

## Australian Gold Fund Performance Report For Quarter Ending 30<sup>th</sup> September 2024

**Strong quarter for established gold stocks as gold breaks out to new highs**

2024 September Fund Performance Statistics				
	Australian Gold Fund	ASX Gold Index (XGD)	Van Eck GDX	Van Eck GDXJ
Quarter Performance	12.32%	19.49%	17.35%	15.87%
Quarter Volatility (%)	24.31%	24.96%	31.14%	36.02%
12 Month Performance	39.97%	41.85%	50.39%	52.53%
12 Month Volatility (%)	24.84%	25.65%	31.33%	35.52%
Performance Since Inception	21.49%	23.64%	47.71%	29.50%
Volatility Since Inception (%)	30.78%	34.47%	38.84%	46.38%
Quarter % Days Outperform XGD	43.94%			
12 Month % Days Outperform	42.62%			
% Days Outperform Since Inception	49.31%			

The Australian Gold Fund rose 12.32% for its fourth consecutive quarter of gains, but underperformed the ASX Gold Index and other benchmark indices.

As in previous quarters, the Australian Gold Fund's exposure to the more speculative gold stocks, namely explorers and early-stage developers, led to this result. That said, the fund's exposure to some of these companies saw strong returns as they started rallying during and after the quarter.

The key drivers for the strong quarter for gold stocks included the first rate cut by the US Federal Reserve in four years, occurring in the September meeting. A week prior to the meeting, headline inflation fell to 3% and core CPI fell to 3.2%. This led to the Federal Open Market Committee to cut the Federal Funds Rate by 0.5%.

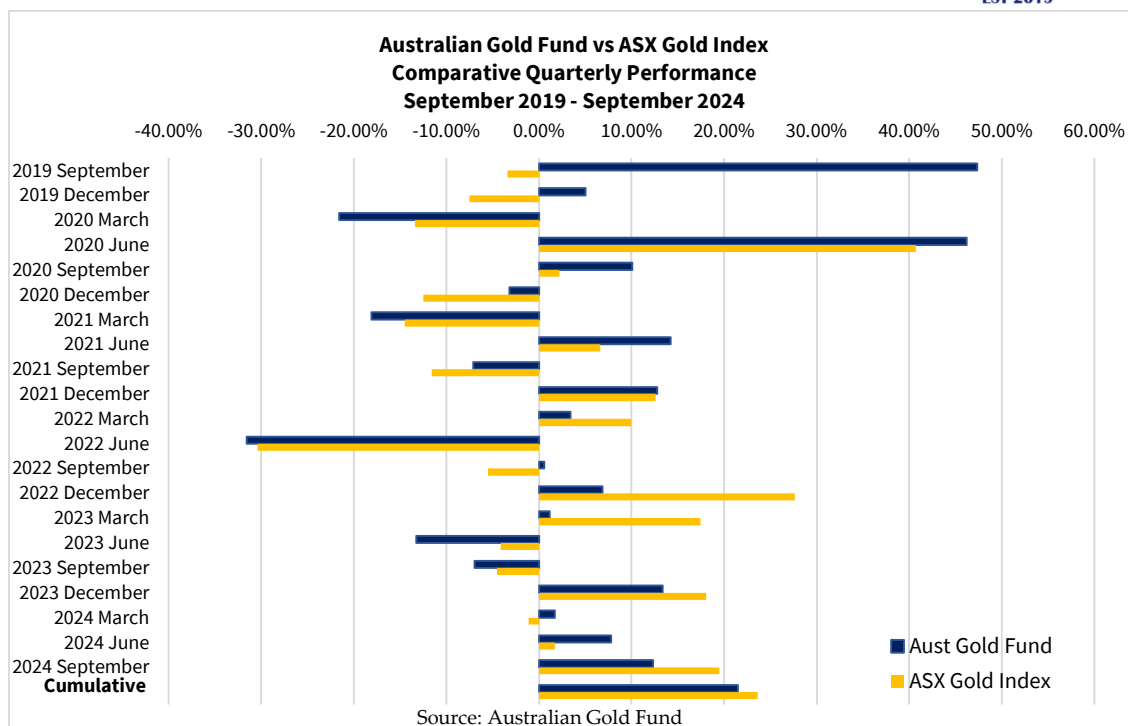
Further boosting the rally in gold stocks was gold continuing its record run while the price of oil fell. The gold-oil ratio rose from 28.7 to 38.8 during the quarter, taking it to levels not seen since the start of 2021.

