The SA Bullion Gold Report
Q4 2014

SA Bullion

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Table 1: Gold Performance to 31 December 2014 (% per annum)[1]

	Quarter[2]	1 Yr	2 Yr	3 Yr	5 Yr	10 Yr
Gold in US Dollar	-0.9	0.1	-14.7	-7.6	2.1	10.7
Gold in Rand	-0.5	10.4	-1.3	3.4	8.0	18.7
Gold in Euro	2.7	13.4	-11.1	-5.7	5.5	11.9

[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
31 Dec 2004	435.60	5.63	2,454.06	1.36	320.47
31 Dec 2005	513.00	6.32	3,253.70	1.18	434.91
31 Dec 2006	632.00	7.05	4,456.07	1.32	479.28
31 Dec 2007	833.75	6.83	5,698.14	1.46	570.26
31 Dec 2008	869.75	9.24	8,040.84	1.39	625.70
31 Dec 2009	1,087.50	7.36	8,008.08	1.43	757.97
31 Dec 2010	1,405.50	6.61	9,298.44	1.34	1,047.67
31 Dec 2011	1,531.00	8.07	12,360.37	1.30	1,179.37
31 Dec 2012	1,657.50	8.50	14.044.10	1.32	1,253.02
31 Dec 2013	1,204.50	10.28	12,385.67	1.38	873.14
31 Dec 2014	1,206.00	11.34	13,679.58	1.22	990.22

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—\$1,200.60, R14,141.34, €1,089.55

Table 3: Calendar Year Performance of Gold

	% US Dollar	% ZA Rand	% Euro
2004	4.6	-11.7	-2.9
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

Q4

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

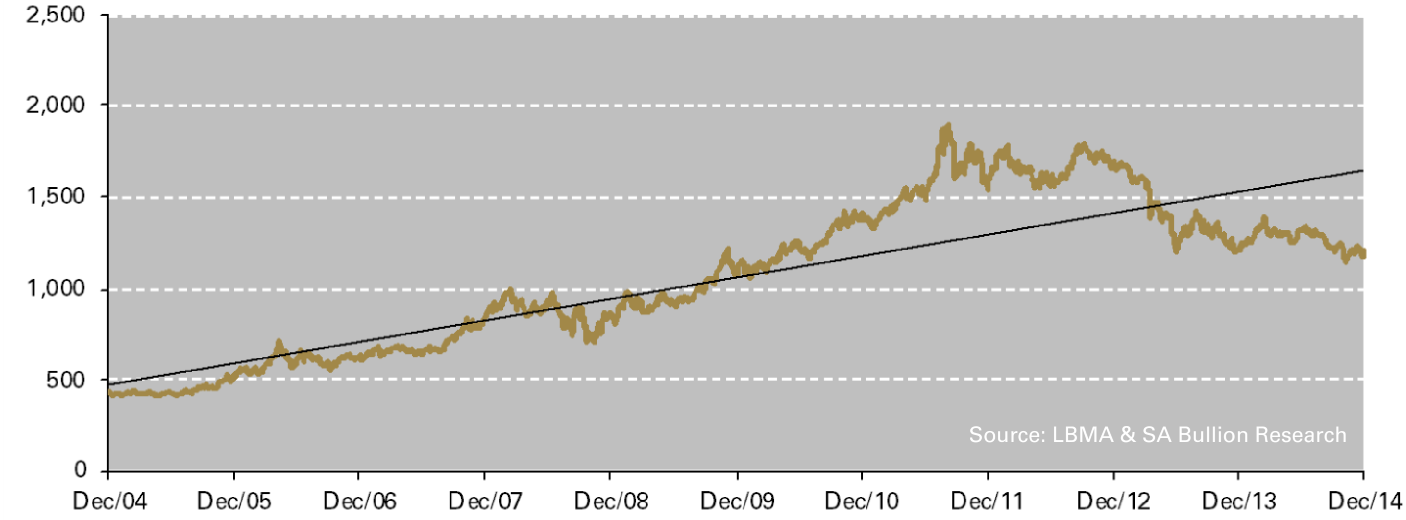
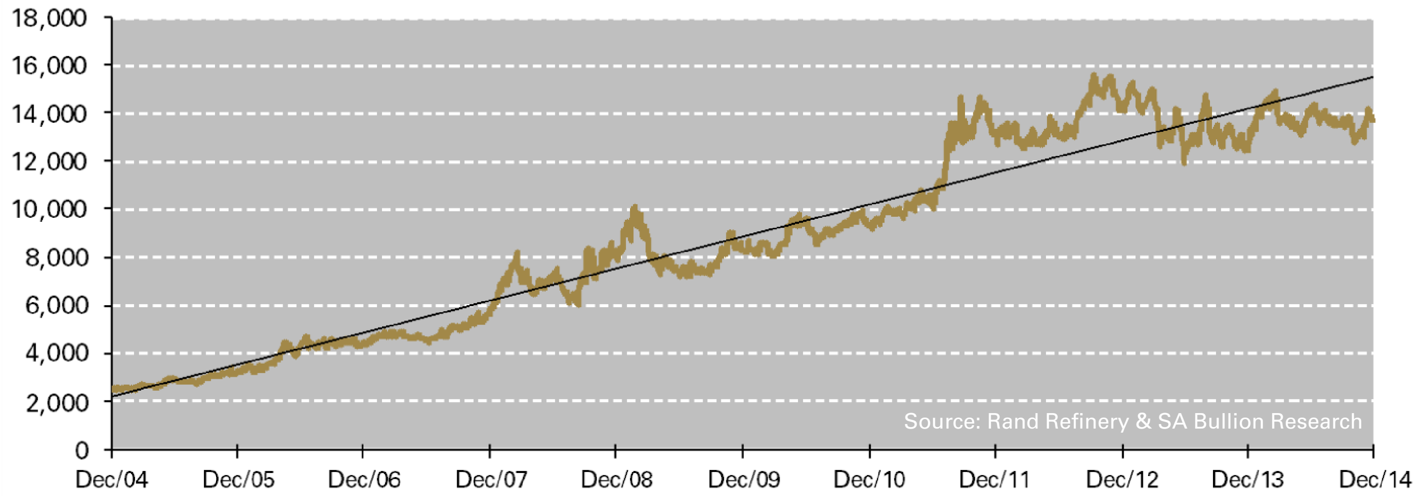


