Australian Gold Fund

Performance Report
For Quarter and Year Ending 31st December 2022

Summary

2022 December Fund Performance Statistics				
	Australian Gold Fund	ASX Gold Index (XGD)	Van Eck GDX	Van Eck GDXJ
Quarter Performance	6.87%	27.64%	20.88%	21.66%
Quarter Volatility (%)	27.33%	38.64%	45.64%	51.40%
12 Month Performance	-23.94%	-7.66%	-8.98%	-14.52%
12 Month Volatility (%)	29.95%	36.82%	39.50%	46.00%
Performance Since Inception	-5.45%	-18.90%	4.61%	-6.09%
Volatility Since Inception (%)	34.18%	37.34%	42.57%	51.65%
Quarter % Days Outperform XGD	37.88%			
12 Month % Days Outperform	48.28%			
% Days Outperform Since Inception	50.45%			

The Australian Gold Fund finished the December 2022 quarter underperforming against its peers. Over the year, the fund's returns lagged its peers on two quarters, resulting in delivering the weakest performance against its peers with a loss of almost 24%. The fund beat the ASX Gold Index on only 37.88% of the trading days during the quarter and 48.28% of the trading days over 2022. The fund's volatility of returns continue to remain the lowest against its peers.

Since inception, the Australian Gold Fund has delivered a loss of 5.45%, significantly ahead of the ASX Gold Index and slightly ahead of the Van Eck GDXJ Index, while it trails the Van Eck GDX Index.

The peer indices bounced significantly over the quarter as investors turned to buying gold producers. Many of the leading gold producers continued rising after achieving their lows in late June and July. The gold indices reached their all-time lows for this bear market, but many of these companies managed higher lows. The subsequent bounce brought more gold producers to rally, gaining momentum into December.

The market turned in favour to gold and gold mining companies from late October as the US CPI reading on a year-on-year basis began to slow down. Inflation continues to remain at significantly high levels and the market expects this to continue into 2023. While the Federal Reserve and central banks continue to express concern about the elevated level of inflation, they are aware that there is a need to slow down on the pace of rate rises. The global economy has been shown signs of distress as a result of what may have been the fastest rate rises in the last three decades, with the threat of a global recession turning into a depression. Market investors therefore are anticipating that central banks may possibly end the rate rise cycle or even reverse it earlier than expected. This has led to the recovery in the price of gold and also asset prices.

Gold stocks rallied strongly and gained momentum into December. The leading gold producers including Northern Star Resources, Gold Road Resources and Perseus Mining led the rally with prices approaching or breaking all-time records. Several late-term developers such as Adriatic Metals, Bellevue Gold, Chalice Mining and De Grey Mining have achieved similarly impressive results. In October, the second wave of companies including Evolution Mining, Ramelius Resources, Silver Lake Resources and West African Resources made their

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lows. Several of these companies rose rapidly and caught up with the companies that had reached their lows earlier. The third wave of companies bottomed in December, most of these being explorers.

Looking ahead, it is likely that gold will continue its bullish trend as central banks have now largely spent their monetary policy ammunition to control inflation. The US Dollar Index has decreased more than 5% from its highs in mid-2022 and continues to trend lower as several countries including Saudi Arabia hint at shifting out of the petrodollar system and embracing trade with the BRICS nations using their own currencies for sale of petrol. The threat of a global recession deepening due to weaker business confidence could see governments and businesses pressuring the central banks to adopt a more accommodative monetary policy.

Should the price of oil continue to remain at around US$70-90 a barrel, this could provide gold producers and mining companies in general with lower operating costs and contribute to improving profitability. The outlook for gold stocks in 2023 is therefore very positive. It remains to be seen whether 2023 may be similar to 2019 when producers surged, or 2020 when the rally was across all gold stocks with explorers and developers delivering triple and even quadruple percentage gains.

The fund's composition as at 31st December 2022 is given below:

	% Portfolio by Market Value	Range
Cash	0.7%	2-10%
Major and Large Producers	5.1%	0-20%
Mid-Tier Producers	18.9%	0-60%
Junior and Micro Producers	11.0%	0-60%
Developers and Explorers	57.2%	0-25%
Precious Metals and Tech ETF	7.1%	0-30%

The Australian Gold Fund continued to shift its portfolio more towards the speculative end of the gold stock space, increasing our exposure to developers and explorers to over 55% of our portfolio by market value. We have continued to overweight on this category relative to our mandate as we are wagering that 2023 could be a repeat of 2020. Indeed several explorers and developers – Adriatic Metals, Bellevue Gold, Chalice Mining, De Grey Mining, Southern Cross Gold and Tietto Minerals have registered significant gains from its lows. There also have been several explorers that have gained more than 10% in a day, though many gave back some of its gains in the next few days. This points to speculator interest returning to this space and soon this buying wave will overwhelm those who are selling into the initial recovery.

Our Top 5 holdings are given below:

Top 5 Holdings
Kingsgate Consolidated
ETFS Short NASDAQ Index
Oceanagold Corporation
Red Dirt Metals
West African Resources

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https://www.goldfund.com.au

While the markets improved into the final quarter of 2022, our fund shifted its holdings by taking some profits from gold producers that rallied to increase our exposure to the ETFS Short NASDAQ Index and also several late-stage explorers and developers. The fund seeks to invest one or two quarters ahead of the crowd by adopting this strategy. We were weeks behind in seeing the bottom for the first wave of gold producers and moved in line with the market in the second wave. However, the most lucrative gains in a gold bull market lie in the speculative end. We have identified several companies with upcoming developmental milestones that could see its shares deliver explosive gains if conditions are right. We have therefore positioned ourselves to try and capitalise on this.

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

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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.

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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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