During the quarter, the fund realised significant capital gains by selling gold producers, and reallocating some of these profits to early-stage and late-stage developers.

We believe the gold stock bull market will help speculative gold stocks deliver substantial returns in the future, exceeding that of the established gold producers. That is why we adopted an aggressive position in our fund. But for now, our fund continue to lag the benchmark indices.

### **Reversing the trend and building momentum for a strong year**

We present our historical quarterly performance below:



The fund started this quarter strongly, following gold's bounce at the end of June. It reached as high as almost US\$2,470 in mid-July before pulling back. By mid-July, the fund was up almost 10%, which was on par with the benchmark indices. However, the Federal Reserve held its interest rate steady at the end of July, bringing gold and gold stocks back to a similar level as at the end of the June quarter.

Gold resumed its ascent in August and September. Gold stocks attempted to follow gold but only broke out of its three-year resistance level following the rate cut in mid-September. Most gold producers and late-stage developers rallied in this round, but most speculative gold stocks did not receive the same level of buying interest. Therefore, we took this opportunity to sell part holdings of the leading gold producers to redeploy to speculative gold stocks.

Stocks we owned that rose the most during the quarter were Catalyst Metals (143.4%), Meeka Metals (84.85%), St Barbara Mines (80%) and Rex Minerals (78.85%). Accounting for our exposure, our best performers were Black Cat Syndicate (50.8%), Catalyst Metals, Meeka Metals and Spartan Resources (46.2%).

## Gold snubs pivotal events and geopolitical tensions, pre-empting the US Federal Reserve's belated rate cuts

Several historical events occurred during the quarter.

In the US, two events left its mark in history, even changing its course. The first was on 13<sup>th</sup> July, with the attempted assassination of President Donald J. Trump at a rally in Butler, Pennsylvania. An investigation revealed the failures of the US Secret Service to protect a presidential candidate. Furthermore, a deeper dive into the communications between the

Biden administration and the leadership at the US Secret Service showed the lengths to which President Trump's opponents would go to derail his campaign.

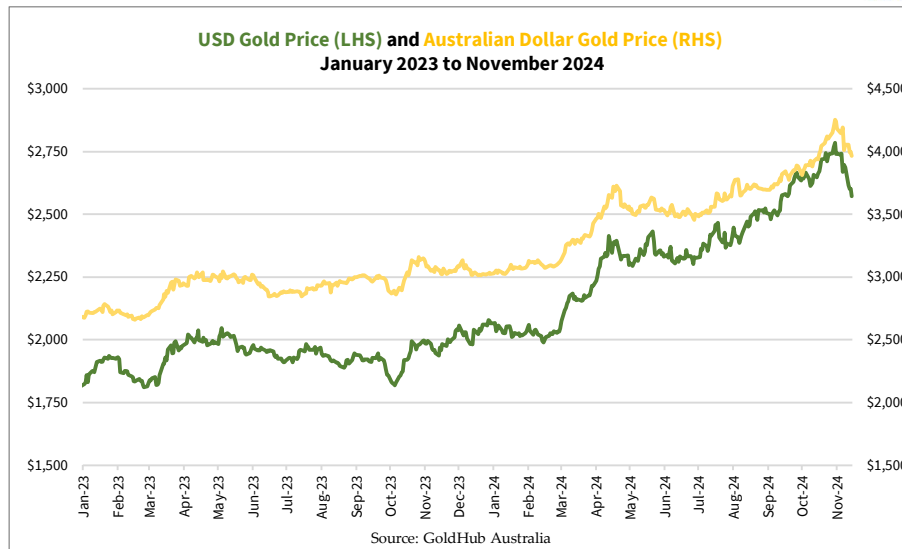
Within days of this incident, the Democrat Party used this and the poor performance at the Presidential Debate at the end of June to blatantly and unceremoniously remove their installed White House Resident, Joe Biden, as the 2024 nominee. The party then replaced him with his running mate, Kamala Harris, who was confirmed at the Democrat National Convention on 22<sup>nd</sup> August.

