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COMMENT

How not to piss it away next time

Keynote speech, Denver Gold Show, 2014

The following keynote address was given at the 25th Denver Gold Show in Denver, Colorado, on September 15, 2014. Afterwards, we were advised by more than one person in the audience that the text was "depressing." We had thought that the implications of our central thesis — there just isn't enough gold to make a good business out of it — was wildly bullish for gold. One gentleman, a well-known executive, quipped: "Umm, it did not come through like that," with a slight grin on his face. We responded by pulling out a phone and quoting a few passages from the a place near the end. "You must put," he advised, "the good parts at the beginning of a talk. By the end of a talk it is too late." Being a very effective public speaker, we will take his advice. Here is what we would feel to be our key takeaway: "The outrageous spiral of credit that we now see will one day have to be monetized and when it is, it is to us where finance will turn. And next time around there will be much more credit chasing far, far less gold." Isn't that bullish enough as to the implications for the gold price? We thought so. Ok, so now for the depressing parts. We note that there have been some minor corrections made but otherwise what follows remains faithful to the text given at the show.

We first came to Denver, to this show, fifteen years ago, back in 1999. Gold had been mired beneath $300 and all hope had been lost. Yes, there was the sugar high of the Washington Agreement, but all that got us was two damaged companies. It felt like the end of the world. Central banks were going to sell all their gold at any price. The US dollar was on a tear. Tech stocks were booming. There was peace in our time. The end of history was clearly bearing fruit.

The report we wrote about the conference was entitled "Beer and Skittles at the Rock Bottom."

In such an environment gold as an asset class was pretty much done. And then rhetoric at the conference pretty much reflected that. It was all about cash costs and making do in any price environment, development and regeneration costs be damned. "What we actually mine is besides the point", to paraphrase one company's message, "we are a business first and foremost and our aim is simply to make money." Gold's monetary qualities were a topic that dare not speak its name. Instead, there was talk of an effort to engage an advertising agency to peddle the metal as jewelry. Gold wasn't money, rather, it was bling.

For the gold bugs amongst us, which, from what we could tell, was pretty much everyone from the investor contingent, it was a pretty dark time. One geo we knew, a geo who went on to make one of the very few major discoveries, was sleeping on his mom's couch. Another had had his front tooth knocked out, but didn't have the dough to see a dentist. Instead, he used glue to affix the knocked-out part back on to the stub. The problem was, it was dissolvable glue. So that meant that when he went around looking for money so that he could make option payments, he only had about 30 minutes or so in front of potential investors to make his pitch. If he couldn't get his pitch in in that time frame, the knocked-off bit would fall out again. Dark times indeed.

Of course, as it turned out, the end of history was proven to be somewhat premature. As we all know, the metal proceeded to move from sub-$300 to almost kiss $2000 over the ensuing twelve years or so. Our community posted some good numbers over this period, at least for a while, and this was while equity markets in general largely treaded water. Vindication was at hand. Our friend got his tooth fixed.

Since these more frothy times we have, obviously, had a pullback. But the metal belies how bad things really are now, a sentiment I am sure we all can share. Some of us are surely better off now than we were in 1999, but many of those who invested in golds are not. If the metal still shows some measure of respect, the shares do not.

The economic hit here was bad, but the reputational hit was far worse. We were right on our investment premise – monetary disorder was at hand as comeuppance for credit run amok – and we went and squandered the opportunity. The last two years have confirmed the suspicions of our sector – not only are we alarmist yahoos, we are also terrible businessmen, not to be taken seriously. Just go look at the tape, generalists will tell us: the brightest investors in the gold business were in aggregate outperformed by a hunk of metal. And that is before deducting management fees.

We, as a community, must take some responsibility for this. The critics have a point: we did squander an epic opportunity. We called the market. We called the macro direction of the globe's economic direction for a decade out. We were right. And then we went and blew it. I can only speak for myself, but this does not reflect well.

Of course now, 15 years on from the nadir of 1999 we find ourselves in the nadir of 2014. The parallels are eerily similar. There was an old bumper sticker that was popular in the oil patch in the early eighties which read: "*Please God let there be another Oil Boom. I promise not to piss it all away next time.*" With techs flying, with equity multiples speaking to never ending nirvana, with risk being for cowards and with the end of history once again firmly within our grasp, we will surely get another boom in bullion. We will get a second chance. The question before us today is, when we do get that second chance: what must we do so that we don't go and blow it again.

