December 2022

Gold Solidifying Amid Shaky Macro Outlook

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December 2022: Hawkish Fed, Sluggish Dollar, and a China Gold Bug

Gold held on to its November gains, bouncing around the $1,800 per ounce level during December. Twenty to thirty-dollar daily moves were common, moving higher on positive inflation reports or lower on strong economic news and U.S. Federal Reserve (Fed) comments to remain vigilant on inflation. The U.S. Dollar Index (DXY)[1] remained subdued following the drubbing it took in November. This enabled gold to maintain some upward momentum. For the month of December, gold gained $55.50 (3.1%) to end the year at $1,824.02.

The People's Bank of China (PBOC) announced it purchased 32 tonnes of gold in November. This is the first official purchase by the PBOC since 2019. In the past, PBOC had purchased consistently for many months between long periods of inactivity. More purchases in December could indicate consistent buying from China in 2023, which could bode well for the gold market.

The gold miners were mostly quiet in December. The NYSE Arca Gold Miners Index (GDMNTR)[2] gained 1.1%, while the MVIS Global Junior Gold Miners Index (MVGDXJTR)[3] advanced 1.7%.

Gold in 2022: It's Been a Wild Ride

For the year, the gold price finished with of loss of just $5.18. While gold ended nearly unchanged, the year was far from calm, with prices dropping $450 from highs to lows before returning to its starting point. Gold saw a maximum drawdown of 11.3% but finished with just a 0.3% loss, which was a very respectable result, given the 18.1% loss for the S&P 500 Index[4] and 64.3% loss for bitcoin.

Average Annual Total Returns (%) as of December 31, 2022

	1 Mo†	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception (2/10/56)	1.25	-13.77	3.91	-2.73
Class A: Maximum 5.75% load	-4.57	-18.73	2.69	-3.30
GDMNTR Index	1.12	8.63	5.68	-3.52

Average Annual Total Returns (%) as of September 30, 2022

	1 Mo†	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception (2/10/56)	-0.93	-20.21	0.75	-5.94
Class A: Maximum 5.75% load	-6.62	-24.80	-0.44	-6.50
GDMNTR Index	0.43	-16.83	2.07	-6.65

Source: VanEck

The performance data quoted represents past performance. Past performance is not a guarantee of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Performance may be lower or higher than performance data quoted. Please call 800.826.2333 or visit vaneck.com for performance current to the most recent month ended.

The "Net Asset Value" (NAV) of a Fund is determined at the close of each business day, and represents the dollar value of one share of the fund; it is calculated by taking the total assets of the fund, subtracting total liabilities, and dividing by the total number of shares outstanding. Investors should not expect to buy or sell shares at NAV.

† 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.

Expenses: Class A: Gross 1.34%; Net 1.34%. Expenses are capped contractually until 05/01/23 at 1.45% for Class A. Caps exclude acquired fund fees and expenses, interest, trading, dividends, and interest payments of securities sold short, taxes and extraordinary expenses.

"War Premium"

Gold had been trading in a range centered on $1,800 for most of 2021. It broke out in February 2022 as warnings surfaced of a possible attack on Ukraine. However, once Russia's bombing of Ukraine began, gold went on to test its all-time highs on March 8 at $2,070 per ounce. By May, the war premium had faded as it became clear that the fighting was not likely to escalate beyond Ukraine.

"Dollar Strength"

The war provided a temporary positive catalyst; however, the dominant driver through most of the year was increasing pressure on gold prices from Fed policies and the U.S. dollar. The market underestimated the resolve of the Fed to fight inflation. In early January 2022, interest rate futures were pricing a 0.77% increase in Fed Funds rates by the end of the year. By April 2022, markets were pricing in at least 1.5% in further rate increases. However, Fed Chairman Jerome Powell continued to talk a tough stance on inflation, and the Fed actually increased interest rates by 4.25%, in one of the sharpest raises in history. The war, the rise in rates, and the relative strength of the U.S. economy contributed to the relentless strength in the U.S. dollar, which made new 20-year highs continue from May to September.

The inverse correlation between gold and the U.S. dollar is well established. Real rates and tail risks also influence gold's performance. However, until 2022, we hadn't realized how dominant of a driver the U.S. dollar could be. The great gold bull markets of the seventies and two-thousands were driven by inflation and the dot-com bust/financial crisis, respectively. Each of these also coincided with a secular *bear market* for the U.S. dollar. While we believe current tail risks (pandemic, inflation, war) are equally as severe as those in past bull markets, the key difference in 2022 was the strong U.S. dollar. This kept the pressure on gold prices, muting the response from inflation, geopolitical turmoil, and other risks.

"Physical Demand Support"

Amid U.S. dollar strength, gold trended to $1,614 on September 28; its low for the year. Technically, gold was poised to trend as low as $1,400; however, gold prices found support from physical demand in India and China, while retail bar and coin demand was strong in the U.S. and Germany. In addition, central banks bought record amounts in the third quarter, led by Uzbekistan, Qatar, and India. Gold tested its $1,614 low several times before making a significant turn higher in November when inflation came in below expectations and Fed Chairman Powell signaled a possible slowdown in rate increases. The U.S. dollar fell hard, and gold broke out, rising to over $1,800 in December.

"Cost Inflation (for Miners)"

Gold stocks went on a bigger roller coaster than gold in 2022. The GDMNTR and MVGDXJ had maximum drawdowns of 30.9% and 37.0% but ended the year with 8.6% and 14.3% losses, respectively. Cost increases combined with lower gold prices caused some companies to miss earnings. The industry guided increased costs in the five percent range early in the year, however; higher commodities prices brought on by the Russia-Ukraine war forced many companies to revise costs at a higher rate. It seemed that 2022 costs would have averaged around $1,200 per ounce, up about 10% over 2021. While a few companies planned on trimming dividends, most dividends remained intact, and stock buybacks continued along with healthy margins. The recent positive gold price trend, along with early indications that costs should remain around current levels, bode well for the miners in 2023.

