Australian Gold Fund

Performance Report

For Quarter Ending 30th June 2020

Summary

The Australian Gold Fund delivered a solid return during the June 2020 quarter, recovering solidly after the heavy losses experienced in the March quarter. The fund delivered a time-weighted rate of return of 46.2%. This compares to the ASX All Ordinaries Gold Index quarterly return of 40.7%, the GDX (in USD) returning 59.2% and the GDXJ (In USD) returning 76.4%. Since 23rd August 2019 to the end of the financial year, the Australian Gold Fund delivered a 19.1% return. Over the same period, the ASX All Ordinaries Gold Index returned 8.3%, the GDX returned 28.7% and the GDXJ returned 25.5%. We are pleased with this return, although we recognise that the gold price in Australian dollar terms increased by 27% during this same period. Investing in bullion would have been preferable and also fraught with less risk.

The market began to rebound in mid to late March, with the gold producers finding a bottom on 16th March 2020, a week before the broader asset markets that began to recover on 23rd March 2020. The recovery was rather substantial across all sectors and industries, though the gold mining industry was quite breathtaking. The ASX Gold Index recovered over 60% from the bottom while the ASX All Ordinaries recovered 32% during the same period. The Australian Gold Fund increased by 56.4% during this period. Certain gold mining stocks more than doubled during this period, with explorers experiencing the biggest increases. At the time of this report, the momentum for gold mining stocks has not yet run out as the price of gold has broken all-time records in every currency including the US dollar.

This quarter saw the main focus in the news being the pandemic as countries around the world faced uncertainty over the rate of infection and the seriousness in terms of mortality. Countries adopted different measures though guided by the World Health Organisation and also public health officials. To date, much debate remains over the efficacy of the most common measures including the use of face masks, self-isolation at home, border control, maintaining safe gaps between people in public and indoors (termed social distancing). The race between pharmaceutical companies in developing vaccines is under way, although anecdotal evidence of doctors around the world using hydroxychloroquine and cocktails of antiviral drugs and natural compounds has also been discussed.

Governments around the world have sought to keep their economies and the financial markets afloat to spur confidence by means of stimulus packages, deficit spending and other measures. This has largely been able to keep the financial markets from dropping further since late March. However, we are aware that this arises more so from a flood of liquidity from central banks and governments leading to devaluation of the currencies around the world and rising prices rather than due to increased productivity. The observed price rises in the financial markets is an optical illusion and it is apparent when one follows the price of gold, which has also risen significantly during the quarter across all currencies including the US dollar.

Going forward, we enter into the northern hemisphere summer months where gold and gold mining stocks seasonally perform very strongly until early to mid-September. We are expecting that the conditions will be rather accommodative to precious metals and mining companies during this period due to the massive stimulus around the world as governments and policymakers desperately try to calm fears of a collapse in the global economy resulting from lockdowns and the global supply chain being damaged

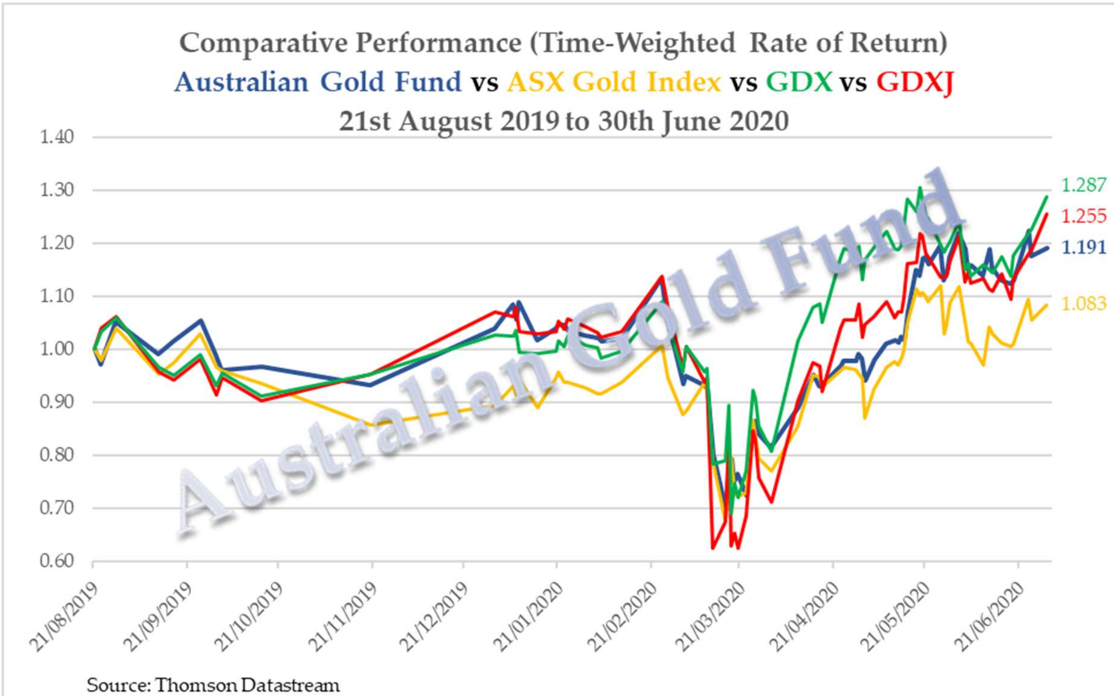
The fund's composition as at 30th June 2020 is given in the table below:

	% Portfolio by Market Value	Range
Cash	0.3%	2-10%
Major and Large Producers	14.5%	0-20%
Mid-Tier Producers	42.4%	0-60%
Junior and Micro Producers	29.9%	0-60%
Developers and Explorers	5.7%	0-10%
Precious Metals ETF	7.2%	0-30%

The Top 5 holdings are given in the table below:

Top 5 Holdings
West African Resources
Resolute Mining
Ramelius Resources
ETF Palladium
Alacer Gold Corporation

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) during this quarter is given in the figure below:



During this quarter, we reduced our holdings in Gold Road, Oceanagold Gold Corporation, Ramelius Resources, Silver Lake Resources and Westgold Resources as their stock price rallied and we felt that they were priced more closely to their fundamentals. We added into our portfolio Aeris Resources, Cardinal Resources, Kingston Resources and Ora Banda Mining as we wanted to expose our fund to late-stage explorers and developer companies. We increased our holdings in Alacer Gold Corporation, Dacian Gold, Newcrest Mining and West African Resources as we saw their prices fall below our valuation range and we identify growth potential for them.

Valuation Thesis

The gold mining companies are classified based on their production level on an annual basis. The classification used in this report is as follows – **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.).

We use the **EV/AISC-Adjusted Annual Production** as a *comparative measure* to evaluate the companies we study. This metric is able to standardise the production and production costs and hence allow for comparison across all classes of producers. 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). The **AISC-Adjusted Annual Production** is measure whereby the annual production of gold per oz is divided by the AISC adjusted by a factor of 1 000. The intuition behind this measure is to value the company by taking into account annual production but giving favourable treatment for lower AISC and penalising for higher AISC. The factor of 1 000 is arbitrarily chosen. As an illustration, if a company produces 250 000oz p.a. at AISC of $1 250, the AISC-adjusted production is 200 000.

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.

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-$11 000/oz*

Mid-Tier Companies *- $3 000-$6 000/oz*

Micro and Junior Companies *- $1 500-$2 500/oz*

The metric is by no means perfect and other factors should be considered including reserve and resource life, projected production volume and costs, management quality and geographic location. Further, it is of a retrospective nature, focusing on past performance and this may not be a good indicator for future performance.

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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