

## INVESTMENT REPORT



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# TIME FOR GOLD IN YOUR PORTFOLIO

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## In this issue

By Magnus Heystek -Investment Strategist

It's a bitter irony that most South African investors have been missing the largest and most durable bull market in the price of gold and gold shares in recent times.

The irony lies therein that SA, for most of the 20<sup>th</sup> century the largest producer of gold by far, has lost this prestigious position to American, Chinese and even Australian gold producers.

At the rate that SA's gold production is falling, it could well drop to number 5 on the list of global gold producers, soon to be overtaken by Canada as well.

It's ironic too, that in another time and place, the steady if not spectacular rise in the price of gold to historic record levels around \$ 1 250 per ounce, would have been accompanied by articles and discussions in the media, the airwaves and on the internet.

In 1988, as business editor of THE STAR, I wrote a front page lead article when the gold price broke through the \$400 dollar ounce level.

Today such news, with gold at three times that level, is barely mentioned on the inside back pages of the same newspaper.

Gold's rise in global financial affairs has largely taken place offshore: in London, New York, Frankfurt & Tokyo, rather than in JHB which traditionally used to be a major player in the global gold market.

The sad truth is that the SA gold mining industry is rapidly shrinking and now produces about 400 tons of gold compared with the 1 000 tons it produced in the 1980's.

At the same time the number and size of listed gold counters on the JSE have declined from about 30 in 1980 to its current miserable number of seven gold counters to choose from.

This partially explains why gold and its spectacular performance over the last ten years is not uppermost in the mind of local investors. The market, the analysts and the excitement has moved offshore.

It's pointless for local investment companies to spend money marketing gold and gold funds when the real action and excitement (and the products to sell) is happening in someone else's backyard.

*Continued on page 2...*

" YOU HAVE A CHOICE BETWEEN THE NATURAL STABILITY OF GOLD & THE HONESTY AND INTELLIGENCE OF THE MEMBERS OF GOVERNMENT .

AND WITH ALL DUE RESPECT FOR THOSE GENTLEMEN I ADVISE YOU, FOR AS LONG AS THE CAPITALIST SYSTEMS LASTS, TO VOTE FOR GOLD".

GEORGE BERNARD SHAW

Global  
Markets  
AND SA ECONOMY

TIME FOR GOLD IN YOUR PORTFOLIO:	1
GOLD'S BULLS RUN:	2
BACKGROUND TO CURRENT BULL MARKET IN GOLD:	2
REASON TO BE BULLISH ON GOLD PRICE:	3
RECOMMENDED GOLD FUNDS:	4
➤ INVESTEC GOLD FUND	
➤ BLACKROCK WORLD GOLD FUND	
➤ ALIQUOT BULLION FUND	
TAX UPDATES:	4
CONTACT US:	4

*Continued...*

This is the consequence of many years of declining gold output, falling grades and rising costs, amongst other contributing factors, resulting in corporate mergers and rationalisation which has reduced the number of listed entities on the JSE substantially.

SA's gold output in the first quarter of 2010 dropped to 43 927 kg., down 12% from the same quarter a year ago and down 15% from the previous quarter.

Harmony Gold Mine has announced the closure of 6 shafts due to unprofitable mining while Goldfields has warned that the anticipated sharp increase in the cost of electricity, which is a major cost factor, will hurt gold mines even more.

The gold index is barely unchanged from 25 years ago and local investors have very limited choices in terms of gold funds, with the Old Mutual and Stanlib gold & precious funds still barely holding out.

This is the crux of this newsletter.

**If you want to participate in potential further gains in this asset class, then you will have to consider offshore gold funds.**

Physical gold, in the form of gold exchange traded funds (such as Absa Newgold) or Krugerrands can still be bought locally, but for the real money spinners you would need to move money offshore in order to invest in global gold funds.

## ***GOLD'S BULL RUN***

**G**old's current bull market started in 1999 at around the time when Gordon Brown, former Chancellor of the Exchequer in the UK and until recently that country's prime minister, decided to sell about a third of that country's gold reserves at prices around \$300 an ounce. It's commonly referred to today as Brown's Bottom.

The loss to the UK fiscus, when compared to today's prices, has been estimated at around £7 billion pounds. Ouch!

Yet many SA investors still hang on to their local gold shares in the waning hope that the local gold market will rise, Phoenix-like, to new heights again.

This view is particularly prevalent amongst older investors who still remember the golden days of Southern African gold shares during the 70's and the 80's.

In contrast, global gold shares have been in a raging bull market for most of first ten years of the 21<sup>st</sup> century & has made global gold investors piles of money.

It has also proven itself to be a very attractive diversifier of risk during the last three years of turbulence in the global financial markets.

## ***BACKGROUND TO THE CURRENT BULL MARKET IN GOLD***

**A**fter peaking at \$850 an ounce on the 21<sup>st</sup> Jan 1980 the gold market toppled over into a 20-year bear market, bottoming at \$259 in 1999. For gold bulls this was a time of anguish while the sceptics, who considered gold to be a "barbarous relic", totally discarded gold and gold shares as a mainstream asset class.

