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In the Inflation/Reflation Debate, Gold Could Win

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VanEck International Investors Gold Fund

INIVX / IIGCX / INIIX / INIYX

Reflation Trade

Gold had a strong start to the year, moving to its monthly high of $1,959 per ounce on January 6 at the same time the U.S. dollar index (DXY)[1] made fresh three-year lows. However, gold quickly reversed course as it became clear the democrats had won a runoff election in Georgia, which, with the help of a democratic vice president, gave them control of the Senate. With this crucial victory, the markets quickly embarked on a "reflation trade", betting that the democrats would pass trillions of dollars of additional spending on pandemic relief, infrastructure and green initiatives. Interest rates spiked higher, taking ten-year treasuries to a ten-month high of 1.18% on January 12. The rise in rates bolstered the U.S. dollar, driving the DXY to its monthly high on January 18, while gold fell to its monthly low of $1,804.

We had thought such a victory for the democrats would be positive for gold because it might lead to more deficit spending, higher taxes and more regulations. However, the near-term rise in yields and the dollar overwhelmed the longer-term implications, at least for now. Gold trended higher in the second half of the month as rates and the dollar eased. Gold ended the month at $1847.65 for a $50.71 (2.7%) loss. The NYSE Arca Gold Miners Index[2] (GDMNTR) fell -3.82%, and the MVIS Global Junior Gold Miners Index[3] (MVGDXJTR) lost -7.06%.

Average Annual Total Returns (%) as of January 31, 2021

	1 Mo†	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 2/10/56)	-7.18	30.86	22.07	-2.64
Class A: Maximum 5.75% load	-12.51	23.34	20.63	-3.21
GDMNTR Index	-3.82	20.69	20.71	-3.29

Average Annual Total Returns (%) as of December 31, 2020

	1 Mo†	1 Yr	5 Yr	10 Yr
Class A: NAV (Inception 2/10/56)	6.81	41.39	23.19	-3.13
Class A: Maximum 5.75% load	0.67	33.26	21.74	-3.70
GDMNTR Index	4.57	23.69	22.45	-4.17

The tables above 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. Investing involves risk, including loss of principal; please see disclaimers on last page. Please call 800.826.2333 or visit vaneck.com for performance current to the most recent month end.

†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 1.49%; Net 1.45%. Expenses are capped contractually until 05/01/21 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.

Hi Ho Silver!

Gold also gained support at month-end when trading excitement broke out in silver. Reddit, a popular online community hosts the WallStreetBets forum, where retail investors and day traders exchange ideas. Early in the month, investors using Reddit targeted electronic game store GameStop Corp. and other relatively small companies with large short interest as buying opportunities. The retail buying and short covering by hedge funds drove GameStop to a 1,625% gain in January. On January 28, the Reddit traders turned their attention to silver, which they allege is being suppressed by banks to mask inflation. As of February first, over the past three trading days, silver has gained 15% to $29 per ounce, the Solactive Global Silver Miners Index[4] gained 23%, and individual silver stocks have gained as much as 59%. Trading volumes and inflows to silver bullion exchange traded products have exploded higher.

Manipulation No Match For Fundamentals

We It's a big stretch for the Reddit traders to go from targeting a small stock with enormous short interest like GameStop to targeting the multi-billion dollar silver industry. It appears that their investment decisions focus on conspiracy theories, social justice and mob rule rather than commodity and industry fundamentals. Nonetheless, they represent a new type of investor to silver that may enable it to trade at higher levels. Silver has been in a bull market with gold, so we don't see it in a short squeeze. In fact, net speculative positioning in silver futures has been long for over a year. The gold/silver ratio is currently at 68, which is near the ten-year average of 70. The ratio hit a low of 31 in 2011 when silver reached its all-time high of $49.80. Also, silver only reached $30 per ounce when gold was making new all-time highs last August. Therefore, higher silver prices here would be well within historic norms. However, many silver stocks are now trading at extraordinary multiples and may pull back once the Reddit frenzy has run its course.

Reddit/WallStreetBets is the first black swan phenomenon since the COVID crash. It is the unintended consequence of radical government policies that drove rates to zero, created trillions of dollars of free money and a society with copious free time. A free market system cannot achieve its function of price discovery and efficient capital allocation if it is subjected to manipulation, government mandates or mob rule. Free markets have been weakened by Reddit/WallStreetBets. In the current environment, the next black swan may bring more ominous damage to the financial system.

Reflation vs. Inflation

There has been a lot of talk in the press of inflation since the democrats have taken control of Washington. We find this misplaced, as there is a difference between reflation, which is stimulating the economy to get back to normal growth, and excessive inflation, which is a rise in wages and prices. The chart shows that inflation expectations have simply returned to normal levels of around two percent, where they have been for decades. The chart also shows how inflation expectations cratered with the deflationary shocks of the financial crisis in 2008 and the COVID crisis in 2020. In both crisis, inflation expectation rebounded to historic norms. Gold is not reacting to inflationary pressures because there is not yet any evidence of excessive inflation.

U.S. Market Inflation Expecations (5 Years Ahead)

Source: Bloomberg, VanEck. Data as of January 8, 2021.

Inflation: Case For vs. Case Against

Here, we contrast the cases for and against inflation.

Case for inflation:

- Shortage of manufacturing workers caused by new e-commerce jobs with higher wages
- The end of cheap labor in China and Asia in general
- The pandemic has reduced capacity in many industries
- The pandemic has also reduced the pace of globalization and international trade
- A savings glut and pent-up demand will bring a surge in post-pandemic spending
- The Fed can never raise rates for fear of crashing the stock market and making debt service unbearable.
- The Fed has adjusted policies to enable inflation above its two percent target
- It is hard to believe the shift to concerted fiscal/monetary stimulus on an unprecedented scale won't bring an inflationary cycle
- The last time we saw such stimulus in the U.S. was in response to the depression and WW II, which brought an inflationary cycle in which the annual change in the CPI peaked at 19.7% in March of 1947.

Case against inflation:

- With the pandemic, spending has focused on goods, so future demand has been satiated
- There is no pent-up demand in services, only a return to normal; you only need one haircut oryou might take that cruise, but not five cruises
- High levels of unemployed will act as an ongoing drag on wages
- Accelerating technological change will keep the cost of goods in check
- The U.S. Federal Reserve (Fed) has been trying to generate inflation for over a decade without success
- Excessive debt and aging demographics will keep a lid on growth
- Millions of households are behind on rent and mortgage payments
- A savings glut reflects more conservative consumers traumatized by the pandemic that spend less.
- Negative rates, massive QE and fiscal stimulus have failed to prompt inflation in Japan for decades recently, Japan has been in deflation for three months.

And The Winner Is...Gold

Weighing the pros and cons, we believe history provides the best guide. The Japan model makes a compelling case against inflation, however, the post-WWII model makes an inflationary cycle the most likely outcome, given the overwhelming stimulus efforts. This would be the most bullish for gold, although, a low growth, low inflation outcome presents abundant risks that could also drive gold for years. Such risks include debt problems, even more radical fiscal and monetary policies, worsening income disparity and social unrest.

All company, sector, and sub-industry weightings as of January 31, 2021 unless otherwise noted. Source: VanEck, FactSet

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[1]The U.S. Dollar Index (DXY) measures the value of the U.S. dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' 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]Solactive Global Silver Miners Index is a freefloat, market capitalization weighted index of international companies active in the exploration, mining and/or refining of silver.

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Diversification does not assure a profit or protect against loss.

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