21

Reasons to own

Physical Gold, Gold Miners and Explorers in 2014

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to Own Physical Gold, Gold Miners and Explorers in 2014

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Much has been written in response to gold's sharp price falls in April 2013 and its tepid performance since; with theories abounding that the price collapse was an orchestrated take down and even more theories exploring what might have inspired such a move.

Tomes of bearish gold market commentary have been published across 2013 similar to the following taken from an article in the New York Times.

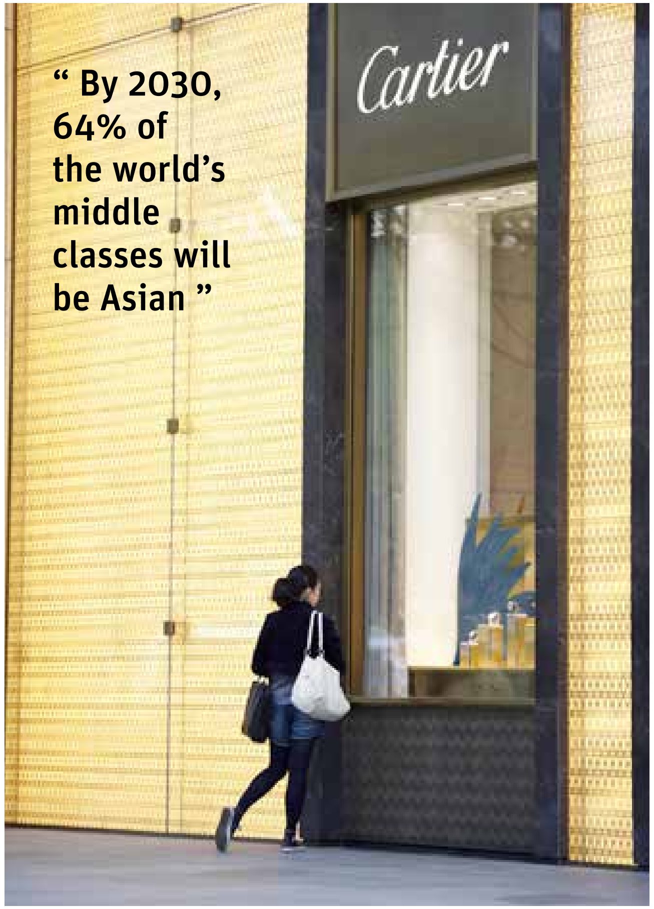
'Two years ago gold bugs ran wild as the price of gold rose nearly six times. But since peaking two years ago it has steadily declined almost by half- putting the gold bugs into flight. The most recent advisory from a leading Wall Street firm suggests prices will continue to drift downwards and may ultimately settle 40% below current levels. The recent gold rout says a lot about consumer confidence in the worldwide recovery. Sharply reduced rates of inflation combined with a resurgence of other more productive investments, such as stocks and real estate, have combined to eliminate gold's allure. The American economy is still on a firm expansionary course and the fear that dominated has largely vanished, being replaced by a recovery that has turned the gold speculators dream into a nightmare.'

The above 'expert' commentary sounds remarkably familiar, except it was in fact published 37 years ago in August 1976, just four days before the gold price bottomed at US$103 an ounce. Over the next three and a half years gold rose by 825% peaking in January 1980 at US$850. Back then of course new multimillion ounce discoveries were not as rare as they are today, China was not an economic super power busily corralling the world's physical gold supplies, and the world's burgeoning gold loving Asian middle classes were virtually non-existent.

Often absent from the volumes of commentary on the gold market in 2013 has been reference to its physical supply and demand fundamentals, a factor which regardless of short term price movements, points to sustained and likely significant future price increases.

Significantly though, lower prices in the paper gold market have consistently been met with vigorous and ongoing global buying of the physical metal, particularly from the East.

