Australian Gold Fund

Performance Report

For Quarter and Year Ending 30th September 2023

Summary

2023 September Fund Performance Statistics				
	Australian Gold Fund	ASX Gold Index (XGD)	Van Eck GDX	Van Eck GDXJ
Quarter Performance	-6.97%	-4.54%	-10.63%	-9.60%
Quarter Volatility (%)	19.66%	24.76%	27.56%	30.35%
12 Month Performance	-12.20%	29.61%	-0.04%	1.27%
12 Month Volatility (%)	23.27%	30.72%	34.14%	37.88%
Performance Since Inception	-22.80%	-12.84%	-1.78%	-15.09%
Volatility Since Inception (%)	32.31%	35.76%	40.46%	48.67%
Quarter % Days Outperform XGD	52.31%			
12 Month % Days Outperform	42.08%			
% Days Outperform Since Inception	49.23%			

The Australian Gold Fund finished negative again for the 2023 September quarter with a loss of almost 7%. It underperformed against the ASX Gold Index but outperformed the US gold stock indices.

Our fund outperformed the ASX Gold Index on 52% of the trading days this quarter. However, it underperformed the index over the past year. This is because the ASX Gold Index has a higher exposure to larger producers. These companies recovered from its bear market bottom last October, ahead of its peers.

Since inception, the Australian Gold Fund continues to lag behind the other gold indices. Our current returns is -22.8%. This is because our company has overweighted our exposure to gold explorers and developers. These companies have generally generated negative returns at low to no trading volume.

In hindsight, we moved early in these trades as prices have fallen since our purchases.

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

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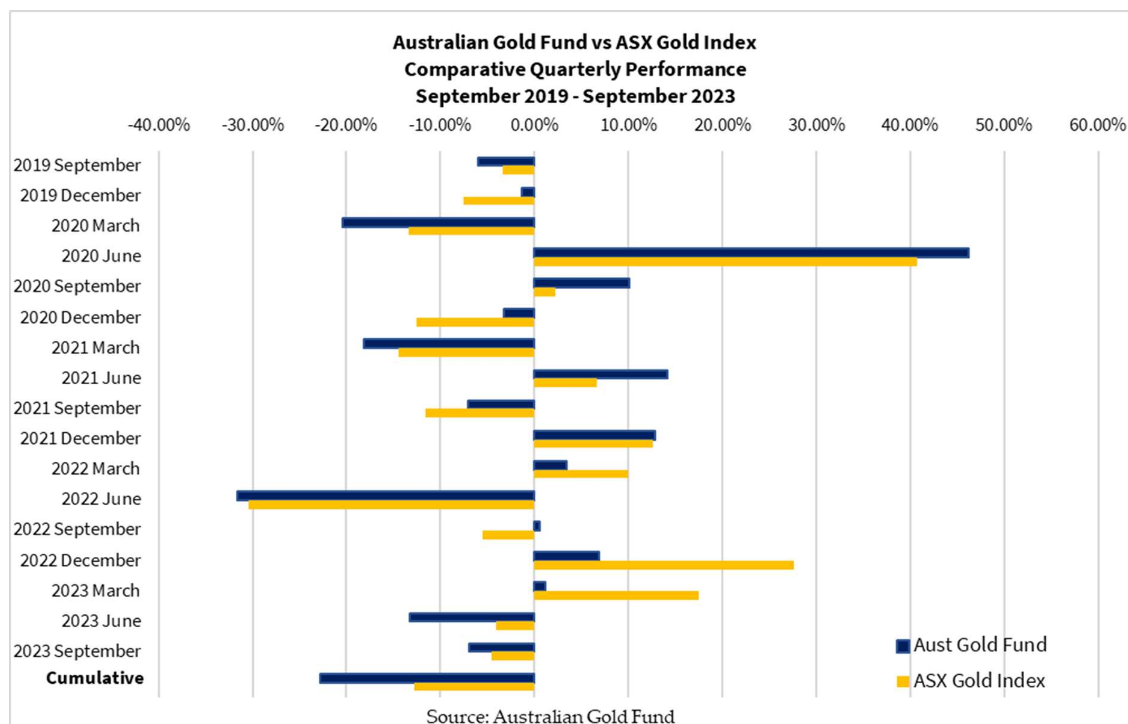

Our returns since inception is just under 10% below the ASX Gold Index.