Outside of the US, the United Kingdom held its general election on 4<sup>th</sup> July, with the Labour Party winning a landslide victory. It secured 412 seats out of 650, sweeping the incumbent Conservative Party out into the wilderness. While the Labour Party won a near supermajority, it garnered just over one-third of the votes. The Conservative Party was defeated largely because many of its supporters voted for the Reform Party UK, which polled third with just under 15% of the vote. The United Kingdom stood out among western countries by having voted for a more progressive government. This contrasted with many European nations that replaced such governments in recent elections and shifted towards nationalism and conservative values.

Meanwhile, the Russia-Ukraine conflict continued as the West's hope for a stalemate dimmed following a series of strategic defeats for Ukraine. Many western countries became reluctant to send further funds and munitions. At the same time, the western media abandoned their overtly pro-Ukraine stance, even beginning to report how Ukraine is facing imminent defeat. Our tongue-in-cheek view is that even if Taylor Swift were to promote Ukraine in her Eras Tour, that would still not garner enough support to turn the tide in this conflict.

As for the Middle East, the Israel-Palestine conflict began to spread as Iran and Lebanon joined the fray. Israel attacked both nations as payback for their support of Hamas and Hezbollah who are fighting against them, using a new generation of precision warfare. Many Hezbollah senior ranking personnel experienced this in mid-September when their mobile communication devices exploded after receiving a mysterious call, which we were sure didn't come from telemarketers peddling a better electricity or gas plan.

Despite many unexpected events that generated uncertainty and instability, gold chose to stay laser-focused on the economy. Gold waited for the US Federal Reserve to spring the trap by announcing its first rate cut to secure its dominant position against the US dollar:



It even moved ahead in July ahead of the Federal Open Market Committee meeting at the end of the month. However, the FOMC thwarted gold's rally a few days before, pushing gold down temporarily. This move was temporary, with gold resuming its rally soon after.

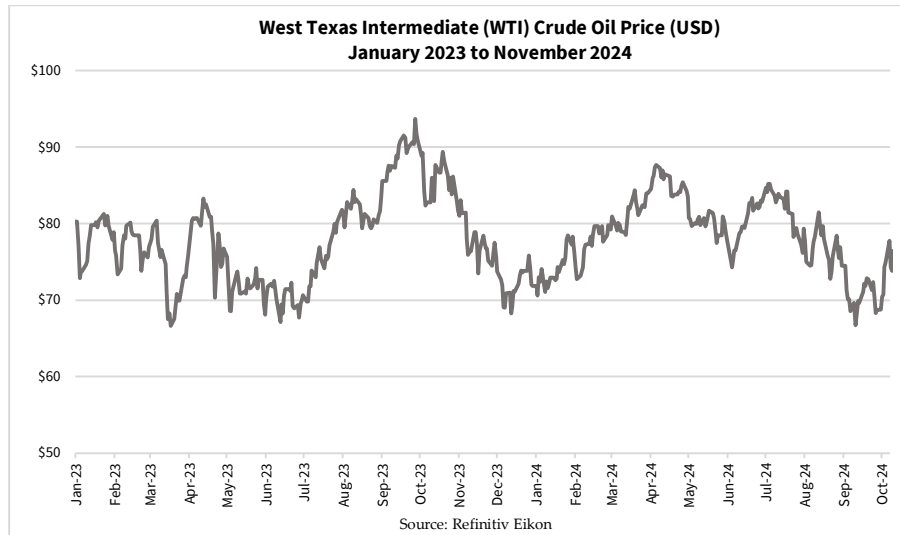
The Federal Reserve was backed into the corner by September, given it was facing the upcoming US election and signs that the economy could not withstand the weight of debt crushing the system. Gold rallied above US\$2,500 before the Federal Reserve met and announced a 0.5% rate cut. By the end of the month, gold was past US\$2,600, with enough momentum to break above US\$2,700 and even US\$2,750 in October.

