



Volatility Ahead for Gold Prices

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In this Q&A, Tom Winmill, Manager of the Midas Fund, talks gold valuations and forecasts the gold price in 2012.

MINYANVILLE ORIGINAL While the gold price moved higher in the first quarter, [gold equities](#) had a tougher start to the year. Tom Winmill, portfolio manager of the **Midas Fund** (MIDSX) says gold mining equity valuations haven't been this attractive in years and points out the most intriguing name in his portfolio.

Q: Gold's momentum seemed to stall midway through Q1, near the end of February. Where do you see the gold price heading for the rest of the second quarter and the rest of the year, in the medium-term, and what's moving it right now?

A: In the fourth quarter of last year, it was just kind of a general sell-off and the move to more liquid assets, I think generally. Then, there was bullishness in the beginning of the first quarter due to the comments of the Federal Reserve about the possibility of additional quantitative easing. That whole thing came to a close, of course, when Bernanke, at the end of February -- I think it was February 29 -- started to say that quantitative easing might not be necessary, there's strength in the economy, and so on and so forth. And then I think, the gold price weakened and gold equities particularly weakened as the market also started to sell off. So I think that's what we've been going through.

There has been, at the same time and more recently, a drop off in demand for gold from Indian jewellers, and their proposed doubling of import levies. So, combining that, which is kind of a medium-term factor, with the steep reduction, we think, of market expectations for further quantitative easing and any other kind of monetary stimulus, we've just seen a lot of weakening. So we have recently cut our estimates for gold. We were probably on the more bullish side, expecting a year-end price for 2012. This is not average, but a year-end price of about \$1950 to maybe \$1850; that's our current estimate of where we think the price will end up at the end of the year. On the other hand, we think there's going to be a lot of volatility and increasingly a lot of that volatility, we think, will occur in the fourth quarter immediately after the election. So, we're still expecting the potential for gold to spike up significantly, so we think that the range for gold for the remainder of the year could be anywhere from \$1500 to \$2100 an ounce, so a lot of volatility, we expect, in the gold price.

Q: Is gold still seen as a safe haven by a lot of investors in this market?

A: It has not shown to be a counter or alternative asset; when other asset classes are going down, gold has also gone down in sympathy. And I think that was highlighted when the question about the European sovereign debt crisis were at its height and the euro itself started to decline and gold went down, so a lot of people say, "Wait, I bought gold for an end-of-the-world, wheels coming off the developed country economic system scenario," and that really didn't happen. So, I think that there is a potential loss of confidence in gold to act as kind of that insurance policy, but I think a little bit of that is maybe missing the trees for the forest. And the forest is that globally, there is, as has been well discussed and documented, a competitive currency devaluation by the major manufacturing and hopefully exporting countries around the world. Over the longer-term, during this period,

certainly since the beginning of the massive Chinese devaluation in the '90s and the US creation of additional money supply and so forth since 2008, you've seen substantial strength in gold. So I think over the longer-term, gold is still a valid alternative currency, but it's subject to these shorter-term trends occurring when market participants are looking for liquidity in the very short term.

Q: Do you see the potential for rising interest rates as a near-term threat to the gold price or is that a longer-term issue at the moment?

A: It can be a threat -- I mean, if all else stays the same and interest rates go up, we say that would be very negative for hard assets. But to our minds, the most important question is: Where are interest rates relative to inflation and inflation expectations? So, you know, for the last 12 months in the US, end of March, the CPI all items index went up about 2.7% in the 12 month period. Two year Treasuries yield 25 basis points. So, essentially those who owned treasuries for the last 12 months have lost -- this is ballpark, of course -- about 2.5% after inflation is taken into account. So if you have treasuries that yield 25 basis points, say they go to 150 basis points... you're still losing after inflation. Our guess is that [interest] rates will start to go up as inflation kicks in.

Q: Obviously gold equities had a bit of a tough first quarter, while gold managed to post a gain. Do you see the disconnect between gold equities and the physical bullion price narrowing anytime soon?

A: If you look at the gold price relative to the pricing of gold mining equities, the valuations are so attractive for gold mining equities; it's really amazing. And the difficulty is screwing up one's courage and taking the plunge, because so much of investor thinking is past performance, whereas we all know, no matter what we are thinking, that actually, for an investor, the most important things are future returns. So, you're seeing very well managed gold mining companies with diverse, global portfolios and plenty of access to capital markets, both debt and equity markets, selling for very low valuations sometimes, current P/Es of 9 and 8, and very low cash flows. Valuations, I'd say, we last saw in the panic time of 2008 and prior to that, I just can't remember, having been in this business since the early '90s. And the cash flows these companies are getting are just enormous, relative to their total market capitalizations. A caveat of course, is that as the countries around the world are strapped for cash, governments, we're seeing more political expropriation.

Q: What else are you looking for in a gold stock in this environment?

A: I'd say the most important single characteristic for a gold mining stock in this environment is access to capital markets. The smaller cap companies that do not obtain reasonably priced equity capital or debt capital are kind of stuck. They may have excellent mines and terrific personnel, but mining is a capital-intensive business and without access to those markets, or access only at a very diluted and expensive price, they really can't go forward. But the large companies that are well managed with accessible balance sheets still have access to capital markets, can still bring projects online, and you can pay very little in terms of cash flow and earnings to get their shares. But they're really, I think, in the driver's seat; the one interesting thing in my mind is that their own reserves and resource statements tend to have been generated at much lower gold prices, around \$1000 an ounce or whatever it is. If you attempt to figure out what of their portfolio in ounces is economic at spot rates for gold, a lot more of their properties and the resources come into their actual reserve statement. They have huge amounts of potential projects and ounces to bring into production, going forward. They almost don't need to do deals to show very attractive growth rates.

Q: Are you expecting more M&A in the sector this year?

A: M&A has really been kind of light, I'm surprised how little M&A there's been, but what we see generally is that most M&A has negatively affected the acquirer. Most M&A has resulted in destruction of value for the acquirer and we've seen **Kinross** (KGC) shares, particularly, decline and the write-off of goodwill has been enormous for them. **Agnico-Eagle**

(AEM) has also had problems with their Meadowbank acquisitions and other acquisitions where they just can't bring those Arctic ounces in as they were hoping. So, I would think that once those memories become more distant, and animal spirits again rise to the surface, there will be more M&A but I think those wounds and the fallacy of doing acquisitions of that nature are still too fresh, so I won't expect M&A until probably the fourth quarter.

Q: Looking at your portfolio, which of your holdings or even stocks you're considering seem the most compelling to you right now, or are your favorites?

A: I'd say an intriguing one, and this is one I would not necessarily recommend for most investors, is **AngloGold** (AU). The South Africans are fascinating because they have been sold down so hard and they have generated significant cash flow. The fun thing about the South Africans is that if the dollar gets strong, that's usually negative for gold, because most gold miners produce and have expenses denominated in dollars, so if the dollar gets strong, their expenses go up and so forth. The South Africans, most of their expenses occur in South African Rand, so AngloGold -- to an extent it has South African operations -- and they are diminished too, I think they're less than half now of revenue; it's somewhat protected, has a built-in hedge against dollar appreciation. They generated free cash flow around a little bit over \$800 million; they're paying down debt dramatically.