It has underperformed the ASX Gold Index in the past four quarters. Out of 17 quarters, we have beaten the ASX Gold Index on 8 quarters.

This is a disappointing result, although we remain positive as we remain firm with our portfolio strategy.

We opted to increase our exposure towards early-stage mining companies. This is because we see how these companies are currently deeply unloved and present substantial upside potential in the future. These companies have experienced an extended bear market which has made them more attractive buys.

This strategy has not yet paid off but there are signs to suggest that this could change soon. We expect that our fund's performance will more than compensate for the poor results in the turnaround for gold explorers and developers. Therefore we continue to increase our exposure to these companies.

The price of gold fell during the quarter ending September 2023 as the US Dollar Index continued to draw from the rising momentum since July as you can see in the figure below:

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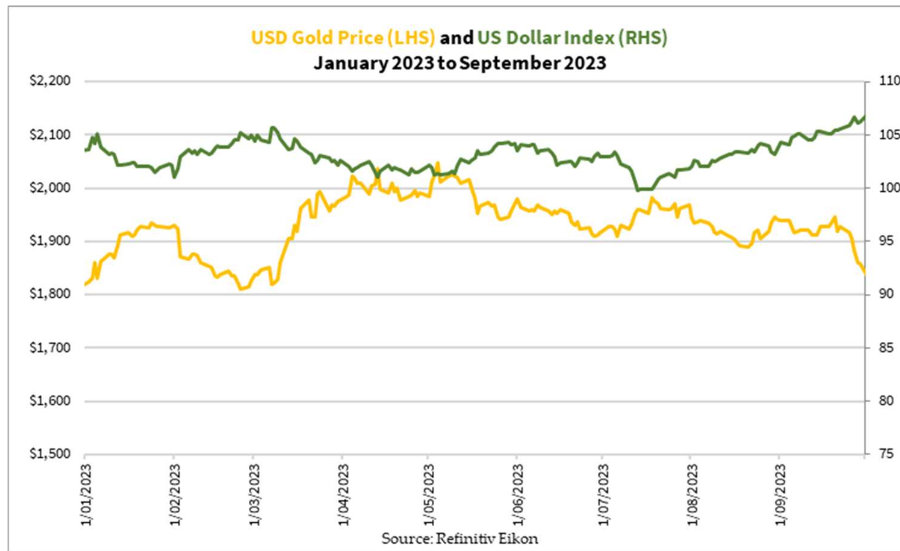
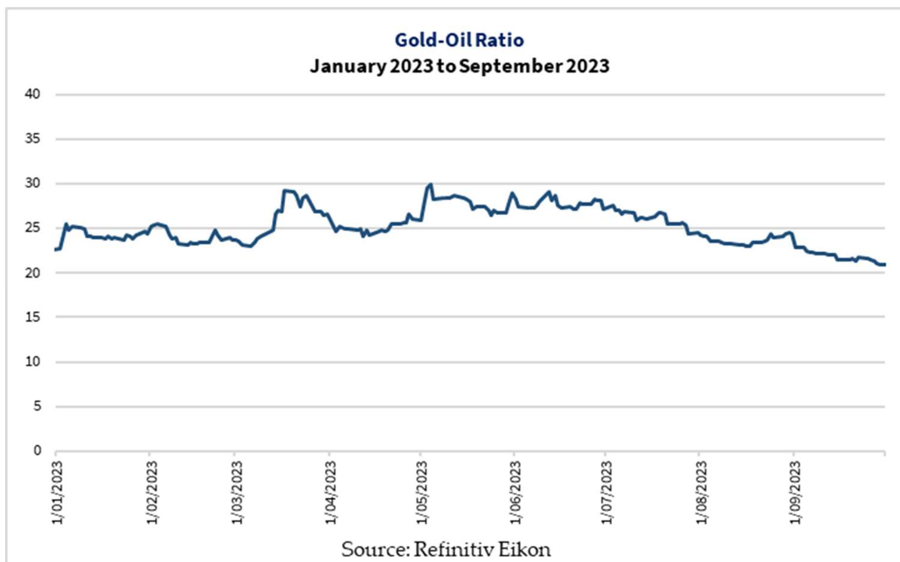


