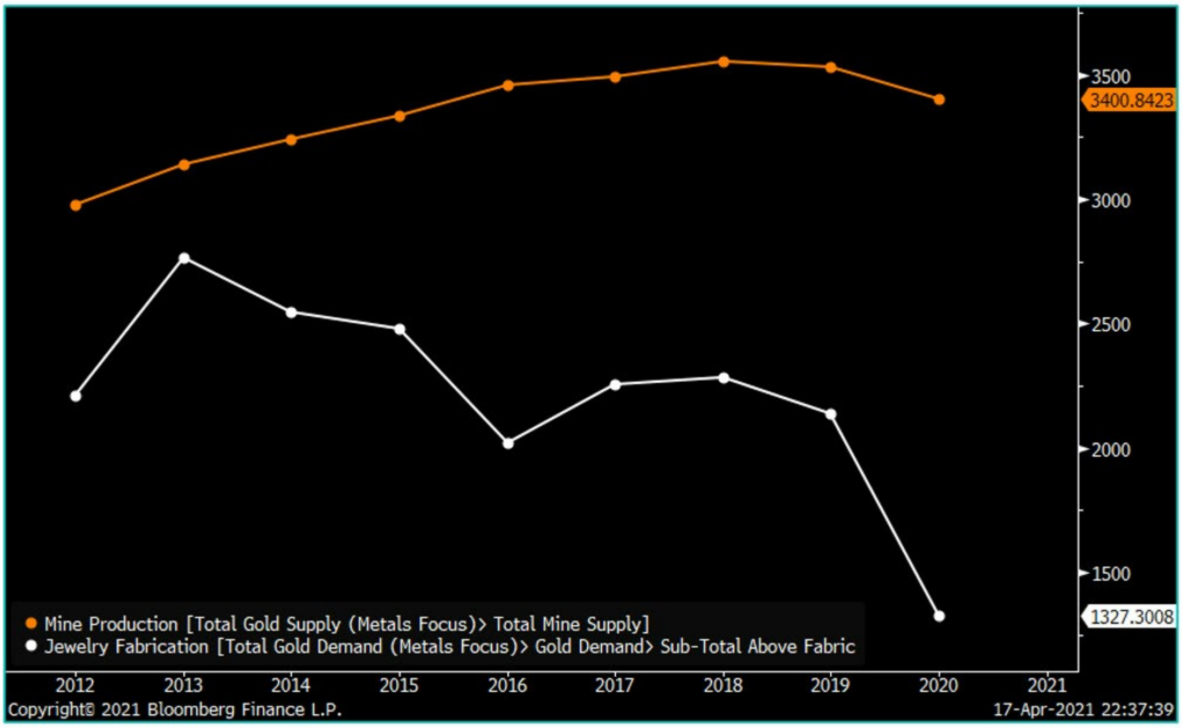
Source: Bloomberg

Concurrently, we also saw speculative positions getting unwound in both gold and silver futures. Rising interest rates, the emergence of Bitcoin and a robust global economic recovery have been used to explain the poor showing of precious metals. Perhaps a more important reason behind the recent weakness in precious metals has to do with something simpler - the Law of Supply and demand.

The annual supply of gold has averaged around 4700 tonnes. Approximately 3500 tonnes of this supply comes from mine production and the other 1200 tonnes per annum is recycled gold which is primarily derived from jewelry being sold for cash. When the price of gold rises, we see increased recycled gold entering the supply chain as people cash in on their old jewelry. Despite a tumultuous 2020, which saw a decline in PGM production, gold production remained quite stable versus 2019. Recycling was higher than normal at around 1300 tonnes in 2020 due to buoyant gold prices and weaker economic conditions.

While supply was fairly stable in 2020, the demand side of the equation was exceptionally volatile. There are four key areas of gold demand – jewelry, retail investments through bars and coins, ETPs and Central Banks. Least unsurprisingly, ETF demand was exceptionally robust in 2020 with ETPs around the world adding almost 900 tonnes of gold to their holdings. What was surprising was that retail investment demand was down year-over-year in 2020. This was not on account of mediocre investor enthusiasm, but because refineries shuttered their operations and the gold logistics chains were disrupted. As a result, high demand for gold coins and small gold bars, only led to high premiums as suppliers were simply unable to meet demand. Central banks around the world also took a big step back from their gold purchases as their attention shifted to helping their respective economies.