Brookings Institution scholar Homi Kharas estimates the American and European middle classes will more than halve over the next 30 years from 50% of the world total to 22%. In contrast, rapid growth in China, India, Indonesia, Thailand, Vietnam and Malaysia will more than double Asia's share of the world's middle classes from its current 30% to 64% by 2030. The game changing and staggering rise of the Asian middle class unleashes a rapidly increasing number



of eager physical gold buyers with both an historical and cultural yearning to own gold, and the disposable incomes to buy it. In addition, China continues to buy the physical metal like never before; powering a seemingly inexorable shift of physical gold from West to East.

Whatever market manoeuvers might take place to lower the price of gold and to reduce its universal appeal as a store of wealth, they are unlikely to defeat the fundamentals of a reduced future gold supply in the face of relentless physical demand from the fast transforming and gold loving Asian nations.

1 According to a Pew Research Centre report the middle class of the US has fallen from 61% of its population in the 1970's to 50% in 2012. But whilst the middle classes of both the US and Europe shrink, those of India and China are expected to continue growing at an almost incomprehensible rate.

2 Already China's middle class is approaching that of the entire population of the US, and according to research by the Wolfensohn Centre for Development in Washington, China's middle class should reach 670 million by 2021, double the number of the entire US population.

3 The Economic Times predicts the middle class in India could reach 267 million by 2016, an increase of 67% from 2011. These increases highlight the shift in wealth from West to East and the massive cash piles of disposable income becoming available to peoples with a desire for consumer goods and importantly, a penchant for buying gold.

4 In 2002 China and India accounted for 23% of world gold demand. By 2012 their combined gold demand had more than doubled to 47% and continues to rise. Gold it seems, will always find a way of getting to those who desire it, and recent efforts by the Indian Government to restrict gold imports are reportedly creating a field day for the Times of India reports that non-resident Indians returning after a stay abroad for longer than 6 months are allowed to bring in 1 kg of gold. One flight in December 2013 from Dubai to Calicut saw its passengers bring in 80 kg of gold, some of them reportedly travelling on free tickets thought to have been provided by gold dealers.

5 According to PricewaterhouseCoopers (PwC), Chinese and Indian 2013 jewellery, gold bar and coin demand now accounts for more than half of world demand, with the US accounting for only one ninth of that these two nations

6 In stark contrast to accelerating gold demand from China, India and Russia the volume of newly discovered gold has reached a record low. Pierre Lassonde the Chairman of gold royalty company Franco-Nevada recently presented to the Denver Gold Forum findings that point to substantial future supply problems. Gold demand has increased 42% over the past decade but during that period gold production has remained essentially unchanged. During the 1990s approximately 100 million ounces of gold was discovered annually but over the past 10 years to 2011 this has reduced to just 30 million ounces.

7 According to the Metal Economics Group's recently released 'Strategies for Gold Reserve's Replacement: The Costs of Finding and Acquiring Gold' discoveries made during 2007 to 2011 will replace only 56% of gold actually mined during the same period. With the current gold price below the total cash costs of many operating gold mines, production cuts will add to future supply shortages in the face of increasing demand. The increasing exposure of newer discoveries to higher geopolitical and regulatory risk environments and more expensive and longer development times could also see gold production decrease in the near term.

8 Average grades for gold containing ore globally declined by 23% from 2005 to 2011 according to Casey Research, grades at the world's top 10 gold mining operations have fallen by more than 75% from 4.6g/t tonne in 1998 to just 1.1g/t in 2012.