A rising price of oil contributed to the gold-oil ratio falling during the quarter, as seen below:



A weaker price of gold and falling gold-oil ratio led to both a fall in the expected profitability of gold producers and weakening investor sentiment towards gold mining companies. Therefore, the ASX Gold Index continued its bearish trend as seen below:

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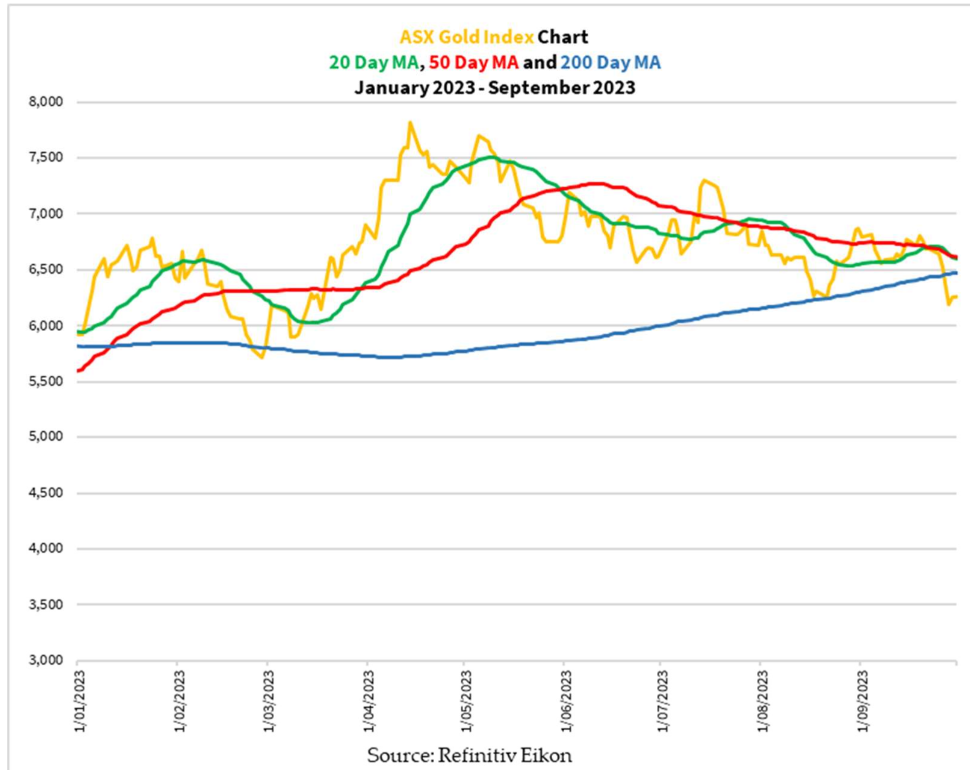

During the quarter, the index declined as the gold-oil ratio consistently fell from around 27 to 21. Market sentiment was hit further by the underwhelming 2023 June quarter results in July.

While several producers delivered higher production that was out of trend, the market saw through this window-dressing and focused on the 2024 guidance. Some of the leading mid-tier producers including Ramelius Resources, Regis Resources and Silver Lake Resources highlighted a marked decline in the coming year's production and higher operating costs. In some cases, their shares fell more than 10% on or around the news release.

Despite the bearish sentiment for the index, the long-term trend remains bullish as shown by the rising 200-day moving average line. The index fell significantly in the final week of the quarter, ending the quarter at its lowest level.