Figure 1: *Gold price history, 1999 to present.*

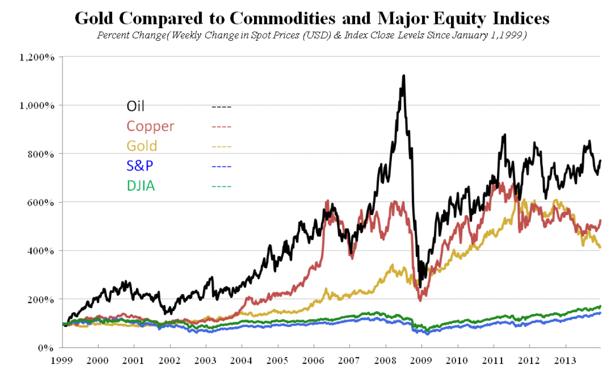

Figure 2: *Gold price performance relative to other commodities and major equity indices.*

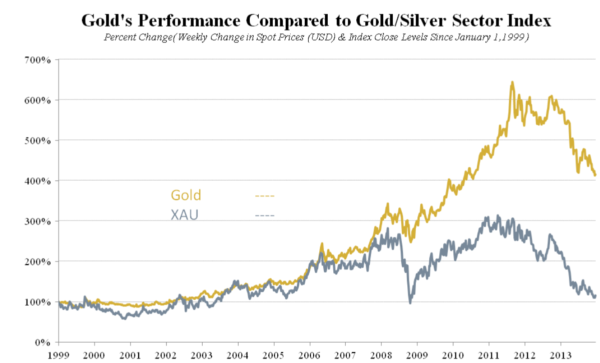

Figure 3: *Gold price performance relative to gold and silver equities.*

Could we have done better?

I think in our heart of hearts we all know that we could have done better. But for sake of the record, let's review how much we could have done better.

Between 1999 and 2013 gold rose by 600%, or about 13% if compounded annually (Figure 1). Even after the pullback this is nothing to sneeze at. If any of us could knock back these numbers out year after year we'd find ourselves in a book somewhere.

This is not to say other commodities also didn't do well over this period. They did. Copper moved from about 60¢ to $3 while oil went from $12 to $100. In this regard, gold did not outperform. But insofar as the rise of the commodity complex reflected the shrinking value of the money, a concept held dear by the gold bugs, I suggest we should take credit for the commodity performances as well.

Against the general street, this was all spectacular. The S&P did just about nothing over the same period (Figure 2). Ditto for the Dow. We were right when everyone else was wrong.

Now, let's look at the shares (Figure 3). We can measure this in any number of ways, but let's start with the XAU, a measure of the senior producers. Between 1999 and 2014, the XAU traded pretty much flat. That's an amazing stat. A dollar into bullion would have returned you six. A dollar into the shares would have returned you back your dollar.

This actually overstates the performance. The largest weight in the XAU is Freeport, a copper stock. If we were to remove Freeport from the index, performance

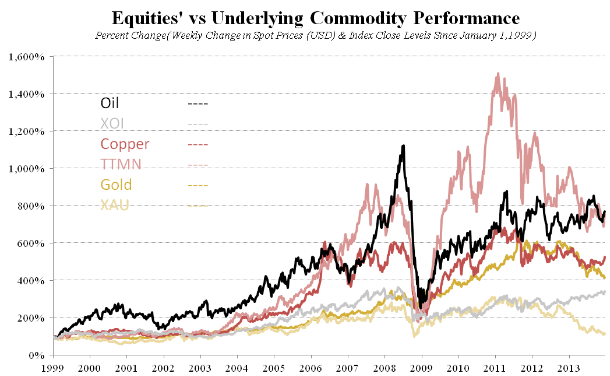

Figure 4: *In relation to the underlying commodity, gold stocks underperformed the most.*

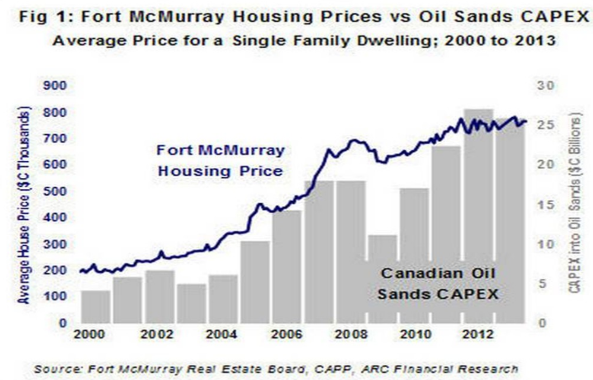

Figure 5: *Cost pressures were not unique to the gold sector, and therefore do not fully explain poor gold equity performance.*

would have been a fair bit worse.

There was a mantra back in the day that a rising tide would lift all boats. This was wrong. The rising tide did not lift all boats. In fact, in aggregate, the rising tide lifted no boats at all.

Other measures of performance include the smaller producers and the explorers. Remember, the premise of the nascent producers and exploration companies was that they offered a cheap option on the gold price. How did these companies fare? We don't have a chart of this, but we all know that cheap option didn't turn out to be that cheap. This group markedly underperformed the senior producers.

And then there were the companies that never made it into any index at all. This would be most of them, in passing. If a junior dies in the forest and an ETF is not there to reflect it, is money lost? Yes, yes it is.

Alright, so gold equities in aggregate treaded water for 15 years, at best. At worst, folks lost all their money. What about the comps? How did other commodity stocks do by contrast? Is it just us? Or is there something in the water that affects all commodity producers?

