Ronald Stoeferle – Gold is back and the party in mining stocks is only getting started

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THE MATTERHORN INTERVIEW – Jul/Aug 2016: Ronald Stoeferle

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On behalf of Matterhorn Asset Management, Lars Schall spoke with Ronald Stoeferle who is Austrian as well as an advocate of the Austrian School of Economics.

Ronald and his partner Mark Valek are co-authors of the extensive and detailed investor report named 'In Gold We Trust'; see the download links at the bottom of this page.

[Video/Podcast] 28 mins

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Transcript

Lars Schall: Good day, ladies and gentlemen. This is Lars Schall on behalf of Matterhorn Asset Management in Zurich, Switzerland. The person I will interview today is Ronald Stoeferle in Vienna.
First of all, congratulations Ronni for this is the 10th 'In Gold We Trust' report that you have just published.

Ronald Stoeferle: Thanks a lot, Lars. I'm really glad that it's already the 10th anniversary of our report, and I think this year we found quite some new and interesting things about gold. It's been quite a lengthy publication again, more than 150 pages, and I'm honestly really happy that it's finally out because it's been a lot of work.

LS: Before we talk about the latest edition of the 'In Gold We Trust' report, let us talk about the history of your reports. How did it all begin?

RS: Well, I worked at Erste Group in Vienna as a research analyst and I was trading gold stocks for quite a while on my private account, and then I went to my boss and said, "You know, I'm pretty interested in gold and everything around, would it be possible to write a short special report?", and my boss said, "Yeah, go ahead", so that's when I started researching gold and, as you know, it's definitely… it's not about gold itself, it's about everything: it's about our monetary system, it's about our society, it's about politics. It's about everything and that makes it fascinating. So, I've written more than 1,000 pages about gold in the last few years and I still get so many new ideas, new perspectives, new charts to create, so I'm already having ideas for 'In Gold We Trust 2017'.

LS: Okay, but let's talk about the latest edition, and the main message is; gold is back.

RS: It is back. I think we have seen quite a brutal correction. As I often tend to say, the market is a maximizer of pain and we have seen maximum pain last year. It's been a classical cycle. It ended with, I would say, desperation, depression, panic. We have seen that analysts all became extremely bearish and, as you know, being a contrarian is tough and lonely, but in general it's the right way to go.

I think that we have seen the bottom in gold last December, when everybody was kind of getting nervous regarding four or five rate hikes in the US. Everybody thought the US economy is doing so well and therefore Janet Yellen will hike interest rates several times in 2016. We all saw that markets pretty quickly showed the Federal Reserve that they don't appreciate rate hikes because our whole system is dependent on cheap liquidity nowadays, and so markets sold off in January and February quite dramatically and gold started rising and gold mining stocks started rising in January.

There is also a pretty interesting chapter in the report. We are in a bull market again. Gold is trading like in a bull market and we have seen this accumulation phase in the last few months. You can tell that people like very successful macro investors – Stanley Druckenmiller, Carl Icahn, Paul Singer, George Soros –, they all have recently bought gold related positions, miners, ETFs, etc. And now I think we will enter the next stage pretty soon which is the public participation phase. When market participants wake up and say, you know, "The fed is basically out of ammunition. They cannot raise rates. Perhaps it makes sense to buy some of this strange shiny metal that doesn't pay any interest" (laughing).

LS: Yeah, but is this nowadays a disadvantage for gold that it does not pay interest?

RS: No. Gold doesn't have to pay any interest. That was always the most ridiculous argument that gold doesn't pay any interest. tt doesn't have to pay interest because it doesn't have any counterparty risk but a couple of years ago, we had at least interest rates and nowadays, gold doesn't pay any interest. Now it can be said that gold doesn't cost any interest, and I think we're seeing negative interest rates now in five different currency areas. This will continue so the opportunity costs of gold are falling, and that's a great environment for gold. I think that institutional players will be probably the marginal buyers that really make an impact on prices. We have, for example, seen that Munich Re, the second biggest reinsurance group, they are hoarding physical gold and they are also storing cash, actual cash, in their vault. So, I think we will see much, much more big institutional players starting to buy physical gold.

LS: Now, taking a look into your report, in chapter two, there is a subchapter D which is entitled ‘Anecdotal evidence of three world views’. Can you talk about this please?

RS: Of course. We are mostly doing asset management and wealth management, so we’re meeting quite a lot of clients, we’re meeting institutional market participants, other asset managers, private bankers, etc. So, we’ve kind of found out that there are basically three different world views with respect to the assessment of the overall economic situation.

First of all, there are the believers. They believe in the system. That’s financial analysts, market pundits and so on. They all believe that the Keynesian economic policy that was implemented after 2008 was correct and that it was necessary. They believe that everything central bankers and politicians did helped to solve the crisis and now we are on the way back. Of course, there is this secular stagnation or the new normal and so on, but that’s just how it is and they don’t see any systemic crisis. So, those are the believers in this system. Their gold allocation is basically zero.

