HEP Quarterly Commentary

Q2, 2021

Market Overview

Gold and gold producers, while still generally volatile, continued to struggle in the second quarter of 2021 as a number of factors kept investors uncertain. A decidedly risk-on broader investing bias continued to spur risk assets in the aftermath of the significant vaccine news announcements of late 2020. A "rotation" of investing sentiment towards more cyclical and reopening themes has become more of a game of investing hopscotch as most sectors continue to benefit from both reopenings and a continued interest in technology themes. Indeed, the tide has continued to float many risk boats, rendering the need for a safe haven asset less prescient.

In addition, a decidedly rising trend for interest rates as stronger than expected gross domestic profit ("GDP") growth and sharply falling unemployment pressured gold. A relatively "less dovish" U.S. Federal Reserve outlook and realignment of the "dots" in June surprised investors and again brought uncertainty to safe havens. June, however, did bring some relief on this front as rates relaxed significantly just as inflation numbers came in hot, leading some market participants to believe that longer-term growth may be harder to come by than previously thought. This recipe of potentially slower growth combined with inflation strength could point to real interest rates remaining deeply negative across the rate spectrum for the foreseeable future. With inflation running at 2.5-4.0% (or higher if current alarming inflation spikes do not dissipate as quickly as the U.S. Federal Reserve projects) the real funds rate could be quite negative right through 2022 and beyond. This may provide support to gold for some time.

Outlook and Positioning

From a technical standpoint the 50 day moving average has crossed the 200 day moving average, which indicates the possibility of momentum shifting to the bulls again. Having said this, messaging from the U.S. Federal Reserve members remains mixed as to where and what will transpire over the next few years. They can only respond to data as released and make rough projections as to what such releases might imply about economic conditions over the next several years. For now, policy remains ultra-loose against a heavily negative real rate reality. While the U.S. Federal Reserve could remain behind the curve for some time, any data is prone to changing that. As such uncertainty remains, covered calls remain a good way to approach the asset class. Clip the rent using option premiums while the picture paints itself, thus turning gold into a yield producing asset as you wait. Gold producer outlooks, at this lofty level of gold, remain very positive. They are on balance healthier and possess cleaner balance sheets than they have in many years. We also see a possibility of significant potential consolidation in the industry as numerous producers account for a good portion of production overall as compared to other commodity spaces.

Gold option premiums, broadly speaking, have stabilized as interest in gold waned. We continue to evaluate appropriate coverage and "moneyness" measures for future writes. As investors await the next move higher for gold, 'clipping the rent' of option premiums may be of some value in generating distributions going forward. Option premiums may also help to generate better overall yields and contribute to lower volatility relative to the underlying basket without call premiums. The covered call strategy can also potentially reduce the volatility of a comparative basket over time.