Australian Gold Fund

Performance Report

For Quarter and Year Ending 31st December 2023

Summary

2023 December Fund Performance Statistics				
	Australian Gold Fund	ASX Gold Index (XGD)	Van Eck GDX	Van Eck GDXJ
Quarter Performance	13.38%	18.06%	17.12%	18.48%
Quarter Volatility (%)	21.68%	30.27%	31.63%	35.70%
12 Month Performance	3.55%	26.87%	9.96%	7.13%
12 Month Volatility (%)	21.84%	28.29%	29.89%	33.10%
Performance Since Inception	-1.84%	2.90%	15.03%	0.60%
Volatility Since Inception (%)	31.80%	35.47%	40.01%	48.03%
Quarter % Days Outperform XGD	50.77%			
12 Month % Days Outperform	45.38%			
% Days Outperform Since Inception	49.44%			

The Australian Gold Fund delivered a positive return for the 2023 December quarter with a gain of over 13%. However, it underperformed against all the benchmark gold stock indices.

Our fund outperformed the ASX Gold Index on 50.8% of the trading days this quarter. However, it underperformed the index over the past year. It also marks the fifth consecutive quarter of our fund's underperformance against the ASX Gold Index.

Since inception, the Australian Gold Fund continues to lag behind the other gold indices delivering a cumulative return of -1.8% while the benchmark indices delivered a modest positive return. This result comes from our portfolio's strong bias towards gold mining companies in the early stages of the mining lifecycle.

We choose to remain steadfast with this strategy as we believe that the early stage gold mining companies will deliver the best potential returns in the coming year. As this fund comprises exclusively of our family's assets, we do not face undue external pressure to cause us to deviate from our target.

The historical quarterly performance for the Australian Gold Fund is given below:

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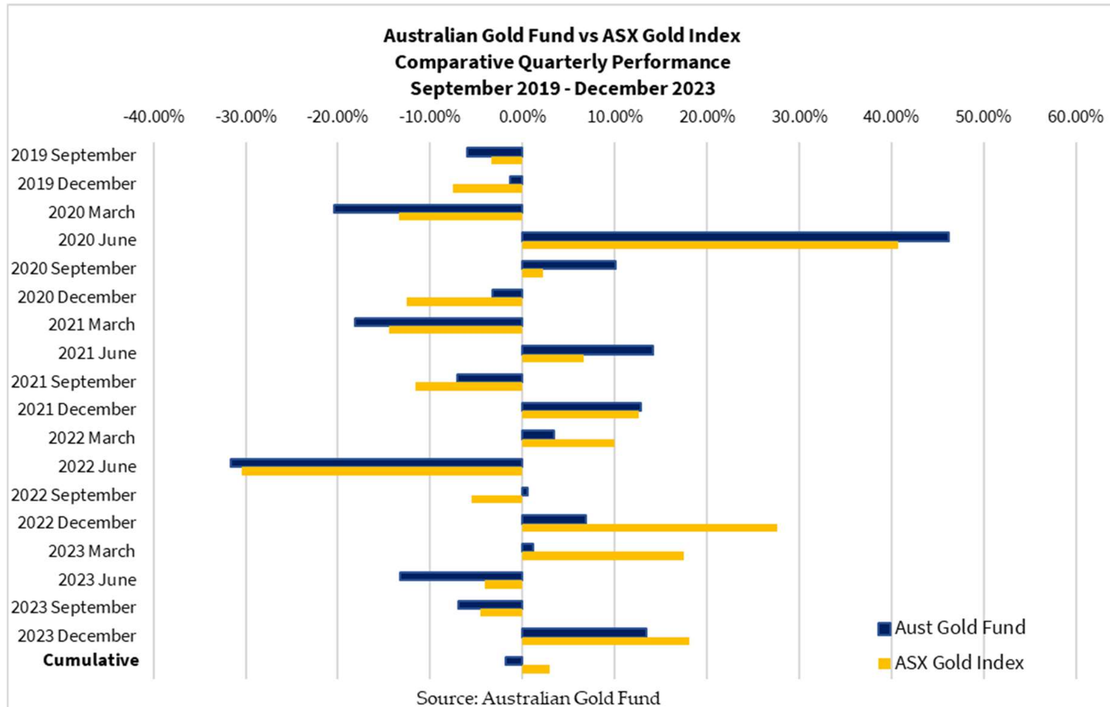

Our fund's returns currently trails the ASX Gold Index by 4.5%.

