The SA Bullion Gold Report

Second Quarter 2015

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Table 1: Gold Performance to 30 June 2015 (% per annum)[1]

	Quarter[2]	1 Yr	2 Yr	3 Yr	5 Yr	10 Yr
Gold in US Dollar	-1.3	-10.9	-0.9	-9.8	-1.2	10.4
Gold in Rand	1.8	3.3	10.3	3.3	8.9	17.4
Gold in Euro	-5.4	8.7	7.0	-6.0	0.7	11.2

[1] Based on LBMA Afternoon Fixes
[2] not annualized for periods of less than 1 year

Table 2: Quarter-End Gold Prices and Exchange Rates[1]

	Gold in $/oz	R/$ rate	Gold in R/oz[2]	$/€ rate	Gold in €/oz
30 June 2005	437.10	6.67	2,917.05	1.21	361.74
30 June 2006	613.50	7.13	4,375.33	1.28	480.72
30 June 2007	650.50	7.05	4,587.33	1.35	481.49
30 June 2008	930.25	7.83	7,282.13	1.58	589.21
30 June 2009	934.50	7.82	7,305.13	1.41	664.89
30 June 2010	1,244.00	7.59	9,443.93	1.23	1,012.70
30 June 2011	1,505.50	6.86	10,321.86	1.45	1,040.07
30 June 2012	1.598.50	8.21	13,123.35	1.27	1,260.45
30 June 2013	1,192.00	9.97	11,881.85	1.30	914.39
30 June 2014	1,315.00	10.64	13,986.58	1.37	962.66
30 June 2015	1,171.00	12.34	14,451.28	1.11	1,046.19

Note 1: Gold prices in US$ and € are LBMA Afternoon Fix prices
Note 2: Gold price in Rand from Rand Refinery
Note 3: Gold prices at time of writing—$1,119.00, R14,363.04, €1,007.83

Table 3: Calendar Year Performance of Gold

	% US Dollar	% ZA Rand	% Euro
2005	17.8	32.6	35.7
2006	23.2	37.0	10.2
2007	31.9	27.9	18.9
2008	4.3	41.1	9.7
2009	25.0	-0.4	21.1
2010	29.2	16.1	38.2
2011	8.9	33.0	12.6
2012	8.3	13.6	6.2
2013	-27.3	-11.8	-30.3
2014	0.1	10.4	13.4
2015 year to date	-3.0	5.6	5.7

Figure 1: Ten-Year Chart of Gold Price in US Dollar [LBMA PM Fix]

