Perspective from
Franklin Equity Group

Metal vs. miners: Gold's rise creates opportunity

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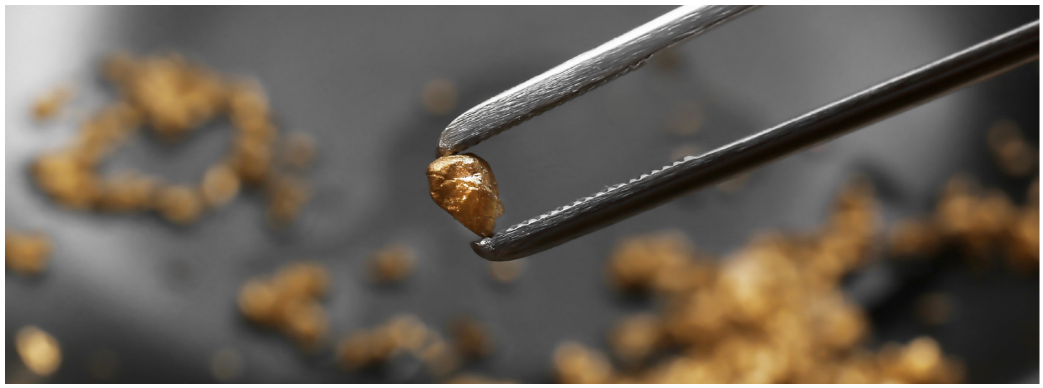


Key takeaways

- Geopolitical risks, economic instability and equity market volatility are pushing some investors to seek out what they believe are more secure assets, such as gold.
- Sanctions and deglobalization of trade are creating opportunities to reestablish gold as a currency alternative for international transactions.
- New demand drivers have pushed gold prices higher, but we believe room remains for historical catalysts—such as US dollar weakness, falling yields or increased investor interest—to raise prices further.
- Despite strong earnings, gold-mining equities materially lagged bullion returns in 2024, potentially setting the stage for mining stocks' outperformance if margins remain robust.

What's driving gold's sustained price strength?

Gold has long been perceived as an investment "safe haven" in times of political and economic uncertainty. However, under-the-radar structural forces shaping the gold market may better explain the metal's recent upward trajectory in the face of factors that have proven to be headwinds in the past, including its historical inverse correlations to the trade-weighted US dollar and higher real bond yields. Gold prices have risen with the emergence of new demand sources over the past few years, with central banks and international trading partners increasing their use of gold as a currency. However, we think traditional factors like US dollar weakness, falling yields and investor demand could drive prices even higher.

We also believe the underperformance of mining equites in 2024 creates a compelling investment opportunity in 2025. Mining equities materially lagged gold bullion returns last year, despite delivering solid earnings and cash flow gains due to higher spot gold prices.[1] We think this leaves mining stocks poised to potentially outperform physical gold—assuming gold either remains in its current trading range or moves higher.[2]

A dynamic gold market in an increasingly multi-polar world

Part of gold's enduring appeal is that it's an easily transported, tangible asset with recognized value almost everywhere in the world. In an increasingly complex and uncertain global economy, many investors and governments are diversifying into gold, signaling their need to mitigate perceived risks with a reliable store of value not tied to any single country's economic or political situation.

Politics around the world have become more divided, resulting in large policy swings as elected officials change. Active armed conflicts continue while governments ramp up military and defense spending. Fiscal deficits are soaring while tariffs and sanctions stoke further economic uncertainty. Many investors and central bankers have reached a point where they can't afford to ignore the risk of potential long-term issues, such as fiat currency debasement[3] and the reversal of the multi-decade trend toward economic globalization. Gold is far from a perfect hedge to all of these challenges, but it has survived—and at times thrived—as a store of value in even more challenging eras over the past several hundred years. Investors may take some comfort that gold appears well-positioned to maintain this role.