It appears it is just us. Here is a plot of gold bullion and the XAU (Figure 4). Now we plot oil and oil shares and copper and base metal shares. Oil is in black and oil shares in gray; copper is in red, and base metals shares in light red. Unlike gold shares, which were effectively flat, senior oil shares were up about 300%. Base metal stocks, as measured by the relevant TSX index, were up a lot more than that. So, it wasn't something in the water. Other commodity producers managed to seize the day and hit it out of the park. It was only the gold who laid an egg. Why? Why did we screw up do badly?

Theories as to why performance was bad

We would rather talk about this first, for there has been no shortage of reasons offered for our underperformance. The cynics would say that these reasons are simply "excuses". We are not sure this is quite fair, for there is a grain of truth in each of them. Let's review in turn:

1) Cost-push destroyed our margins: There is no doubt that we saw massive cost push in the sector since 1999. The price of everything went up, from steel to chemicals to labour. When I was going through mining engineering school in the mid to late eighties, summer jobs were scarce. Ten years later, a geo one year out of school got paid $100k to hump a drill rig and log core. The consultants were all backed up. Everything was late and that cost more money yet. We could go on. You know what the conditions were like as much as we do. It was a very challenging time to do business. We know that.

All that said, it does not explain the gold equities poor performance. Cost pressure hit base metals in precisely the same way they hit the golds. And cost pressure on the oil patch was similar – look at this chart of the cost of housing in Fort McMurray (Figure 5). If housing triples in cost, labour will be soon to follow. If these two sectors – oil & base metals – did not get hamstrung by escalating costs, then how can we use this as a reason for gold's underperformance? In a word, we can't.

2) The Bullion ETFs soaked all the money away: It is true that, for the first time, most investors over the last cycle had a choice. And there is no doubt that this competition sapped flows from the equities. But does that explain the poor performance?

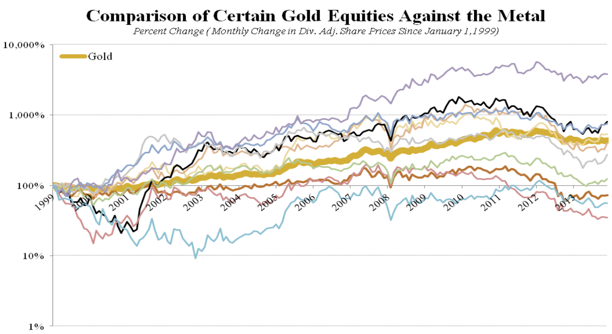

Figure 6: Some gold equities outperformed the metal, despite underperformance in aggregate. In our view, this is evidence that structural issues in the gold industry were not insurmountable barriers.

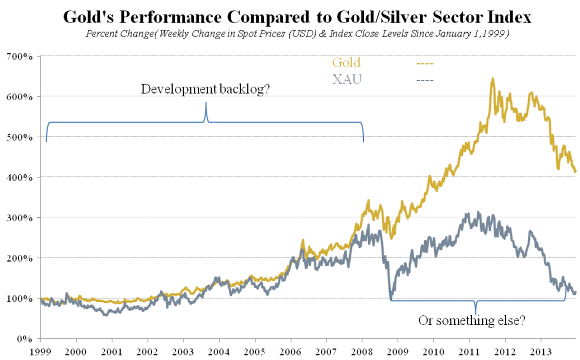

Figure 7: Much of the equity performance drag occurred well after the bear market of 1999-2001. It is unlikely that problems 15 years ago were responsible for the performance illustrated above.

First off, inflows into bullion ETFs surely had a positive impact on the gold price and, by extension, gold companies' top line. This doesn't speak directly to the point at hand, but I thought it worth pointing out that the equities should be grateful, in this respect, that these conduits existed.

As for "stealing away investment dollars" – really? The fact remains that gold equities had every chance to prove that, in addition to benefitting from a rising price they could, unlike the bullion ETFs, also generate a return. If gold companies had been able to do this, then more investment dollars would have surely flowed their way.

Proof-in-pudding here lies with the fact that a few gold producers *did* generate such returns and they *did* outperform the ETFs (Figure 6).

Competition is supposed to enhance performance, not detract from it. Can gold equities only do well if we have a monopoly in the space? Can we not do better?

3) The bear market of 1999-2001 left irreparable scar tissue: There is no doubt that $250/oz was a lousy price and that there was suffering in the producer community. Companies did get behind on development, especially the hardrock, narrow veined set. We agree there was some catch-up to do. That said, a few counterpoints:

3a) The USD price may have been awful, but the grade was a fair bit better than it is now and the FX, for many companies was also much more favourable. This is not to say times weren't bad, but maybe, just maybe, the times were bad less because the gold price was awful and more because outside funding had dried up. We will have a fair bit to say about this later.

