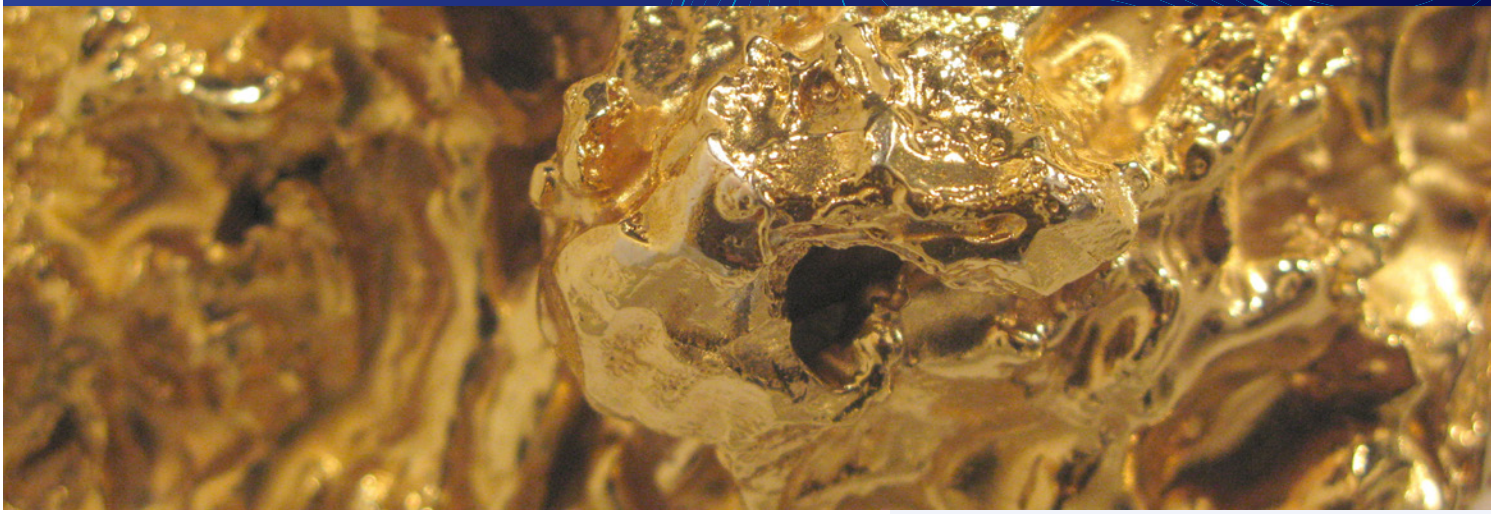


Stay Gold

Financial markets were rattled by a litany of interlocked challenges during 2022, including war, high inflation, rising interest rates and fears of recession.

While gold rallied in the weeks leading up to and immediately following Russia's late-February invasion of Ukraine, its price softened as financial markets shifted their focus to the Federal Reserve's efforts to combat persistently high inflation. This volatility in the face of uncertain conditions prompted many to question its reputation as a safe haven and had some commentators asking, "Why bother?"

Ultimately, we believe that 2022 highlighted why a number of First Eagle's portfolios "bother" with a strategic allocation to gold; namely, because its reputation as a potential hedging tool for capital preservation is unparalleled, if perhaps misunderstood. Gold behaved as expected—if not better—in 2022 given the year's conflicting dynamics; though the intra-period movement in price was significant, gold's return of -0.3% in 2022 handily outperformed equity and fixed income markets alike.[1]

We expect uncertainty—monetary, economic, policy, geopolitical, etc.— to persist in 2023, and we are inclined to prepare for range of potential outcomes. Our view is that of all the available potential hedging options, both real and financial, gold's differentiated risk-return characteristics could promote long-duration resilience across the widest variety of adverse circumstances.

