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Evy Hambro explains why he believes gold fundamentals support an upward pricing trend.

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golden opportunities?

Over the past nine years, gold has managed to post successive increases in its annual average price, navigating the choppiest of waters. So far this quarter, against the backdrop of very volatile global equity markets, gold bullion gained 13%,* reaching highs of \$1,258 per ounce on the back of continued investor concern over the eurozone debt crisis and the prospect of this spreading to other areas. With gold hitting all-time highs in several currencies in recent weeks (including the euro), it is worthwhile reminding investors of the fundamental factors which may drive the gold price in the coming months.

demand side

There has continued to be strong investment demand for gold, with investors viewing gold, a real asset, as a potential hedge against medium-term inflationary pressures and US dollar weakness. It is also able to provide important diversification benefits as investors continue to look to gold as a safe haven asset and an alternative currency in the face of volatile currency markets. In my view these ongoing concerns may take some time to resolve.

As you may expect, jewellery demand (which has in the past made up the largest component of total demand) has been weak during the credit crisis. It was down by around 20% in 2009 but has remained strong in emerging markets and is likely to

grow in the future. Indian gold imports were 30 tonnes in March, an 84% increase compared to the same month in 2009. It is believed that much of this demand was driven by restocking by Indian jewellers.

Interestingly, the World Gold Council recently announced that they expected the demand for gold in China to double over the forthcoming decade. They forecast this coming from both jewellery and investment demand, as the world's fastest growing consumer of the yellow metal has more than doubled its share of global demand in the past seven years.

mining supply struggling to grow

Since mine supply peaked in 2001, the gold mining industry has been struggling to grow production. Despite an increase of 7% in 2009 (which was in part driven by the Grasberg Mine in Indonesia), there is little material sign of growth during the coming few years. In fact, there are few operations in 2011 and 2012 of notable size and others are coming to the end of their lives. It may be the case that the growth in supply seen in 2009 may be offset by declines elsewhere. In addition, those areas where gold mineralisation is being discovered tend to be in regions of higher political risk. At the current price there is not sufficient incentive for gold mining companies to bring on significant amounts of new supply.

central banks

A notable recent development is the strategic shift in the attitude of the world's central banks towards gold. We have seen developing countries (most notably China and India) increasing their gold reserves as they seek to diversify their foreign exchange reserves, in particular to reduce their exposure to the US dollar. This was further illustrated by both Iran and Azerbaijan recently declaring their intention to increase their gold holdings. It is also notable that recently there has been a distinct lack of gold supply into the market from European central banks and the only known vendor has been the IMF. The conclusion that can be drawn from this is that gold is now seriously considered by central banks as a monetary asset and a useful source of diversification in a way that has not been seen for at least the last two decades. Whilst the immediate impact of this strategic shift on the gold price may be limited to possible supply curtailments, the long-term implications are extremely supportive as looking back over the last fifty years central banks have tended to be a good indicator of broader investor appetite for gold.

gold mining shares

Recent results from the sector have generally been positive, with companies generating strong cash flow and reinstating



shares versus physical gold

We believe the best way to gain exposure to a rising gold price is through gold equities which offer the opportunity to capitalise on this growth as they benefit from a positive correlation to the gold price. The team uses its experience and skill to invest in those companies that are in production and with the ability to grow production, which can provide an additional leverage to the gold price. We therefore believe that over the long term it should be more profitable to invest in gold equities than physical gold, especially since gold equities can continue to experience growth even when the gold price remains flat. Furthermore, physical gold cannot quickly and easily be converted into cash; it needs to be stored and possibly insured. ●●

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The BlackRock Gold and General Fund is available through the Skandia Investment Solutions platform and Skandia's Life and Pensions fund ranges.

gold price in US dollars/oz



Source: Datastream as at 18 June 2010.

or increasing dividends. In the past two years, we have also seen operating leverage return to the sector, with companies focusing on translating the higher gold price into higher profitability. One cloud on the horizon, however, is the Henry Tax Review. The Australian Government has proposed a Resources Super Profits Tax. This tax, at 40%, applies to earnings from resource deposits in Australia from July 2012.

The current proposal by the Australian Government is deemed to be negative for those operating in Australia but it is likely that the proposed legislation will evolve before it is finalised. It is worth noting that, before this proposal is passed into law, there will be stakeholder consultations and a government election which may be instrumental in the final proposal.

*Source: Datastream as at 18 June 2010.

Past performance is not a guide to future performance. The fund can invest in mining shares which typically experience above-average volatility when compared to other investments. Trends which occur within the general equity market may not be mirrored within mining securities. The funds do not hold physical gold or other commodities.

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