Then there are the skeptics. This camp comprises people who already have some doubts about the sustainability of the very extreme economic policy measures that have been taken. So, they know that what the central bankers did, that those are big experiments that nobody really knows how they’re going to develop. They are concerned about the future of the financial system. And those are, from my point of view, the most interesting market participants. I think they are the marginal buyers and you can tell, having a look, we’ve got one chart in the report showing the total amount of bullion held by ETFs, by exchanged traded funds, and you can see that it’s a very pro-cyclical behaviour. So, every time gold rises, ETF holdings also rise. Every time gold falls, people are selling those gold ETFs. So, what we have seen since 2013 was a big exodus out of ETFs, and now since the first quarter of 2016, they are already starting to pile up still on a pretty low level, but I think those skeptics, they will play an important role as they are the marginal buyers for gold. Of course those are… yeah, it’s a pretty large group because I think there are people out there who question all those interventions by central bankers and by politicians, and they know that we basically are just kicking the can further down the road. So, that’s an important group and probably this is the largest group.

And then thirdly there are the critics of the system. They are convinced that the monetary architecture is systemically flawed and my partner, Mark Valek, once said, “Once you become an Austrian, you remain an Austrian”. So, most of those people have got their world view based on the Austrian School of Economics, so they know that we’re in a systemic crisis and that our financial and monetary system is the root cause for all those problems that we’re having and I think the interesting thing about that is that it’s basically a one-way road. Once you get that, once you believe or you know that we always need more debt, more inflation to keep everything alive then you won’t go back and become a believer into the system again. That’s basically a one-way road and the growth of this group is kind of pre-determined. So, I think it’s really interesting to differentiate between the motivations and the gold allocations also of those three groups. And this is something that I think is pretty unique and that’s why we are pretty proud that we wrote this chapter in the report.

LS: You've talked about different camps. When it comes to gold, there is the camp of the so-called "conspiracy theorists", and in your new report, there is a chapter entitled 'financial repression' and it has a subchapter E, 'The fix in gold price manipulation exposed'. Now, what did it expose and is it still a theory?

RS: No, it's not a theory. I mean I've been writing about those manipulations or interventions for a couple of years now and I'm quoting Chris Powell, the Secretary of GATA, and he brilliantly said, "There are no markets anymore, just intervention", and I think that's a great quote. So, basically every price is manipulated. It's bond markets, I mean via quantitative easing, central banks are massively disturbing and manipulating bond prices. Currencies are managed, so why shouldn't gold be managed? Ed Yardeni, who is definitely not a tin foil hat or a gold bug, he said, "These markets are all rigged and I don't say that critically, I just say that factually".

We have seen so much evidence in the last year. We had the Deutsche Bank settlements, for example, then before there was already the study by Rosa Abrantes-Metz, and her husband. It's just so obvious that the price of gold is also managed but we also know that… I think this underlying market force is so strong that it cannot be manipulated forever.

LS: Is it like when you have a ball and you go into the water and you suppress the ball under the surface, the deeper you go and once you lost control of the ball, the higher it will jump out of the water?

RS: Exactly. That's a great analogy, yeah.

LS: We always talk more or less about three things every time we talk about gold, and these are three ratios. The first is what information do you get these days from the silver/gold ratio?

RS: Well, as you know in our investment process, the gold/silver ratio is really important. So, for us, it's, I would say, an indicator for inflation versus deflation. One main takeaway of the report is that inflation dynamics are currently changing and you can tell that from the gold/silver ratio that peaked above 80 and is now heading downwards, so silver is outperforming gold, and that's a very good sign.

We already researched that in our last report saying if you want to see a really strong bull market in gold, silver has to outperform gold. Another important topic is if you want to see rising inflation rates, normally silver also outperforms gold. So, that means a falling gold/silver ratio, and we're having that now.

We also did some technical analysis on the ratio itself and it really looks good, so perhaps going forward if our assumption is right that gold is in a bull market, then you want to be long silver especially. Of course, silver is much more volatile, not everybody can live with this volatility, but I think it's a great idea now being long silver.

LS: Another ratio that we like to talk about is the gold-to-oil ratio. What do you make of the gold-to-oil ratio these days? Which of the two is going to break, gold cheaper or crude higher? And moreover, if the gold-to-oil ratio moves back to anything showing stress levels in the oil market, what sort of price do you see?

RS: Well, first of all, the gold/oil ratio is extremely high these days so the average is around 15 and now we're roughly at 30; so one ounce of gold buys 30 barrels of oil. I think with the normalization… I mean my long term target for gold is $2,300, as you know, so in combination with the normalization of the gold/oil ratio to around 20, the price of oil would be at $115 per barrel. I think that's a price level that most participants don't even consider as an extreme tail risk anymore. You know, with all the political situation going on in the Middle East, I wouldn't rule out oil trading above $100 again. In fact, I'm one of the most bullish analysts when it comes to oil, first of all from a sentiment perspective. Nobody really cares about oil at the moment. We're always hearing the same arguments that there's so much supply coming out of fracking and so on but I think this is a flawed argument. And from my point of view, in some sort of a stagflationary environment, we might see definitely higher oil prices and I think stagflation is one of our strongest calls going forward and I think we're already kind of in the middle of a stagflationary development at the moment.

