STARBOARD
ASSET MANAGEMENT

*Risk Management for nagivating your future.*

Starboard Weekly Report Ending May 12, 2017
Charts of the Week



This week we have two relative strength charts comparing VanEck Junior Gold Miners ETF (GDXJ) with Gold and comparing VanEck with a peer ETF - Sprott Junior Gold Miners Index (SGDJ). Both charts are provided by StockCharts.Com.

**TECHNICAL**
The first chart shows a recent sharp decline in the GDXJ when compared to the price of gold. This severe move is abnormal and it has to do with problems created by the tremendous growth of this ETF. The assets of this popular vehicle have grown to 4.2 billion hence forcing them into a position of not being able to buy certain stocks in their index. This problem comes from the fact that junior gold stocks have small capitalizations. Since most are Canadian their laws do not allow investors to own more than 20% without making a tender offer for the entire capitalization. Van Eck's solution is to buy shares of another ETF they manage and this GDX is a large cap gold index. The uncertainty around changing the index has caused a great deal of selling in junior gold stocks. The second relative strength SGDJ to Gold was not quite as negative to Gold as the GDXJ. I prefer this smaller ETF that has 130 million in assets. Both of our charts are showing signs that this selling may be ending, but until this issue is resolved by either creating a new index or expanding their holdings, any sustained junior gold stock rally will be held back. It is quite ironic that too much money coming into the juniors would cause a price decline, but welcome to the world of Indexed ETF investing.

**FUNDAMENTAL**
Everybody wants to own an indexed investment rather than the actual company. When this focused investing is unraveled, the new concentrated phenomenon will be setting us up for a prolonged bear market environment. Excessive demand in an index creates many problems and the GDXJ problems are unique because of the small capitalization of the holdings within their index. The larger indexes, such as the S&P, do not have capitalization issues. However, narrow ownership across a broader market centralizes ownership demand into only 500 companies. These index holdings are in the trillions of dollars in the same 500 companies. When the sponsors of these index funds have to liquidate to meet redemptions it will put tremendous selling pressure on the very indexes that are relied upon by the investing public. The potential panic effect of these declining indexes will create continuous selling until supply is dried up, which in my view will take quite a few years. The last concentrated investing was the nifty fifty in the 1970's and it took 8 years for that episode to unwind.

**ASIDE**
"History is a vast early warning system." Norman Cousins (an American political journalist)

Take heed as the market storm approaches.