Gold's move in the past 18 months was always about the weakness of the global economy and the petrodollar system. Wars, geopolitical tensions and civil unrests may favour gold and boost its price. But gold's sustained rally comes from the continual depreciation of the US dollar and other currencies, assured by growing debt, unbridled deficit spending and wastage.

This assertion was confirmed after President Trump and the Republican Party achieved a clean sweep in the US election, taking the White House, the House, and the Senate, as well as winning the popular vote. With the America First policy securing the mandate, the market quickly bought the US dollar and sold gold.

Will this last? Or is this a relief rally? We shall find out in the next four years. We expect much volatility and fakeouts in the next three months leading up to and after President Trump's inauguration.

## Bullish Gold-Oil Ratio trend points to better operating margins for producers

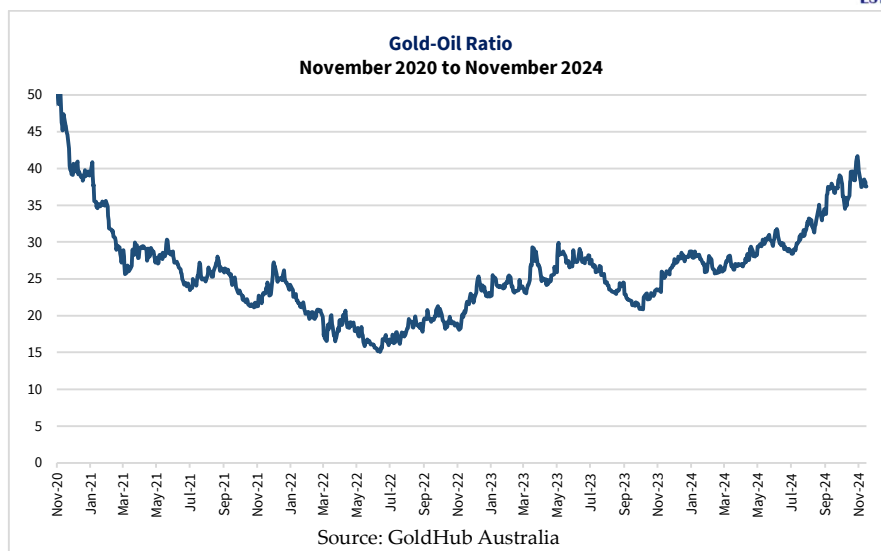


During the quarter, the price of oil rose above US\$80 a barrel and went as high as US\$85. This did not last long as it retreated to US\$75 by the end of July, remaining below this level for the rest of the quarter. Despite continuing conflicts in the Middle East and fears that Israel would plunge into direct conflict with Iran, Lebanon and Syria, the conflict remained under control.

At the same time, the demand for oil reduced in many countries as businesses and households felt the brunt of inflation and massive debt levels. The global economy continued showing signs of a recession. Businesses reduced investment and laid off staff. Households cut down on spending as income barely rose. The massive debt levels caused residential and commercial property prices to weaken in many places.

But the most telling sign of economic weakness comes from central banks starting their cycle of cutting rates. They do this to boost liquidity and increase business activity. But like what happened in previous rate-cutting cycles, it will likely spur more inflation and redistribute wealth from the poor to the rich.

