GOLD BULLION

Still a safe haven

Gold bulls insist bullion will continue to rise but, as recession fears ease, is the metal still the safe haven it once was?

For many investors, gold has proved to be a valuable safe haven during the financial crisis and recession. While financial markets were falling, the gold price did well in leading currencies and greatly outperformed risky assets such as equities and property.

However, fears about a financial meltdown have faded in recent months, and hopes for a return to growth next year are rising. If this optimism is justified, will gold lose its lustre for many investors as demand for the metal decreases in less jittery markets? Or, could surging inflation rekindle investor interest in gold?

WHAT IT MEANS

- Gold may have lost some of its glister
- Inflation fears may rekindle interest

Both of these scenarios may unfold in the coming months. Gold may underperform relative to assets which are recovering, such as equities and other commodities, but it should retain its long-term role as a hedge against inflation and currency weakness. A lower gold price could also help lift demand from the industrial and jewellery sectors.

Gold tends to perform differently, and follow different cycles, from most other assets. It has different roles whose importance varies, depending on economic and political events. It is always a commodity, used in the industrial and jewellery sectors, and demand from these industries is linked to economic cycles and the gold price.

Falling jewellery demand was one reason gold did not do better than it did, failing to maintain prices above US$1 000/oz in a world financial crisis.

Investors see gold not simply as a commodity but as an alternative currency, a hedge against inflation and a

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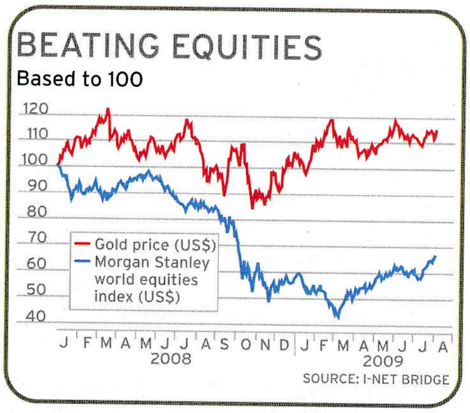


safe haven in economic or political crises. For some investors, gold is always worth holding because they see it as an ultimate store of value.

How well has gold performed recently? It has certainly done well compared with equities. After peaking in mid-October 2007, the Morgan Stanley world equity US$ index fell by 59% to its low in March this year. In the same period the dollar gold price rose by 25%.

Equities have recently outperformed gold, rising by 55% from the March low, while gold has risen only 3%. Over the full 22 months since world equities peaked, equities are down 37% in dollars and gold is up 29%. This included a period of dollar strength, as the US currency also regained favour as a safe haven, though it's weakening again now. In weaker currencies such as the pound or the rand, gold's outperformance is much greater.

"If gold is regarded as a currency, it has been the best performer of its class since the start of the financial crisis," says Allan Gray portfolio manager Sandy McGregor.

SA Bullion MD Hilton Davies says gold's relative strength goes back to the beginning of this decade.

After its recent recovery, the JSE all share index (Alsi) is now down 20% since mid-October 2007. In the same period the rand gold price has gained 50%. Since the Alsi peaked in May 2008, local equities are down by 25% and gold is up 7% in rand.

At about R7 600/oz, the rand gold price is now 23% below its highs in February. For local investors, who invest in gold in rand, that reinforces the question: is there still a case for gold?

The gold bulls have little doubt about this.

"Gold is firmly established in a strong uptrend and the fundamentals are excellent," says Davies.

The July *Gold Investment Digest*, published by the World Gold Council (WGC), a producers' body, cites several bullish arguments. These relate to currencies, inflation and prices of other assets.

In June, says the WGC, gold moved as high as $981,75/oz, coinciding with the quarterly low in the dollar, "which was pressured, among other things, by growing questions about its future as the world's reserve currency". Gold remained supported, it adds, by increasing signs that the worst of the global recession may be behind us and a corresponding uptick in investors' fears about future inflation.

According to a new analysis by the WGC, which examines gold's performance as a tactical inflation hedge and long-term strategic asset between 1974 and 2008, though in the low and moderate inflation years real returns from gold were only mildly positive, in the high inflation years it rose in real terms by an average of 14,9%.

