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Mark Noble

Hello, I'm Mark Noble, Executive Vice President of ETF Strategy at Horizons ETFs, and this is the latest episode of Generation ETFs. We've been referring to 2023 internally as the year of yield for a number of reasons, but the most important of which is we have a view that with higher interest rates, investors are going to become a lot more focused on using income-generating strategies to meet a larger portion of their total return targets. Now, when we are focusing on yield, it can raise questions as to the merits of owning some asset classes, particularly ones that don't pay any income, of which gold would probably be the most well-known. At the same token, the macroeconomic environment for gold seems quite favorable in 2023.

Mark Noble

With us today to discuss why gold has found some momentum is Nick Piquard, our Vice President, Portfolio Manager for Horizons ETFs. Nick believes that gold and gold equities are well-positioned for positive returns in 2023, and there are also additional income opportunities that can be generated by using covered calls to enhance the income that can be earned from writing calls on gold.

And this is a strategy that can be a surprisingly strong income generator, particularly for investors who want to take advantage of these positive macroeconomic conditions in gold. Anyways, I'll let Nick get more into this. Nick, great to have you on. I think maybe the first place we should start is what is happening with gold right now? And I think it seems to me that a lot of the momentum we've seen coming out of the lows in November, where gold was it at about \$1,650 an ounce US, it's now around \$1,900. It has to do with the economic view. A lot of people are wondering if we're heading towards a soft landing or possibly a deep recession.

Nick Piquard

Yeah, it's been a very volatile year in all asset classes, and gold is no exception. And what we saw at the end of November is really a topping out of this very strong US dollar that we'd seen before that. Since then, the US dollar's come down over 10%, and that's really helped the gold prices recover. And the backdrop of that as well is a lot of physical fundamental buying happening in the gold market. In the past, last half of 2022, central banks added more gold to their vaults than they have in the past 50 years. And so you have a combination of a weaker US dollar, strong buying, that really helped the price of gold.

Mark Noble

So why are central banks backing the truck up on gold? It does seem a little bit startling that after 50 years you've got this frenzy for gold buying.

Nick Piquard

There's a few theories related to that, but one of the things is definitely diversification of reserves for central banks. Central banks have mostly been using US dollar as the reserves in the past 50 years or so. And what's happening now is because we had the conflict in Russia, and potentially cold relationships with China, they may want to diversify away from holding US dollar as a reserve asset. In other countries we're noticing as well. And so I think many countries are looking at the situation today in the world and saying, "Maybe it's better for us to have a little bit of gold."

Mark Noble

I was surprised though in 2022 that gold didn't do more, especially on the front end of the year, because you generally view it as a store of value. And what we saw was, for example, cryptocurrencies taking off in early 2022, well, they started the tail off, but especially in 2021 and then moving into 2022. And it's an inflationary environment, so you would expect that gold would offer some value there, but it really hasn't. Any thoughts on why we're seeing this movement now but weren't last year?

Nick Piquard

Yeah, and I think that's a fair point. I think there's two things that really drive the price of gold. Inflation is one of them, but real yields is another aspect because gold doesn't earn any interest. And so when you're looking at the Federal Reserve hiking interest rate as aggressively as they did, some investors wonder, "Is it better to own US dollar cash where I'm actually getting an interest return on that? Or is it better to own gold?" And I think that did not help the price of gold. Despite that, gold outside of just owning US dollar cash, gold was one of the best asset classes to own in 2022 relative to bonds or stocks.

Mark Noble

So this is going to bring us to the question that's probably the top end of getting exposure to gold, which is do you buy the equities or do you buy the bullion? And I know there's no right answer here, but I'm hoping you can give listeners a bit of a sense of where's the benefit of buying the gold miners and where's the benefit of buying gold bullion?

Nick Piquard

Yeah, and I think that's a great question. And if you look at 25 years ago or so, when I started in the business, there weren't that many options if you wanted gold exposure. Gold ETFs didn't really exist, ETFs were just beginning. And so if you wanted exposure to gold, a lot of investors would go to gold miners. Now, gold miners have some advantages and disadvantages. The advantages is they tend to be leveraged to the price of gold. So in a gold bull market, they tend to outperform owning gold outright. The problem with the miners is that there's a lot of operational risks associated with them as well, in terms of jurisdiction risk, labor issues, energy costs, and that can affect margins. And we saw a little bit of that last year with energy costs going up as much as they did and labor interruptions, that can impact the profitability of gold miners.

Nick Piquard

Despite that, if you look at gold miners today, you look at the big gold miners, a basket of big gold miners, such as the one that we own in our own ETF, a covered call ETF, in GLCC, it still has dividend yield of 2.5%. So these companies are making money.

