SA BULLION

The SA Bullion Gold Report

Second Quarter 2016

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Table 1: Gold Performance to 30 June 2016 (% per annum)[1]

	Quarter[2]	1 Yr	2 Yr	3 Yr	5 Yr	10 Yr
Gold in US Dollar	6.8	12.9	0.2	3.5	-2.6	8.0
Gold in Rand	7.4	36.3	18.7	18.4	13.8	16.2
Gold in Euro	9.5	13.5	11.1	9.1	2.7	9.5

[1] Based on LBMA PM Fixes.
[2] Not annualized for periods of less than one year

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

	Gold in US$/oz	R/$ rate	Gold in R/oz[2]	$/€ rate	Gold in €/oz
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
30 June 2016	1,321.50	14.91	19,703.56	1.11	1,187.50

Note 1: Gold prices in US$ and € are LBMA PM Fixes
Note 2: Gold price in Rand from Rand Refinery

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	-11.4	19.1	-1.1
2016 year to date	23.7	20.9	21.2

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

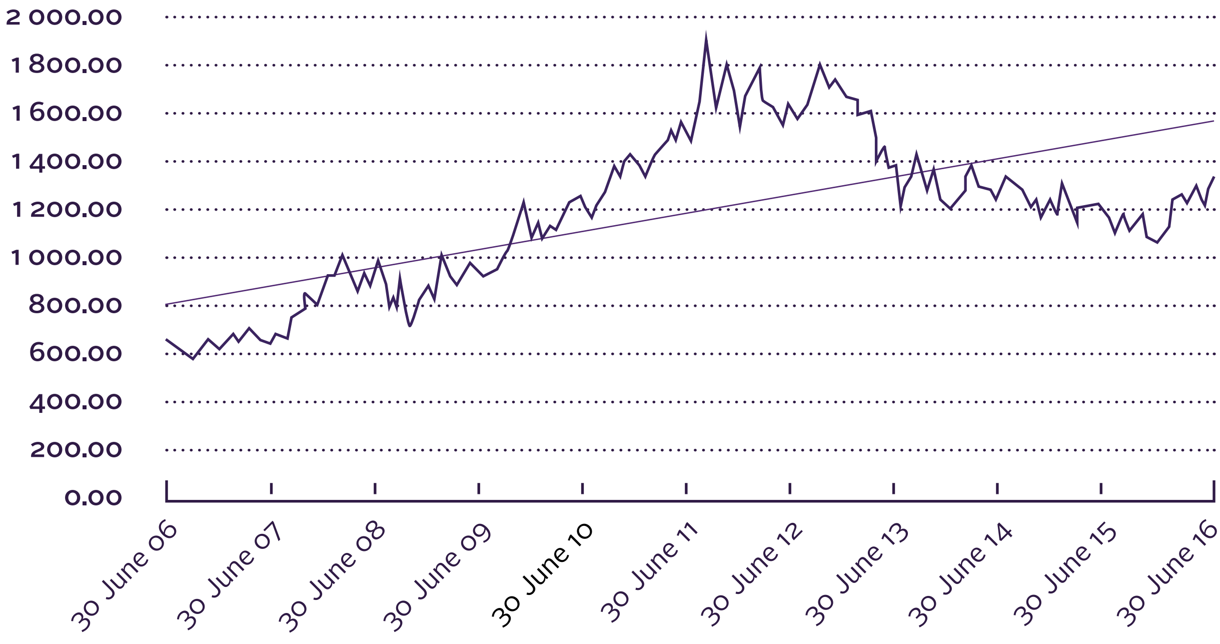
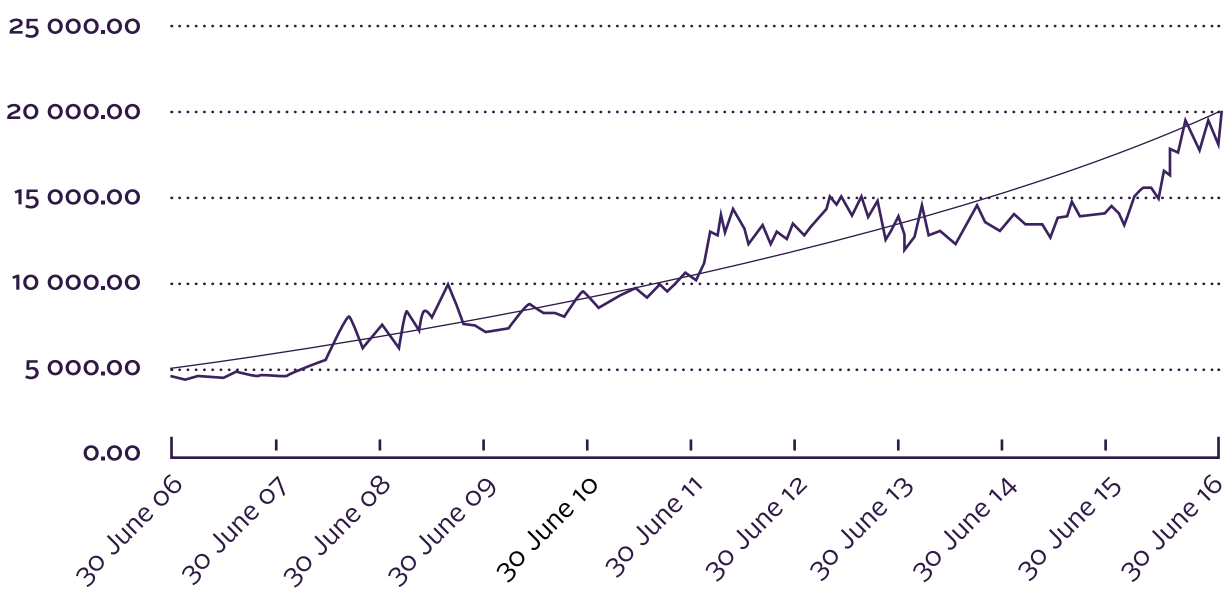


