Australian Gold Fund

Performance Report

For Quarter Ending 31st March 2021

Summary

Fund Performance Statistics				
	Australian Gold Fund	ASX Gold Index (XGD)	Van Eck GDX	Van Eck GDXJ
Quarter Performance	-18.07%	-14.50%	-9.77%	-17.01%
Quarter Volatility (%)	28.63%	31.87%	42.98%	34.26%
12 Month Performance	27.81%	7.57%	41.79%	62.70%
12 Month Volatility (%)	34.71%	38.06%	48.14%	40.46%
Performance Since Inception	4.18%	-17.17%	14.61%	15.77%
Volatility Since Inception (%)	39.57%	41.38%	61.62%	50.02%
Quarter % Days Outperform XGD	47.62%			
12 Month % Days Outperform	54.41%			
% Days Outperform Since Inception	52.97%			

While we ended the December 2020 quarter with an air of optimism as we expected January to February to be bullish for gold, this did not eventuate. Rather, this quarter saw another decline in the gold price with rather brutal selling off of gold mining stocks. The Australian Gold Fund performed poorly this quarter with a return of -18.07%. We underperformed against the ASX Gold Index which has delivered -14.5%, the GDX at -9.77% and the GDXJ at -17.01%.

The rolling 12-month return looks more encouraging. Our return was 27.81% compared favourably against the ASX Gold Index which delivered 7.57% but we underperformed against the GDX and GDXJ at 42.98% and 34.26%, respectively.

Since inception, we have delivered 4.18% returns. We are outperforming significantly against the ASX Gold Index which has delivered -17.17%, though underperforming against the GDX and GDXJ at 14.61% and 15.77%, respectively.

We continued to have the lowest volatility of returns against our peer indices, whether during this quarter, the rolling 12-month period and since inception. We consider this to be a strong indicator that we are able to deliver superior risk-adjusted returns in the longer term. Furthermore, for this quarter, the Australian Gold Fund outperformed against the ASX Gold Index on 47.62% of the trading days. In the last 12 months, it was 54.41%. Since inception, it was 52.97%.

The March quarter saw the Biden administration implement their policies regarding the economy, immigration and foreign affairs – all of which resulted in broken promises and a flagrant disregard for the US Constitution. The US energy industry was dealt a severe setback with the Keystone pipeline being shut down and the Louisiana gas field leases being suspended. The resultant decline in US energy production contributed to the oil price rising by 25-30%. The Biden administration passed the US$1.9 trillion relief bill as a measure to boost the economy. That said, much of the cash appears to be spent on paying Democrat states that locked down and destroyed their economy, funding foreign and domestic activist groups rather than compensating small businesses and households. Ironically, households would receive a $1 400 cheque as opposed to $2 000 promised prior to the Georgian Senate run-off election. More absurdities were hidden in the bill, including paying households to keep their children from returning to school or paying Federal workers if they did not return to work.

The massive spending expected to be implemented by governments worldwide led to increased borrowing from central banks. However, the US Federal Reserve has announced their intention to implement yield curve control in an attempt to normalise their fiat currency system. The expectation of higher real bond yields dampened sentiment for gold and precious metals. The attempt in early February to implement a short squeeze on the spot silver price, following on the WallStreetBets trend of short squeezing certain stocks, caused a temporary spike. However, the silver spot price returned to pre-squeeze levels by the middle of February. Cryptocurrencies gained strongly in the quarter, possibly causing investors to instead chase this massive rally at the expense of gold and other precious metals.

The fund's composition as at 31st March 2021 is given below:

