



ASA Gold's Merk: The Market Is Already Pricing In A Recession

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Axel Merk, chief investment officer of the ASA Gold and Precious Metals fund. Read the Q&A below as Axel says that the market is pricing in a recession and the start of rate cuts down the road, and the gold market is already reacting because it tends to lead in these cycles. Merk makes the case for owning both precious metals and the mining companies now, though he notes their different risk profile and uses; he points out that both are being embraced now because the miners would be lumped in

with all equities and poised for a takeoff if a recession is shallow, while the metal will be a diversifier in the event that a downturn is more severe and protracted.



Axel Merk

The podcast can be found on AICA's website by clicking here: <https://aicalliance.org/alliance-content/pod-cast/>

CHUCK JAFFE: Axel Merk, chief investment officer at the ASA Gold and Precious Metals fund is here, and we're talking all that glitters now on The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And today we're talking with Axel Merk, he is president and chief investment officer at the Merk

Funds and Merk Investments but he also is chief investment officer at the ASA Gold and Precious Metals Fund, a closed-end fund that trades under ticker symbol ASA. You can learn about the fund at ASALtd.com. You can also learn more about business-development companies, interval funds, and closed-end funds at AICAlliance.org, the website for the Active Investment Company Alliance. Axel Merk, great to have you back to The NAVigator.

AXEL MERK: Great to be with you, Chuck.

CHUCK JAFFE: This is a really interesting time to be talking about gold, because of course historically what people want from gold has been a hedge for inflation. And it hasn't worked that way, as we've seen the worst inflation we've seen in decades. But it has been showing of late that maybe it's not a terrible hedge against some of the sociopolitical unrest. So as you're looking at the market right now, what's your take on gold and what its role should be?

AXEL MERK: Gold is so simple yet so misunderstood. Gold is a brick, right? It's a very unique brick. It's the most sensitive indicator of our monetary craziness we have in the world, and gold did just fine I would think through this period but it didn't go quote/unquote "through the roof". Part of that was of course we had this very hawkish Federal Reserve that raised interest rates, and so when you get compensated for holding cash, then gold doesn't compete very well. Now obviously some people say, "Hey, inflation is so high." Well, when it comes to any investment, it's a forward-looking market, and one of the ways we look at the price of gold is versus longer term real interest rates. Now obviously nobody knows what real interest rates will be 10 years from now but there are market-based measures, and they have gotten significantly into positive from previously negative territory, and in that context gold has held up very well. On a forward-looking basis, it's of course a question, can the Federal Reserve continue to be as hawkish as they have been or have they quote/unquote "pivoted" as far as being less hawkish, let alone speak about great cuts down the road? And so there is gold, and of course you mentioned ASA, that's about gold mining. But the broader context is a longer-term outlook, what may happen to the real value of money.

CHUCK JAFFE: And what's your expectation there? We've watched as what people were saying might be digital gold, cryptocurrency. Well, that certainly did even worse relative to everything that was going on, so that's not necessarily working. What's your take on what's going to happen next?

AXEL MERK: If you'd just look at what the market thinks, the market thinks that we've seen the peak in real interest rates on a forward-looking basis; 10-year real yields or TIPS yields, those sort of things have peaked or have been near a peak. And the Federal Reserve has decided to pivot from doing 50 basis point rate hikes to 25, they might pause in a few months and so the market is pricing in that we'll get a recession and cuts down the road. We've had inflation readings that have been a tad more benign, which means the Federal Reserve may be more benign. One of the things people get wrong is usually when inflation moves higher, a currency strengthens rather than weakens. And the reason is because the market thinks the Central Bank will do the right thing, and then only over time that the market realizes, "Oh, maybe they don't." And so that's why these reactions are a little counter-intuitive often, that on the initial high inflation reading, something that's interest-rate sensitive may actually move in the opposite direction to what we may think. We think and we see that both in the price action of gold and gold miners and on flows that we've seen on our open-end products, that people are embracing gold and gold miners. And part of that is that gold and gold miners react earlier, so if we have a shallow recession, well, equities may be off to the races pretty soon, all equities, but if we have a more severe recession, then the traditional equities may suffer quite a bit. Whereas gold and gold miners historically then react much earlier. We saw that in the 2008 crisis and in other recessions in the past. And so they tend to be more sensitive, they tend to react earlier in the cycle than other equities.