KEY TAKEAWAYS

- Gold's volatility amid the ample challenges of 2022 prompted many to question its reputation as a safe haven.
- While multiple factors can affect the price of gold, we believe changes in real interest rates—i.e., the difference between nominal interest rates and inflation—are the most important driver over the medium and long terms.
- With only a very slight decline in price for full-year 2022, gold handily outperformed equity and fixed income markets alike and underscored why a number of First Eagle's portfolios maintain a strategic allocation to gold.
- We expect uncertainty—monetary, economic, policy, geopolitical, etc.—to persist in 2023, and we continue to think that gold's reputation as a potential hedging tool for capital preservation is unparalleled.

1. Source: FactSet; data as of December 31, 2022.

Living in the Real World

In 2022, no-longer-transitory inflation become a meaningful concern in developed market economies for the first time in many decades. Since gold is widely viewed as a potential hedge against inflation, its price should benefit from multi-decade-high inflation levels, right? Well, it's not quite as simple as that. While inflation can help influence movements in the price of gold, it's not the primary catalyst.

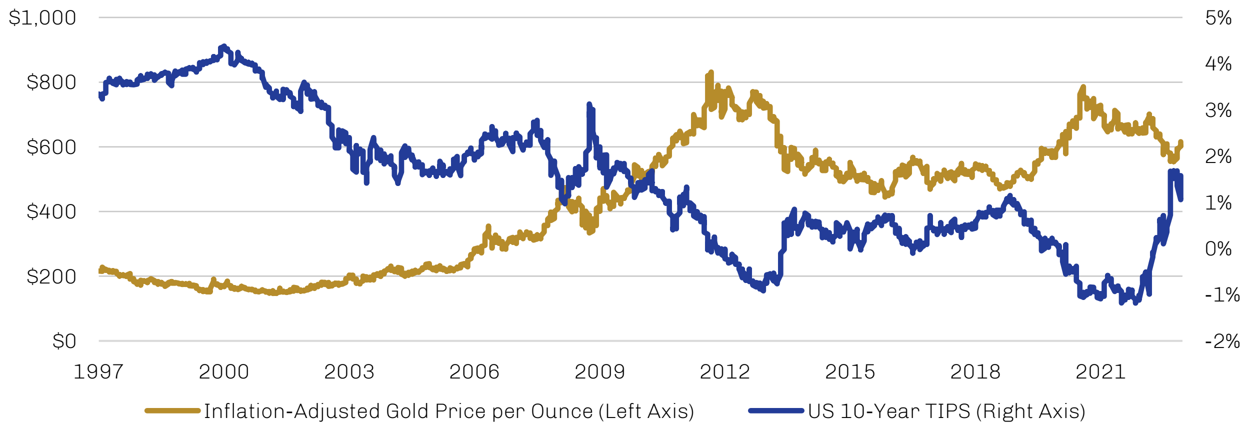
Consider gold in 2022. Gold rallied early in the year as investors flocked to perceived safe havens in the weeks leading up to and immediately following Russia's invasion of Ukraine in late February. However, it wasn't long before markets turned their attention to the likelihood that the Fed would soon act to combat unflagging inflation, and gold's 2022 peak was established only days before the central bank launched one of its most aggressive rate-hike cycles in decades. Signs that the Fed may be prepared to slow its pace of tightening prompted a November rebound in gold, and the metal finished the year down only 0.3% despite significant intra-period swings in both directions.[2]

While multiple factors can affect the price of gold, we believe changes in real interest rates—i.e., the difference between nominal interest rates and inflation—are the most important driver over the medium and long terms. Real interest rates represent the opportunity cost of owning gold; since it pays neither dividends nor interest, gold is relatively expensive to hold when real interest rates are high and relatively inexpensive to hold when they are low. Thus, real interest rates and the price of gold historically have been negatively correlated; as shown in Exhibit 1, when real interest rates have moved lower, the gold price, despite some lead/lag effects, has generally moved higher and vice versa.

> We believe changes in real interest rates are the most important driver of the gold price over the medium and long terms.

Exhibit 1. Real Interest Rates Historically Have Been the Key Driver of the Gold Price

January 1997 through December 2022; Consumer Price Index, 1982–84 = 100



Source: Bloomberg; data as of December 31, 2022.