We note that our 2023 September Quarter Performance Report contains an error where it states that our returns lag the ASX Gold Index by 10%. Upon revision, it trailed the ASX Gold Index by less than 1%.

As discussed above, our underperformance largely spans from our preference to increase our exposure to less established gold mining companies. During the quarter, we continued to slightly reduce our exposure to the larger producers to shift to developers and the marginally profitable gold producers. This is because we anticipate that gold will continue to rally in 2024, boosted by the prospect of several rate cuts from the US Federal Reserve.

During this quarter, gold staged a solid bounce that was a result of the outbreak of the Israel-Palestine conflict in early-October. The prospect of another military conflict provided gold with a war premium. At the same time, the US Dollar Index retreated almost 5% over the quarter as US headline inflation continued to slow as you can see below:

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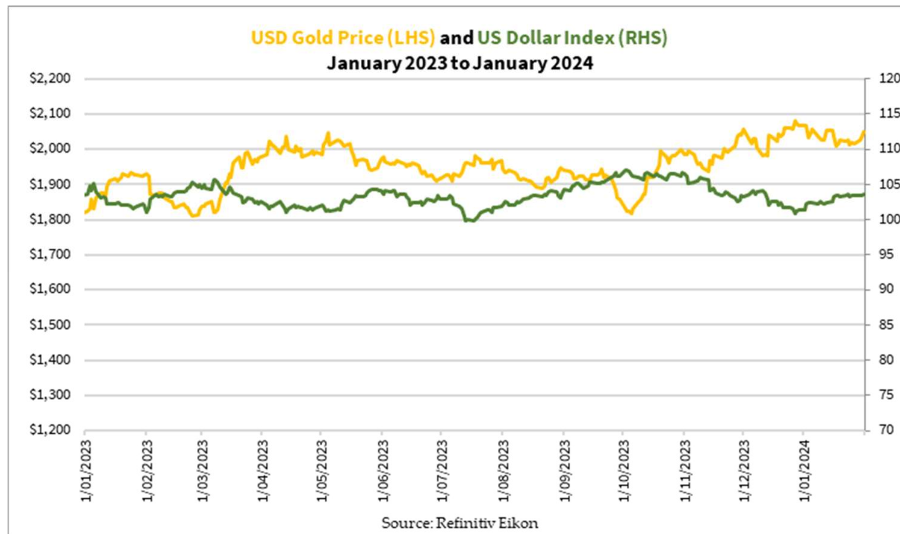
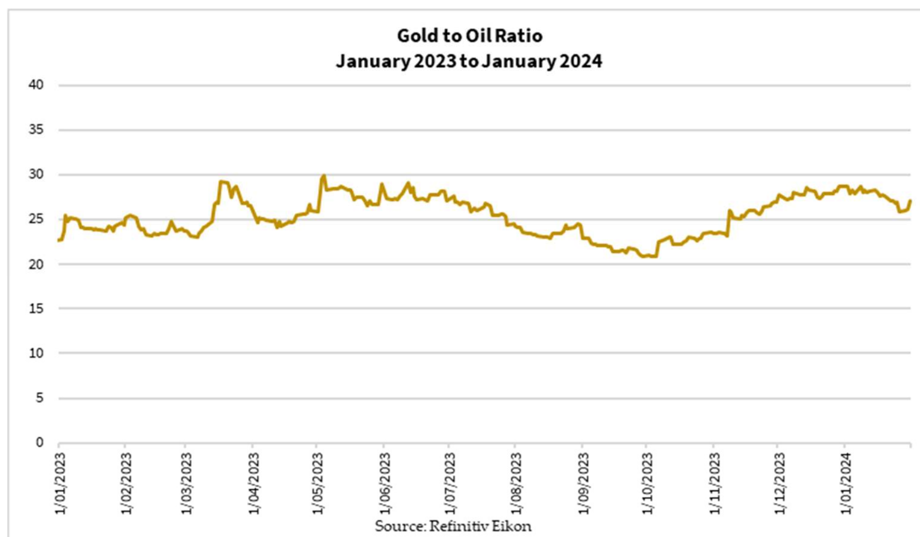


