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Eric Strand, Founder and Portfolio Manager – AuAg Funds

Gold Stays Gold, Forever

By Eugeniu Guzun – HedgeNordic

Gold has delivered an annual return of about 7.7 percent in U.S. dollar terms since August 15, 1971, the day U.S. President Richard Nixon removed the U.S. dollar from the gold standard. Eric Strand, a precious metals specialist who manages the fund boutique AuAg Funds, offers a different perspective on this development. At an annual rate of 7.7 percent, "the U.S. dollar has experienced a cumulative devaluation of 97 percent relative to gold since the historic date of August 15, 1971." Strand considers gold as the unchanging benchmark and measures the development of fiat currencies in relation to gold.

Despite gold's proven effectiveness as a hedge against the erosion of purchasing power over the past 50 years, Nordic institutional investors have broadly refrained from including this precious metal in their portfolios. "It is very strange that institutional investors overlook gold when, based on return tables, the metal exhibits a very stable return profile. Since 2000, it has had only three negative years compared to eight for the broader equity market," wonders Strand. He emphasizes gold's stability, attractive returns, low correlation, high liquidity, and absence of counterparty risk.

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By incorporating exposure to metals such as gold, institutional investors can enhance their allocation to alternative investments and benefit from a distinct return stream that is relatively uncorrelated with other asset classes. AuAg Funds, a fund management boutique with a focus on precious metals and green tech elements, has introduced an innovative investment product – an exchange-traded fund (ETF) that invests in a select group of ESG-friendly gold mining companies. This ETF aims to provide both larger institutional investors and smaller investors with a leveraged play on the price of gold, without relying on financial leverage. "Investing in gold miners is a leveraged bet on gold because their production costs remain relatively static while their revenue rises and falls with the price of gold," says Strand.

This means a miner's profits increase faster than the price of gold. To illustrate the operational leverage of gold miners, Strand offers an example: "Suppose the price of gold is $2.000 and a miner's mining costs amount to $1.500. In this case, the miner would generate a net profit of $500." He continues, "Now, if the price of gold increases by ten percent to $2.200, the miner's net profit would rise to $700 given the static production costs." This increase in net profits from $500 to $700 implies a 40 percent gain for a ten percent increase in the price of gold.

AUAG'S INNOVATIVE ETF SOLUTION

Investor demand for exchange-traded funds (ETFs) has been steadily increasing and is expected to continue due to their appealing features, including low cost, simplicity, transparency, and liquidity. Recognizing this growing demand, Strand decided to design and launch an ETF that offers Nordic and European investors a novel opportunity to gain exposure to gold through investments in gold miners. "With major players such as iShares and VanEck in this space, we wanted to offer something better," explains Strand.

The AuAg ESG Gold Mining UCITS ETF (Ticker: ESGO) developed by Strand has three distinct features: non-market-cap weightings, less portfolio concentration risk than a market-weighted index, and a best-in-class sustainability-aligned portfolio. The ETF also boasts a competitive annual cost of 60 basis points, which is lower than that of traditional funds. The ETF currently trades on the London Stock Exchange, Deutsche Börse Xetra, Borsa Italiana in Milano, Euronext in Paris, and Zürich.

The initial step in creating the ETF involved developing an index with the German index provider Solactive. Strand's first decision was to avoid the traditional market capitalization-weighted structure employed by most ETFs. "While a market-cap-weighted ETF is generally beneficial, in relatively smaller sectors such as gold mining, a market-cap-weighted structure would result in two or three large companies accounting for 35 percent of the ETF's exposure," explains Strand. Aside from this concentrated risk, mega-cap companies within the sector may deliver smaller returns in a bull market compared to large and mid-cap gold mining companies. By design, the AuAg ESG Gold Mining UCITS ETF maintains a higher exposure to mid-sized mining companies compared to a market-cap-weighted ETF.

To address these concerns, the UCITS-structured ETF has 25 companies equal-weighted at four percent, resulting in more allocation towards mid-cap miners. This relatively concentrated portfolio is designed to offer diversified exposure to gold miners without diluting the exposure through excessive diversification, or diworsification. "We prefer concentrated portfolios because, as active managers, we can closely monitor all our investments within a concentrated portfolio," explains Strand. "Having 25 companies in a portfolio is sufficient for achieving diversification, demonstrating our strong belief in this select group of companies."

Another important reason behind the relatively concentrated portfolio is Strand's emphasis on investing in the "best-in-class" gold mining companies from a sustainability perspective. "We select the top 25 best-in-class miners based on their ESG risk scores using data provided by Sustainalytics," explains Strand. "Our portfolio is rebalanced quarterly to invest in the 25 best-in-class companies, favoring the adopters and excluding the laggards," he elaborates. "This approach not only aligns with sustainability goals but also incentivizes positive change within the mining industry. Inclusion in our ETF may not be their largest focus, but we view this as a mechanism to promote change and continuous improvement in ESG scores among mining companies."

Classified as an Article 8 fund under the SFDR, the AuAg ESG Gold Mining UCITS ETF also ranks in the 79th percentile within the global universe of approximately 34,000 funds in coverage, according to the MSCI ESG Fund Ratings. These ratings are designed to measure the Environmental, Social, and Governance (ESG) characteristics of a fund's underlying holdings.

THE BENEFITS OF GOLD AS A COMMODITY AND AS AN INVESTMENT

Strand sees gold as having two distinct narratives: one as a commodity with essential uses in various technologies, and another as an uncorrelated investment that protects against purchasing power erosion. "Gold has two different stories," starts Strand. "Due to its unique physical properties, around ten percent of all mined gold goes to industrial and technological applications serving a crucial role in various sectors such as computing, telecommunications, automotive, aerospace, medicine, and beyond," he elaborates. Gold's usage in technology contributes to its demand and adds a layer of fundamental support to its market dynamics. "Gold and precious metals are enablers for a lot of solutions."

On the monetary side, gold is recognized as an investment that protects against the loss of purchasing power and economic uncertainties. "Gold serves as a hedge against monetary inflation. Its price reflects the unabated amount of debt creation and money printing," explains Strand. "Short-term, price inflation may come from many different sources. But longer term, price inflation is a result of monetary inflation."

Strand argues that instead of enduring a severe recession, central banks opt to stimulate economies and financial systems at the first indications of economic difficulties. "That would mean monetary inflation again because nobody wants to go through a hard recession anymore. A recession may be a good thing to force inefficient businesses to restructure or exit the market, but nobody wants to experience that. No politicians normally survive it, so it's not going to happen. Incentives are there for more monetary inflation and that will be good for gold and gold fund