CHUCK JAFFE: There are times when investors would rather own the miners than the metals, and there are times when you'd rather own the metals versus the miners. Now you of course invest in both, although not necessarily as much with ASA but in some of the other funds that you've got where you're looking more at the metals than the miners. Where are we on that spectrum, metals, miners, both?

AXEL MERK: They really have a different risk profile and somewhat more slightly different investors I think, although one tends to lump them together. But gold, some people use it as a diversifier. Volatility similar to equities, sometimes higher, and long-term diversification near zero, and then in addition to that of course you get the protection against the deterioration of the purchasing power of the currency. When you go to gold miners, people want to have more juice, they want to have more leverage, and you really have to distinguish between the majors and then downstream to the explorers. The majors are intended to be

levered better on gold, and I say intended because sometimes that works and sometimes doesn't. The idea is the cost of mining is stable, and then as they price goes up we have a disproportion of profit and the companies should go through the roof. There's some caveats to that because the majors have actually been not investing, so they're generating a boatload of cash which you think is good, but it means you have less of a leverage to the price of gold. And at the other end of the spectrum, inflation also has hit them with higher commodity costs, it's very energy intensive to mine. Now the good news is that we might have seen the peak of the energy side of things. When it goes downstream, you're really buying almost an option on them striking gold literally. So these are exploration companies, they don't have the high production costs, but these companies have a lot of credit risk because they only get funded until the next phase in the exploration. Eventually with the goal that either they build up a mine or be acquired. And there's been very little acquisition activity in this space, but if you go downstream, and ASA as we're talking about that, we've really focused more on the downstream end. So those are opportunities and it's really a levered player on the levered field to begin with. It's a fairly volatile type of investment, not for the faint of heart. Very different from the gold investor that quote/unquote "just looks for a protection of purchasing power".

CHUCK JAFFE: Let's talk a little bit about structure as well. ASA, the ASA Gold and Precious Metals fund was actually started in 1958, and it was 60 years old, it was 2018 when you guys became appointed as the investment advisor to the funds. You of course have a long career running the Merk Funds, and you have gold and precious metals funds there including OUNZ if folks want to look at the ETF version that's talking about metals. How big a difference is it owning these assets in a closed-end fund versus an ETF or an open-end fund? Does it change at all the way you manage?

AXEL MERK: We took over the fund actually in 2019, we started having discussion with the board in 2018, and when we took the fund over we really repositioned the fund substantially. It was a very sleepy product that was the tail end of the very extended bear market in gold miners, and we really started shifting it downstream. And in the context of your question it's very relevant. A closed-end fund does not have the daily redemptions that an open-end product has, so we decided we might as well take advantage of that and help to finance many of these small exploration companies. Aside from the volatility I mentioned, there's really a

value proposition because we can invest in much smaller companies than some of the bigger funds can, and as we do that we help to quote/unquote “institutionalize the assets”. Meaning these companies, as they advance in their life cycle they will then be able to accept money of bigger companies as they grow, and there's, we believe, a disproportionate value appreciation. Again, not all of these companies will make it and some of that is going to be volatile, but it provides for a unique opportunity to do something with a closed-end vehicle. And we've gotten I think a very good name in the industry for being there for many of these exploration companies. Doing this and providing capital to good management for good projects, it's a unique thing that you cannot do with an open-end product.

CHUCK JAFFE: Well, Alex, this has been really interesting, I appreciate you joining me on The NAVigator to talk about. Thanks so much for joining me.

AXEL MERK: My pleasure.

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