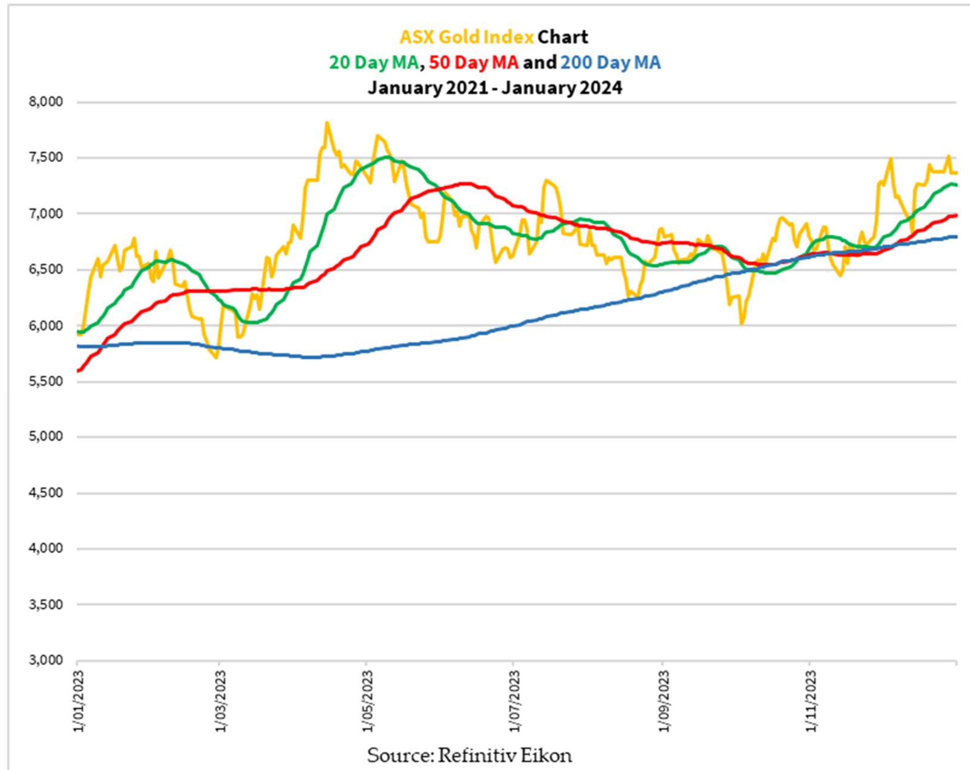
This caused market investors to anticipate rate cuts will come earlier. The US Federal Reserve indicated in December that the rate rise cycle was over and it was reviewing when to start cutting rates to encourage more business activity.

At the same time, the price of oil fell during the quarter. The rising price of gold and a falling price of oil helped boost the gold-oil ratio. It rose from 21 to 28 during the quarter, as seen below:



This was a very encouraging quarter given the strong rising trend with the gold-oil ratio. When you look at the gold-oil ratio since June, this quarter was almost a mirror image of the last quarter.

As expected, the rising gold-oil ratio helped boost the ASX Gold Index. The index staged a 20% recovery over the quarter, bouncing from its lows of just over 6,000 points at the close of the previous quarter. It ended the year at its highest level since early May. You can see the index performance below:



The ASX Gold Index recovered almost 25% from its lows in the late-September to the end of 2023. All the moving average trendlines showed a positive setup going into 2024. However, with the benefit of hindsight, the index was trading well aboe the 50-day moving average. The index was stretched from a technical perspective, although supported by the fundamentals.