Figure 2: Ten-Year Chart of Gold Price in South African Rand (Rand Refinery first pricing)



Gold Price Action in the Fourth Quarter

In the fourth quarter gold was fairly flat in US Dollar and South African Rand terms and up 2.7% in Euros as that currency swooned relative to the Greenback. For the calendar year gold ended flat in US Dollar but showed its currency diversification benefits as it was up strongly in Rand and Euro as those currencies performed poorly over the twelve months. The short term story is essentially one of a resurgent US Dollar.

Over the long term, and here we are speaking of 10 years, gold has been an excellent investment relative to cash. It has performed at around 11% per annum in both US Dollar and Euro, while in Rand it has been a fantastic performer at greater than 18% per annum. The Rand performance is, of course, indicative of a declining local currency – a key tenet of our story to South Africans in particular and residents of Emerging Market countries in general.

2014 in Review

Oil

The big story of 2014 was the collapse in the oil price. For 3 years Brent Crude traded around $110/barrel and in June 2014 Brent traded at up to $115/barrel. Then the slide began and in 6 dizzying months Brent Crude plunged below $50/barrel.

There are two key changes behind the oil price collapse –

1. The fracking explosion in the United States; and
2. The tapering off of the great China boom.

In the last 4 years US oil production has gone from 7 million barrels per day (bpd) to 11 million bpd thanks to fracking. In the same period the production of the rest of the world has remained static at 76 million bpd.

Following the 2008 Financial Crisis global economic growth has come from the emerging markets, principally the BRIC Nations – Brazil, Russia, India and China. At the heart of it all has been China. But in the last two years everything has changed. The great Chinese boom is slowing rapidly and commodities have suffered dramatic falls as a result. Most recently oil has been the victim of price collapse.

Low oil prices are good for major oil importers such as Europe, Japan and South Africa. They are bad for oil exporting countries and oil companies; and they are very bad for the high-cost US oil fracking companies. The biggest loser is probably Russia (which is basically one big oil business) and the country is rapidly going bust.

