

EUREKA *report*



Can the gold rush last?

By Tim Treadgold
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PORTFOLIO POINT: Gold is proving its critics wrong and soaring to new heights as governments around the world grapple with debt.

Waiting for the gold price to fall has become an expensive exercise for non-believers in the strength of the so-called “barbarous relic”, which is acting as a whistleblower on irresponsible governments and their paper money.

Spot gold reached a new record on Tuesday night of \$US1609.51 an ounce – or \$1500 in the local currency – before taking a breather and settling below \$US1600 on fresh optimism that US politicians would break the impasse over raising the debt ceiling.

The question for investors is whether gold is finally capitulating following a stellar multi-year streak or consolidating for a once unimaginable push to \$US2000 and beyond as governments around the world decide that debasing their currency is the only way out of years of profligate spending.

In truth, investors have been arguing both sides of this debate for decades and are no closer to having it resolved since Lord Keynes in 1924 relegated the role of precious metal to nothing more than a “barbarous relic”.

Gold, however, refused to go away despite the assaults of its critics. More cautious observers (including me) continued to say that gold has a crucial role: it is the canary in the investors’ cave warning of dangers ahead.

But in my opinion, there is nothing that can take the place of having physical exposure to gold in your portfolio, which I confessed to back in 2008, revealing my investment in two five-ounce bars of gold that to this day serve as a key defensive component of my portfolio (click [here](#)).

Investors who ignore the hedge gold creates against uncertainty and inflation do so at the expense of their own portfolio – witness gold’s appreciation of roughly 150% over the past five years at a time when the ASX 200 has gained just 10%.

So in this special report on gold, what I want to examine why there is such strong demand for gold around the world before highlighting a handful of small to large cap gold miners from across the spectrum that have the potential to grow with the gold price or outperform through discovery and rising rates of production.



Perhaps the biggest danger we face today as investors is a severe outbreak of global inflation, and economic stagnation which, when combined, becomes a truly horrible condition known as “stagflation” – rising prices but no growth.

Europe’s banking mess, and America’s budget blues, both seemingly intractable issues that could stumble along for years, are crystal-clear pointers towards increased demand for gold as investors seek protection from politically inspired economic Band-Aids that fail to address the core problem of unmanageably high government debts.

Over the next few months it will become more attractive for government – especially the US government – to “inflate away” its debt problems, a process that might already have started with its massive stimulus programs called quantitative easing, which are nothing more than printing ever higher piles of paper money.

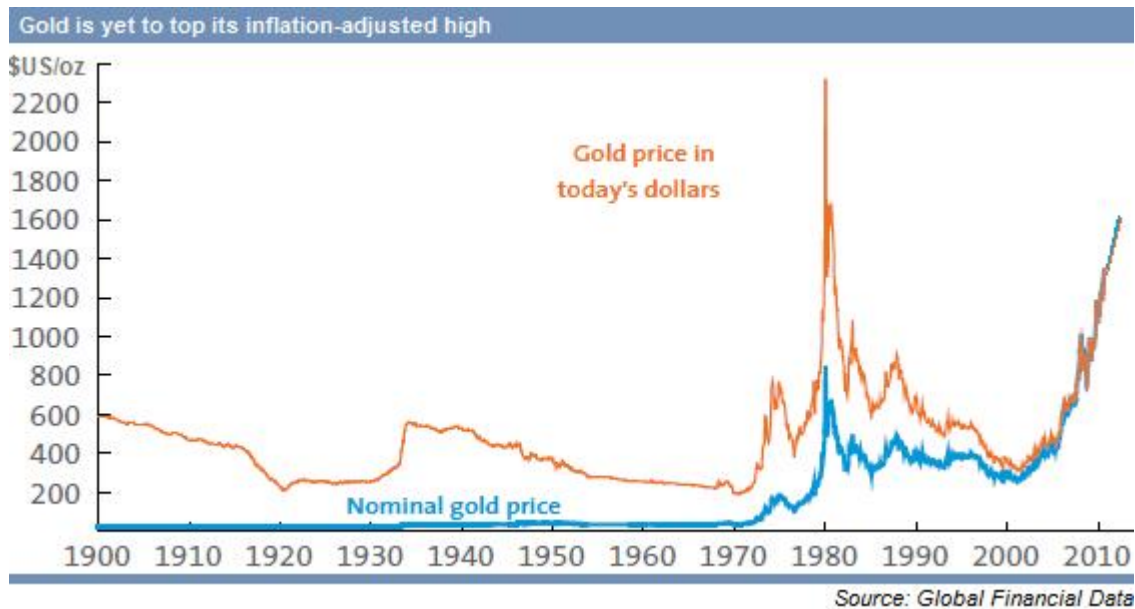
This risk has already been recognised in China, where it recently owned up to doubling its gold reserves to 1054 tonnes, valued at around \$US56 billion or just 1.6% of its total foreign reserves. Statements from the Chinese Chamber of Commerce indicate its desire to lift these reserves to 8000 tonnes, a move that would see the world’s remaining economic powerhouse acquiring roughly two years’ total global production with blindingly obvious knock-on

