



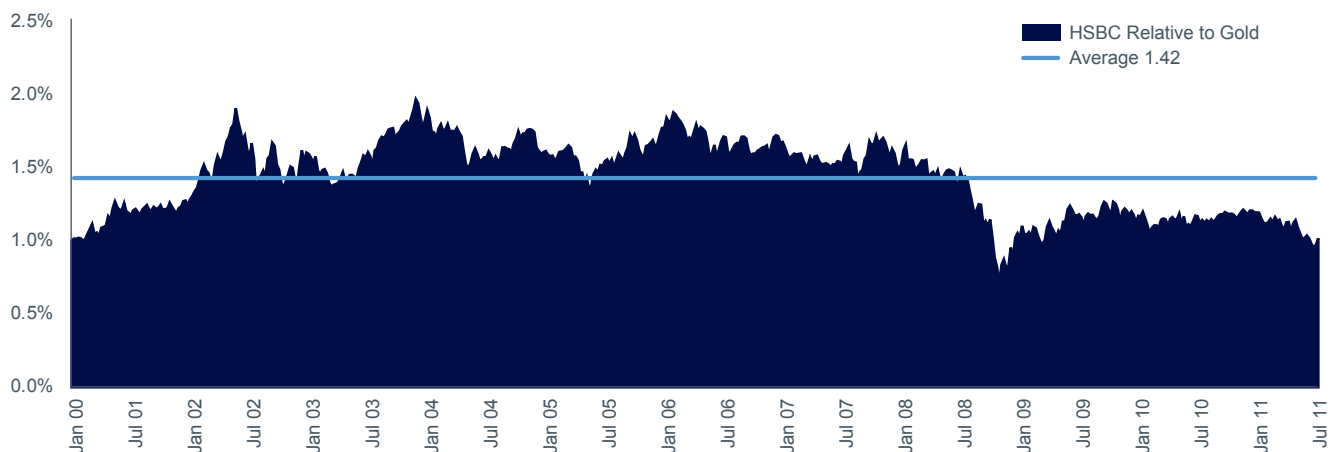
# Gold update

## Why have gold equities underperformed?

The bout of gold equity underperformance relative to the gold price has been underway for some time now. Year to date, the gold price has climbed 28%, while the HSBC Global Gold mines Index has just raised 1%\*. The reasons for this are Barrick Gold's copper acquisition, cost inflation on the back of higher oil prices eroding margins, higher capex on new gold mines and North African risk contagion. More recently, however, the relative underperformance of gold equities has been compounded by global economic news flow and reactions to the latest round of quarterly earnings.

## Recent developments

- **A general equity sell-off.** Despite the fact that gold has been registering all-time highs, general risk aversion has increased and equities have been sold down – we believe, indiscriminately. We witnessed a very similar pattern emerging during the global financial crisis of 2008, which presented an excellent buying opportunity for gold equities. Although poor, the underperformance this time around has not been as severe as 2008 where there was forced selling of equities, as can be seen from the chart below.



Source: HSBC Gold Equity Index relative to USD Gold, Bloomberg, Investec Asset Management, 10.08.11

- **Second quarter gold company results** currently being released have been weak from a cost and capital expenditure perspective. Most companies have shown significant increases in capital expenditure plans given rising input costs and a shortage of capital equipment. The resultant impact is a decline in the value of these businesses of approximately 5%. Dividend yields have also been reduced as cash flows from operations have not materialised to the extent that the market had expected given higher energy costs which are 40-50% of mine cash costs.
- **The use of gold exchange traded funds (ETFs)** as a substitute for equities. Approximately 7 million ounces have been added over the last fortnight as investors flock to what is perceived to be a liquid, easily accessible vehicle with no operational risk issues.
- It has come to the market's attention that **John Paulson's flagship hedge fund has started** receiving redemptions given its poor performance over the year. Given his large gold allocation we suspect there has been some selling pressure on the gold equities.

*Out of the Ordinary*

## The Fed's announcement supports higher gold prices

Again, we would reiterate our positive stance on both the gold price and gold equities. The announcement by the US Federal Reserve – extending "exceptionally low" interest rates until mid 2013 and Chairman Bernanke's pledge to start a third round of quantitative easing (QE3) should the US economy fail to regain momentum – provides, we believe, further support for the gold price to move higher. Recent central bank gold purchases by Thailand, South Korea and Mexico highlight Emerging Market economies' desire to diversify their US dollar reserve holdings.

## Gold company margins are likely to expand

With the gold price trending higher and the oil price moving lower from \$125/b to \$106/b, gold company margins should expand in the third quarter relative to the previous year and relative to the second quarter. In this scenario, cash flows will be strong and it is likely that dividends will be increased into year end.

\*Source: Bloomberg, all index returns in USD terms, as at 31/08/11.

ENDS

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\*As at end March 2011

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