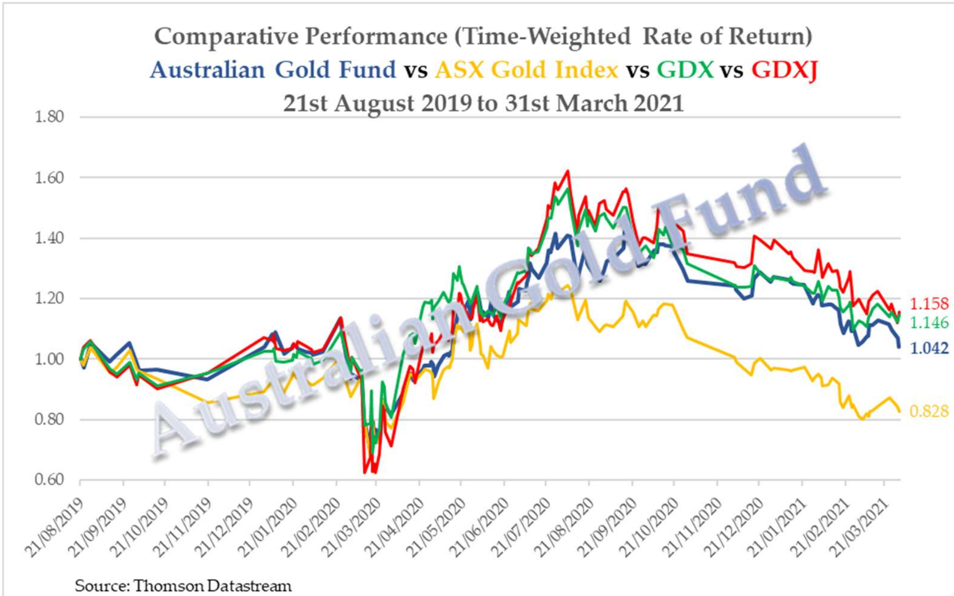
	% Portfolio by Market Value	Range
Cash	2.4%	2-10%
Major and Large Producers	17.7%	0-20%
Mid-Tier Producers	38.7%	0-60%
Junior and Micro Producers	29.2%	0-60%
Developers and Explorers	12.0%	0-10%
Precious Metals ETF	0.0%	0-30%

The Top 5 holdings is given below:

Top 5 Holdings
West African Resources
Ramelius Resources
Westgold Resources
Aeris Resources
Silver Standard Resources

During the quarter, we adopted an aggressive strategy to position our portfolio towards large and mid-tier stocks to capitalise on the seasonal rally for gold mining companies this quarter. We sold out of our ETF positions and increased our holdings in Aeris Resources, Evolution Mining, Oceanagold Gold, Silver Lake Resources, Silver Standard Resources, West African Resources and Westgold Resources. We reduced our holding in Dacian Gold, Kingsgate Consolidate, Kingsrose Mining and Resolute Mining. Our stake in Cardinal Resources was sold to Shandong Gold in their takeover offer, resulting in a 25.8% profit. We also added to our portfolio Alkane Resources and Austar Gold during this period to boost our future gains, taking advantage of the falling prices in gold mining stocks this quarter.

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 (Updated 18th April 2021)

We analyse gold producing companies using the **Valuation to Profit Margin Multiple.** Our empirical studies have shown that the stock price is most aligned to this metric, as opposed to earnings, production, resources and reserves. Our metric is comparable across different classes of gold producers as it standardises by the company's scope of production. We observe that investors prefer companies with higher production and reward them with a higher multiple. The multiple combines the valuation metric, which we use the **EV/AISC-Adjusted Production,** and the **Profit Margin**.

The EV/AISC-Adjusted Production calculates the market value of one ounce of gold produced, adjusted by the All-In Sustaining Cost. The reason for scaling production by AISC is 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. The Profit Margin is the difference between the Realised Sale Price and the AISC.

As a rough guide, the fair value ranges for different mining company classes are as follows:

EV/AISC-Adjusted Production

***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*

Valuation to Profit Margin Multiple

***Major and Large Companies** – 8-12*

***Mid-Tier Companies** – 6-10*

***Micro and Junior Companies** – 3-5*

We believe a multiples method for valuation is more suitable than the typical Discounted Cashflow approach because the latter approach requires projection of cashflows into the future. We consider projection even beyond the next twelve months to be very speculative, especially in mining. We have observed the unreliable nature of management outlook on production and costs after seeing their track record. On top of that, forecasting the gold price and broader economic conditions that impact on the company's performance are also difficult.

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 calculates 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.

We use the management guidance in our valuation input as this is the most objective information to base our estimates. We believe that investors similarly use this information in guiding their analysis and decision making. We recognise taking the management guidance at face value may not always be optimal as they tend to report favourable outlooks and may try to delay bad news. In such cases, we seek to qualify this in our SWOT analysis and adjust it in our Valuation to Profit Margin multiple.

The **Fair Valuation Range** in our reports reflects the price range we consider to be sensible based on the company's performance and the prevailing market conditions. We trade based on this range. We adopt the **margin of safety** approach (refer to Seth Klarman's book of the same title) and hence this range is wider than what typical equity research analysts would use in their reports. Companies trading outside the fair value range are significantly over or undervalued. Investors should look more deeply into the company's operations, financial performance and recent market announcements to determine if the market anticipates a possible re-rating. 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 may not necessarily improve the 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 a company have potential to convert their resources and reserves into cashflows in future. Their success is contingent on 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. We have tried and tested our valuation against the actual price estimates and our investment returns. We let these results speak for themselves.

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.

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