Mark Noble

This also then brings us to the next question. I mean, what we're really well known for at Horizons ETFs is our covered call gold ETF strategies. And it goes back to what you were talking about earlier, where last year one of the challenges with the gold investing is how do you value this asset class when what a lot of the drive was looking at the interest rate that could be earned on the US dollar or the appreciation of assets that pay an income, gold doesn't pay an income. But I think one of the things we've been having a lot of success with over the last 10 years is we have two ETFs, as you highlighted, the Horizons Covered Call Gold Producers Index ETF (GLCC), as well as the Horizons Gold Yield ETF (HGY), which writes call options on bullion. Those two ETFs have been around for more than 10 years, and they're actually able to benefit from these macroeconomic moves by generating a monthly income. But I'm curious how that's done.

Nick Piquard

Well, I really like those two ETFs because if you look at your average investment portfolio for someone who is trying to generate some income, gold has always been a great diversifier, but one of the problems with gold, of course, is that it doesn't earn a yield for the portfolio. And so adding it to the portfolio reduces the overall yield. And so a lot of investors might think, "Well, this is not a good idea," even though it has those diversifying benefits. So what we like with HGY and GLCC is the fact that you can earn a yield while still getting exposure to the underlying asset. So how do we do that? Well, let's take HGY for example. We own underlying gold ETFs and we then write call options on those ETFs.

And what that allows us to do is collect an option premium for the call that we sell and that generates a premium which we can pay out as yield to the investors. Now, that does limit some of the upside because when you write a call option, you're selling some of the upside on the underlying asset, but we only do it on a portion of the portfolio. So in the case of HGY, for example, we only write on 33% of the gold ETF that we own. So you're still getting at least two thirds of that upside.

Mark Noble

So you're getting basically two thirds the upside to the exposure to gold bullion, and then you're writing at the money, which means you're just selling away the upside on the other third. What sort of yield do you generate through that strategy?

Nick Piquard

So right now, and one of the nice things about the past couple of years is that we've seen more elevated levels of volatility, both in gold and outside of gold, in all asset classes really. And so for HGY right now, we're able to yield around 6% in terms of an annualized dividend yield, which is paid monthly because we write those options every month.

Mark Noble

So right now, 6% annualized yield plus getting about two thirds at a minimum of the upside of gold?

Nick Piquard

That's correct. Which is a nice benefit for somebody who owns an income portfolio or is trying to generate income but wants that diversifying benefit of owning gold.

Mark Noble

Because for income investors, gold has somewhat been, I don't want to call it dead weight because there's a diversifying benefit to it as a store of value, but it's not going to work with the rest of your portfolio to generate that cash flow. So HGY is clearly a way for you to do that. Now, let's pivot to GLCC. GLCC, you're now writing covered calls on the equities. How is that structured?

Nick Piquard

GLCC is one of my favorite covered call ETFs because I think that if we see another leg up in the gold prices, as I expect, I would say that the miners are very well-positioned to take advantage of that. And so in that portfolio, we track an index, which is the largest North American-listed gold producers, companies like Barrick or Newmont, Agnico Eagle, they're amongst the larger companies that we own. And then we write call options on the individual names. Now, the nice thing about doing a covered call strategy on the miners is because they're more volatile, you tend to get a higher yield. So we're already getting about a 2.5% dividend yield on the underlying portfolio, then we're adding another 8% or so in options yield. So you're looking at over 10% yield using GLCC as a way to gain exposure to miners. One of the reasons I really like the miners here is that we're starting to see consolidation in this space. This is something that probably started a few years ago, but it's really being kickstarted now in the past couple years, most recently with a Newmont trying to buy Newcrest.

Nick Piquard

And what I think that means is that the miners are positioning themselves for higher prices, and so they want to make sure they have adequate growth and that they can consolidate their costs ahead of a...

Mark Noble

Yeah, they're running very lean balance sheets, if you look at them relative to their sectors.

Nick Piquard

Yeah, and generally, when we see this M&A (mergers and acquisitions) activity, it usually gets followed by more M&A activity, which means, A, that the stocks are not that expensive because why would you be acquiring stocks if you didn't think they offered value? And it means, to me, more potential upside ahead.

Mark Noble

Perfect. Nick, thanks for your time today. I just want to reframe everything for those listening. So the whole idea of what we're talking about is the idea that if you have a positive outlook on gold, given the macroeconomic environment, which we believe could be a slight decline in the US dollar, the view that some of that flight from cryptocurrencies moves towards gold as people become a lot more concerned about the global debt load, and the just overall inflationary impact that that's had, gold looks favorable. But for investors that are looking for income, you've got these positive factors supporting gold and gold equity. And this is also a way that, through GLCC and HGY, you can generate an income. So if your view is over the next two to three years that gold and gold equity should continue to benefit from these macroeconomic conditions, there's your baseline support to provide you positive capital returns, the covered calls are taking advantage of the elevated volatility to add additional income.

So we call it golden yield, and that's what's happening with these two ETFs. Again, GLCC and HGY. Thank you so much, Nick. I really appreciate your time today.

Nick Piquard

Thanks for having me.



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