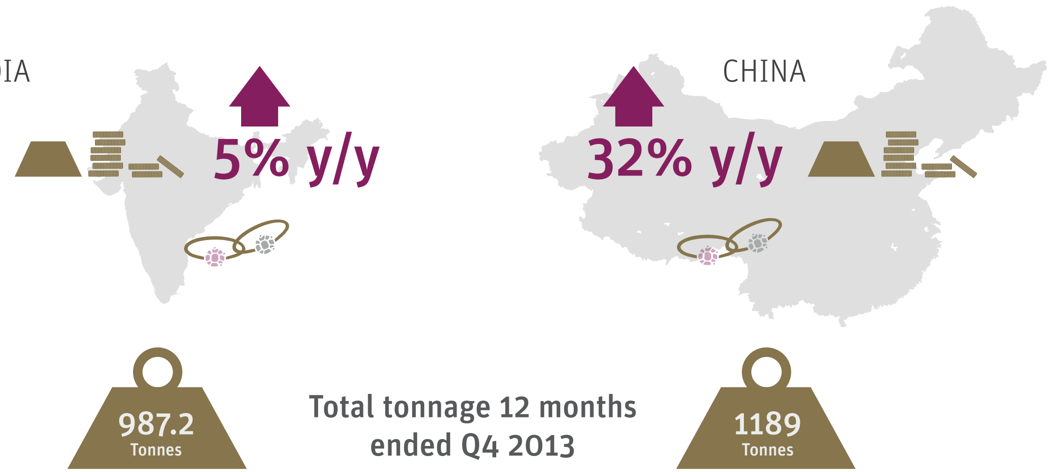
9 The 'easy' gold has already been mined and along with falling grades and increasing production costs, Thomson Reuters estimates global all-in cash costs in 2013 at US$1,250 per ounce. With recent prices remaining perilously close to the cash costs of many producing mines gold production is likely to fall in the face of record demand for the physical metal.

10 Despite global exploration expenditure reaching US$8billion in 2011, only four discoveries of greater than 3 million ounces of gold were made from 2008 to 2011, a factor which further underpins future prices as buoyant demand outstrips supply. Despite record exploration expenditure in 2012 new discoveries were at their lowest for more than 40 years.

11 The worst financing environment perhaps ever for gold mining juniors is resulting in reduced exploration and mine development pointing to further supply restrictions.

Gold demand in India and China 2013

% change 12 months ended Q4 2013



12 **Gold stocks are selling at almost 10 year lows versus the gold price. The flagship HUI gold-stock index is currently trading at just 17.4% of the gold price (as at 25.03.14), around the lowest levels since January 2001 when gold languished at US$265, just prior to the commencement of gold's secular bull market run.**

13 In the twelve months to September 2013 Chinese gross gold imports through Hong Kong increased 91% compared to the same period to September 2012.Not only is China buying record amounts of physical gold, it is also buying producing gold mines as well. This allows China to potentially produce gold at a rate below the market price, with this production also by-passing the market as it heads for China.

14 **Russia is the world's 4th largest gold producer with 2012 production increasing to 205 metric tons and in addition it is also purchasing record amounts of gold.**

15 Over the past decade Russia's central bank has bought more gold than any other country with China coming in second. Russia's reserves recently raised above 1,000 tonnes, a 70% increase over 2010 levels.

16 **In 2013 Chinese and Russian gold mines produced a combined 640 metric tons of gold, around 20% of world production, little if any of which is likely to ever see the market.**

17 Even if all of China and Russia's combined current gold production was available to the market it would only cover a third of India and China's combined 2012 jewellery, bars and coins consumption of 1,648 tonnes of gold.

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18 **In 2012 the world's central banks increased their gold purchases by 534.6 tons, the most they have added in any single year since 1964. According to findings by the World Gold Council central banks spent US$235 billion on gold purchases in 2012, an all-time high, and a 17% increase over 2011, despite lower gold prices**

19 US Mint coin sales jumped to a 3 year high in April 2013 reaching 209,500 coins compared to 62,000 coins in the previous month, and gold coin sales to October 2013 have already surpassed those of 2012.

20 **The Thomson Reuters GFMS 2012 Gold Survey shows 'World Investment' in gold (deemed to be the sum of implied net investment in physical gold bars, coins and medals) doubled from 800 tons in 2008, to 1,600 tonnes in 2012.**

21 In summary, the world is facing a momentous and fast moving shifting in wealth from West to East. By 2030, 64% of the world's middle classes will be Asian; a collective population with an historical and cultural yearning to possess gold. This shift is accelerating whilst new significant gold discoveries are becoming even rarer, despite record exploration expenditure. China is predicted by the OECD to become the world's largest economy by 2016. It is also the world's largest gold producer, a net gold importer and has now started to buy producing gold mines as well. Is China's currency on the path to being backed by gold? Whether it is or not, rapidly increasing global demand for physical gold, and looming difficulties in supplying it, is an obvious recipe for large-scale future price increases.

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