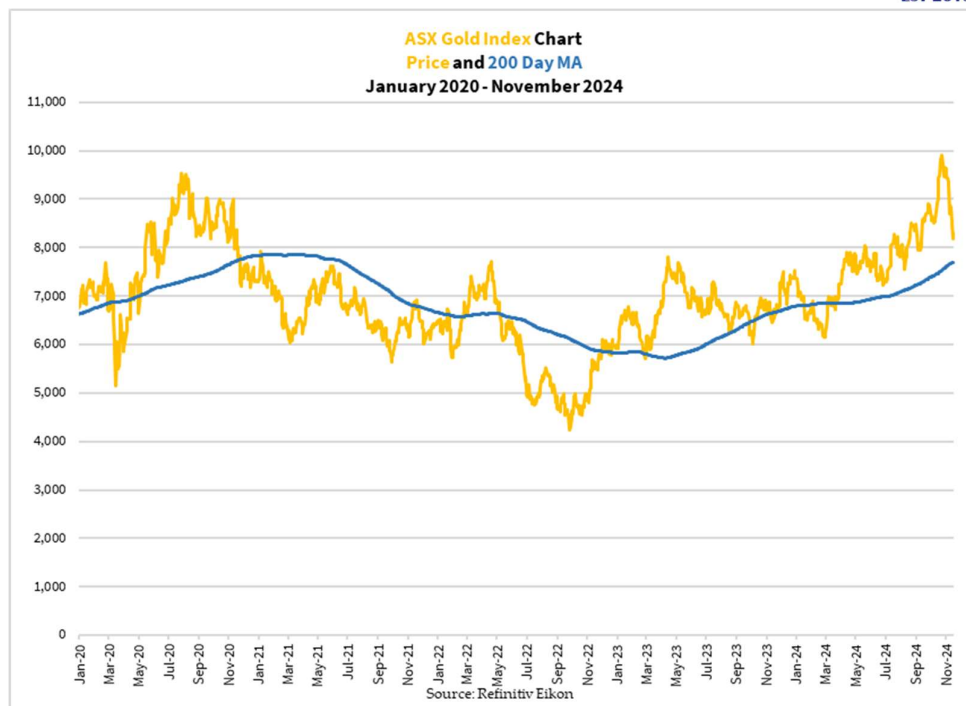
The rising price of gold, coupled with a retreat in the price of oil, propelled the Gold-Oil Ratio from 28.7 to 38.8 during the quarter, as seen below:



The positive trend for the Gold-Oil Ratio means gold producers have operated in the best environment over the past four years. The operating margins for the 2024 June quarter were the best seen since 2020, rising to an average of 42.3%. As the Gold-Oil Ratio continues to hold above 30, gold producers will be delivering above-average operating margins. This, in turn, should attract more general investor interest as gold mining becomes one of the most profitable industries.

#### **Gold producers – Strong operating margins and first Federal Reserve rate cut fuels rally**

Moving to gold stocks, the ASX Gold Index finally broke its major resistance level of 8,000 points and was heading to 9,000 points by the end of the quarter. As you can see below, the index succeeded on its third attempt in September, after the Federal Reserve's rate cut:



Since late June, the ASX Gold Index has followed a pattern of rallying around 1,000 points from its previous low before retracing 600-700 points and resuming its rally. Investors were twice disappointed in mid-July and mid-August when the ASX Gold Index looked ready for a rally after breaking above 8,000 points before giving back its grounds. September proved to be third time lucky as the base was set just below 8,000 points and the momentum of this upswing took it nearly to 9,000 points by the end of September. Unlike the previous quarter when the ASX Gold Index started well and ended weak, this quarter finished on a high note.

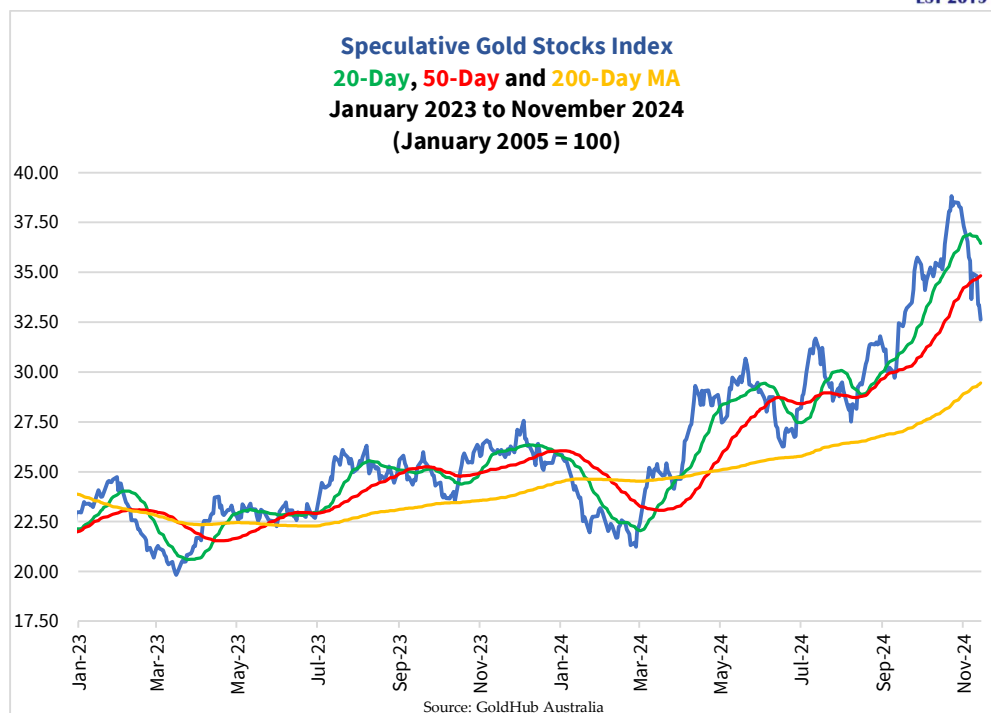
The ASX Gold Index set a new record in October, and was within inches of trading at 10,000 points.