On the other hand, the trend in the Speculative Gold Stocks Index is slightly different as shown in the figure below:

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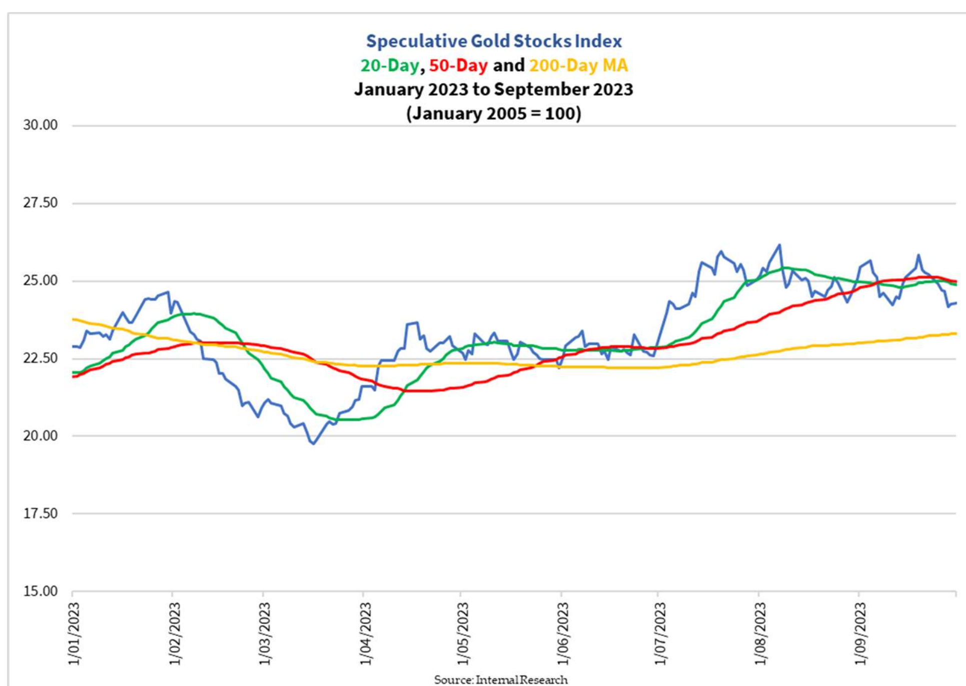

Gold explorers and developers as a group appeared to have bottomed in mid-March this year. It bounced during March to April and again during July. However, disappointing performance from gold producers for the 2023 June quarter suppressed market interest for gold explorers. This is why the index traded at a tight range.

We are encouraged by the bullish setup of the Speculative Gold Stocks Index as shown by the rising moving average trendlines and the index trading above the 200-day moving average. Since the end of the quarter, the index is setting up for a breakout.

It is worth noting that the index is weighted more towards larger explorers with a market value exceeding $100 million. These companies were able to gain ground during the quarter. Many smaller explorers with market value less than $30 million made new lows as there was capitulation selling.

The fund's composition as at 30th September 2023 is given below:

	% Portfolio by Market Value	Range
Cash	-0.7%	2-10%
Major and Large Producers	10.5%	0-20%
Mid-Tier Producers	40.3%	0-60%
Junior and Micro Producers	10.0%	0-60%
Developers and Explorers	35.7%	0-25%
Precious Metals and Tech ETF	4.1%	0-30%

The Australian Gold Fund's allocation to producers increased during the quarter. Besides mentioning earlier in this report that this arose from our developers and explorers underperforming this quarter, several developers and explorers were incorporated into producers as they were taken over.