3b) The pipeline in 1999 looked robust as compared to even five or ten years later. Goldstrike was still in a sweet spot, El Penon was taking flight and the entire dump leach industry was starting to make hay. As a result of a shift in some structural factors, including the liberalization of mine finance and the opening of exploration frontiers including, most importantly, South America, the gold companies had better inventories than they'd had in some time. This should have mitigated the low price environment and in many ways did.

3c) The tsunami of capital that flowed our way once the market turned after '99 surely made up for cash flows that had been choked by low prices during the bust years a few years before. If the study we have undertaken here stopped in 2004, then fine. But the underperformance went on for years, far outlasting any bear market hangover that might or might not have existed.

3d) Finally, copper at 60c also sucked. And look what they did.

At the end of the day, we note that the underperformance of the shares started well into the cycle. (Figure 7.). This should dispel the notion that the last bear market "held the shares back". Rather, it points to something that happened once the cycle was well underway.

4) Gold has qualities that make people lose their minds. Maybe this is true. But what is it about the metal that makes people go nuts? And is there a better way to express what people mean by this?

5) We are all either stupid or greedy or both.
That's how general resource managers would characterize the problems in the sector. We think it is more

complicated than that.

The short answer as to why performance was bad

The short answer as to why share performance was poor is simply because gold mining has been a crappy, crappy business. There is a longer, more interesting answer that we will get to in a moment, but the best, most direct way to explain the share performance is to look at the underlying business performance, which has been, to say the least, uninspiring.

Let's take a brief moment to walk through the business performance of a representative group of ten senior gold producers and then compare that to similar representative groups in the oil and base metals business.

Plotted here (Figure 8) is the retained earnings plus cumulative dividends of this group of gold producers since 1999. The value of these senior gold producers as seen through an accountant's eyes has risen by only \$6b. Ten companies. Over fifteen years. When the gold price rose six fold. And we only have \$6b to show for it.

We can perform the same exercise on the oil stocks (Figure 9). Here, retained earnings plus cumulative dividends has increased from \$150 billion to \$1.3 trillion, a more than 800% increase.

And for base metals, retained earnings plus cumulative dividends has increased from \$23 billion to \$313b, a more than 1000% increase.

This represents a massive outperformance as compared to the gold companies. It is actually a fair bit worse than that. Not only has the value of gold businesses stagnated, but the businesses themselves have been divided into increasingly smaller pieces.

Most gold guys premise their investment thesis on the natural prolificacy of the central bank money printers. In this regard, we were surely right. Boy, did they print. We were right on that score.

But the shame of the sector is that we arguably printed more than them. The irresistibility of issuing scrip against future gains is surely a universal temptation. If people can, they generally do.

Here is a chart of production per share for golds and the oil companies (Figure 10). If you owned a gold stock in 1999, your share of production decreased dramatically over the next 15 years. Whereas in oil, your share of production increased smartly over the same time frame.

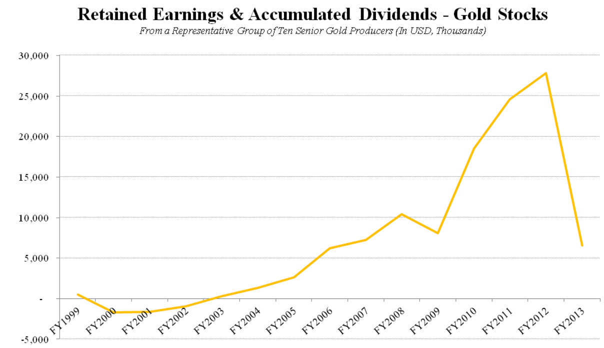

Figure 8: *Total retained earnings plus cumulative dividends are plotted over a 15 year period, for a representative group of 10 major gold producing companies. The total increase for these 10 companies was \$6b.*

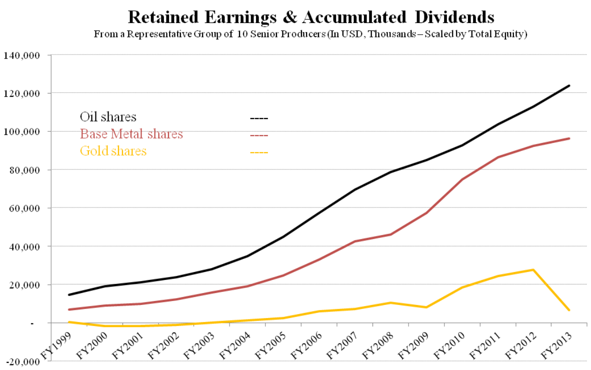

Figure 9: *The results from Figure 8 are compared to similar representative groups of companies in the oil and base metals sectors. For the oil group, retained earnings plus cumulative dividends increased from \$150b to \$1.3t. For the base metals group, they increased from \$23b to \$313b. A scaling factor was used in Figure 9 for more direct comparison to the gold group, rather than showing 3 vertical axes. The scaling factor used for oil was a constant 10.3, and 3.3 for base metals. These factors represent the average ratio (over the 15 year period) of total equity for our oil and metals groups to that of our gold group. Other scaling factors can be used, and were tested, but the trend remains the same.*