Capricorn Metals, Emerald Resources and West African Resources, being the producers with the highest operating margins, set new highs during the quarter. However, Northern Star Resources, the largest Australian gold producer, had to wait until late-September to break its 2020 record.

This quarter's biggest gainers were mainly junior producers and developers. Given the higher price of gold improved their operating margins, these companies closed the gap as investors took renewed interest in their potential to deliver solid gains.

### **Gold explorers and developers – Strong trends remain, but many still lag behind**

We now move to the Speculative Gold Stocks Index, our in-house proxy metric for the performance of explorers and early-stage developers. The graph below shows the index performance since 2023:



The index mirrored the moves of the ASX Gold Index. Still, only a handful of explorers and early-stage developers with promising projects, regular news flows, and solid cash balances lifted the index.

The disparity was significant, with companies we own, like Black Cat Syndicate, Maximus Resources, Meeka Metals, Rex Minerals, and Southern Cross Gold delivering solid gains during the quarter. Most companies in this space traded thinly, if at all. Some rose by double-digit percentage points in a day, only to pare back shortly after.

These conditions are what investors would see in a bear market, rather than a bull market. For this reason, while the Speculative Gold Stocks Index looks particularly bullish, this space remains largely unloved and dormant.

We suspect investors are waiting for silver to break out above US\$35 to pile into this space. Interestingly, while October was a great month for gold stocks, the recent pullback occurred with President Trump's confirmed win, opening another opportunity to buy the dip.



## Pushing our portfolio to the limit to capitalise on risky gains

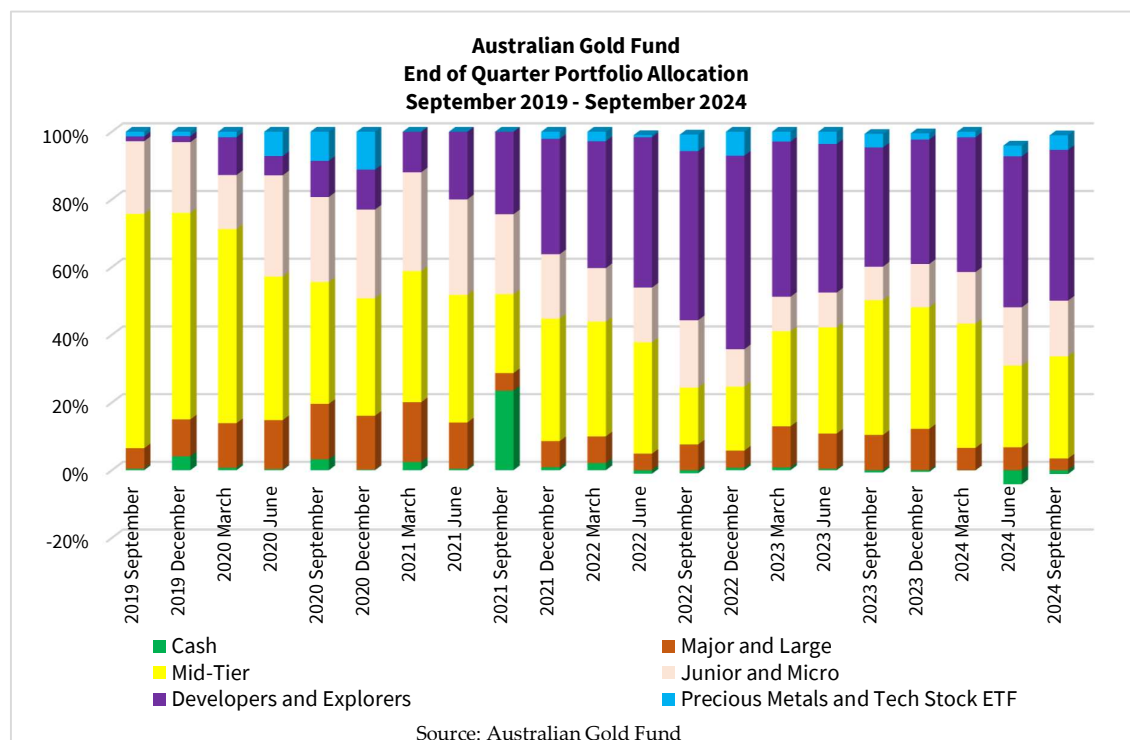
The following table outlines the Australian Gold Fund's portfolio composition:

