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THE NORTHERN MINER
THE GLOBAL MINING NEWSPAPER
www.northernminer.com
OCTOBER 17-23, 2011 • VOL. 97, NO. 35 • SINCE 1915

Political risks worry investors

BY ALISHA HIYATE

While most gold miners at the Denver Gold Forum last month touted their increasing dividends and "undervalued" stocks, fund managers warned that political risk is a bigger issue than many companies acknowledge.

Citing events as varied as **Semafo**'s (SMF-T) evacuation of expat personnel from Guinea, news of which broke during the conference, and increasing mining taxes in Quebec and Australia, Midas Fund portfolio manager Thomas Winmill says companies are facing higher risks everywhere they go.

"Whether you're evacuating personnel or you're evacuating capital, there are reasons why you may not want to be in certain jurisdictions," he said in an interview at the show.

"When the prices go up for commodities, local governments historically have gotten grabby, and I think that's one of the most important things to bear in mind in investing in this later part of the cycle."

News reports say locals seeking jobs at Semafo's 20,000-oz.-per-year Kinero gold mine in Guinea attacked the operation and houses of expatriates working at Kinero, following a three-day protest.

The mine added a small portion of the 260,000 oz. of gold Semafo produced last year, mostly from operations in Burkina Faso and Niger.

One way for individual investors to mitigate political risk is through investing in royalty companies, Winmill says, although the Midas Fund does not hold any.

"We think at Midas that currently the sweet spots are the cash-flowing producers," Winmill says, who adds that the company is "one hundred and twenty percent invested in shares." With $100 million in assets, it is 20% levered.

"Mining equities have reflected generally a flight from equities in the main market, so these lower valuations that affected general equities are also affecting mining equities," Winmill says. "We think that if they can continue to surprise on the upside market expectations, they'll do well . . . The ones that can actually deliver on expectations or exceed them, we think are really going to accelerate."

David Christensen, CEO of **ASA Gold and Precious Metals** (ASA-N), a long-term-oriented, closed-end fund established in 1958, agrees that political risks were underplayed by presenting companies.

"Mining companies have always been one of the first industries to enter into any new area to develop a business, " Christensen said from his office in San Mateo, Calif., in a post-conference interview.

While the risk is something that can be diversified away to some extent in a larger portfolio, Christensen, who's also a director of the Denver Gold Group, says that individual investors should be aware of political risks.

"We're not afraid of the political risk profile, but we are cognizant of it and try to make sure that we don't overweight the portfolio to any one region or sector. We wouldn't want to be 90% Burkina Faso," he says. "It's not easy, by the way. You could easily put together a portfolio of four or five stocks and end up with a very heavy weighting to some of these countries."

Even though gold miners' increasing focus on capital return is welcome, the dividend theme that many companies discussed during the conference has its own risks, Winmill says, who's based in New Hampshire.

"I think a lot of it is being done by companies that really may not have the cash flow to support it, but view it as a competitive necessity," he warns.

"It could be positive for some companies and their shareholders, but I think it could be damaging for other companies because they may be back in the market selling additional equity to raise money that they've already spent on dividends," he says. "So it's a little bit of smoke and mirrors for some companies, and it's a really legitimate exercise in proper corporate stewardship for others."

While the gold price has pulled back to US$1,600–1,700 an oz. since the Denver show and volatility has only increased, both Winmill and Christensen believe gold — and gold equities — will head higher.

"Gold mining companies have been overlooked for the last year or so, especially since the market crashed in 2008 and investors realized that the mining shares carried a great deal of risk that wasn't inherent in gold bullion," Christensen says, who explains investors have been looking to gold bullion to hedge currency and general market risks. "That is starting to come around and people have begun to realize that the companies, over time, clearly have added a lot more value than owning gold bullion."

Midas Funds gold forecast calls for US$1,750 per oz. gold at the end of year, and a range of US$1,650 to US$2,200 next year, with the yellow metal ending 2012 at around US$1,950 per oz.

ASA Precious Metals' forecast is for gold to trade between US$1,400 and US$2,000 an oz. for the next couple of years.

Midas Fund's biggest holdings at the moment are in **Goldcorp** (G-T, GG-N), followed by West Africa-focused **Avocet Mining** (AVN-L). Winmill also likes the world's largest primary silver miner,

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Fresnillo (FRES-L). The Mexican miner is "perhaps the most attractive play from a dividend perspective," he says. It has been paying out a large portion of its net income for years and is majority owned by a parent, **Industrias Peñoles** (IPOAF-Q), which will ensure that dividends continue on.

Christensen's favourites are **Alacer Gold** (ASR-T), which has operations in Australia and Turkey, and Guatemala-focused **Tahoe Resources** (THO-T), both of which have assets and management teams he expects will perform well over the long-term. ASA has also been buying more shares in **Centerra Gold** (CG-T), which holds the Kumtor mine in Kyrgyzstan.