So little volume, so much value

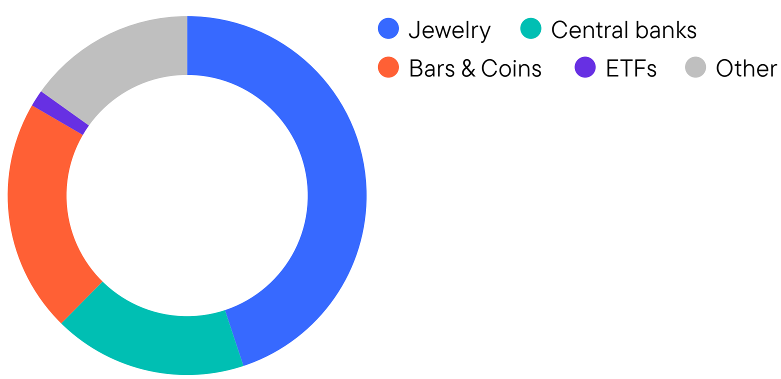
If all the gold ever mined was melted down and poured into one volume, it would form a cube with sides that measure roughly 22 meters each—which would fit into three typical Olympic-sized swimming pools.* This highlights the rarity of gold despite its historical significance and widespread use.

*Source: World Gold Council data as of year-end 2024.

New retail gold distributors like Costco are making it easier for consumers to buy gold at low premiums, expanding on the access established gold markets in India, China and the Middle East have provided. The estimate of all the gold ever mined (approximately 6.95 billion troy ounces)[4] divided by the world population (8.2 billion as of mid-March 2025)[5] works out to be about 0.85 troy ounces per person. So, anyone walking out of Costco with a one-ounce gold bar is holding more than their fair share of the world's gold, which helps highlight just how rare it actually is. While the global gold market represents US$20 trillion in assets, less than 1.5% is held by physical gold exchange-traded funds (ETFs) and 21% is held as bars or coins by individual investors. Thus, gold is still a very small part of most investment portfolios.[6]

World Gold Holdings

Exhibit 1: Distribution of Above-Ground Gold



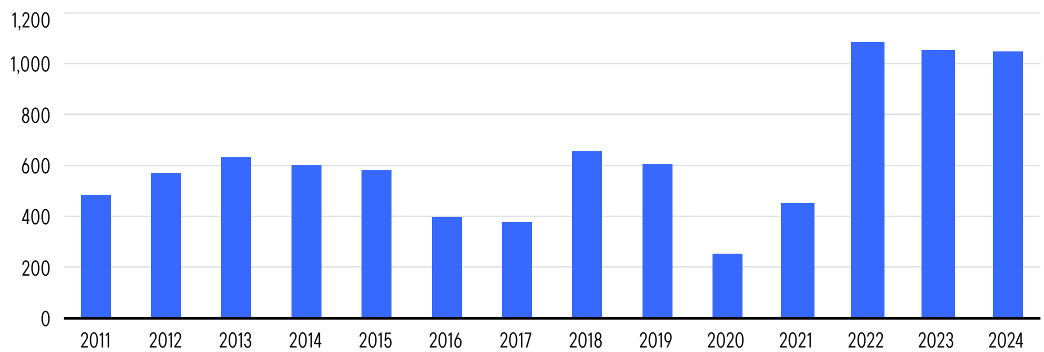
Sources: "Above Ground Stock." Metals Focus, Refinitiv GFMS, and World Gold Council. February 11, 2025. Data as of December 31, 2024.

Sanctions, deglobalization and the reemerging role of gold in international trade settlements

Sanctions and trade pressures have also led to an increase in non-US dollar trading, some of which involve gold. The renewed use of gold as a global currency alternative has grown its utility and created a new source of demand to increase liquidity in exchanges. Central banks are also finding value in the fact that gold is a hard asset that's not controlled by any single government or financial system, a characteristic that has attracted net buying from central bankers every year since the 2008 global financial crisis (GFC). Purchases have accelerated for the past three years as global trade relationships have deteriorated.[7]

Central Bank Positioning in Gold

Exhibit 2: Central Bank Purchases (Metric Tons)