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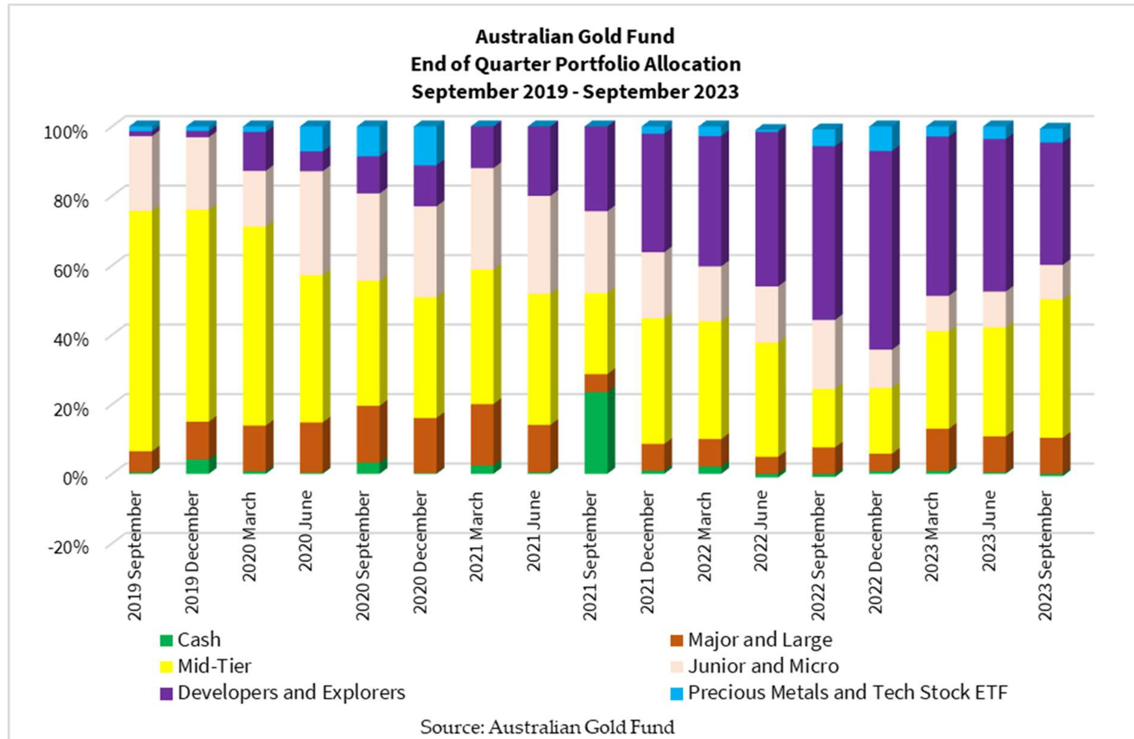
Genesis Minerals became a mid-tier producer after taking over the Leonora operations from St Barbara Mines in late July.

Kingsgate Consolidated poured its first gold during this quarter.

We accepted Ramelius Resources' offer for our Musgrave Minerals shares in August.

Our historical allocation is in the figure below:



In the past six quarters, the Australian Gold Fund has increased its exposure substantially towards developers and explorers. This is because we are seeking to capitalise on the upside potential of these companies. As mentioned before, this strategy has largely resulted in paper losses. We have continued to double down on this strategy as we see the Speculative Gold Stocks Index set up for a bullish phase in 2024.

Our Top 5 holdings are given below:

Top 5 Holdings
Oceanagold Corporation
Westgold Resources
Ramelius Resources
Kingsgate Consolidated
Red 5

This quarter saw our Top 5 holdings comprising only gold producers. This was a sharp change from the previous quarter when we had three non-producer companies that formed our Top 5 holdings.

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Musgrave Minerals was taken over by Ramelius Resources during the quarter. We subsequently sold a small parcel of Ramelius Resources to allocate to other explorers and developers.

We took part profits on Delta Lithium as it rallied to almost $1, shifting our holdings to mid-tier gold producers and early-stage developers.

Meanwhile, our holdings in Black Cat Syndicate increased but the price plummeted by over 40% as it raised capital in late-August and announced a funding package for the development of the Paulsens mine the following month, just before the end of the quarter. Our confidence in the company has strengthened, despite mounting paper losses.

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.

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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.

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