In SA, inflation has remained much higher than in the US, but that contributes to rand weakness. The rand gold price rose by 32% in 2005; 37% in 2006; 31% in 2007; and 40% in 2008. So far this year, it's down 7,4%.

Other research shows returns from mainstream assets such as equities, bonds and cash usually weaken in periods of high inflation. The correlation between gold and these assets is relatively low, as shown recently.

There is also a long-standing negative correlation between gold and the dollar (meaning their prices often move in opposite directions).

This has become more relevant with the dollar's weakness since March, linked to rising concerns about the US fiscal deficit and US debt.

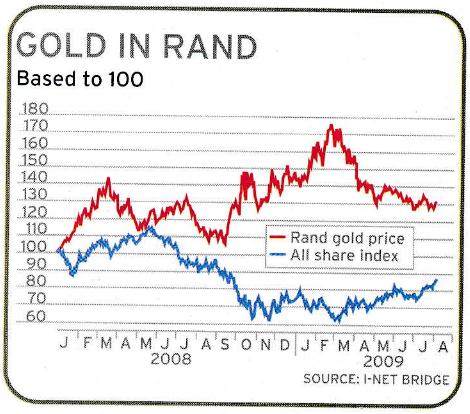
McGregor says doubts are emerging about whether the US is in fact a financial safe haven, and whether the dollar will retain the most important attribute of a reserve currency: that it remains a stable store of value.

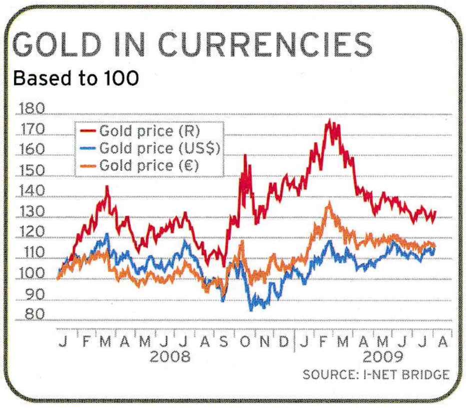
"Given the large surplus of capacity and high unemployment, inflation seems improbable in the near term, but when world economic growth resumes, it could return with a vengeance," he says.

There are also reasons for caution about gold.

After more than doubling in recent years, it may decline as other assets become more attractive. If the world economy keeps recovering, investment and speculative demand for gold may weaken but growth may not be strong enough to boost demand from other sectors, such as jewellery, except at lower prices. The world could also enter a period of low growth with low inflation.

Supplies of gold could also rise, possibly through increased sales by central





banks — though in recent years supplies have been declining because of shrinking production by miners and buying by Asian central banks.

Even on a long-term view of gold's role as an investment or investment hedge, there have always been sceptics.

When Milton Friedman, the high priest of monetary economics, visited SA in 1976, he said: "Historically, gold has not proved a very good hedge against inflation . . . as of today, gold is a highly speculative commodity whose price may go anywhere depending on speculation."

Yet gold today does have a strong and growing following based on its reputation as a protector of purchasing power and a portfolio diversifier. This requires a strategic view. Forecasting its price over 12 months is always tricky.

Local investors who want to gain exposures to gold can do so in several ways, including an exchange traded fund (ETF), direct purchases of physical gold, coins or gold shares.

Absa's NewGold, the JSE-listed ETF, offers direct exposure to gold through a liquid financial instrument. Its price directly reflects the rand price of gold.

SA Bullion offers investment products that give investors full ownership, at wholesale market prices, of physical gold stored in the Rand Refinery. With these products, investors can avoid the counterparty risk linked to ETFs.

Krugerrands are another form of physical gold ownership, but these are available only in limited quantities and can be difficult to store or transport.

Gold miners' shares are another option, but they carry other risks, including high costs and declining production. The shares have often underperformed the gold price. **Andrew McNulty**

GOLD MINING

Adding ounces

Venezuelan president Hugo Chavez may be disliked in mining circles because of his nationalisation of resources assets, but you won't hear a bad word about him from Gold Fields CEO Nick Holland. For good reason: Africa's second-biggest gold producer is what Holland calls a "passive investor" in Rusoro Mining, which has mines in Venezuela, with a 26% stake.