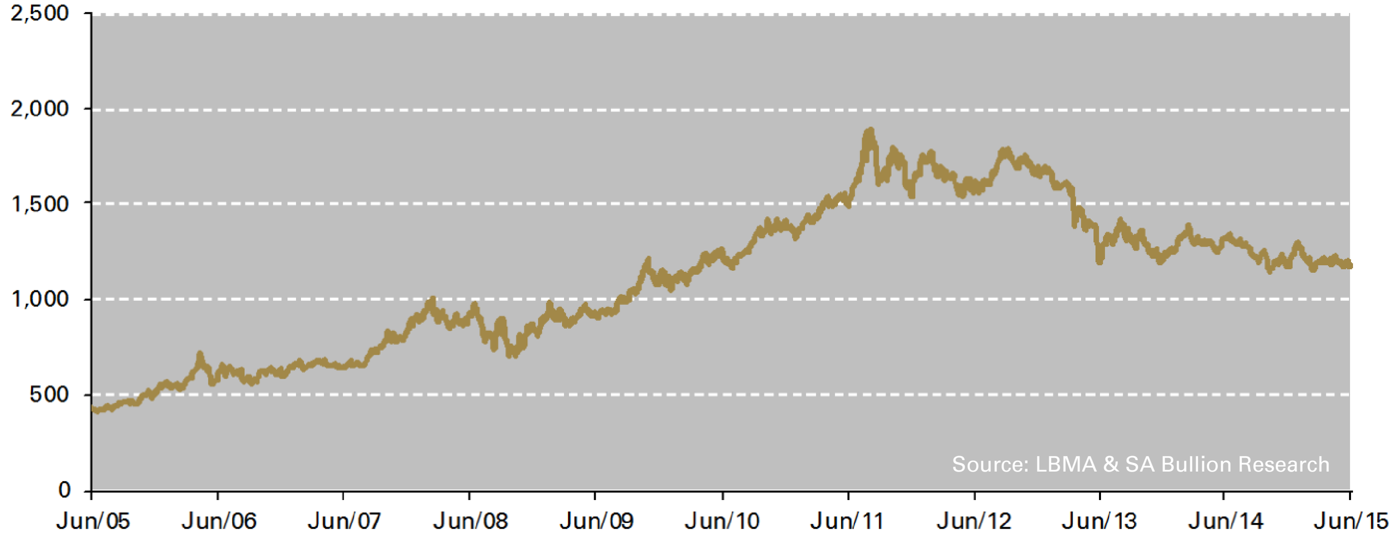
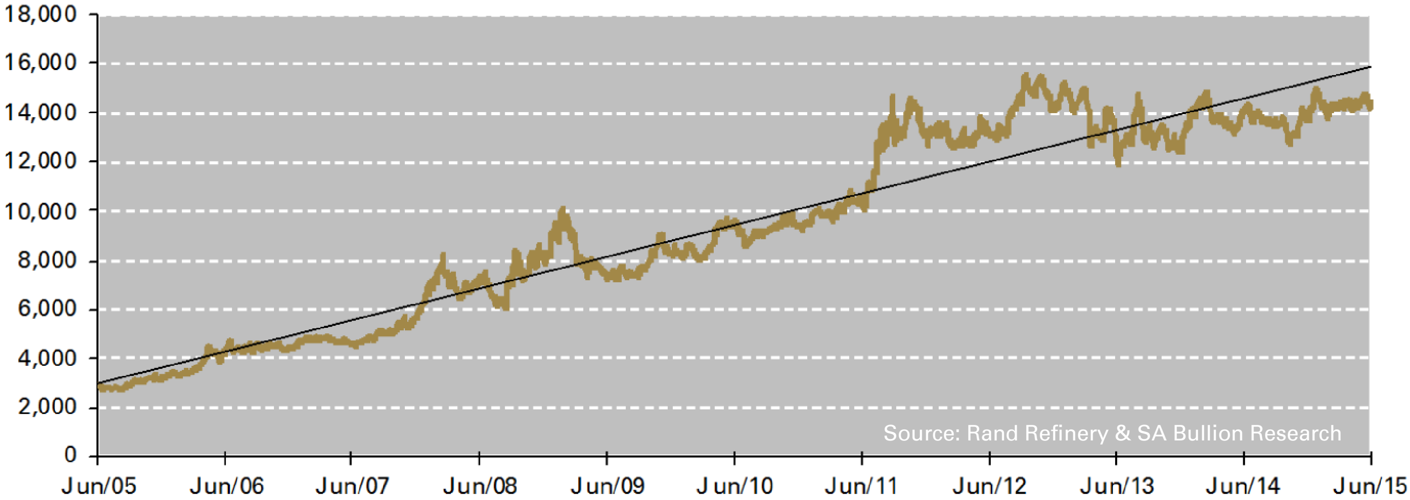


Figure 2: Ten-Year Chart of Gold Price in South African Rand (Rand Refinery first pricing)



Gold Price Action

The second quarter was fairly 'bouncy'. In US Dollar gold traded at a high of $1225 on 14 May and a low of $1,164 on 5 June. In Rand gold traded at a low of R14,071 on 4 May and a high of R14,748 on 9 June. This almost reverse image was as a result of the Rand declining rapidly between the two date clumps.