Gold in 2023: Reemergence Amid a Gloomy Outlook?

Quite a few things that worked against gold in 2022 turned positive as the ball dropped in Times Square. Inflation peaked around mid-year and appears to be heading lower. Many retailers and manufacturers had bloated inventories, and ports, railroads, and package delivery trucks have spare capacity. These prompted the Fed to reduce the size of its rate hike in December, with further reductions or pauses probable in 2023. The U.S. dollar bull market run may end since U.S. Treasury rates were down from October peaks. The DXY declined 9.8% from its 20-year highs in September, and we expect to see the U.S. dollar weaken further if a recession develops. Several reasons to expect economic weakness in 2023:

- Record yield curve inversion
- A common belief is that the Fed policy is felt in the economy with a lag. In 2023, the economy will feel the force of one of history's most aggressive rate hiking cycles.
- A reeling housing market from high mortgage rates and unaffordable pricing. According to Redfin Corp, luxury home sales fell 38% YoY in the three months that ended in November, the most on record since 2012.[*]
- Consumers projected spending of the last of their pandemic-era stimulus savings in 2023.

Geopolitical tensions and deglobalization have many non-western central banks diversifying away from the U.S. dollar. Net central bank gold purchases in 2022 were one of the strongest years on record. There has been a growing reluctance to rely on the U.S. dollar for forex reserves and commerce since Western sanctions have frozen over half of Russia's $500 billion in forex reserves. Many countries see no guarantees that the U.S. won't use the U.S. dollar to retaliate for some future infraction that is less egregious than bombing a neighbor. As this new world order evolves, there could be less demand for the U.S. treasuries that enable the U.S. to maintain its deficit-fueled lifestyle.

[*] https://investors.redfin.com/news-events/press-releases/detail/854/redfin-reports-luxury-home-sales-sink-38-the-biggest

The financial system has operated under ultra-easy and unprecedented monetary policies for over a decade, characterized by extremely low-interest rates and massive quantitative easing. With its first rate increase in March, the Fed has just begun to attempt to normalize policies. Inflation remains far above its two percent target, and its balance sheet of treasuries and mortgage-backed securities is over $8 trillion. Just nine months of tightening financial conditions has resulted in the cratering of the housing market, a crash in cryptocurrencies, a derivatives debacle for British pension funds, and the collapse of a major cryptocurrency exchange. What tail risks will the next nine months bring as a slowing economy is likely to be added to the mix?

Ballooning Deficits and Inflation Waves: Make Gold a Solid Choice?

Higher interest rates create extraordinary systemic risks as monetary conditions continue to normalize. The monthly federal deficit was a record $249 billion in November. On December 30, President Biden signed a $1.65 trillion omnibus spending bill. The government continues to pile on to its $31.3 trillion national debt, which is equal to 124% of GDP, while debt service is becoming a major expense. Recently, the Wall Street Journal's Greg Ip quoted a 1981 paper by Thomas Sargent and Neil Wallace: "A government that runs unsustainable deficits will, one day, fail to sell enough bonds, at which point the central bank will have to finance the shortfall by printing money. The central bank may initially try to control inflation by raising interest rates sharply. But this will widen deficits further and ultimately make inflation even harder to control."[**]

The U.S. Consumer Price Index (CPI)[5] has trended from a peak of 9.1% in June to 7.1% in November, indicating that the first inflation wave is ending. Will there be a second wave? In 1974, the CPI peaked at 12.3%, then fell to 4.9% in 1976. Many thought inflation was finished; however, it roared back to peak again at 14.7% in 1980. Today, the labor market remains tight, while trade and supply chains have become more difficult since the pandemic and the Russia-Ukraine war. The current inventory glut should prove temporary as we expect China's economy to emerge from its COVID quagmire eventually. Energy markets will surely see more volatility, while the rush to green technology will keep upward price pressure on many commodities. Once the Fed stops tightening, we will be watching for the next inflation wave. The Fed might find a second wave more difficult or even impossible to deal with.

It looks like gold's competition with bitcoin has ended. It was never clear just how much gold demand, if any, was being siphoned off by cryptocurrencies. The choice is clear for anyone who has contemplated the gold versus bitcoin debate. Bitcoin and other cryptocurrencies are risk assets. On the other hand, gold is a defensive asset, a store of wealth, and a currency alternative with intrinsic value as a central bank asset, as jewelry, and for industrial uses. Its unique role in the financial system has been confirmed once again.

A shift in gold's investment outlook can be seen in bullion ETF flows. Global bullion ETFs experienced heavy outflows from April to November. The outflows have now stopped, and while a stronger catalyst is probably needed to prompt inflows, at least the selling pressure has abated. Perhaps 2023 will bring a renewed focus on the yellow metal.

[**] https://www.wsj.com/articles/to-solve-inflation-first-solve-deficits-this-theory-advises-11667391310

All company, sector, and sub-industry weightings as of December 31, 2022 unless otherwise noted.

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[1] U.S. Dollar Index (DXY) is a measure of the value of the U.S. dollar relative to a basket of foreign currencies. [2]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. [3]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. [4]S&P 500 is the market-capitalization-weighted index of 500 leading publily traded companies in the U.S. [5]Consumer Price Index (CPI) is a measure of the average change in the price for goods and services paid by urban consumers between any two time periods. It can also represent the buying habits of urban consumers.

Index returns are not Fund returns and do not reflect any management fees or brokerage expenses. Certain indices may take into account withholding taxes. Investors cannot invest directly in the index. Index returns assume that dividends have been reinvested.

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