Mackenzie Resource Team Commentary

Q4-2021 COMMENTARY

Performance

Mackenzie Global Resource Fund (series F) returned 8.6% outperforming its blended benchmark return of 6.9%. For 2021, the Fund returned 48.1% against the benchmark return of 28.9%.

Mackenzie Precious Metals Fund (series F) returned 15.7% against the blended benchmark return of 11.2%. The Fund's substantial outperformance can be attributed to takeover bids for two core holdings. For the year 2021, gold consolidated the large gains of the prior year, ending down 5% (in CAD). The Global Gold Index ended the year down 5.3%, with the Fund modestly outperforming, ending the year at -4.2%.

Contributors & Detractors and Activity in Mackenzie Precious Metals Fund

There were two contributors. A long-term core holding of the Fund, Premium Resources (up 45% during the quarter) accepted a friendly takeover offer from Australian gold miner Newcrest. In the view of the portfolio managers, the offer undervalued the potential for further operational improvements and the exploration potential, as highlighted by a new discovery that was made just weeks prior to the takeover. Exploration-stage Great Bear Resources (up 112%) received a friendly takeover offer from Canadian gold miner Kinross. The offer was the result of a competitive bidding process for this recent discovery in Ontario.

Silver equities continued to underperform, lead by Gatos Silver (-11%) following an ill-timed equity issue, and MAG Silver (-3%) which experienced project delays; it raised equity too.

The portfolio managers reduced their position in Evolution Gold Mining, which embarked on an aggressive re-investment cycle in its core assets and several acquisitions.

Concerned about operating cost inflation, large-cap holdings such as Newmont Mining were reduced in favour of investment in exploration-stage companies which are less sensitive to operating cost pressures.

Contributors & Detractors and Activity in Mackenzie Global Resources Fund

The fund derived much of its outperformance from its exploration and production exposure and in particular natural gas. Underweight to Specialty Chemicals and a strong overweight to Forest products also helped.

The fund was underweight oil integrated companies which performed well. However, the fund maintained an overweight in energy overall allowing it to outperform. Names such as Advantage Energy Ltd. and Storm Resources Ltd. exploration were strong contributors.

Market Outlook, Review and Strategy

Comments on gold

Gold sentiment was weighed down in 2021 by the belief that a short-term spike in inflation would quickly dissipate. While headline inflation readings reached levels not seen since the 1970s, inflation expectations by market participants remained well-anchored and gold therefore moved largely sideways. But the drivers of current inflation go beyond the short-term pandemic related demand spike. Th unprecedented monetary and fiscal stimulus, de-globalization, the energy transition, and underinvestment in natural resources all conspire to structurally higher inflationary pressures. Workers are logically demanding higher wages, bolstered by a tight labour market as natural aging and the pandemic take their toll. This price/wage spiral raises the specter of 'sticky' inflation.

Higher-than-expected inflation has not been experienced by the Federal Reserve, nor financial market participants, for many decades. This alone raises the possibility of policy error and substantial market volatility. In an ideal scenario, pandemic-related short-term inflation pressures dissipate, and the Fed raises interest rates just enough to bring demand under control, while maintaining post-pandemic economic momentum. Such a 'goldilocks' scenario would benefit broad markets (and natural resources) and reduce the need for gold as an alternative investment. However, there is a real possibility that the Fed might already be too late with its planned rate hikes and could lose control over inflation expectations, which would be very bullish for gold and other hard assets. Conversely, a panic over-tightening of monetary conditions could prematurely terminate the economic cycle in which case gold would be quickly sought after as a safe-haven asset.

Inflation pressures, the risk of monetary policy error and subsequent market volatility, combined with rising geopolitical tensions, all point towards an allocation to gold. An allocation of 5-10% towards gold and gold equities provides portfolio insurance and has historically resulted in reduced portfolio volatility and higher returns for the Canadian investor. This portfolio insurance is especially valuable insurance for Canadian investors who have reached their maximum allocation to equities, are reluctant to hold low-yielding bonds, and seek a prudent risk control measure against the erosion of purchasing power.

Precious metals equities continue to enjoy high operating margins at spot gold prices, although operating cost inflation (i.e., diesel, steel and labour) has started to dent profitability. The portfolio managers anticipate a bifurcation in the gold sector between those companies that have the discipline to allocate their ample cash flows in a balanced process between sustaining capital, growth capital, dividends and capital returns, and those companies that need to replace rapidly declining reserves in a generally ex-growth sector, through reinvestment into mining projects and M&A.

Our gold holdings with a mix of large and mid-sized producers, as well as a mix of junior producers/exploration/development companies. Large-cap international producers such as Gold Fields and Agnico Eagle enjoy asset diversification and strong balance sheets. Mid-cap resource-rich producers such as SSR Mining, Wesdome Gold Mines and Karora Resources have an attractive combination of operational leverage combined with exploration upside. True value creation in the precious metals industry tends to originate at the drill bit, where the Team has bought exposures to small-cap explorers and developers, such as Aya Gold & Silver, Skeena and Solaris Resources.

Comments on other sectors including energy, base metals, and lumber

After a very strong 2021, 2022 will likely be a year of consolidation for commodities as many digest the recent price gains. However, we do not expect protracted declines. Rather, it is likely that commodities will establish a new floor in 2022, with very few retreating to the mid-cycle prices of the last 10 years. Lumber, a key ingredient to the North American housing sector, is an example of our thesis. The second quarter of 2021 saw the two-year advance in lumber prices hit a new all-time high, averaging US$1,300/1000bf. Prices have since retreated, and have seemed to establish a new range of US$500 - US$800. This is a level that we believe will prove sticky and a significant departure from the lower average price of ~US$350 between 2010 and 20201.

Oil and gas remain in a very strong supply and demand environment for 2022. Discipline on capital investment in 2022 is following 2 years of underinvestment by the industry just when the economy and energy demand were improving. We expect prices to stabilize above our mid-cycle prices of $65 oil and $3 gas for this year. Similarly to other commodities, energy stocks are a long way from discounting current prices. The real question remains whether mid-cycle price expectations must move up to new levels to convince companies to add supply.

Most commodities languished for 10 to 14 years after the 2008-2011 peaks. Weak prices forced producers to continually restrain capital investment, which is impacting today's supplies. While the latest price recovery has been impressive, it has done little to convince companies and shareholders to change their preference for dividend increases, share buybacks and debt reduction. China was the main driver of commodity demand in the 2000s. We believe the next decade or two will be about infrastructure and climate action. This handover should allow prices to stabilize at higher levels than expected compared to the current market consensus. Likewise, few, if any, companies are priced for growing demand nor higher mid-cycle prices. To incentivize resource companies to meet society's environmental aspirations, capital markets will need to price these businesses as part of the long-term solution. That should be reflected in higher earnings multiples, the ultimate signal, in our opinion, for company executives to redeploy capital and address climate change.

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*Mackenzie Gold Bullion Fund, is no longer being managed by the Mackenzie Resource Team. This is now a passively managed Fund which invests only in Gold Bullion.