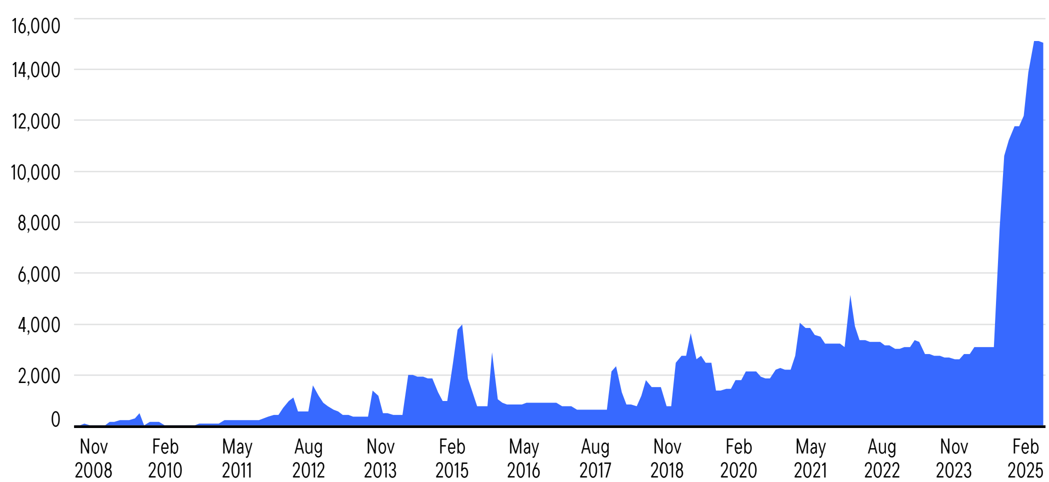


Source: World Gold Council. Analysis by Franklin Templeton. February 28, 2025.

Sanctions on Russia and other countries (i.e., Iran, North Korea, Venezuela, Cuba and Belarus) showed how quickly an entity can lose access to assets that are either held in other countries or tied to global trading platforms. Targeted states facing restrictions and economic isolation may seek to hold some gold beyond the reach of such penalties. In China's case, gold-buying power is coming not only from the government, but also from Chinese retail investors who want an alternative to the beleaguered domestic property market as a place to store their wealth.

A Large Uptick in Shanghai Futures Exchange Gold-Buying Activity

Exhibit 3: Shanghai Futures Exchange on Warrant Gold Stocks—10 Year (in Kilograms)



Source: Bloomberg, LP. As of March 13, 2025. These figures refer to the amount of gold that is registered and available for delivery against futures contracts on the SHFE. This information is crucial for traders and investors as it helps them understand the supply/demand dynamics in the gold futures market. There is no assurance that any estimate, forecast or projection will be realized.

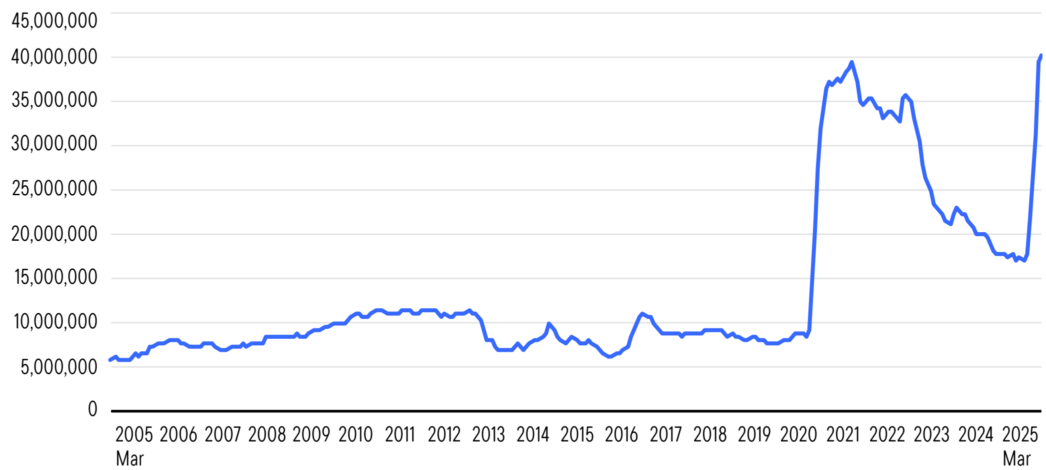
In our view, if parts of the world are shifting back to using gold for international trade, as they did before the 1970s, a significant amount of gold would need to be mobilized into more accessible venues. This could explain some of the large inflows of bullion into places like the Shanghai Gold Exchange.[8]

