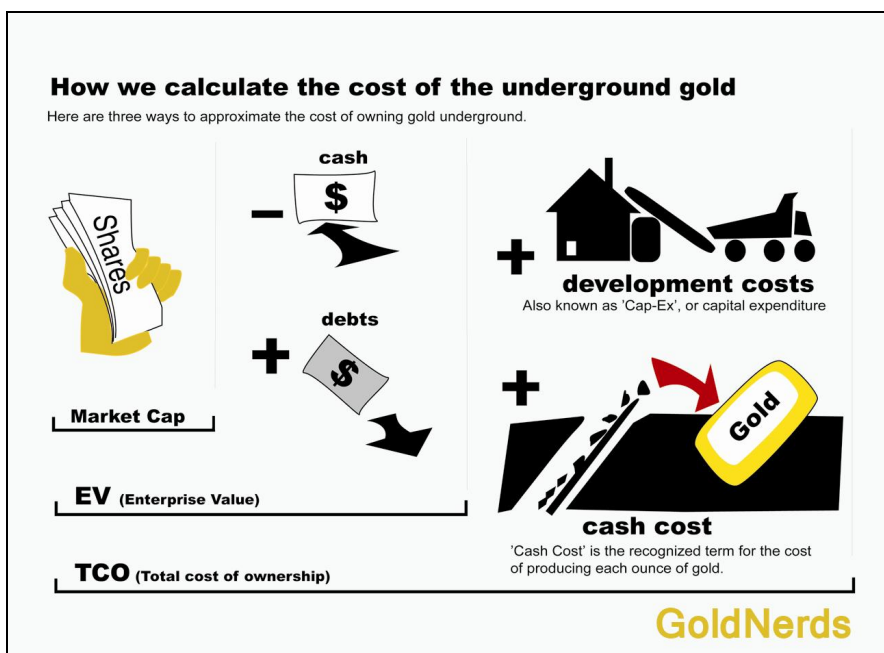


WILL THE AUSSIE GOLD SECTOR TANK?

Today I want to provide an update on the Australian gold sector. In the recent issue of our newsletter we discussed the dangers of a rising gold price environment coupled with underperforming gold shares. We highlighted the downside risk to gold shares if or when the gold price inevitably corrected. Over the last 10 days or so we got that correction. Given the severity of the falls I felt a market update was warranted.

There is much talk at present of a repeat of the GFC with many investors fearful. I am not going to downplay the severity of the problems that are unfolding in Europe and the potential market fallout ahead. However, the way I see it there are some big differences between 2008 and 2011. Few people saw 2008 coming and hence the problems and panic which unfolded were always going to be far more damaging. Fast forward 3 years and every man and his dog still remembers 2008 like it was just yesterday! Many are naturally pre-empting a repeat performance and are waiting for those “buy of the century” conditions to return (there is a lot of money on the sidelines). I know of some gold investors who have sold almost everything and are presently waiting. In this article I am going to put forward a case that this consolidation period for gold is unlikely to be as severe or protracted as many are predicting. I will combine fundamental and technical analysis in a single chart to make my case. Fundamentally, I will be referring to an indicator called Total Cost per oz (TCO).

WHAT IS THE TOTAL COST PER OZ (TCO)?

