

# With Market Mania, Sanity in Gold

By Joe Foster, Portfolio Manager

## VanEck International Investors Gold Fund

INIVX / IIGCX / INIIX / INIYX

### Fund Review

The International Investors Gold Fund’s Class A shares returned 0.85% for the one month period ending January 31, 2018 (excluding sales charge), while the NYSE Arca Gold Miners Net Total Return Index (GDMNTR)<sup>1</sup> returned 1.96% for the same period. The Fund is actively managed and invests mainly in gold-mining equities.

Average Annual Total Returns (%) as of January 31, 2018				
	1 Mo <sup>†</sup>	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 2/10/56)	0.85	-1.34	-7.14	-3.16
Class A: Maximum 5.75% load	-4.92	-7.04	-8.24	-3.73
GDMNTR Index	1.96	0.63	-9.61	-6.23

  

Average Annual Total Returns (%) as of December 31, 2017				
	1 Mo <sup>†</sup>	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 2/10/56)	7.54	13.03	-8.95	-2.47
Class A: Maximum 5.75% load	1.38	6.48	-10.02	-3.04
GDMNTR Index	4.56	12.21	-11.88	-5.58

<sup>†</sup>Monthly returns are not annualized. Please note that precious metals prices may swing sharply in response to cyclical economic conditions, political events or the monetary policies of various countries. Investors should be aware that recent market conditions resulting in high performance for the gold sector may not continue.

Geologist Joe Foster has been part of VanEck’s gold investment team since 1996. The Fund is managed by a specialized investment team that conducts continuous on- and under-the-ground research to assess mining efficiencies and opportunities.

### Market Review

The gold price continued to move higher after becoming oversold ahead of the December 13 Federal Reserve (the “Fed”) rate announcement. After reaching a 17-month high of \$1,366 per ounce on January 25, gold finished the month with a \$42.10 (3.2%) gain at \$1,345.15 per ounce. The move to new highs was driven by U.S. dollar weakness. The U.S. Dollar Index (DXY)<sup>2</sup> sunk to lows last seen in 2014, due to currency comments and trade tariffs announced by the Trump administration, strong economic data from the Eurozone, and European Central Bank (ECB) minutes that suggested it might move sooner than expected to unwind its bond buying program. The last days of the month brought some weakness for gold as markets begin to see increasing chances of a Fed rate hike in March.

Gold stocks seem to be consolidating after outperforming gold in December. The equities trailed gold bullion in January as the NYSE Arca Gold Miners Index (GDMNTR)

Expenses: Class A: Gross 1.35%; Net 1.35%. Expenses are capped contractually until 05/01/18 at 1.45% for Class A. Caps exclude certain expenses, such as interest.

The tables present past performance which is no guarantee of future results and which may be lower or higher than current performance. Returns reflect applicable fee waivers and/or expense reimbursements. Had the Fund incurred all expenses and fees, investment returns would have been reduced. Investment returns and Fund share values will fluctuate so that investor’s shares, when redeemed, may be worth more or less than their original cost. Fund returns assume that dividends and capital gains distributions have been reinvested in the Fund at NAV. Index returns assume that dividends from index constituents have been reinvested.

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advanced 2.0% and the MVIS Global Junior Gold Miners Index (MVGDXJTR)<sup>3</sup> declined 1.6%. Many companies reported positive fourth quarter and year-end production results. Due to the muted reaction in their share prices, valuations continue to track below long-term averages. In the current environment, gold stocks are not receiving much attention as investors focus on the broader stock market, cryptocurrencies, and other commodities.

## Market Outlook

A surge in interest rates was also supportive of gold in January, as 10-year U.S. Treasury rates advanced to their highest level in nearly four years. In 2017, rising bond rates proved to be a headwind for the gold price. However, since mid-December rates have risen in tandem with the gold price. We believe this is because the latest increase in rates has been driven by inflation expectations rather than activity from the Fed. It seems the market is beginning to view full employment, tax stimulus, and synchronized global growth as inflationary. Commodities have been trending higher. There is also growing potential for protectionist trade policies and purchasing managers globally are finding it increasingly hard to fill demand. There is a nationwide truck shortage in the U.S. and The Wall Street Journal reports strong wage growth in several metropolitan areas.