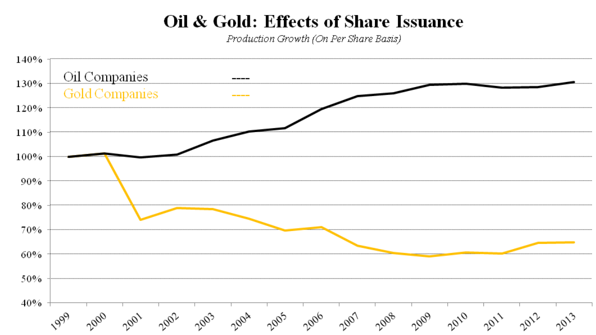

Figure 10: *Production per share of our gold group declined, while it climbed for our group of oil producers (base metals were omitted due to insufficient data at time of presentation). A conference attendee pointed out the large drop in 2001. We later traced this to a major share issuance by a producer with a significant weighting in our group of 10. This issuance was in connection to two major acquisitions.*

This speaks to something fundamental we must address.

In passing, we excluded base metals because we hadn't yet collected sufficient production data to make a fair comparison given the various products of each producer. But we would be surprised if this looked that much different than the oil group.

Why did the shares perform so poorly? We see the answers here: 1. Because the businesses themselves performed poorly; and 2. Because between the start of the cycle and the end of the cycle the investor ended up with a lot less business per share.

Are these two elements – bad business and bad capital management – related?

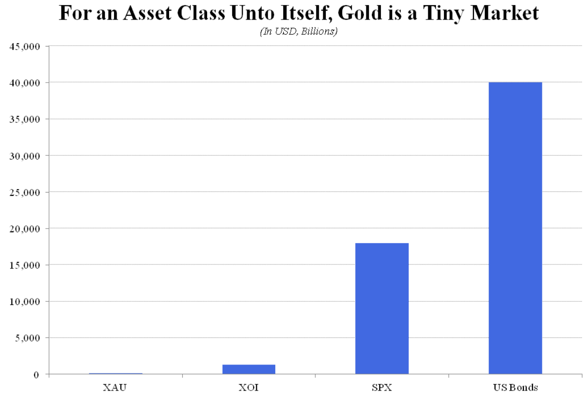

Figure 11: *Gold is a tiny sector as compared to stocks and bonds. But gold is an asset class unto itself, with disproportionately high demand by investors.*

<u>Why, then, is gold a crappy business? And why is capital management so problematic?</u>

Most of what we have said so far is likely depressingly familiar. Maybe here it gets a little more interesting.

No, we don't think we are stupid nor greedy, notwithstanding what the general resource funds are inclined to say. Yes, maybe we are somewhat crazy, but not stupid. Nor greedy, at least no more so than any other sector. Rather, it is our position that there is something intrinsic to the gold business that fundamentally mitigates against the sort of returns that we need as investors to compensate us for the risks we take.

Here is our theory in a nutshell: At current prices, there are not enough good opportunities in the gold sector to accommodate investor interest. This imbalance distorts decision making and leads to malinvestment. We liken the situation to trying to empty a pitcher of water into a shotglass. The shotglass gets filled, but everyone else gets wet.

Gold is an asset class unto itself that has macro characteristics generally uncorrelated to competing asset classes. This is to say that gold "performs" in times when other asset classes don't. The World Gold Council has done some great work on this as have others. When stocks sag – buy gold. When bonds unravel – buy gold. We don't need charts for this part of the presentation.

But here's the deal. Gold is a tiny sector as compared to stocks and bonds (Figure 11). The market value of the XAU is about $140b. The market value of the XOI, the senior oil index, is about $1.4t. The market value of the S&P is about $18t. The market value of the US bond market is about $40t. For an asset class unto itself, it is a tiny, tiny market.

And when this asset class comes into favour, all hell breaks loose. We visualize it as follows: some dude in London comes into the office one morning and decides he wants a position. "Position me," he says. "Half a billion." Now, half a billion into gold equities with a push of a button into such a small space is an awful lot of gold equities in an awfully short period of time. And the money has to go somewhere, doesn't it? But what if there is nowhere for it to go?

Getting back to the analogy of the pitcher and the shotglass, why don't people get wet in oil or, say, copper? This is a key question and the answer goes a long way in explaining the mess we are now in.

Here is our answer: unlike copper, unlike oil, gold has shown itself to be inelastic with respect to marginal flows of incoming capital. This is to say gold's capacity to absorb incoming capital efficiently has shown itself to be limited. The money has nowhere good to go. The opportunities just aren't there.

Compare gold with the oil sands. Heavy oil in Alberta lies beneath much of Eastern and Northern Alberta in various grades, depths and qualities. The easiest oil was already being extracted even when oil was in a slump back in the 1990's. As the price of oil went up, it became economic to exploit areas where the resource was more costly to extract. The higher the price went, the further afield, so to speak, you needed to go to develop marginal capacity. But there was marginal capacity as far as the eye could see. Exogenous capital invested in the sector could, in this way, be efficiently deployed and provide the investor with returns commensurate with the risk.