effects.



Older Australian investors will remember the awful period in the 1970s when oil-price shocks combined with a period of bad financial management by the Australian government to produce a burst of high inflation and sky-high interest rates, which saw the floating rate on home mortgages hit 17%, and the Australian stockmarket endure a lost decade.

The winner from the dreadful 1970s was gold which, in January 1980 hit a high of \$US835 an ounce, the equivalent today (after inflation) of \$US2400. It is this figure of \$US2400 that is seen as the next logical target for gold bulls everywhere.



There are arguments against owning gold and chief among them are that current valuations cannot be justified as anything but bubble territory, pointing to the relatively small amounts of money moving into what is seen as the last financial haven.

Further, the gold bears say that gold is inert and does not pay any interest, which makes it an illogical investment in the same category as sea-shells or the stone money of the Pacific's Yap Island.

The problem with that view is that gold is a commodity that has taken on the form of a currency by every country in the world and is therefore beyond the mistakes and paper-money manipulations of any one government.

Without boring readers with a full run down of the attractions of gold, it is only necessary to ask why central banks own gold.

The answer is obvious, they might not like it but every other central bank owns some gold knowing that when it comes to dealing with the central bank of another country the common item of exchange is gold.

If it's good enough for central banks it ought to be good enough for all investors, who should have 5–10% of their portfolio exposed to gold in one, or more of its many forms: bullion, exchange-traded funds, or shares in gold mining companies.

Is it too late to jump aboard the gold train? Perhaps, but unlikely, given the mounting financial problems of Europe and the US.

The real question is whether you can afford not to have some exposure to a commodity that is reliving its role as the world's reserve currency, an object of value beyond the reach of politicians.

Bullion, locked safely in a bank vault, is the most comforting form of gold ownership in troubled times.

A well-managed exchange traded fund (ETF) such as the SPDR Gold Trust currently holds 1249 tonnes of gold valued at \$64.2 billion – ranking it as the equivalent of the world's 10th biggest central bank. (Eureka Report has also

covered the Australian dollar-hedged gold ETF from BetaShares which has gained more than 7% since we **reviewed** that product.)

But, for investors who prefer their gold in the form of the shares of traditional gold miners, with their capacity to generate capital gains as well as pay dividends, there is a wide choice, especially in Australia, which has one of the world's most active gold production and exploration industries.



Top stock on the list of most stockbrokers who have kept their eyes on gold is **Newcrest Mining (NCM)**, easily the Australian gold sector leader and one with a brilliant future as new mines are developed and the company pumps up its dividend payments. On current trends, and at current gold prices, Newcrest is on track to report a net profit for the year which ended on June 30 of close to \$1 billion, rising in the current financial year to around \$1.6 billion, when the dividend could rise sharply.