Looking specifically at 2022, stubbornly high inflation prints prompted the Fed to raise its federal funds target rate by 425 basis points between March and December while maintaining steadily hawkish rhetoric.[3] The real interest rate—as represented by the yield on 10-year Treasury inflation-protected securities (TIPS)—trended decidedly upward in response, climbing from around -1% in March to an early-November peak above 1.7%, the largest spike in real rates since the global financial crisis.[4] That the price of gold fell about 18% during the trough-to-peak period in real rates during 2022 doesn't come as a surprise. It's worth noting, however, that the gold price's decline of 0.3% for full-year 2022 handily outpaced most risk assets—including equities (S&P 500 Index: -18.1%) and long-term bonds (Bloomberg US Long Treasury Index: -29.3%)—and provided the portfolio ballast we seek.[5]

Despite the market, macro and geopolitical trends pointing to the contrary, the behavior of real and nominal interest rates in 2022 suggests the Fed has convinced investors that it will be successful in its efforts to get prices under control without tipping the economy into a protracted decline. The yield on 10-year TIPS, our proxy for real interest rates, is composed of the current nominal 10-year Treasury rate plus market expectations for

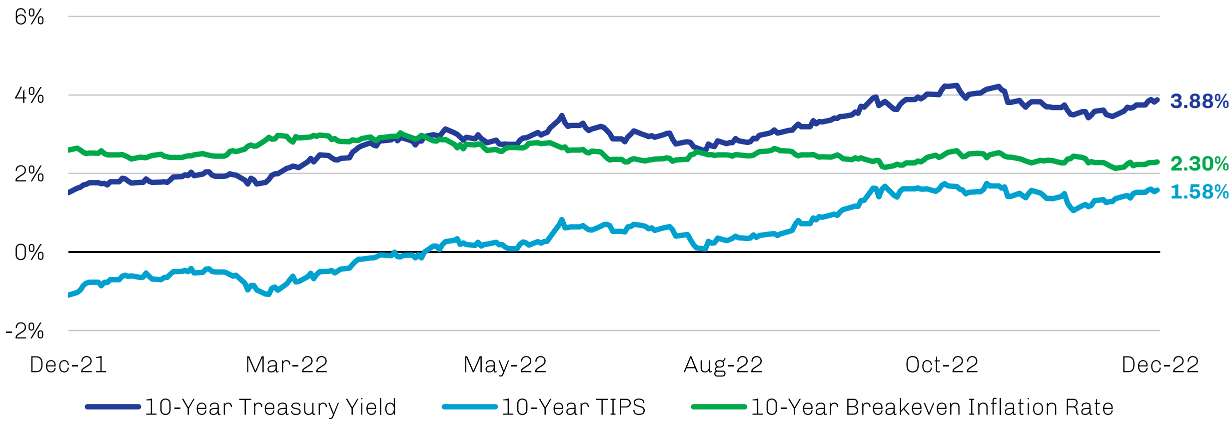
2. Source: FactSet; data as of December 31, 2022.
3. Source: Bloomberg, data as of December 31, 2022.
4. Source: Bloomberg, data as of December 31, 2022.
5. Source: Bloomberg, data as of December 31, 2022.

average inflation over the security's tenor (termed the "breakeven inflation rate"). As shown in Exhibit 2, the breakeven inflation rate peaked in March and has been biased lower since, implying that inflation expectations remain anchored. It also implies that the increase in real interest rates during 2022 was fueled primarily by higher nominal rates, whose path to levels not seen since 2008 indicates confidence that significant rate cuts will not be needed to stimulate a flagging economy.

> The Fed appears to have convinced investors that it will be successful in its pursuit of a "soft landing."

Exhibit 2. Fed Tightening in 2022 Appeared to Cool Inflation Expectations

January 1, 2022, through December 31, 2022



Source: FactSet; data as of December 31, 2022.

Central Bank Demand Bolstered Gold in 2022

Another tailwind for gold's late-year rally came from central bank buying. In fact, gold's initial leg higher in November can be traced back to the release of a report that central banks purchased 399 tons of bullion during the third quarter.