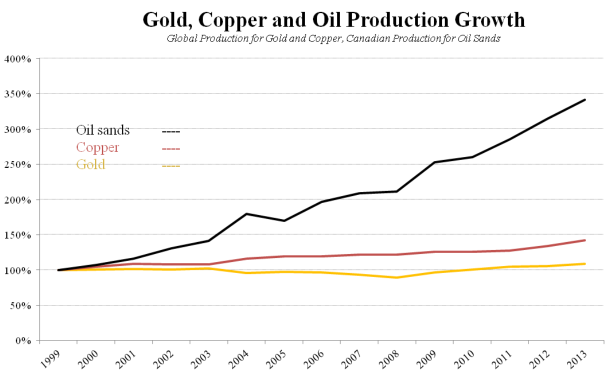

***Figure 12:** Using production in 1999 as a base year, overall production was roughly flat for our group of 10 gold producers. Production increased for our oil and base metal groups. We think gold scarcity is a relatively bigger problem for gold miners than commodity scarcity is for the other producer groups.*

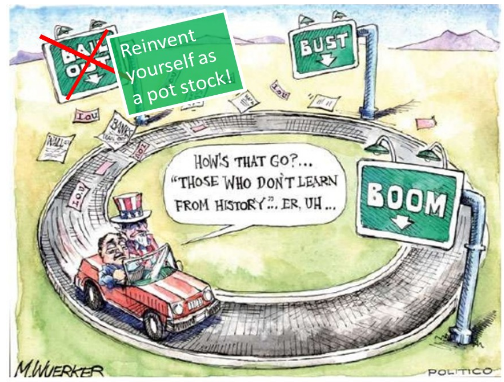

***Figure 13: Austrian Credit Cycle Theory:** This theory posits that artificially low cost of capital fosters "malinvestment" which, in turn, leads to the classic boom-bust business cycle. Normally, the culprits here are central banks, but the arguments here can equally be applied to the gold mining sector.*

The opportunities were elastic with respect to higher prices.

The same can be said of copper and base metals in general, although it is not as obvious as the oil sands. But at the turn of last decade, there was no shortage of subeconomic base metals deposits. With gold, not so much….

For whatever reason – and we can talk about this – the gold sector is inelastic with respect to marginal inflows of capital. This is clear by the numbers. It is difficult to get an exact number of how much money sloshed into the sector over the last fifteen years - $50b?, $100b? More? – but it is a big number. And what was the response of the industry? Gold production pretty much flatlined. Compare this with the oilsands and copper, both of which, in response to injections of capital, saw robust growth (Figure 12).

It is really quite amazing that we chucked billions and billions and got no supply response at all. What this tells us is that there is simply not a lot of gold out there. How many genuine finds were there in the last cycle? Half a dozen? A dozen? In fifteen years we might have discovered enough new material to keep the mills turning for two or three years. The raw material was just not there, even in the face of the avalanche of money to tease it out.

To step back and re-cap: being an asset class unto itself which from time to time comes into favour generates substantial investment demand. Gold is a small sector to begin with – lots of money into a small sector drives down the cost of capital and encourages issuance. Against this there are fewer still opportunities within the small sector to invest the incoming capital in projects that can reasonably be expected to provide a return commensurate with the risks. Supply/demand kicks in and the cost of capital for "bad projects" gets driven down. Money gets raised. And it ends in tears.

This is a structural problem unique to the gold sector. And embedded in this structural problem is an element of self perpetuation. Limited opportunities in a small sector that is an asset class unto itself. It is like getting incentivized to pick fruit from the same depleted orchard. And as the orchard gets more and more depleted the remaining fruit is perceived to be that much more valuable. Rinse and repeat.

Austrian Credit Cycle Theory (figure 13) posits that an artificially low cost of capital distorts investment analysis and fosters "malinvestment." The primary whipping horse of the Austrian School has been the central banks, printing money at will and, by this, sending counterproductive signals to investors. And they've been right on this: time shares in Vegas met their fate and ghost cities in China will surely meet theirs. Both these examples stand as monetary artifacts.

But gold equities too stand as monetary artifacts. The malinvestment is all too clear. The industry, clearly incapable of feeding itself on a sustainable basis through retained earnings, has designed itself to attract evermore capital, because, that is how we've learned to survive – you do what you gotta do. Instead of a wealth creation engine, the gold equity space is more likened to a wealth tractor beam. And that has only made things worse. Gold equities are arguably the mining equivalent of Chinese ghost cities. Again, the problem is structural. We, standing here, have no easy answers except to say that if we are to become a sustainable industry – a "real" business as the generalist would quip, we need much higher gold prices.

Can we do better next time around?