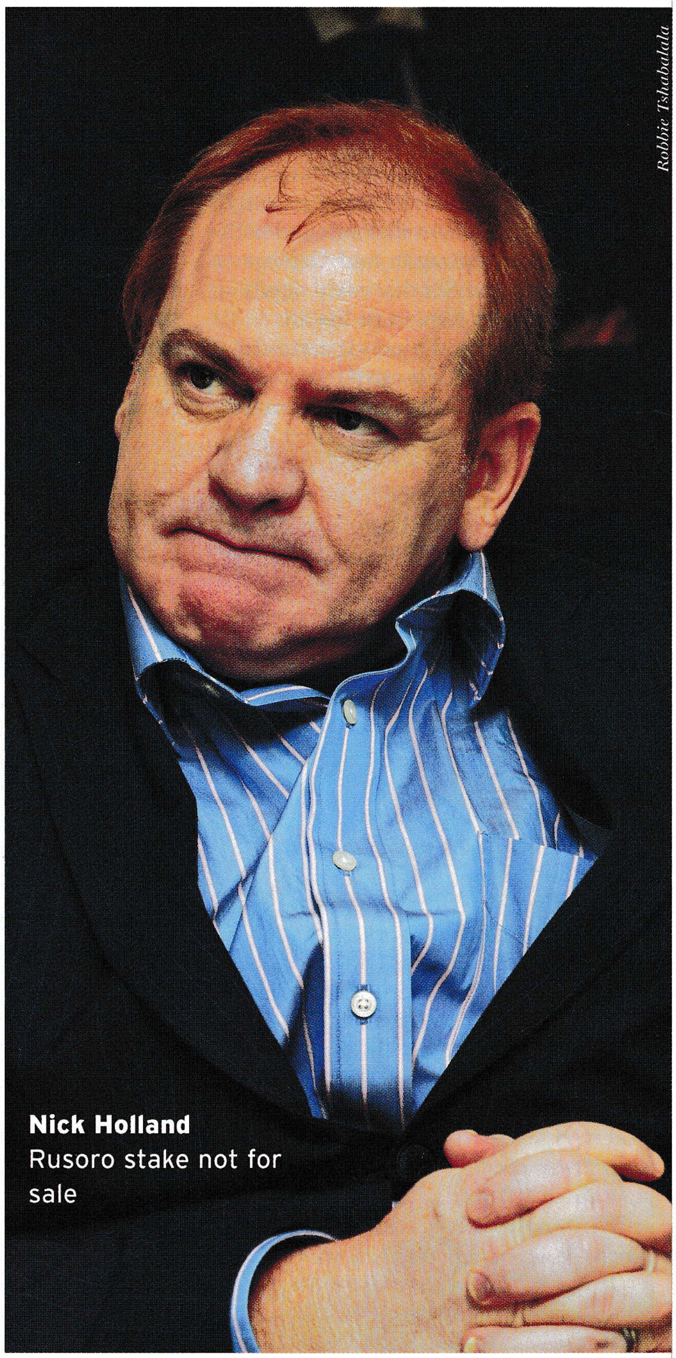
Though based in Vancouver, Rusoro is backed by Russian money. Holland confirmed last week that Gold Fields is determined to hang onto that stake. The company sees it as a long-term option on Venezuela, and it should be a good one. Chavez has declared Rusoro the government's preferred partner in developing gold projects there.

In any case, Holland says, the company's share price hasn't exactly been ablaze of late. The stock is hovering around C$40c, off a year high of $1,04.

"There's no way we are going to sell that company at this price," he says. "We'll put it in the bottom drawer . . . there's no reason to try to sell it."

Gold Fields picked up the Rusoro stake in 2007, when it swapped its Venezuelan Choco 10 mine for the company's scrip. Rusoro announced last month it had started a study to lift Choco 10's production to more than 500 000 oz/year after 2012, from the current 170 000 oz/year. This would make it one of the world's biggest gold mines.

Holland's resolve to keep Rusoro is in contrast to Gold Fields' move in June to give up its stake in Chinese miner Sino Gold. The Johannesburg-based company



Nick Holland
Rusoro stake not for sale