Figure 2: Ten-Year Chart of Gold Price in South African Rand



Gold Price Action

The second quarter was a double-dip roller coaster but with a strong upward slope. In US Dollar gold started at $1213 on 1 April and ended at $1,320 on 30 June. In both currencies this was a very strong quarter for gold.

For the year to 30 June gold put in a strong performance in all currencies. In US Dollar gold returned 12.9% and in Rand gold was up 36.3%, indicating that the Rand declined an alarming 24% against the US currency.

In the last ten years gold price performance has been 8.0% per annum in Dollar and 16.2% per annum in Rand. These returns have rewarded the prescient investor.

Gold in an Era of Unbacked Currencies

Our long term clients know only too well that our central tenet is **'Gold versus Cash in the Bank'**. We do not see gold as a competitor to shares, bonds or property. We see gold as a monetary unit – as it has been since the time of Croesus, King of Lydia, in 550 B.C.

Why "gold versus cash in the bank"? you may ask. The answer lies in the fact that all national currencies (and supra-national currencies – like the euro), are entirely unbacked today. Until 1971 there was foreign convertibility for the US Dollar. This meant that foreign governments were able to make demands on the US government to convert Dollar holdings into gold. Then while facing immense conversion demand (especially from France), President Nixon of the US 'closed the gold window". In effect, foreign governments could no longer approach the 'gold window' (a figurative box-office style window at the US Federal Reserve) with their demands for exchange of Dollars into physical gold bullion.

The Bretton Woods System that was imposed by the Allies in 1944 (but in reality, imposed by the United States as the new powerhouse of the world), ensured that the US Dollar became the 'de facto' global reserve currency. This meant that all currencies of the world were referenced to the Dollar. And the Dollar was referenced to gold; at an exchange rate of $35 to 1 oz of gold (as it had been since 1934.

With the closing of the gold window in 1971 President Nixon took the US and the world off the Gold Standard. This was the beginning of what we at SA Bullion call The Era of Unbacked Currencies.

I'm quite sure that your next question is: "if gold doesn't back the Dollar what does"? The answer: the full faith and credit of the United States government. In other words, nothing tangible backs the Dollar, or any other unit of currency, for that matter. The Dollar is worth something because people think it is worth something. This means that confidence in the unit is all-important; and that confidence flows from confidence in the United States.

What becomes apparent is that in order to understand gold one has to understand the Dollar. And in order to understand the Dollar, one has to understand the United States. And in order to understand the Rand, one has to understand South Africa. For these reasons we are students of the United States, South Africa and their respective currencies.