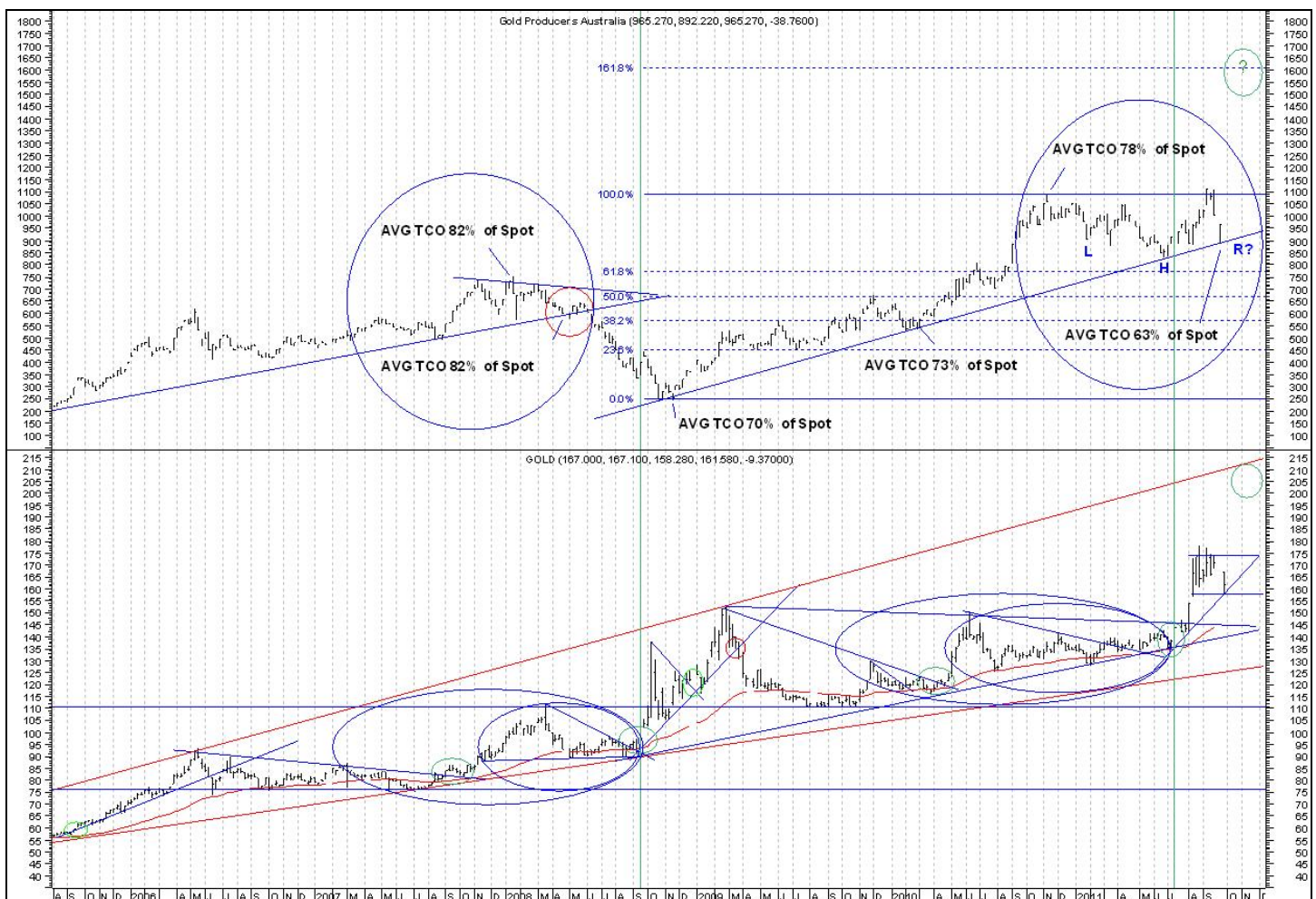


For those of you unfamiliar with this concept, it is an indicator we use at www.goldnerds.com to help our subscribers properly establish what they are paying per oz of mineable gold or silver when buying shares in a

particular company. After establishing an enterprise value (EV) for the company, we roughly estimate how much of their gold/silver inventory may potentially be mined. This allows us to work out an EV per mineable oz (similar to EV per reserve and resource oz calculations). The next important step is to gain some perspective on how much that mineable gold or silver is going to cost to get out of the ground. For this we take into consideration the operating cash cost for the company's project(s) and also look at the capital costs associated with mine construction and or expansion related activities. We add these factors to the EV per mineable oz to arrive at what we call the **Total cost per oz (TCO)**. This piece of information is valuable on two fronts:

1. From an investor's perspective it can be a very powerful tool for comparing similarly staged gold and silver mining companies for value.
2. We can take the average TCO for a group of producing companies and divide this by the spot price of gold to gauge whether gold mining companies in general are expensive or cheap at specific points in time (what we have done in this article).

AUSTRALIAN GOLD SECTOR OVERVIEW



Technical Take:

In the above chart we have the Aussie gold ETF (ASX:GOLD) in the bottom section and our custom Australian Gold Producers Index (API) at the top. I have circled in blue the period leading up to the GFC sell off as well as our present circumstances. At first glance, the two situations actually look alarmingly similar. Unlike 2008, however, the gold price has rallied strongly right from the start of the present market turmoil (note the two vertical green lines). This time around the Aussie gold shares rallied initially before losing momentum in the last couple of weeks with the gold price correction. Technically, for the API, no damage has been done and the long term trend line remains intact (commenced rising from late 2008). I have also outlined what looks to be the formation of a bullish inverse head and shoulder pattern within our current consolidation phase. With the recent sharp correction the right shoulder looks to be taking shape. For this to be confirmed, we would need to see present support levels hold and a rally back up towards the neckline of 1,100. We have an upside target for the API of 1,600 which we would expect to be achieved some time in the first half of 2012.

The gold price (bottom section) looks to presently be trading in a flag formation which usually marks a temporary consolidation before the resumption of the preceding trend, which in this case is up. Our intermediate term target is over 200 (or A\$2,000/oz+). This chart appears to support our bullish take on the API and the unlikelihood of a 2008 style crash.

Fundamental Take:

In the above chart I have also introduced TCO percentages at various strategic points in time. This is the average TCO of the companies making up our API index divided by the spot price of gold (**source:** www.goldnerds.com). You will see the average TCO has typically traded in a range of between 60% and 80% of the gold spot price. In the lead up to the breathtaking decline of gold shares during 2008, we see this percentage stayed around 82% (the expensive end of our range). Towards the end of the GFC, we were down to just 70% of the spot price. This marked the beginning of a huge rally which topped out at the beginning of 2011 at a TCO percentage of 78%. Since then the gold price in Australian dollars has rallied strongly without a corresponding rally in the gold shares. This has seen the average TCO percentage recently fall to 63% which is significantly below the number registered at the end of the GFC (70%). These much stronger fundamentals are likely to shore up the sector this time around. This in turn reinforces our positive technical outlook.

SUMMARY

In concluding, despite some worrying signs in world markets, I am reluctant to part with the core positions in my favorite Aussie gold miners. I used last Monday's severe correction (the worst I have seen) to add to my positions. Will we see even better opportunities in the weeks and months ahead? This is definitely a possibility but there are no guarantees. One of the cardinal sins during a bull market is to part with your core holdings. It's the market's job to shake out as many people from these positions as possible! For those of you sitting on the sidelines, I sincerely hope you get that "buy of the century" event and what's more have the nerve to take advantage of it. For the rest, I encourage you to learn to live with the volatility and what's more use it to your advantage. Always keep some cash up your sleeve and get used to buying the major dips and profit taking on extreme rallies. This is admittedly a very difficult skill to master.

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For anyone interested, I write a free newsletter on the precious metals markets. Alternatively, for all the latest fundamental information on gold stocks (both Australian and North American) and some useful indicators in the stock selection process, I invite you to visit www.goldnerds.com. Many articles demonstrating how we have employed this product to identify undervalued gold stocks are available at The Global Speculator website.

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