After Newcrest there is a long line of gold stocks worth researching, but the seven which catch my eye are:



Silver Lake (SLR) A pure Australian gold producer valued at \$389 million with all of its assets close to the WA home of gold, Kalgoorlie. Production has been running at a modest 70,000 ounces a year, but is set to rise strongly as mining is expanded at the company's Mt Monger operations south-east of Kalgoorlie, and a second mining centre is developed near Mt Magnet in the Murchison district of WA. Management is forecasting gold production of 300,000 ounces from 2014, with a series of announcements expected in the next few months, including a substantial reserve upgrade from recent exploration.



Resolute (RSG) One of the many Australian miners now doing their best work in Africa. Overlooked for the past few years because it took on the technically complex Syama mine in Mali, Resolute appears to have finally tamed a project that had tricked previous owners, including BHP Billiton. Recent improvements in production at Syama have encouraged the company to announce a major expansion of operations, including deepening the open pit, which will add seven years of life. At the same time, the gold reserve at Syama has been boosted to 2.94 million ounces, and production costs lowered. On the market, Resolute has rebounded from lows about 12 months ago to its current market cap of \$645 million.



Kingsrose (KRM) A fast-growing small-cap producer with the appeal of mining a super high-grade series of mineralised veins near the southern tip of the Indonesia island of Sumatra. Cash operating costs at the 85%-owned Way Linggo mine are ridiculously low, coming in at \$US21 an ounce in the March quarter. Growth prospects are significant with discovery continuing at a brisk rate along strike to the north of the current mine. Best recent drill hits include a 1.1 metre vein assaying 46.9 grams of gold a tonne, plus 87.9 grams per tonne of silver.



Medusa Mining (MML) A remarkable success story in the Philippines, the \$1.4 billion Medusa is focused on the historic Co-O mine, which has been producing at a rate of around 100,000 ounces a year at a cash cost of \$US186 an ounce. Management has a plan to boost production over the next five years to 400,000 ounces a year, with costs remaining close to \$US200 an ounce. Medusa controls a large package of richly mineralised tenements near the east coast of the island of Mindanao. Copper could eventually join gold production.



Troy Resources (TRY) Once a pure Australian-focused gold miner, now a business with its best assets in South America. The migration to mines in Brazil and Argentina has not been smooth, but a period of declining production and boardroom instability has given way to rising gold output tipped to be around 80,000 ounces a year, mainly from the Casposo mine in Argentina. Perhaps more attractive than current production, and a long history of dividend payments, is the appeal of Troy as a \$334 million takeover target with North America's aggressive miners keen on assets in their "back yard", especially companies with exploration upside which Troy has on its tenements around Casposo.

Gold Road Resources (GOR)



Gold Road (GOR) A pure explorer at this stage of its life, Gold Road was “explored” in some depth in Eureka Report on **May 30**. The target is to unlock the geological secrets of a remote piece of WA about 500 kilometres northeast of Kalgoorlie. If current success continues, Gold Road could uncover a fifth major gold “shear zone”, although it will be seriously remote and will have a high capital development cost. A three-rig drilling program will maintain news flow for the rest of the year, leading to a significant resource upgrade in the future. Right now, Gold Road is a pure exploration story with a value of \$188 million.

Ausgold (AUC)



Ausgold (AUC) Is a second pure exploration play pursuing a similar theory as Gold Road but in a far more hospitable location. It’s primary asset is the Katanning project set in wheat and sheep country of WA’s southwest, which Eureka Report took a close look at on **July 11**. A major drilling program is under way, with the aim of delivering a resource upgrade over the next few months. Essentially, Ausgold is drilling deeper under, and along strike from, a small historic mine that was developed in the 1990s but killed by a gold price as low as \$US250 an ounce. Future price moves from this thinly traded \$121 million explorer will be dictated by drilling results and assay news.