US Macro-Economic Update

Economy

The US economy has received the greatest stimulus since 2008, in the history of humankind. And yet it is moribund. Our long term clients will nod their heads in agreement – we have been saying for years that the US economic future is one of low growth (stagnant) and persistent inflation i.e. Stagflation. Given the recent (post-2008) monetary and fiscal stimulus the US economy should be growing at pre-crisis levels – at least 6% per annum. Observe the latest Gross Domestic Product (GDP) figures and their direction:

Quarter	Annualised Growth Rate (%)
2015 Q2	3.92
2015 Q3	1.98
2015 Q4	1.39
2016 Q1	1.07

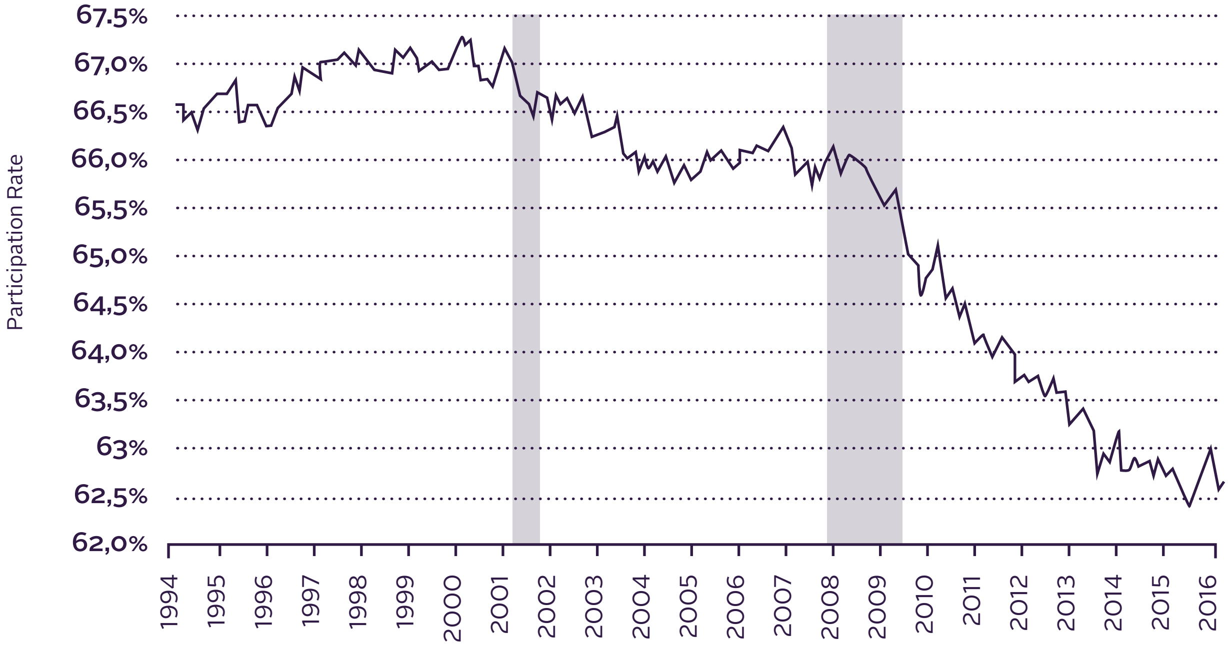
Over 70% of US GDP is attributable to consumer spending. Due to this fact the state of unemployment is of crucial importance. Now we know that the Bureau of Labor Services (BLS) has recently, on 8 July 2016, produced unemployment statistics that at face value appear pretty good. The BLS statistics indicate that 287,000 new jobs were added in June and that the official rate of unemployment (known as U3) is now 4.9%. This is interesting. The figure of 287,000 is largely fictional made up from a business birth/death model and the BLS has a pretty poor record of overstating and later revising downwards.

The broader U6 has the unemployment rate at 9.6%. This category includes unemployed people who are 'discouraged' and have not looked for jobs in the prior 4 weeks. Those jobless people who looked for work in the prior four weeks fall into the U3 series.

Now this is where it gets interesting. After being unemployed for more than 12 months a person is no longer unemployed (Magic at work!). These people are categorized as constituting no part of the labour force. And the jobless people in this category have been vapourizing in their droves! To pick this up one has to interrogate not the unemployment numbers but rather the labour force numbers, or more simply the Labour Force Participation Rate (which is the percentage of the total population in the labour pool (employed plus unemployed) relative to the size of the population. Retired people, children, incapacitated people and permanently discouraged workers do not form part of the Labour Force.

The item that has caught our attention for many years now is that the BLS is statistically shrinking the labour force numbers quite dramatically, year after year since 2000. Viz.

Participation Rate (Labor Force as a Percent of Population)
To June 2016, Seasonally-Adjusted [ShadowStats, BLS]



In May alone the BLS lopped 587,000 from the labour force. This means that the unemployed rate can go down even while more people become unemployed! This is not inspiring.