Overall there was not too much to shout about for the quarter. In US Dollar gold was down 1.3% and in Rand it was up 1.8%. The quarter continued the trend of the last three years where the US Dollar has been strengthening and the emerging market ("EM") currencies – most notably the Rand – have been rapidly weakening as the currency flow has been from EM nations to the US.

Gold has been a poor investment for Americans for the last three years. For the last two years it has been a good investment for Europeans and South Africans. These divergences can be put down to currency movements.

In the longer term of ten years all the various currency investors in gold have been well-compensated by price performance.

Global Macro-Economic Commentary

Short term volatility in financial markets in the last quarter was largely attributable to reactions regarding three items:

- The Greek credit crisis
- Chinese central bank gold purchases
- Financial market difficulties in China

We do not see the Greek issue as particularly important for anyone but the Greeks. China is a different matter, and here we have very deep-seated long term concerns. Our concerns include a cooling economy, an aging population, and most importantly, the likelihood that China will not be the great exporter of disinflation to the west that it was for 15 years.

Oil has tumbled 25% since late-June and is down 55% in the last year. Iron ore, at $55/ton is down 70% since the highs of 2011. Gold in US Dollar has slumped 42% from the 2011 high of $1,900 to the present $1,100. Much the same story can be read across the commodities complex and is largely attributable to a strengthening US Dollar and to cooling global growth.

Our educated guess is that if we are not at the bottom of the cycle now, it is not too far off. Strong bull runs always have their birth in despair and capitulation, and some of the best indicators of despair and capitulation are firstly, the news articles and commentaries that predict eternal night (right before dawn!), secondly, physical dumping, and thirdly, under-investment in new productive capacity.

On the subject of news articles and commentaries, we find that coverage has reduced dramatically and almost without exception any coverage of commodities and precious metals is negative in the extreme. Regarding physical dumping, the fact that the biggest gold fund in the world, the US-based SPDR Gold Trust, has lost 70% of its assets from its 2011 peak is news that gets us interested. Regarding investment in new productive capacity, the vast majority of primary sector producers worldwide are in shrinking (and survival) mode and not expansion mode.

Should we be right about the commodities cycle bottoming soon then one should expect consequences not only for precious metals and commodities prices but also for inflation.

<u>US Economic Commentary</u>

Regular readers will know that we have long predicted a grueling struggle for the US economy following the 2008 blow-up. Notwithstanding truly phenomenal stimulus by both the monetary (Federal Reserve) and fiscal (Treasury) authorities, the US has limped along with only a marginal upwards trend. This is of course of great importance when trying to divine the trajectory of the Dollar.

Of great interest to us is that the US Bureau of Economic Analysis has lately produced evidence of an even poorer recovery than previously believed. We refer to the BEA's National Income and Product Accounts: Gross Domestic Product – Second Quarter 2015 (Advance Estimate)*. In this period of astonishing stimulus when GDP growth should be rocketing along at 5 to 8 percent per annum we are advised that average GDP growth performance for the years 2012 to 2014 has been revised downwards from the poor figure of 2.3% to the even poorer figure of 2.0%.

The relevance of the previous paragraph concerns the long-range solvency issues and fiscal instabilities for the US government. By extrapolation, we are concerned with the US Dollar and following that, the direction of the gold price.

Importantly, new evidence as it unfolds continues to support our thesis that in all likelihood one should expect US and global financial system disruptions and US Dollar debasement. In the next section we set out the benefits of owning gold in such circumstances.

*see www.bea.gov

<u>The Big Picture and our Perspective</u>

Gold is complicated. How does one value the metal?

Over the sweep of the most recent five thousand years an ounce of gold has fed a family for a month. In the most recent couple of hundred years it has been known to buy a gentleman's suit on Saville Row. Of course there has been much short-term volatility in the gold price along the way, but we are speaking in terms of broad brushstrokes here.