	% Portfolio by Market Value	Range
Cash	-1.1%	2-10%
Major and Large Producers	3.5%	0-20%
Mid-Tier Producers	30.8%	0-60%
Junior and Micro Producers	16.8%	0-60%
Developers and Explorers	45.5%	0-25%
Precious Metals and Tech ETF	4.4%	0-30%

Similar to the previous quarter, we overexposed to stocks and closed with a negative cash position. While we sold some producers during the quarter and shifted them to the smaller end, such as explorers and early-stage developers, many of the latter classes didn't rally. Therefore, our portfolio's value comes mainly from producers, though explorers and developers comprised a little over 45%.

During the quarter, Adriatic Metals and Kingston Resources were upgraded to junior producers as their mine operations commenced.

Our historical allocation is in the figure below:



Our portfolio composition is similar to last quarter, though we sold some producers to take profits and deployed part of these to explorers and developers. Going forward, our strategy

is to sell more producers and even the speculative gold stocks as the gold stock bull market moves into the manic phase.

Subsequent to the September quarter, we began selling some of the top performing gold stocks and shifted to the precious metals ETFs instead. This reduces our portfolio's risk exposure especially when we enter the manic phase of the gold bull market.

### **Top 5 Holdings**

Our Top 5 holdings are given below:

Top 5 Holdings
<i>Black Cat Syndicate</i>
<i>Spartan Resources</i>
<i>Kingsgate Consolidated</i>
<i>Rameliuss Resources</i>
<i>Westgold Resources</i>

4 of the top 5 holdings featured in the previous quarter, with Spartan Resources replacing Oceanagold Corporation, which we took part profits as it rallied above C\$4.

Our top two holdings this quarter, Black Cat Syndicate and Spartan Resources surged into position, sparked by their 50.8% and 46.2% rallies, respectively. Investors are excited about both companies because of their mine deposits and future potential in producing high-grade gold. We reduced our Spartan Resources holdings by a small amount during the quarter to take some profits.

Our Kingsgate Consolidated holdings remained unchanged during the quarter while its shares pulled back by around 14%. The company's weak operating performance in the June quarter disappointed the market, causing investors to sell and look for better options. Despite this, we remain optimistic about the company's future as it ramps up the Chatree mine, which is now running both processing plants to deliver gold and silver.

We reduced our exposure to Rameliuss Resources and Westgold Resources as both companies rallied during the quarter. Both companies are in their sweet spot, thanks to a high Gold-Oil Ratio boosting their operating margins. But their market capitalisation exceeds \$2 billion, significantly reducing their upside potential. For this reason, we prefer to seek outperforming gains elsewhere.

## Valuation Thesis (Updated 18<sup>th</sup> 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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