The biggest decline in gold demand came from the largest demand sector – jewelry. Gold jewelry demand soaks up almost 50% of the total annual supply and in 2020, demand for jewelry collapsed. We had already seen a drop in jewelry demand out of China in 2019 as COVID-19 related shutdowns began to affect the country later that year. For the full year, jewelry demand declined from 2137 tonnes in 2019 to 1327 tonnes in 2020.



Source: Bloomberg

So far in 2021, despite the doom and gloom that Western precious metal investors are feeling, gold demand is resurgent once again. Indian jewelry demand has already bounced back strongly with March 2021 imports coming in 471% higher on a year over year basis. In fact, India imported a record 160 tonnes of gold in the month of March alone.

We saw similar trends play out in the silver market in 2020. According to the Silver Institute, the silver market has remained in a small deficit since 2019 with demand edging out supply. We do not have clear data for silver available just yet. However, based on preliminary estimates, 2020 is expected to produce a small reduction in silver mine output, as a result of COVID-19 related shutdowns in South America. On the consumption side, manufacturing demand for silver was softer both for industrial as well as silverware use in 2020. However, similar to gold, silver saw an increased level of investor interest last year with a record level of silver bullion flowing into silver ETFs. Over 280 million ounces of silver flowed into ETPs last year. Silver is often referred to as poor man's gold and indeed, retail investor interest in silver surpasses gold. At the retail level, investor interest for silver coins and bars was much stronger than what we saw in the gold bullion market. Refineries have been unable to keep up with retail demand for silver coins and bars. Despite the softness in silver prices through 2021, coin and bar demand has remained exceptionally strong through 2020 and into 2021. Lack of adequate silver coin and bar supply has left most dealers are charging hefty premiums for the physical metal even today.

Looking ahead, we remain strongly optimistic about our outlook for precious metals. Investor sentiment in the Western world is at a trough and appears to be improving daily. We are also seeing India and China pick up where they left off. Many weddings and event celebrations have been held off in India and other countries on account of COVID-19. These events represent strong pent-up demand for both gold and silver. Softer prices encourage more demand from Indian and Chinese buyers who aggressively buy the dip because they view gold and silver as a long-term store of value.

In our Q4 note, we had made note of the compelling value in the precious metal mining space. Despite the challenging environment we experienced during this quarter, our bullish conviction has remained unchanged. Mining companies are trading near the bottom end of their historical valuations.

Source: Bloomberg

Through 2020, gold averaged $1707/ounce while silver averaged just over $22/ounce. Despite the recent weakness in gold and silver, both metals continue to trade above their 2020 averages. Producers in our Strategy are expected to generate record profit margins in 2021 at prevailing metal prices while delivering strong EPS and FCF growth. Valuation multiples are also at a trough, but not for long. We rarely see the combination of low multiples and rising earnings. It is important not to lose sight of the big picture here. We are in a precious metals bull market and March appears to have marked an important low for the sector. Precious metal miners appear poised for a strong move higher.

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NINEPOINT SILVER EQUITIES CLASS - COMPOUNDED RETURNS[1] AS OF MARCH 31, 2021 (SERIES F NPP 423)

	1M	YTD	3M	6M	1YR	3YR	5YR	INCEPTION
Funds	-8.4%	-15.3%	-15.3%	-6.1%	106.5%	22.9%	17.5%	0.7%
Index	-7.1%	-14.9%	-14.9%	-9.1%	77.6%	14.4%	13.5%	-2.2%

[1] All returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at March 31, 2021; e) 2012 annual returns are from 02/28/12 to 12/31/12. The index is 100% MSCI ACWI Select Silver Miners IMI (CAD) Index and is computed by Ninepoint Partners LP based on publicly available index information.

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