US Corporate Profits

Ultimately corporate profits are the drivers of stock markets. And we have certainly witnessed massive corporate profit growth in the US post-2008, fuelled by Quantitative Easing (QE). However, as we said in our Second Quarter report last year, the enormous growth in US corporate profits was almost entirely due to three 'once-off' bonanzas, and that they were unrepeatable. Our third point on the subject in that Q2 Report was the effect of the release of loss provisions by financial institutions.

Returning to the first sentence in this section: ultimately corporate profits are the drivers of stock markets: Since 2008 we have witnessed a massive rise in QE-fuelled corporate profits and a concomitant massive rise in the US stock market. It should be noted that prior to the 2008 collapse, corporate profits had been sliding downhill for more than a year, while the stock market was perpetually rising to new records.

Today we have witnessed a year of sliding corporate profits (as evidenced by the S&P 500 companies) as those once-off bonanzas ease out of the system, yet the stock market continues to set new record highs. (We think 'watch out!')

Gold Supply and Demand

A slowdown in demand typically precedes a retreat in prices.

In 2014 we witnessed global gold demand declines in the important areas of jewellery (demand down to approx. 2,150 tonnes) and Exchange Traded Funds (outflows of 159 tonnes). Bar and coin demand was also down on 2013. Offsetting weaker private sector consumption to some extent was massively increased central bank purchases at 477 tonnes for the year. Overall, gold demand at 3,924 tonnes was 4% lower than in 2013.

On the supply-side recycled gold contracted from the previous year for the third year in a row to approximately 1,122 tonnes. Mine supply though, increased to a record high of 3,114 tonnes. Total supply was 4,278 tonnes and thus considerably more than demand.

Overall, weak supply/demand fundamentals were in play for 2014 as a whole.

In 2015 demand is forecast to be in the range of 4,100 to 4,200 tonnes while new mining supply would appear to be under pressure resulting in an improved supply/demand picture. (Source: data from the World Gold Council)

US Dollar Strength

The year 2014 was the year of the Dollar. The Greenback strengthened dramatically against all the major currencies. Dollar strength had its underpinnings in several factors:

- A growing US domestic economy;
- Speculation of imminent rising US interest rates;
- An improving current account due to a collapse in the cost of imported oil;
- A massive flow of global funds from underperforming emerging markets to an outperforming US stock market.

The Outlook for the Year Ahead

Asset prices are forward-looking and price near-term expectations into valuations. Importantly, one has to discern beyond the near term.

In our view US equities are very fully-valued. This is an important point as US stock markets have acted like a vortex, sucking in much of the world's capital and certainly a large share of capital that was previously invested in gold. Shares are valued at extremely high levels relative to long-run averages – a price to earnings ratio of around 27 versus a long term average of around 19. Equities are vulnerable. This because economic growth is weakening once again and because corporate earnings do not appear to be able to hold the rising trend. History tells us that the US faces a recession on average once every seven years. If averages were to hold, the US is about due for a recession now. Furthermore, should the US Federal Reserve take steps to raise interest rates, corporate earnings will be negatively impacted and valuations will suffer. We would not bet on a great stock market story this year and believe that it is appropriate to hedge one's bets in this regard.

We expect the Fed to begin tightening (raising interest rates) beyond June and to continue with regular, incremental increases beyond that. We also expect inflation to start becoming an issue a year from now, and to become a very ugly problem for the US as deflation abates in the rest of the world (from which the US is currently importing disinflation).

Regarding South Africa and the Rand, we find it impossibly difficult to fathom direction in the short term. In the long term however, we are confident in predicting Rand depreciation against the major currencies. Our view is underpinned by the country's trade and fiscal deficits, a business-unfriendly regime and poor electricity supply.

In Closing

Given the incredibly high equity valuations in the US, we think that equities are vulnerable. Given the vulnerability of equities, we think the Dollar is vulnerable. Given the economics to be found in South Africa, we think the Rand is very vulnerable in the long term. Gold and oil have made massive retreats in recent times and are at price levels that render new exploration uneconomic and therefore create attractive fundaments. Overall, we think that putting all one's bets on yesterday's winners is not wise and that some small bets on recent laggards (including gold), makes sense.

All best wishes for a successful 2015.

Hilton Davies