Now we will look at the Speculative Gold Stocks Index which is our in-house proxy metric for the performance of explorers and early-stage developers. The figure below shows the index performance over the past year:

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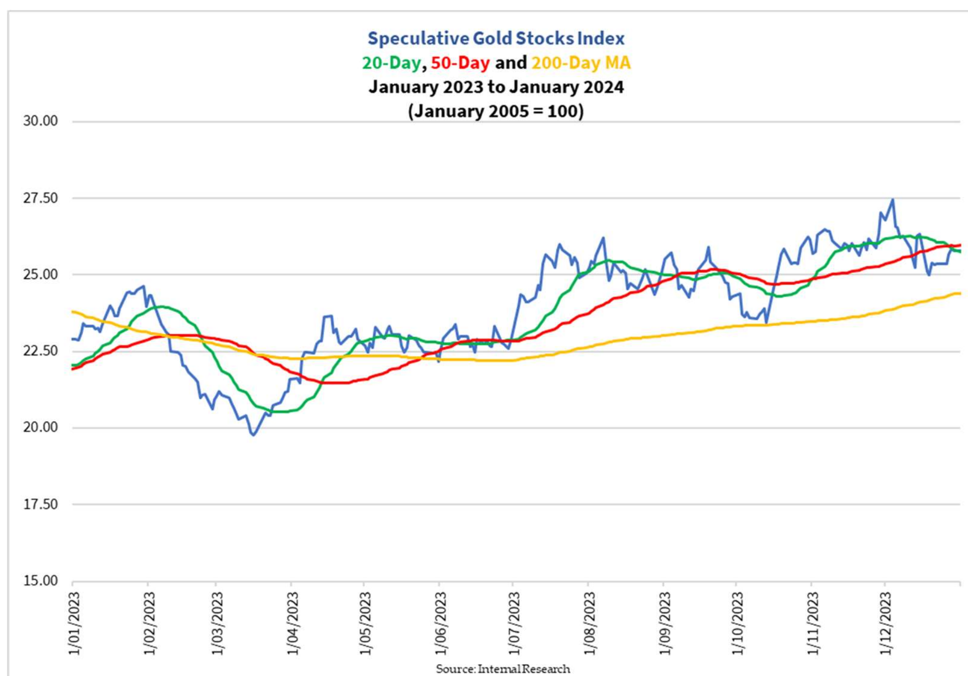

During the quarter, gold stocks in the earlier stages of the mining lifecycle rallied. At one stage, the index was up by almost 20%. However, the index corrected by 10% during December. Therefore, it ended the quarter underperforming relative to the more established producers.

Part of this underperformance comes from several explorers needing to raise capital. The extended period of the weakness in this section of the market meant that many explorers were facing liquidity constraints. Some companies even made new lows during this quarter, even though the index is trading almost 30% higher than the bottom in March 2023.

Several companies were hoping for an earlier recovery in the price of gold and gold stocks to ride the boom. Even though these explorers ended the quarter in a technical bull market, many still found it difficult to access funds without having to offer their shares at a steep discount.

The technical setup of the Speculative Gold Stock Index ended the quarter much weaker than the ASX Gold Index. Similar to the more established gold producers, gold explorers are currently deeply undervalued, although significant risks remain.

The Australian Gold Fund considered the relative risk-reward ratio with these companies and believed that it was worthwhile to shift our portfolio more towards this space.

The fund's composition as at 31st December 2023 is given below:

	% Portfolio by Market Value	Range
Cash	-0.5%	2-10%
Major and Large Producers	12.3%	0-20%
Mid-Tier Producers	36.2%	0-60%
Junior and Micro Producers	12.9%	0-60%
Developers and Explorers	37.1%	0-25%
Precious Metals and Tech ETF	1.9%	0-30%

