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THE NORTHERN MINER

THE GLOBAL MINING NEWSPAPER

www.northernminer.com

OCTOBER 17-23, 2011 • VOL. 97, NO. 35 • SINCE 1915

The gold run has only begun, gurus say

BY ANTHONY VACCARO

VAIL, COLORADO — Moderated by pension fund manager and published gold bull Shayne McGuire, a robust discussion on the finer points of the yellow metal unfolded at the Precious Metals Summit between Thomas Kaplan and John Hathaway.

Kaplan is the founder of Tigris Group and the chairman of The Electrum Group, a New York City-based investment, advisory and asset-management firm with a principal focus on natural resources.

Hathaway is the senior managing director at Tocqueville Asset Management. He is the portfolio manager of the Tocqueville Gold Fund, Tocqueville Gold Partners and the Gold Equity strategy.

What follows is not a direct transcript of the talk. Rather, it captures highlights from the question and answer session.

Question: Do you see a return to the gold standard?

Thomas Kaplan: We're not allowed to say we do. The easiest way to be discredited is to make a case for the gold standard . . . if you want to appear like you are a know-nothing troglodyte, then say we are going back to the gold standard.

John Hathaway: I don't think the premise of investing in gold is based on going back to the gold standard. It may or may not happen. But the fact that gold is readily available to every citizen has democratized gold and made it part of the everyday conversation.

We will continue to measure paper assets against gold, and we don't need it to have an official status.

Gold is still seen as a fringe asset. But at least now, we can talk about it in polite company. It used to be just Tom and me, and a few others.

It is now the benchmark against which fiat currencies are measured, because what's really happened is that the opinion of paper has gone down so much. It's not that gold has appreciated so much.

Are we in a gold bubble?

TK: John Paulson asked, 'Why own gold?' And he said that when he looks at all of the other currencies, the only one he wants to be denominated in is gold, because you can't print it or debase it.

John Hathaway said that for all those who believe there is a bubble in gold, the bubble is not gold — it has been in paper.

And now, after a 40-year experiment which has failed, gold is allowing investors to be their own central banker in the classic sense. They can manage precious metals in-line with currency.

JH: My observation is that individuals are quicker to make investment decisions, and foundations are more involved in dialogue.

But when you come to pension funds — even college endowments and unions — there is no exposure to gold and no interest. Sovereign wealth funds, they tend to be bureaucratic and slow to decide. So there's some interest there, but no action.

What you see in the press is a lot of ink that leads people to think that maybe [gold buying] is overdone. But what I see is that people are generally underexposed and paralyzed, because the gold price has done so much already.

And they're thinking, maybe I'll buy on a pullback. And then when a pullback happens, everyone gets scared and no one buys.

What is happening in Europe, and how can it affect gold prices?

TK: The trajectory on the gold price is up, and all the reasons that would make one bullish over the years have only been accentuated by what is happening in the world . . . [Juergen] Stark's resignation tells you all you need to know about Euroland.

It's hard to imagine that the euro could come on par with the dollar.

Fiat currencies are all relative instruments, and all the central banks want lower currencies right now. The U.S. doesn't want a stronger dollar and the Europeans would love euro–dollar parity, if in getting there the very existence of the euro itself wasn't called into question.

The Japanese want the yen to move down, the Swiss want the franc pegged to the euro . . . all of the paper is rubbish. It's all toilet paper. On occasion — because we can print it — the U.S. dollar is double ply.

What about central banks, and fiscal and monetary policy?

TK: For first time in 30 years, central bankers are net buyers of gold. Every day, new governments want to have their reserves in gold.

The official sector is competing with the private sector over something miners can't produce enough of, and that is a perfect storm.

Gold could go to US$10,000 an oz. And it could go higher. I see no reason why gold can't do what the Dow did. In 1983, the Dow finally broke through 1,000 points, and then marched up to 14,000 points over a couple of decades.

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If someone had said back then that the Dow could go from 1,000 to 14,000, they'd have asked what you were smoking.

I don't believe the real move in the price of gold has even begun. I think this is all just foreplay. I think they're playing with us.

JH: The key thing is that currencies are the instruments of the state. All instruments of fiscal policy and social policy in the U.S. for the last 50 years have been redistributionist and creating safety nets and entitlements, and the dollar reflects that.

The obligations of the state are baked into the currency, and those promises can't be kept. They won't be paid in full and instead will be devalued. And that devaluing will be done in terms of inflation.

We would need another Paul Volcker or Ronald Reagan to come along to derail the gold price, and I can't see that happen.

Rolling it back will be painful and politically contentious. But that is what would have to happen for me to say, 'Game over.'

The disease is widespread in all Western democracies and changing that will be very, very tough.

What is the future of mining in the developing world, given that some central banks may covet the gold being mined?

TK: Ultimately, jurisdiction will be a huge factor in gold mining.

What you will find more and more is that gold and silver mines in less-developed countries will be looked at by those governments as the only secure source of cashflow.

When that happens, no sense of decorum will prevent a sequestration of gold output. Now maybe it will be done fairly.

The tide toward keeping gold within a country's borders has begun. We see it in Russia. China and Venezuela are talking about it.

But of course, it would be better if they allowed companies to develop mines, and then nationalize them.

It will happen more and more in Africa as well. Hopefully it will happen in a gentlemanly way, because they don't want to destroy the golden goose.

Central bankers don't want to appear to be idiots. So it is only natural that they are saying, 'Let's reverse course.' Up until recently they were selling gold. They were the ones meeting the supply gap.

So what happens when they stop selling? We're beginning to correct a 40-year aberration, and there's no reason that correcting it won't take decades longer.

What is the best way to play gold going forward?

JH: Gold equities are what I'm invested in. They are like very long, dated options on the gold price... in-the-money options that pay dividends, and are based on value creating activities that are independent of gold prices. Mergers and acquisitions activity, mine construction, discovery — they are all value creating and within the confines of the gold-mining business.

Gold is terrific, but it is an inert object with monetary traits. And that's great, and valuation of that in paper will continue to rise. So hey, why not have exposure that gives you that, plus something other than currency depreciation?

That is the broad case for gold equities. And they are as cheap as they have been since the bull market started. I view gold stocks as a layup.

What industry has rising cashflows that are undervalued? It's a short list.

We just have to say, look at fundamentals. They are cheap stocks, and if you want a call on gold, they are a great way to play it.

TK: One of the greatest questions out there is: Why is there this disconnect between gold and gold equities?

My theory is that there is a level of disbelief in gold's ability to maintain its price levels or go higher that is absolutely astounding.

It is an incredibly under-owned asset. It's the contrary of a bubble. With a market cap of US$400 billion globally, they are under-owned and gold itself is under-owned, and its price is rising because there's not enough of it to go around.

As for mergers and acquisitions, that will pick up, because majors will see the first inflows of real capital.

The real money will go to the biggest-cap companies first, because that's what you do when you're still not sure about gold prices... you go to the biggest names.

But then you will get a tailwind from the majors. All the producers without a growth profile will be the odd men out.

So the ones with more growth will be the institution's favourites, because bulls will want as many ounces as possible.

When majors start to feel good about themselves because of their rising share prices and the institutions start asking, 'Where's the growth?' then they will use their paper more liberally.