While inflation could pick up, we do not believe it will reach levels that might drive gold. In fact, we believe there have been structural changes in the economy that mute the inflationary cycles that goods and services experienced in the past. Globalization, immigration, and technology have evolved to enable companies to produce as much as needed to meet demand. Bottlenecks do not last. Everything has become commoditized. Competition is intense. E-commerce drives retail. Low wage immigrants take unwanted jobs. Many companies are announcing one-time bonuses and other perks with the new tax cuts. At this time, we have not heard of any company announcing permanent wage increases. Contracting, outsourcing, and automation keep wage growth low. Demographics are also anti-inflationary as boomers move into harvest mode. For years the Fed has failed to raise inflation to its targeted 2% by flooding the economy with liquidity. That liquidity, instead of raising consumer price inflation in the real economy, has generated asset price inflation in the financial economy — stocks, bonds, real estate, cryptocurrencies, art, etc. Now the Fed is tightening. Gold or gold stocks are seen as a real economy inflation hedge, however we do not see it as a significant driver in 2018.

In our December commentary we talked about the risks of a downturn in a late-cycle economy, as well as the possibility of a market decline that morphs into a debt-driven financial crisis. We now believe the markets have entered the mania phase of this cycle. A series of experiments by Harvard and MIT grad students reported in The Wall Street Journal show that when rates are low, investors' appetite for risk increases beyond what seems logical. It is hard to characterize the price action of cryptocurrencies as anything but a mania. The High Tech Strategist newsletter quotes economic historian Charles Kindleberger: "At a late stage, speculation tends to detach itself from really valuable objects and turn to delusive ones. A larger and larger group of people seeks to become rich without any understanding of the processes involved".

Across other markets the mania is broadly based. Goldman Sachs estimates that the prolonged bull market in stocks, bonds, and credit has left a measure of average valuation at the highest since 1900. The Dow Jones Industrial Average (DJIA)<sup>4</sup> had the most new highs ever recorded in 2017 and saw its longest run without a 3% correction. The S&P 500 Index (SPX)<sup>5</sup> has broken similar records. Margin debt on major stock exchanges tracked by the Financial Industry Regulatory Authority (FINRA) increased 21% in 2017. The Wall Street Journal found the outperformance of growth stocks in January was the most in such a short period aside from the last year of the dot-com bubble. Manias rarely end quietly. When they end, they typically crash. They can last for years and we speculate that the current mania might run its course into 2019. Former Chairman of the Federal Reserve Alan Greenspan famously recognized "irrational exuberance" in the markets three full years before the peak of the tech bubble in 2000.

Gold is recognized as a hedge against financial stress and tends to outperform other investments in severe market downturns. In a June 2017 report, ETF Securities looked at gold's performance during drawdowns of over 15% in the S&P 500. Since 1982 there have been ten such S&P drawdowns that averaged -24.4%. The corresponding average performance of gold was +7.2%. A 2011 bulletin by Lombard Odier looked at gold real returns in major global banking crises since the Great Depression. They found five banking crises lasting from 12 to 57 months during which the real performance of gold averaged +20.6%.

Most people reading this report carry the Tech and Housing mania in their financial memory. In the table below, we broadly characterize the markets since 1995 as bull/manias, crashes, and recoveries to see how stocks and gold investments behaved in each. We examine the returns of the S&P 500, gold, the Philadelphia Stock Exchange Gold and Silver Index (XAU)<sup>6</sup> and the actively managed VanEck International Investors Gold Fund (Class A - INIVX).

#### Bull/Manias:

Gold investments do very poorly when the bulls are running at full speed. Investors generally feel no need for a safe haven<sup>7</sup> in a market that rises relentlessly. However, gold and gold stocks are performing somewhat differently in the current mania. Substantial losses occurred in the cyclical bear market in gold from 2011 to 2015 when gold and the XAU declined 41.4% and 76.1% respectively, while the SPX gained 98.4%. As the markets now reach their mania phase, there is no longer heavy selling pressure on gold and gold stocks. In fact, they have stabilized with nice gains in 2016 and 2017. Also, there are other factors such as the U.S. dollar, real rates, and geopolitical risks that have recently influenced the gold price.

#### Crashes:

Gold is the clear winner in a crash, fulfilling its role as a hedge against financial turmoil. The performance is mixed for gold stocks.

Many gold stocks did very well in the Tech Crash, but suffered losses in the Housing Crash. We believe industry fundamentals were the reason for their poor showing. China was driving a commodities super-cycle in which costs rose relentlessly. Shortages in labor, equipment, and materials along with record energy prices drove double-digit cost inflation. Margins were squeezed and companies failed to meet market expectations. Performance was also compromised by poor management decisions. As a result, gold stocks suffered deratings in 2008 and 2011 when their value relative to gold diminished substantially. We believe gold industry fundamentals today are more like those around the time of the Tech Crash. Companies have regained efficiencies and are well managed, standing to fully benefit from any rise in the gold price.