If we are right about all this, namely, that the cause of the underperformance is structural, it is going to be tough to do better next time around. That said, we'd be remiss if we didn't try. A discussion here would thus be constructive.

A look at the central actors in the gold equity space – issuers, brokers and the buy-side – will reveal that each has a localized interest in perpetuating the patterns outlined here. For example, the fund manager is acting in his own interests to accept money from that dude in London. It would be very difficult for him to say, "You know something – keep the money. Yes, of course we like the sector, but there is nothing attractive to invest in at these levels. Put the money into the metal instead and buy me lunch sometime."

As for the brokers – us guys – we are highly incentivized to sell freshly minted stock as opposed to off the run stock on the board. Commissions on new issues are about twenty times greater than off the run agency trades. Everything, including research, is thus skewed in that direction.

And the companies are, at least from one perspective, crazy to say no to cheap capital. I remember Seymour Schulich saying at a Euro Nevada AGM back in 1999 that if someone offers you two dollars for a dollar, take it.

So there is a paradox such that if everyone acts in their own interests, we end up acting against our own collective interests, printing shares, raising money and plowing them into bad investments.

So one thing we can do, against the grain, is try to shave these incentives back into our collective interests. For example, it may be in a company's short term interest to take cheap money – two dollars for a dollar, as it were – but if you take that cheap money and go and blow it, long term, are you better off? We found no clear pattern between issuance and long term performance as we thought we might – maybe we are not looking at this in the right way – but we do note that the best performing gold stock has, after its initial raise to get its first mine going, hardly issued any shares at all. Buying new issues may not be a sound investment strategy long term.

As for the sell-side – and here is our thirty second self-interested pitch – there are lots of good gold equity analysts out there but I am not sure they get paid to say what they really think. This phenomenon is hardly unique to the gold equity sector, but any effort to direct incentives for analysts away from serving the banking group would help everyone longer term.

Levelling incentives will help, but what we really need is a much, much higher gold price. If we want to be able to accommodate an influx of capital in such a way as to provide investors a return, we need somewhere to put it. And right now, at these gold prices, there are very few places to put it. Future gold production will come from 1g/t deposits in the Maricunga with a purpose-built de-sal plant on the coast for the mill. We need $5000 gold for this to work. Let's, as an industry, say as much.

This is all to say that we think it would go a long way to be more honest with investors. The industry now is set up to draw in capital, because without the influx we'd all be out of a job. This is long term unhealthy. Gold mining at $1300 sucks. We are not self-sustaining at $1300. We are not self-sustaining at $2000. We need much higher prices if we are to become a real business, namely, to make enough money from one mine to find and build the next mine. We are nowhere near that now.

We must say as much. But we don't. Instead we come up with evermore taglines. The tagline in 1999 was "cash costs". Today it is "all-in sustaining costs."

"All-in" – full disclosure! No catches! And "sustaining" – we can last forever! We have the lungs of a Kenyan marathoner!

Of course this is grossly misleading. If you want to see a sustainable industry, look at Potash Corp (Figure 14). Potash has an average mine life of about 80 years. They don't drill. They don't have to. And they operate on way better margins than the average gold company. Why can't we do this?

Copper wouldn't look quite as good as potash, but it would look at lot better than gold. Evidence over the last cycle suggests it takes ten years to put a new find into production, plus minus, if it ever gets into production. Viable gold industry reserves don't stand at a whole lot more than that now.

We have no idea what the true cost of sustainability is. We can estimate the cost of looking for gold, but

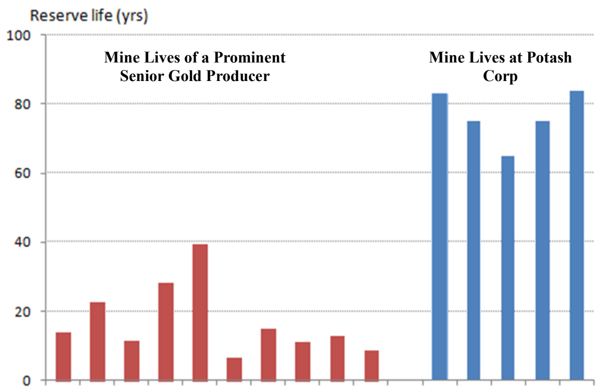

Figure 14: In the red we see the reserve lives of a given senior gold producer as measured in years at current production levels. In the blue, the same for Potash Corp. One business is sustainable, the other is not.

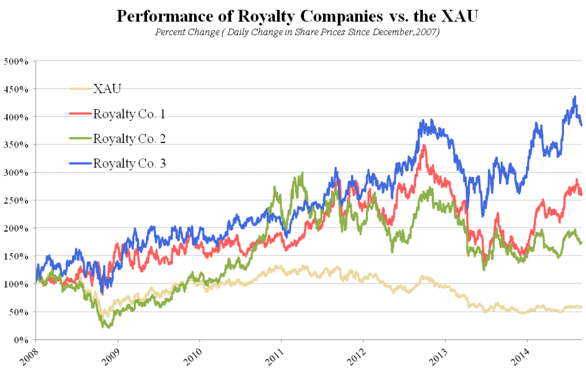

Figure 15: Royalty company performance was significantly better than gold equity performance.

we cannot know the cost of finding gold. What we do know is that we ploughed in billions and billions and didn't find nearly enough. So the true sustainable price has to be much, much higher.