ShadowStats computes statistics where they add back the permanently marginalized (e.g. begging at the traffic lights) and they have US unemployment at 22.9%!

Our Reckoning

We see that growth in real income for the US consumer is poor. The willingness of the consumer to take on new debt so as to spend is very poor. The consumer is heavily stressed and this continues to impair business activity.

Economic deterioration appears to be intensifying and the US appears to be headed for recession. We see a high likelihood of QE4 (fourth round of Quantitative Easing). We see the Federal Reserve as being unable to raise interest rates in any meaningful way for a long time. We see the Dollar as likely to suffer setbacks. Cash in the bank in America looks like a bleak bet.

South Africa Macro Update

The Rand had a very strong run during the heyday of the commodity boom, peaking in 2006 and 2007. In addition, President Mbeki and Finance Minister Manuel ran a tight ship and the Rand was rewarded. For some years it was the top performing currency in the world. Those halcyon days ended however, in 2011. South Africa changed course and the Rand went with it. The commodity cycle turned down, government prudency ended and President Zuma set off on a course of building an idiocracy and a system of patronage.

CONSIDER THESE FIGURES INDICATING THAT THE RAND HAS HALVED IN THE LAST FIVE YEARS:

Date	Rand : Dollar
30 June 2011	6.86
30 June 2012	8.21
30 June 2013	9.97
30 June 2014	10.64
30 June 2015	12.34
30 June 2016	14.91

The three key drivers of the Rand today are:
- **Economic growth** (as measured by GDP)
- **Credit Ratings**
- **Government and Political Leadership**

GDP Growth

As a major beneficiary of high commodity prices and voracious commodity demand by China, the Rand rode the crest of the wave in 2006. Prudent and accountable government assisted. In the second quarter of 2006 the annualized GDP growth rate was a very high 5.8%.
In late 2008 Lehmann Brothers failed in the US, setting off the worldwide Financial Crisis. The second quarter of 2009 marked a low point due to this crisis. It also marked the start of the Zuma presidency.

ANNUALISED GROWTH RATES FOR A SELECTION OF YEARS IN THE PERIOD 2006 - 2015:

Year	% annualised
2006	5.8
2009	-1.4
2010	2.8
2011	2.3
2012	3.6
2013	4.0
2014	0.8
2016	-2.0

For a period of four years, up until 2013, South Africa performed reasonably well, due to the strong foundations that had been laid in the previous 15 years. Thereafter this began to change. High budget deficits and extremely poor government that was openly hostile towards business began to take a toll. The economy has taken a battering and the Rand with it. GDP is contracting and South Africa is headed for a recession while a rapidly growing population is facing the disillusionment brought on by empty promises carelessly broken.

First quarter 2016 annualised GDP growth was -1.2%. The IMF predicts 0.1% growth for 2016. These are dismal times for South Africa!

South Africa's Credit Rating

The three major rating agencies, namely S&P, Moody's and Fitch, all have South Africa teetering on a rating of BBB-.

Credit ratings are used to 'rate' a borrower's ability to repay interest and capital on loans. The ratings have great import in that they affect the interest rate at which government will be able to make future borrowings. They also affect the decisions of lenders as to whether or not they will invest in the sovereign debt of the country.

Sovereign debt (debt issued by countries) is broadly rated Investment Grade and Junk. The lower boundary of Investment Grade is BBB-. South African government debt sits on this precipice. Should South African government debt face another downgrade, in a string of rating downgrades in the last five years, most foreign investors will decline to further invest in South African debt and they will be forced to sell their current holdings. Large insurers, mutual funds and pension funds typically operate with investment policies that prohibit investment in Junk bonds. Their exit from the South African market would be highly detrimental to the economy and the Rand.

NOTE S&P'S RATINGS FOR SOUTH AFRICAN GOVERNMENT BONDS SINCE 2000:

Closing

We struggle to see positives. We are underwhelmed by US and Dollar prospects. In South Africa we see an economy that is suffering under troubled global growth and awful political management. Compounding those woes is the likelihood of a ratings downgrade that would set the cat amongst the pigeons. Whilst we do not like the prospects for Dollar cash in the bank we like the prospects of Rand cash in the bank a whole lot less. We cannot find any compelling reasons why the Rand might alter its course of the last five years relative to the Dollar. We see cash in the bank in South Africa as a certain bet for losing money.

The full faith and credit of the US government, and more so, that of the South African government, is, for us, eroding before our eyes. For years we have been advocating 'gold rather than cash in the bank'. We need to make our point louder.

With warm regards

Hilton Davies