While this represented the strongest quarter for gold demand from central banks since 2000, it was quickly eclipsed by the 417 tons of gold bought in the fourth quarter. The 1,136 tons bought in full-year 2022 was a 152% increase over 2021 and the most activity since 1967.*

Not all institutions report their gold holdings or purchases publicly or on a regular basis, and about 75% of the fourth quarter buying went to unidentified institutions. Among the leaders in reported purchases during the year were Turkey and China. Notably, China—which had not provided information on its gold holdings for more than three years—reported purchases of 62 tons of gold in November and December to bring its total reserves above 2,000 tons for the first time. While there could be a number of reasons, both economic and political, for central banks to diversify their reserves with gold, these purchases provided massive support to the gold price.

* Source: World Gold Council; data as of January 31, 2023.

A Potential Hedge for All Seasons

The market appears optimistic about the Fed's ability to tame inflation. But what if the Fed fails? What if its aggressive intervention amid a backdrop of massive federal debt prompts the kind of deflationary shock we saw in 2008? Or what if any number of potential black swan events emerge to waylay the journey back toward normalization and force the Fed to intervene? As students of history, we are inclined to prepare for a range of potential outcomes; we believe doing so includes a strategic allocation to gold—an allocation that has been beneficial during such recent challenges as Russia's invasion of Ukraine (2022), the outbreak of Covid-19 (2020) and the global financial crisis (2008).

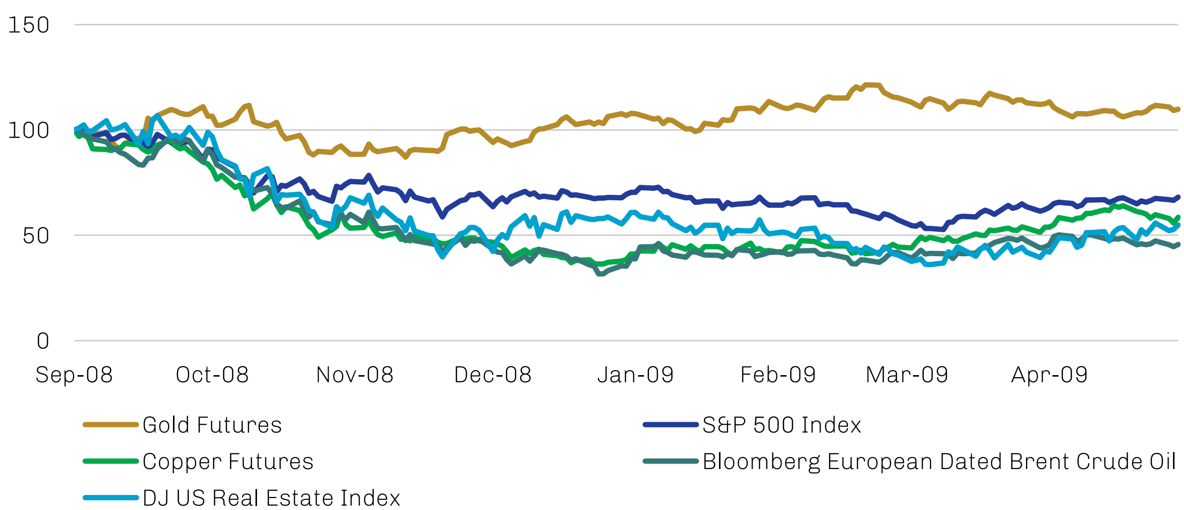
Our view is that of all the available potential hedging options, both real and financial, gold's differentiated risk-return characteristics could promote long-duration resilience across the widest variety of adverse circumstances. Over the past two centuries alone, gold has withstood inflationary episodes and deflationary spirals, political revolutions and rapid technological evolution, localized conflicts and world wars, pandemics and treatments for them.[6]