Trump 2.0: A new tariff-driven world balance

US President Donald Trump's use of broad-based tariffs has forced banks to adjust their risk-management practices from a global view to a regional one. They are realizing that gold held in London may not be a good hedge for financial exposure in the United States if there is a tariff barrier between the two markets. As a result, significant amounts of gold have moved from London—home to some of the largest and most secure gold vaults in the world—to New York as risk managers try to balance risk ahead of Trump 2.0 tariffs, which themselves are part of on an ongoing effort to address trade imbalances and national security concerns. So much gold moved into the United States in January that it skewed US economic data, forcing economists to publish "gold adjusted" gross domestic product forecasts.

A Pandemic-Level Spike in COMEX Gold Inventories

Exhibit 4: COMEX Gold Inventory (Troy Ounces)



Source: Bloomberg, LP. As of March 12, 2025.

Recent geopolitical tensions and reduced cooperation among major economies have prompted many countries to hoard or repatriate physical gold stockpiles to diversify reserves and reduce reliance on the US dollar.

Gold producers' stronger fundamentals

Although gold-mining equities have performed well in the past year, in general their share prices have not kept up with the increase in cash generation from elevated gold prices. As a result, valuations at spot prices have contracted for many companies despite significant improvements in their balance sheets and much stronger business fundamentals.

Gold equites are inherently volatile, so we believe it's important that investors right-size their allocations accordingly. That said, our research suggests the industry has never been stronger, with many gold producers showing net-positive cash positions on their balance sheets. This environment stands in sharp contrast to previous cycles, when gold companies were spending money on new mine construction by taking on debt, while soaring costs offset much of the benefit of higher gold prices.

Today's mining companies are much more conservatively run, with an eye on profit margin expansion and cash generation, which we think provides some potential protection from any downside in gold prices. While their newfound financial discipline is admirable, we also think these management teams have underinvested in future supply and anticipate that many companies will likely struggle to maintain gold production solely from internal projects over the next decade. Given this backdrop, we anticipate producers will turn to mergers and acquisitions to boost production and rebuild a pipeline of gold exploration and development options.

Conclusion

Many gold producers have seen earnings and cash flow rise faster than their share prices, resulting in contracting valuation multiples despite improving business fundamentals and a positive outlook on future earnings growth. With equity valuations running significantly below market averages, investors appear skeptical about the sustainability of current gold prices. We believe this creates an opportunity for gold mining equities to appreciate even in a relatively flat gold-price environment, while still being well positioned to benefit if prices continue their upward trajectory.

Endnotes

1. Source: Bloomberg, L.P. Data compares gold's spot price versus the FTSE Gold Mines Index. The FTSE Gold Mines Index is designed to reflect the performance of companies that primarily derive their revenue from the mining of gold. To be included in the index, a company must consistently produce a minimum of 300,000 ounces of gold per year and derive at least 51% of its revenue from mined gold. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. Past performance is not an indicator or a guarantee of future results.
2. Source: Bloomberg, L.P. From the beginning of February to mid-March 2025, the trading range for spot gold was approximately US$2,850 to US$2,950 per ounce.
3. Fiat currency debasement refers to the reduction in the value of a country's currency, typically caused by excessive money printing or inflation. When a government increases the money supply without a corresponding increase in economic output, it can lead to higher prices and a decrease in the currency's purchasing power.
4. Source: World Gold Council.
5. Source: "Current World Population." Worldometer. March 14, 2025.
6. Source: "Demand and Supply." World Gold Council. February 5, 2025.
7. Source: World Gold Council.
8. The Shanghai Gold Exchange (SGE) is the world's largest physical gold trading center and a key global benchmark for gold price discovery. The SGE offers a variety of gold-related products, including spot, deferred and futures contracts. It also provides services for trading, delivery, storage and settlement of gold. The exchange plays a crucial role in the global gold market by providing a transparent and regulated platform for gold trading.

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