"All-in sustaining costs" is thus more accurately defined as "break-even run-off costs." Or, put differently, the price of gold at a price where the investor loses all his money once the gold runs out.

I think we need to say these things a little more forcefully. If we were to do so, it would go some ways in taking back price influence from the financial types and paper punters who opine about death crosses and waves and other distractions. To the central actor in the market – producers – gold is now desperately cheap. Yet we, the producer community, are the muppets of the business. We are hapless price takers. And we make the difference up with other people's money. This is unlike anything you would see in oil or potash, among other commodities. In this respect, with a nod to the aforementioned, consolidation in the sector would also strengthen our hand. This will likely happen in the coming years and it will be none too soon. But let's start with some blunt honesty first and reclaim the market that should have been ours all along.

Does any of this matter?

We think this matters a lot. We mentioned that back in 1999 there was talk of getting an advertising agency in to help brand gold a little better; de Beers and their efforts with diamonds were off-cited as an example to follow. We, along with most investors, thought a campaign relegating gold to mere jewelry detracted from its long-standing and proven utility as sound money. I think we have been proven right in this regard. In the least, Cyprus would agree.

But this is not to say "branding", as it were, is not important. It is. And if were to brand gold as a monetary asset, how would we do it? Here is our 30 second chip shot at Madison Avenue: Gold is a fundamentally conservative asset; it speaks to prudence and its natural home is in a defensive portfolio. It is where you go first and foremost not to lose money. Gold equities should be something that you can depend on. We need the shares to have the same characteristics as the metal – defensive, prudent, something that you can depend on. In this regard, we have really fallen short.

Substantiating this thesis is the performance of the royalty companies. As compared to the more traditional producers, the royalty companies have been a moonshot (Figure 15). Their great accomplishment, as we see it, is that, for the most part, they haven't gone and stepped on any cow patties. They haven't gone and lost anyone money. Look at their multiples now. One royalty company advertises itself as like a bullion ETF but one that offers a return. This formula seems to work, no matter the size of the return. Producers should take page from this book.

We don't know how much to read into this, but a few years ago we note that the shares broke before the metal (Figure 16). And by the time the metal did break, a lot of people had already lost a lot of money on what, certainly in retrospect, were foolish propositions. And if one loses money on the shares, how are you going to feel about the metal? Likely, not so much. If we want to see long term appreciation in the sector, we must be mindful that a loss of confidence in one part of the sector will surely infect what's left. We all have an interest in protecting the brand. This

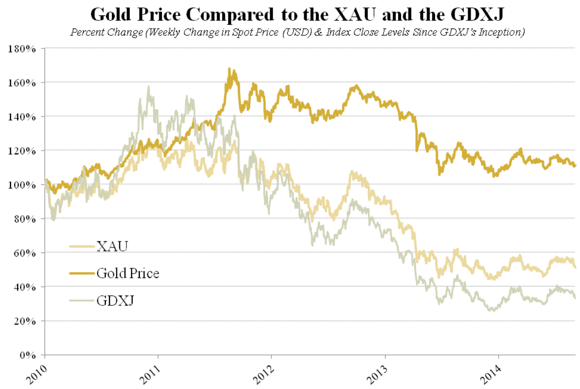

Figure 16: *The decline in gold equities starting in 2011 seemed to lead the decline in the price of gold. Is it possible that the two markets are connected via a common brand?*

collectivist prescription may grate against the politics of the gold bugs, but I am from Canada. And as everyone knows, we are all socialists up there. But still….

All this said it will remain a challenge not to repeat the mistakes of the past. Between politics, geology, and sundry technical challenges, gold mining will in the best circumstances remain a tough business. And even if we do get a gold price that allows the sector to exploit the marginal opportunities – and either we will or we won't have a sector left – the sector will remain tiny as compared to the asset classes that will be trying to rotate in. This will once again drive down the cost of capital and temptation will again reign.

Put differently, as set against oil and base metals, we will always be the pretty girl at the ball. We will always receive more attention than our dance card will allow for. And the suitors will always be charming. We are stewards of the world's future gold production, and this production will prove to be precious indeed. The outrageous spiral of credit that we now see will one day have to be monetized and when it is, it is to us where finance will turn. And next time around there will be much more credit chasing far, far less gold.

A policy of total modesty is not the answer and that is not what we are suggesting. There is nothing wrong with flaunting our wares. But at the next ball, when suitors swarm, if we manage to comport ourselves in a manner more in keeping with our high station, we feel there will be less regret come the morning after.

I thank-you all for your time.

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September 15, 2014

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