Take the disinflationary impulse of the global financial crisis, for example. As depicted in Exhibit 3, gold initially spiked higher when Lehman Brothers declared bankruptcy in September 2008, only to collapse alongside equities, oil, real estate, copper and most other risk assets as liquidity breakdowns across markets paradoxically pushed real yields higher.[7] While gold ultimately shed more than 20% to reach its mid-November trough, the potential hedge value of gold reasserted itself as other risk assets continued to founder. By the end of 2008, gold's 5.8% gain historically made it one of the very few assets to deliver a meaningful return in 2008. By the time equity markets reached their cyclical nadir in March 2009, gold was more than 20% higher than its pre-Lehman price.[8]

> Our view is that gold could promote long-duration resilience across the widest variety of adverse circumstances.

Exhibit 3. Gold Has Weathered a Range of Historical Challenges, Including the Global Financial Crisis

September 15, 2008, through April 30, 2009; September 15, 2008 = 100



Source: Bloomberg; data as of December 31, 2022.

6. Source: World Gold Council; data as of December 31, 2022.
7. Source: FactSet; data as of December 31, 2022.
8. Source: Bloomberg; data as of December 31, 2022.

The 1970s—a decade that offered not only high inflation but also high unemployment, sluggish economic growth and freeform turmoil—provide a contrasting example. Throughout history, gold prices have tended to be at their highest—and real interest rates at their lowest—when the economy was weak and/or experiencing inflation, periods that have tended to coincide with low levels of confidence in the economy and government, and thus a greater inclination among investors to hold a universal currency like gold rather than its manmade substitute. Trading freely following the collapse of the Breton Woods system in 1971, gold's price grew 25-fold by 1980, bolstered in part by its lack of industrial utility, a trait that can make the prices of other real assets like base metals sensitive to economic activity and serve as a headwind during periods of stagflation, such as we saw in the late 1970s.[9]

While the Fed's gravitational pull on the gold price during 2022 was unusual given the combination of war in Europe and high inflation, it served as a good reminder of why we don't maintain a directional view on price. Instead, we value gold for its attributes as a potential hedge that may help mitigate the risk of permanent impairment of capital.

9. Source: Bloomberg; data as of December 31, 2022.

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Investment in gold and gold-related investments present certain risks, including political and economic risks affecting the price of gold and other precious metals, like changes in US or foreign tax, currency or mining laws, increased environmental costs, international monetary and political policies, economic conditions within an individual country, trade imbalances, and trade or currency restrictions between countries. The price of gold, in turn, is likely to affect the market prices of securities of companies mining or processing gold and, accordingly, the value of investments in such securities may also be affected. Gold-related investments as a group have not performed as well as the stock market in general during periods when the US dollar is strong, inflation is low and general economic conditions are stable. In addition, returns on gold-related investments have traditionally been more volatile than investments in broader equity or debt markets. Investment in gold and gold-related investments may be speculative and may be subject to greater price volatility than investments in other assets and types of companies.

All investments involve the risk of loss of principal.

One cannot invest directly in an index. Indices do not incur management fees or other operating expenses.

S&P 500 Index is a widely recognized unmanaged index including a representative sample of 500 leading companies in leading sectors of the US economy. Although the S&P 500 Index focuses on the large cap segment of the market, with approximately 80% coverage of US equities, it is also considered a proxy for the total market.

Bloomberg US Long Treasury Index measures the performance of US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury with a maturity greater than 10 years.

Consumer Price Index for All Urban Consumers (CPI-U) measures the changes in the price of a basket of goods and services purchased by urban consumers.

Dow Jones US Real Estate Index measures the performance of real estate investment trusts (REIT) and other companies that invest directly or indirectly in real estate through development, management, or ownership, including property agencies.

Federal funds rate is the interest rate at which depository institutions (banks and credit unions) lend reserve balances to other depository institutions overnight on an uncollateralized basis.

Treasury inflation-protected securities (TIPS) are a type of US Treasury issuance whose principal value is indexed to the rate of inflation.

Volatility is a statistical measure of the degree to which an individual portfolio return tends to vary from the mean, based on the entire population. The greater degree of dispersion, the greater degree of risk.

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