The dotcom bubble in 2001 followed soon thereafter by the bursting of the US property market bubble in 2007, the US banking crisis in 2008 and now the Euro sovereign debt crisis, were the catalysts for the current bull market in gold and gold shares.

At the heart of this bull market lies the primordial fear that the global financial market (banks, governments & sovereign lenders et al) is built on sand and cannot be trusted.

There is even talk of a return to the gold standard, abandoned by US pres. Richard Nixon in 1971. Investors globally have been rushing to gold and gold shares to protect their wealth.

It is important to note that the euro price of gold has risen sharply during the crisis in Greece as European investors, fearing the worst, have been withdrawing savings from traditional accounts in waves in order to buy gold and gold-related investments.

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Rand Refinery, the world's largest gold smelting facility, has been forced to raise its production to 25-year highs as Europe's debt crisis boosted demand for gold coins.

Output in the last week of May rose by 50% to 30 000 ounces of blank coins for minting by the SA Mint, which produces the Krugerrand, the world's most widely held and actively traded gold coins.

Krugerrands were introduced in 1967 & so far 47 million coins have been produced and sold worldwide. However, buying Krugerrands, although a good investment, has a mark up of up to 8% for buyers on the secondary market.

## *REASONS TO BE BULLISH ON THE GOLD PRICE*

**H**ow much higher can gold go? And is it too late to be investing in gold? There is increasing confidence, even in mainstream economic circles, that the gold price could move much higher over the next decade or so, largely in response to the fragility of the global financial system.

The 50% or so increase in the gold price over the last two years corresponds almost perfectly with the massive increase in sovereign debt and money supply, especially in the US, as governments opened the money taps to stimulate economic activity.

For a while after the Credit Crunch hit home in 2008 was there a school of thought that the euro could act as a reserve currency to the US dollar. These hopes have now all but vanished in the wake of the euro's own version of the credit crunch.

Many central banks over the world have also been buyers of gold in recent times which has further underpinned the gold price. Foreign-exchange rich countries like China and Russia have been increasing their gold holding in recent times in an effort to diversify away from the US dollar.

They are particularly concerned about the rising debt levels of the United States which would cause serious problems to the US dollar should the expected optimistic growth rates in that country not materialize.

US government spokesmen have been trying to reassure markets that a sharp increase in the US growth rate would go a long way to reduce these deficits.

However, the markets are sceptical and have been buying alternative stores of value. For the first time in 20 years the central banks of the world have become net buyers of gold. Central bank buying has been particularly evident in recent months every time the market undergoes small corrections. This is done not to disrupt the orderly and steady gains in the price of gold.

And finally, the introduction of gold Exchange Traded Funds (ETF's) six years ago has had a major impact on the physical demand for gold. It is estimated that about 2 000 tonnes of gold has been bought by ETF's worldwide.

This has served to underpin the gold price against a backdrop of declining gold production. With no new major gold discoveries in sight, certainly not on the scale of the Free State gold mines in SA during the 1950's, will this further add upward pressure on the gold price.

**At Brenthurst Wealth we have been recommending investing in gold for some time now, but very few clients could be persuaded to follow this route.**

**We again repeat our recommendation: the best route for would-be-gold investors would be to move money offshore and invest in one of the following three options we have investigated:**

- Aliquot Bullion fund.
- Investec Global Gold Fund.
- Blackrock World Gold Fund.

### **➤ ALIQOT GOLD BULLION FUND:**

This fund was launched in 2003 and invests directly in physical gold, giving investors a 100% unleveraged exposure to gold. It offers weekly liquidity and is available in US dollars, Pound Sterling and Euros.

The fund has a 5-star rating from Morningstar Rating and has been a top quartile fund in its sector (Open ended Offshore funds Equity Precious Metals) category.

It has given an annualised return of 18,09% since 2006 and has a very low correlation to equity markets.

## ➤ INVESTEC GLOBAL GOLD FUND:

This fund has a 20 year track record and is managed by Daniel Sacks from South Africa. The returns over one year was 14,8% (year-end 31 May 2010) while the annualized return over five years was 21,1% per annum. The fund size is \$318 million and can also invest in other precious metal shares, incl. silver and diamonds.

## ➤ BLACKROCK WORLD GOLD FUND:

This is the largest gold equity fund in the world with assets under management of close to \$7 billion. It is an equity-based fund which invests in gold shares and shares of precious metal counters. Returns over the past year was 12,8% while the average annual return over 5 years was an astonishing 21.8% per annum. This fund is AAA-rated.

# 2010 TAX SEASON: UPDATES

Although no date has been released by the South African Revenue Service as to when taxpayers can start submitting their 2010 income tax returns an official announcement is expected within the next month.

Brenthurst Wealth tax clients are welcome to submit their 2010 supporting documentation to Gavin Butchart In the interim.

Should you not be a Brenthurst Wealth tax client and require assistance with your 2010 tax submission, please feel free to contact Gavin on 011 799 8100 or email [gavinb@brenthurstwealth.co.za](mailto:gavinb@brenthurstwealth.co.za).

## INVESTMENT ADVISORS

Please contact your dedicated relationship advisor in order to discuss any questions you might have with regard to investing in gold.

As a general rule of thumb we recommend a 10% exposure to gold and gold shares but this can vary depending on personal circumstances and risk tolerances.

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