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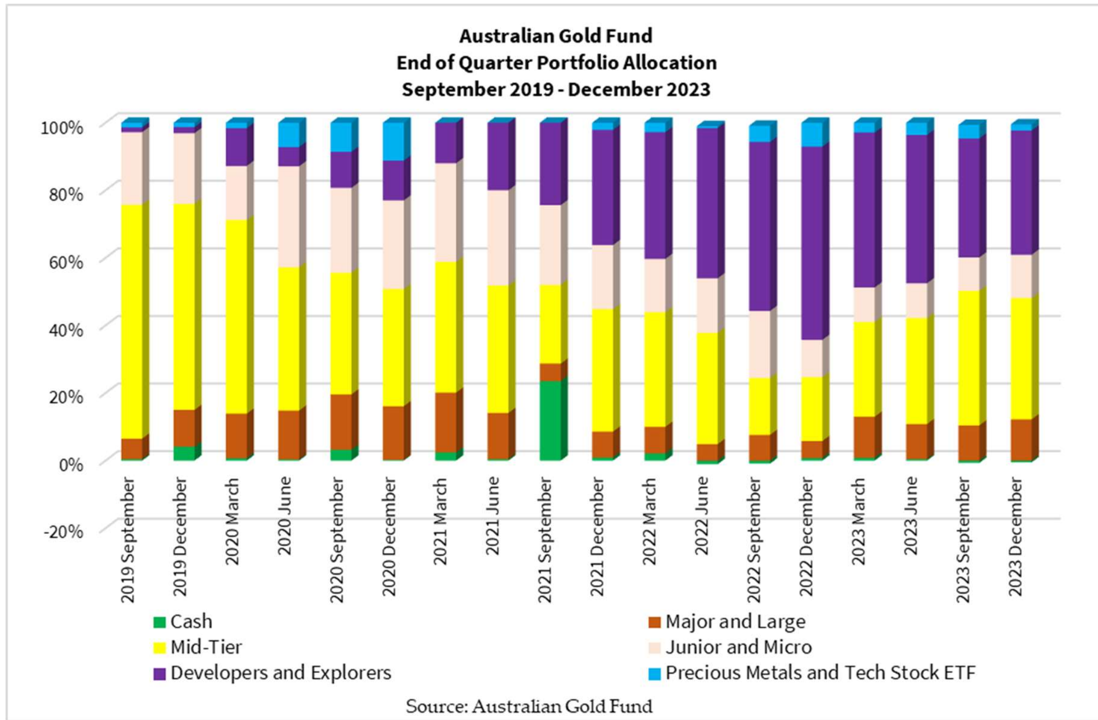
Our historical allocation is in the figure below:



The Australian Gold Fund's allocation to producers increased slightly during the quarter. Our exposure to explorers and developers similarly increased as we reduced our exposure to precious metals ETFs. Furthermore, gold producers had a stronger quarter than explorers and developers, which offset our trades that increased the number of units held in these stocks.

Among the producers, we took some profits in mid-tier producers that have delivered proportionally better performance than the major, large and junior producers. We deployed some of the capital to large and junior producers that have marginally profitable operations. This is to increase our chance of leveraging off the turnaround in the mining sites.

Our Top 5 holdings are given below:

Top 5 Holdings
Oceanagold Corporation
Kingsgate Consolidated
Westgold Resources
Ramelius Resources
West African Resources

Our fund ended the quarter with the Top 5 holdings comprising only of gold producers. Kingsgate Consolidated became our 2nd largest holding, overtaking Westgold Resources and Ramelius Resources. Our 5th largest holding was West African Resources, which replaced Red 5 during the quarter as we reduced some of our Red 5 holdings as its shares traded above 30 cents.

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Our fund took some profits in Westgold Resources and Ramelius Resources during the quarter, with the former outperforming its peers significantly thanks to its unhedged gold position.

In mid-December, Regis Resources announced that it would pay $98 million to close out its forward gold sales contracts which were on average worth $1,571. This is almost half the current price. Given this move, we added to our holdings.

Looking at the big picture, our fund continued to reduce some of our holdings in gold producers that have recovered the most since October 2022. The funds from these sales went to the more speculative explorers and developers as we seek to capitalise on these stocks' higher potential gains when the bull market gains momentum in this space.

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,

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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

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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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