LS: As for gold equities, the report says, "As a result of this, we expect that in coming years, mining stocks will once again become the kind of leverage on gold that investors crave". Now, what kind of result?

RS: Well, you know that we have seen a brutal bear market in mining stocks. Gold bucks index was trading above 600 and then it collapsed within a few years to 200, and I think this short intraday dip below the 100's at the gold bucks index, the HUI, this was probably one of the greatest bear traps in history. Since then, gold mining stocks rose I think 150%, but nobody really believes in this rally and I've got a great chart showing bull markets in mining stocks and you can see that those are actually quite a ride. At the moment, we're only at the beginning of this party probably. It's like if you join a party at eight or nine, that's not the time when the party really kicks in. Around two or three, that's probably the time when the party is really going on, and then you should be smart and leave the party a bit too early probably, and it's the same in investing.

So, this party in mining stocks is only getting started and I think the reasoning for that is that there's been some creative destruction going on in this sector. We have seen that, you know, the companies, they are taking care of cost discipline now. They became more transparent. They wrote off big projects. They focus on reserve grades, so they're really focused again on profitability, and we have seen their margin actually, we're pretty stable. In fact, I think that the leverage on a rising gold price is much higher nowadays than a couple of years ago because those companies that really survived this massive bear markets, they're now resting on a really solid foundation. Therefore, I think, yeah, we've got great investment opportunities especially in the developer segment, but also in single mining stocks, and that's what we're focusing on nowadays in our investment process.

LS: With regard to BREXIT, you say in your report that more economic and monetary stimulus programs to counter the disintegration of the EU should be expected. Now, this is also a bullish indicator for gold.

RS: Definitely, but one should not forget that we wrote that in the last report, those geopolitical events; they usually don't have a huge impact on the price of gold. That's basically the icing on the cake normally. Most of the time, we are seeing… the most important driver for gold is inflation dynamics and real interest rates. Those geopolitical events are, yeah, often what journalists use as their reasoning, "So there is a crisis, gold is rising, okay. The reason for rising gold prices is this crisis". I think that's a bit too naïve from my point of view.

LS: But is this only a geopolitical event? I mean this is perhaps very interesting seen from a financial point of view because of the City of London.

RS: It is, but I think it's not going to be that dramatic. They will probably negotiate for the next two years and they will come out with some sort of compromise. I don't think it's that bad and you can already see, you know, the British pound gained quite significantly the last few days. I don't think it's going to be that bad. I think what we can expect is there will be further downgrades of economic growth going forward. We will see, sooner or later, a recession. Everybody will blame the BREXIT as the reason for the recession. I think that central banks will step in. I mean right on the day of the BREXIT, all central banks said they will provide enough liquidity to the system and that's basically the trigger for gold going forward. They will stay lower for longer, they will implement more monetary, let's say, steroids, and we will have negative interest rates perhaps also in the US sooner or later. There will be Keynesian fiscal interventions and that's going to have an impact on gold but not the BREXIT itself. I think that's a bit overstated.

LS: Yeah. Now, there is the third ratio that we like to talk about and that is the stock to flow ratio of gold. Why is this interesting vis-à-vis other commodities?

RS: Well, the stock-to-flow ratio, as you know, I've been writing about this topic for years now – I think that's really crucial to understand as an investor. Gold is not consumed, it's hoarded, so therefore gold has got different aspects, different characteristics compared to commodities, and that's the reason why we, for example, in the whole report we really don't care about classical supply and demand dynamics like most of the mainstream publications regarding gold analysis. So, for us, it's much more important to analyze factors like the trend and inflation expectations, interest rates, trend of the US dollar and other fiat currencies, commodity prices, credit spreads, opportunity costs, and confidence in the political system. Those are the most important drivers for gold but not supply/demand statistics but this is something, for some reason, that nobody really cares even in the gold scene, and that's why we are not getting tired of emphasizing that this stock-to-flow ratio is so crucial.

LS: Okay, thank you very much for this interview.

RS: Thank you very much, Lars. It’s been a pleasure, as always.

Ronald-Peter Stoeferle*, who is a Chartered Market Technician (CMT) and a Certified Financial Technician (CFTe), was born October 27, 1980 in Vienna, Austria. During his studies in business administration and finance at the Vienna University of Economics and the University of Illinois at Urbana-Champaign in the USA, he worked for Raiffeisen Zentralbank (RZB) in the field of Fixed Income / Credit Investments. After graduating, Stoeferle joined Vienna based Erste Group Bank, covering International Equities, especially Asia. In 2006 he began writing reports on gold. His benchmark reports on gold drew international coverage on CNBC, Bloomberg, the Wall Street Journal and the Financial Times. Since 2009 he also wrote reports on crude oil. In 2013, Stoeferle and his partners incorporated Incrementum AG in Liechtenstein, where he manages a fund that is managed based on the view of the Austrian School of Economics. Moreover, in 2015 he published the book ‘‘Austrian School for Investors’’, co-authored with Mark Valek and Rahim Taghizadegan.*

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