Gold is not like an equity. <u>It does</u> have a price where buyers and sellers meet, and it is susceptible to macro-economic forces, but <u>it does not</u> have a business plan, managers, customers and a balance sheet. And gold cannot go bankrupt.

Gold is only vaguely like a bond (we speak here of a sovereign bond issued by a country). Both are passive instruments and zero-coupon bonds also pay no interest and investors expect the return to be in capital growth. But a sovereign bond embodies the risks that flow from the managers of the country i.e. the government. Gold is the opposite.

Gold is a little like a parcel of land. Both have value derived from scarcity, utility and attractiveness. Neither produce income and both cost money to maintain. Both have a capital value that varies a fair degree from time to time, largely related to demand and to political risk.

Gold has characteristics in common with Picasso paintings, Mont Blanc pens, Ferrari cars, etc in that it is tangible (i.e. an actual physical thing) and has value derived from scarcity and beauty. These items also produce no income and cost money to store and insure. They also hold their value and appreciate in real-terms in the long run.

Gold is quite similar to a currency. Both are stores of wealth, both are units of exchange and both have high value-density. Gold has been used as a means of transacting for thousands of years - currencies, more recently so. But where they differ enormously is that gold is scarce and difficult (and expensive) to produce, whereas currency is of infinite supply and costs effectively nothing to produce (but of course there are consequences to rampant production - think of Zimbabwe in recent times!).

Of course one could go on ad infinitum. And as you would expect, experts create valuation models on all these items and come up with forecasts based on extensive inputs into complicated formulae (we do too!). Every and any model is flawed however. If this were not the case the modellers would quickly obtain all the wealth on the planet. Theoretically a perfect model is possible but that model would have to be an exact replica of the Universe and it would have to be housed in another dimension and its clock would have to be running a little ahead of ours!

At SA Bullion we see gold as a competitor to cash in the bank. Flowing from this we see the benefits of gold as being -

1. A currency diversifier and a hedge against one's own currency (for South Africans, think Rand-hedge);
2. A long-term store of value and hedge against long-run inflation;
3. An intrinsic 'hard-currency' that provides stability and liquidity in times of stress.

This leads me to one of our core beliefs. *We believe in bedrock investing where every individual owns their own home and saves a portion of their wealth in gold.* We do not express an opinion on the rest of an individual's capital as there are a myriad of personal opportunities and circumstances.

We believe that a home and some gold provide an enduring foundation upon which to build one's personal empire, irrespective of size. Neither a home nor gold can go bankrupt. Both have inter-generational value and provide a family with security in terms of a roof and in terms of an ultimate safehaven currency.

A Note to South African Investors

Four years ago, on 30 June 2011, the Rand : Dollar exchange rate (i.e. the number of Rands required in order to buy one US Dollar) stood at R6.86. At 30 June 2015, the rate stood at R12.34. This loss of 44.4% in value relative to the US currency represents an annualized loss of 13.65%. Think about that, 13.65% per annum! If this rate were to persist in the future, a Rand will be equivalent to one US cent (1c) in 14 years' time!

If the above paragraph does not convey the need to think about currency diversification and a strategy of Rand-hedging, then I don't know what does. In the investment management industry there is the old adage "cash is king". Well, cash is not king when it is losing value at the rate of nearly 14% per year!

South Africa faces significant challenges. The problems of its own making are all too well documented and discussed in the daily media. But over and above these difficulties, South Africa suffers the collective fate (although, sometimes it's a positive!) of being a commodity-producing Emerging Market economy. It goes without saying that there is also the macro issue of an aging and economically slowing developed world.

Closing

In US Dollar terms gold has made a huge retreat in the last four years and new supply of gold is fragile as miners are in trouble. This, combined with the despair and capitulation concerning gold gets us extremely excited about current levels for new investment into gold. Investors in developing nations, including South Africa, have the additional overlay of requiring a currency-hedge and here gold fulfills both requirements. We urge investors to take action and invest a portion of their wealth in gold now.

Hilton Davies