Australian Gold Fund

Performance Report
For Quarter Ending 31st December 2020

Summary

Fund Performance Statistics				
	Australian Gold Fund	ASX Gold Index (XGD)	Van Eck GDX	Van Eck GDXJ
Quarter Performance	-3.17%	-12.47%	-7.54%	-0.47%
Quarter Volatility (%)	33.41%	35.66%	44.95%	37.55%
Year to Date Performance	22.31%	8.45%	23.66%	30.36%
Year to Date Volatility (%)	42.92%	46.87%	72.32%	58.59%
Performance Since Inception	31.33%	10.68%	37.39%	40.17%
Volatility Since Inception (%)	42.80%	44.21%	67.86%	55.01%
Quarter % Days Outperform XGD	59.09%			
Year to Date % Days Outperform	52.29%			
% Days Outperform Since Inception	53.78%			

The December quarter was one where returns may appear disappointing given they are negative, but this is within the expectation due to the seasonality trends for precious metals and gold mining stock performance being weak at this time of the year. The Australian Gold Fund nonetheless outperformed against the ASX Gold Index by a significant 9.3%, as we delivered a return of -3.17% while the ASX Gold Index delivered -12.47%, the GDX delivered -7.54% while the GDXJ delivered -0.47%. Compared to the same period last year of -1.33% and ASX Gold Index of -7.54%, this year's December quarter saw a more pronounced retreat in the prices for gold mining stocks. For the 2020 year, the Australian Gold Fund delivered 22.31% return, outperforming against the ASX Gold Index that delivered 8.45% but we underperformed against both the GDX and the GDXJ. The underperformance needs to take into account the Australian dollar appreciated almost 10% relative to the US dollar during the year. If that was taken into account, we may have likely outperformed against these indices as well.

Our fund's returns volatility is the lowest against our comparator indices, thus showing that our investment strategy is able to place us on a higher position along the risk-return curve. Furthermore, despite the December quarter being weaker, our returns volatility for this quarter is less than the volatility of returns over the entire year. Furthermore, for this quarter, the Australian Gold Fund outperformed against the ASX Gold Index on 59.1% of the trading days, bringing up the 2020 outperformance from 50% to 52.3% since the previous quarter and since inception, we have outperformed against the ASX Gold Index on almost 53.8% of the trading days.

Interesting events occurred in the final quarter of the 2020 calendar year as the US election cycle took precedence. While at the time of writing of this performance report in early February 2021 suggests that the Biden administration is now set in stone, we take the highly controversial view that this is not the case. Even as many people are now convinced that all attempts by the Trump legal team to dispute the election results have been unsuccessful, the Senate holding the impeachment trial now for the next week or so may well see unforeseen twists and turns. We believe that it is not a done deal. The resultant impact of the Biden administration has seen cryptocurrencies and the broader market continue to rise, with clear market manipulation and financial regulators working to keep the game going. Precious metals, along with the truth, continue to be the key victims in this topsy-turvy society.

The fund's composition as at 31st December 2020 is given in the table below:

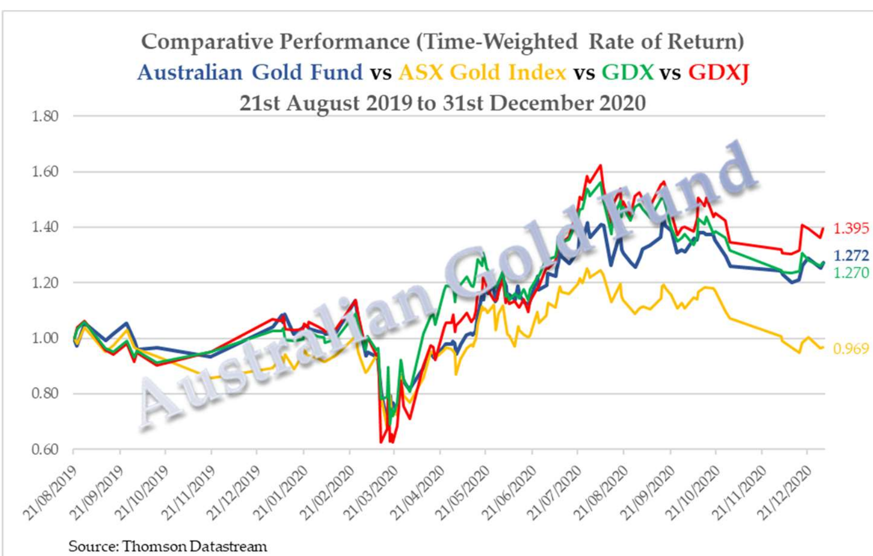
	% Portfolio by Market Value	Range
Cash	0.2%	2-10%
Major and Large Producers	15.9%	0-20%
Mid-Tier Producers	34.7%	0-60%
Junior and Micro Producers	26.2%	0-60%
Developers and Explorers	11.8%	0-10%
Precious Metals ETF	11.2%	0-30%

The Top 5 holdings are given in the table below:

Top 5 Holdings
West African Resources
Ramelius Resources
ETF Palladium
Resolute Mining
Westgold Resources

During the quarter, we began to reduce some of our holdings in early October including in Silver Lake Resources and St Barbara Mines. However, in late October, we began to purchase some Oceanagold and Ramelius Resources as their prices made them compelling. In early December, we further sold down some stocks to generate some cash and reallocated to expose ourselves from junior and mid-tier gold producers to some large gold producers including Evolution Mining and Saracen Mineral Holdings, in anticipation to their merger with Northern Star to form the second largest ASX-listed gold producer stocks. However, as the prices continued to fall into the end of December, the proportion of our portfolio by market value comprised of major and large producers continued to fall while that of junior producers and precious metals ETF actually increased since Aeris Resources and West African Resources continued to strengthen.

