AGF Precious Metals Fund

FUND COMMENTARY SECOND QUARTER 2017 | **FOR ADVISOR USE WITH INVESTORS**

FUND FACTS

FUND CATEGORY:	BENCHMARK INDEX:	DATE OF INCEPTION:	INVESTMENT STYLE:	PORTFOLIO MANAGERS:
Precious metals	S&P/TSX Global Gold Total Return Index	September 1993	Bottom-up growth	AGF Investments Inc. Ani Markova, CFA, MBA, LIFA, CIM

Market overview

The gold price had a strong start to the quarter, driven by political uncertainty following U.S. airstrikes into Syria and British Prime Minister Theresa May's call for snap elections in April. It later retreated as political risk subsided, ending the quarter down 0.6% in U.S. dollar terms.

The outcome of the French election in which centrist candidate Emmanuel Macron defeated leftist leader Marie Le Pen contributed to the fading of political risk, with the gold price retreating in the aftermath. The Conservatives loss of a majority in the U.K. snap elections led to a wider range of potential outcomes for Brexit – an event that failed to support the gold price.

As widely expected, the U.S. Federal Reserve raised rates by 25 basis points to 1.00% -1.25% at its June policy meeting and discussed plans to normalize its balance sheet. The European Central Bank also suggested that it may roll back its asset purchase program earlier than expected, which led to increased expectations of tightening monetary conditions and in turn pressured the metal.

The U.S. dollar weakened during the period amid mixed economic data but, this did not result in gold price strength given expectations of tightening monetary policy. First quarter GDP growth of 1.4% was below the 2.1% reported in the fourth quarter, while the pace of job additions moderated. However, the unemployment rate fell to 4.3%, the lowest level in sixteen years, and manufacturing activity remained in expansionary territory with an ISM Manufacturing Index reading of 54.9 in May. Investors' focus turned to fading inflation pressures causing real interest rates to increase.

Gold equities were down 6.0% during the quarter as represented by S&P/TSX Global Gold Index, underperforming the metal. Exchange-Traded Fund (ETF) holdings of gold increased 3.1% to end the period at 60.7 million ounces.

Fund overview

As at June 30, 2017	3 mo.	1 yr.	3 yr.	5 yr.	10 yr.	PSD*
AGF Precious Metals Fund (%) (net of fees)	-7.7%	-18.9%	0.1%	-4.8%	-2.3%	6.5%
S&P/TSX Global Gold Total Return Index (%)	-6.0%	-22.3%	0.6%	-7.4%	-2.2%	-

Source: AGF Investment Operations.

* Performance start date (PSD): Sept. 27, 1993.

For the three-month period ended June 30, 2017, the portfolio underperformed its benchmark, the S&P/TSX Global Gold Index, returning -7.7% compared to -6.0% for the benchmark. This was largely a result of security selection given the Fund's relatively higher exposure to junior mining companies that underperformed during the quarter, exacerbated by index and EFT rebalancing. However, sector allocation contributed to performance, driven by exposure to the Silver and Diversified Metals & Mining sub-sectors.

Amongst the top detractors from performance was Asanko Gold Corporation, a gold producer with operating assets in Ghana, West Africa. The company's share price came under pressure after a short-seller issued an unsubstantiated report that it was shorting Asanko based on flawed geology, a partial collapse on the west wall pit and an urgent need to spend on significant capital expenditures resulting in a liquidity crunch. We continue to hold the stock, as our channel checks confirm production is progressing well and on plan. Additionally, the partial pit wall failure is not new and had been previously reported by management, with previous slippages having minimal impact on production. Importantly, the company subsequently issued an independent third-party Definitive Feasibility Study that confirmed forecasted annual production of 230,000 ounces at all-in-sustaining-costs of US$968 per ounce over 20 years. The company is run by a proven management team that built the Esaase mine on time and on budget and offers potential for production growth from a plant expansion.

A top contributor to performance was Evolution Mining Ltd., a mid-tier gold miner, operating six mines in Australia. The company outperformed in part owing to expectations that Evolution Mining would be included in the index that the GDXJ is based on, which led to increased demand for the stock. The company also reported positive results during the quarter, with production in line with estimates and better-than-expected costs. Additionally, management provided an update to resources and reserves with an additional 1.14 million ounces added to reserves, the majority of which came from a recent acquisition. We continue to hold the stock given a strong free cash flow profile buoyed by increasing group production and lowered operating costs.

Outlook

We are constructive on the gold price over the medium-term. However, in the near-term, the gold price could remain range bound as we are in a seasonally weak period typically characterized by subdued physical demand from the major markets of China and India. That said, there is potential for investor demand to support the metal, particularly should we experience any volatility in equity markets owing to any delays in passing tax reforms and tax spending budgets in the U.S.

The gold price has been under pressure on expectations of tightening monetary policy, as the market is pricing in one additional rate hike this year and as the U.S. Federal Reserve has discussed intentions to commence balance sheet normalization in the coming months. Similarly, the European Central Bank has suggested that it is ready to taper its asset purchase program, adding to the view that monetary policy is shifting in developed economies. We see room for the gold price to move higher if the Fed moves away from the current trajectory of interest rate hikes and/or the ECB delays tightening. The impact to the real economy of any tightening measures could also have important implications for the gold price and will be important to watch. We also note that while inflationary pressures have abated, real rates remain relatively low, which is typically supportive of the gold price.

Geopolitical uncertainty also remains, given rising military tensions in Asia and the Middle East, which could drive volatility and increase safe haven demand for gold. This, along with uncertainty on the impact of U.S. fiscal policies and debt ceiling negotiations, could lead to equity and currency market volatility.

Some of the risks we see in the short-term include continued weakness in physical demand beyond the seasonally weaker summer months. Waning of investment demand could also pressure the metal.

We are currently finding opportunities amongst junior miners and have added to our exposure to juniors over the last few months. As senior gold miners grapple with declining mine lives, we expect merger and acquisition activity (M&A) to target exploration and single asset companies operating in safe geopolitical regions. Further, as the gold price has recovered from the protracted downturn between 2011 and 2015, junior miners have improved their ability to access funds and ultimately unlock shareholder value on their respective gold projects.

Gold companies are expected to remain focused on containing their costs, which should help sustain cash flows in the face of any near-term gold price weakness. In this environment, we continue to look for companies that have quality assets, strong management teams and that are trading at attractive valuations. Our focus continues to be on disciplined stock selection and diversification to ensure the Fund has exposure to current and future profitable gold production.

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