#### Recoveries:

Both gold and gold stocks outperformed in the recoveries. Many gold stocks exhibit exceptional leverage to the gold price in the recovery phase. When companies are well managed and costs stay contained, they bring earnings and resource leverage. In addition, there is a scarcity component. Capitalized at roughly \$260 billion, according to VanEck research, the global gold industry is relatively small. When investors decide they need a safe haven, there may not be enough gold stocks to go around.

### Performance in the Age of Central Bank Profligacy

	From	To	S&P 500	Gold	XAU	INIVX
<b>Tech Bull/Mania</b>	Jan-95	Mar-00	264.2%	-23.3%	-35.6%	-61.3%
<b>Tech Crash*</b>	Mar-00	Oct-02	-43.4%	11.1%	9.4%	59.8%
<b>Recovery**</b>	Oct-02	Oct-07	104.7%	136.5%	205.0%	329.4%
<b>Housing Crash***</b>	Oct-07	Mar-09	-54.7%	25.4%	-32.4%	-29.3%
<b>Recovery</b>	Mar-09	Sep-11	77.8%	97.6%	91.3%	154.3%
<b>New Bull/Mania</b>	Sep-11	Jan-18	184.7%	-27.3%	-56.3%	-56.0%

\* peak to trough in the SPX

\*\* trough to peak in the SPX

\*\*\* SPX trough to peak in the Gold price

Source: Bloomberg, VanEck. Data as of January 31, 2018. INIVX Expenses: Class A: Gross 1.35%; Net 1.35%. Expenses are capped contractually until 05/01/18 at 1.45% for Class A. Caps exclude certain expenses, such as interest.

The table above lists cumulative returns and past performance which is no guarantee of future results and which may be lower or higher than current performance. Returns reflect applicable fee waivers and/or expense reimbursements. Had the Fund incurred all expenses and fees, investment returns would have been reduced. Investment returns and Fund share values will fluctuate so that investor's shares, when redeemed, may be worth more or less than their original cost. Fund returns assume that dividends and capital gains distributions have been reinvested in the Fund at Net Asset Value (NAV). Index returns assume that dividends from index constituents have been reinvested.

\*All company weightings, if mentioned, are as of January 31, 2018, unless otherwise noted.

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Any indices listed are unmanaged indices and include the reinvestment of all dividends, but do not reflect the payment of transaction costs, advisory fees or expenses that are associated with an investment in the Fund. An index's performance is not illustrative of the Fund's performance. Indices are not securities in which investments can be made.

<sup>1</sup>NYSE Arca Gold Miners Index (GDMNTR) is a modified market capitalization-weighted index comprised of publicly traded companies involved primarily in the mining for gold. <sup>2</sup>U.S. Dollar Index (DXY) indicates the general international value of the U.S. dollar. The DXY does this by averaging the exchange rates between the U.S. dollar and six major world currencies: Euro, Japanese yen, Pound sterling, Canadian dollar, Swedish kroner, and Swiss franc. <sup>3</sup>MVIS® Global Junior Gold Miners Index (MVGDXJTR) is a rules-based, modified market capitalization-weighted, float-adjusted index comprised of a global universe of publicly traded small- and medium-capitalization companies that generate at least 50% of their revenues from gold and/or silver mining, hold real property that has the potential to produce at least 50% of the company's revenue from gold or silver mining when developed, or primarily invest in gold or silver. <sup>4</sup>The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ. <sup>5</sup>S&P 500® Index (S&P 500) consists of 500 widely held common stocks covering industrial, utility, financial, and transportation sectors. <sup>6</sup>The Philadelphia Gold and Silver Index (XAU) is an index of thirty precious metal mining companies that is traded on the Philadelphia Stock Exchange. <sup>7</sup>Safe haven is an investment that is expected to retain its value or even increase its value in times of market turbulence.

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About VanEck International Investors Gold Fund: You can lose money by investing in the Fund. Any investment in the Fund should be part of an overall investment program, not a complete program. The Fund is subject to the risks associated with concentrating its assets in the gold industry, which can be significantly affected by international economic, monetary, and political developments. The Fund's overall portfolio may decline in value due to developments specific to the gold industry. The Fund's investments in foreign securities involve risks related to adverse political and economic developments unique to a country or a region, currency fluctuations or controls, and the possibility of arbitrary action by foreign governments, including the takeover of property without adequate compensation or imposition of prohibitive taxation. The Fund is subject to risks associated with investments in debt securities, derivatives, commodity-linked instruments, illiquid securities, asset-backed securities, and small- or mid-cap companies. The Fund is also subject to inflation risk, short-sales risk, market risk, non-diversification risk, leverage risk, credit risk, and counterparty risk.

Diversification does not assure a profit or protect against loss.

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666 Third Avenue | New York, NY 10017

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