The relative performance of the fund against the ASX Gold Mining Index (XGD), the VanEck Vectors Gold Miners Exchange Traded Fund (GDX) and the VanEck Vectors Junior Gold Miners Exchange Traded Fund (GDXJ) since inception is given in the figure below:



Valuation Thesis

Our key valuation metric is the **EV/AISC-Adjusted Annual Production** as we have found in our empirical study that the market valuation is most aligned to this metric, as opposed to earnings, resources and reserves. We also prefer a multiples method over the typical Discounted Cashflow Method for valuation because we understand that beyond even one year of projection, everything is highly speculative – whether it is the management outlook on production and costs as well as the gold price and broader economic drivers. To allow for comparison across all classes of producers, our metric can standardise by the company's scope of production as we observe that the market values the companies with higher production with a greater multiple. However, we scale production by AISC because we believe that not all ounces are equal. Companies that can produce gold at lower cost are naturally more profitable and deserve a higher multiple of their production and other operational or financial performance measures. We use the following classes for the different tiers of gold producing companies – **A** (major producer – 1Moz p.a. or more), **B** (large producer – 0.5-1Moz p.a.), **C** (mid-tier producer – 150 000-500 000oz p.a.), **D** (junior producer – 50 000-150 000oz p.a.) and **E** (micro producer – less than 50 000oz p.a.).

The **Enterprise Value** is the sum of the market value of equity (stock price multiplied by number of issued stocks) and net debt (total borrowings less cash and gold bullion, but excluding gold in circuit and ore stockpiles). This metric quantifies the market value of the company's assets deployed in the company's operations. The **AISC-Adjusted Annual Production** calculated as the annual production of gold per oz divided by the AISC adjusted by a factor of 1 000. The factor of 1 000 is arbitrarily chosen as a way to standardise the final metric. As an illustration, if a company produces 250 000oz p.a. at AISC of $1 250, the AISC-adjusted production is 200 000.

When determining the production ranges in our valuation metric, we take the management guidance as this is based on their access to information relating to their operations and progress. We believe that the market will use the guidance figures to base their valuation and investment decisions. This may not always be optimal given that some management may have their bias in reporting their outlook, as well as having a track record of announcing surprises. In such cases, we seek to qualify this in our SWOT analysis and adjust it in our EV/AISC-Adjusted Production multiple.

The **Price Range** determines a reasonable range for which the company stock price should be trading at. This range is relatively wide as it considers the **margin of safety**. A company whose stock price is currently outside the fair value range is significantly over or undervalued and investors should look more deeply into the company's operations, financial performance and recent market announcements. This range should not be taken as the sole driver for investment decisions, but as a starting point for further research to identify the potential causes for the current stock price.

We recognise that many analysts consider discretionary forecasts and adjustments on the company's production level, ore grade, cost levels, resources and reserves and economic factors into their valuation. We have studied many of these reports and recognise their merits. However, our view is that such subjective adjustments are dubious in terms of additional accuracy of their estimations. This is because with mining companies, both internal and external drivers that affect the company's future performance are unpredictable. Furthermore, we understand that while a company with substantial resources and reserves have potential to convert into substantial value in future, this is contingent on the successes in building the infrastructure, extracting the ore from the ground and processing it in a cost-effective manner. We recognise the criticism by many regarding our approach, but we have tried and tested our valuation against the actual price performance as well as through our own investment performance. We let these results speak for themselves.

Given the rise in gold price in the recent three months, we see reason to re-rate the gold mining companies' valuation metrics upwards to reflect their improving profitability as well as increased enthusiasm from investors. As a rough guide, the fair value ranges for different mining company classes are as follows:

Major and Large Companies *- $8 000-$12 000/oz*

Mid-Tier Companies *- $4 000-$7 000/oz*

Micro and Junior Companies *- $1 500-$4 000/oz*

We also add that after reviewing our reports, we have found another metric that may inform the fair value ranges, namely the Operating Margin. The Operating Margin is the difference between the Gold Sale Price per oz and the AISC. A higher Operating Margin implies higher cashflow generation. We have also found that the market appears to take this into account when determining the price they will pay to purchase the stocks. We found that there is a link between the Operating Margin and our EV/AISC-Adjusted Production in that 8-12 times the Operating Margin gives a reasonable EV/AISC-Adjusted Production.

Glossary

The **All-in Sustaining Cost (AISC)** is a measure adopted by the World Gold Council as a standardised measure of production costs. This cost includes typically the **Cash Cost** associated with the direct production (extraction, transportation, processing and refining costs, staff salary and wages and relevant corporate costs) as well as **Sustaining Expenditure** that may include maintenance of mine equipment and infrastructure, insurance and administration costs over its production life. Companies may still have discretion in apportioning their expenses.

The **Net Cash/Debt** is the net amount of cash and bullion the company holds after their borrowings and interest-bearing debt are paid. This represents the liquidity position of the company, although this measure does not consider whether the debt is current (due within the next twelve months) or not. A company in a significant net debt position is owing more than they currently have in cash and bullion, which may potentially put them in financial distress if the debt is due soon.

The **Net Cashflow from Operations Excluding Maintenance Capital Expenditure** measures to what extent the company can generate cashflows from its operations after paying for its operating costs as well as Cash Paid for Purchases of Property, Plant and Equipment and the Cash Paid for Development Expenditure in the Investing Cashflows section of the Statement of Cash Flows. It does not include Cash Paid for Exploration and Evaluation, which is assumed to be growth capital expenditure. This is by no means a stable and comparable measure as different companies may have discretionary interpretation of what constitutes as Operating Activities and Investing Activities or Development, Exploration and Evaluation expenditures.

Disclaimer

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