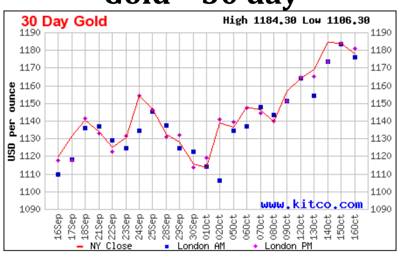
# INVESTING IN THE BRAVE NEW WORLD

**www.CipherResearch.com**

**October 19, 2015**

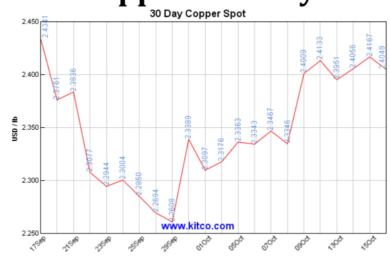
## Market Monitor

**Gold – 30 day**




**TSX.V – 180 day**

**Copper – 30 day**




## Market News Headlines & Comments

- Gold Ends Week Up Amid Slight Consolidation But With Long Term Bullish Overtones
- Precious Metals Test Initial Resistance
- How This Gold-Mining Fund Is Outshining ETF Peers

## M & A Activity

Deal activity increased in Q2 of 2015 to 35, up from 23 in Q1 2015. Transaction value more than doubled to US$6.59 billion in the second quarter, up from US$2.93 billion in Q1 and more than 4 times the US$1.89 billion from Q4 2014.

## Financing Activity

The number of financings over US$5.0 million grew to 732 in Q2 2015, up from 586 in Q1. The total amount raised in Q2 increased to US$11.25 billion, up from US$10.03 in Q1, but is still below the US$15.45 billion raised in Q$ 2014.

## Development Activity

Look for comments on recent PEA, Pre Feasibility and Feasibility reporting in upcoming letters

## Drill Results

Drilling activity continued to decline as falling metal prices continued to impact exploration. In Q2 2015, 363 projects reported results compared with 380 in Q1 and 418 in Q4 2014.

**INVESTING IN THE BRAVE NEW WORLD**

Most of you would probably agree that technological advancement and increased globalization have greatly enhanced the investment process while simultaneously making it more challenging to navigate.

Gone are the days when conservative investors could put their hard earned money in an interest bearing savings account and rest assured that they would generate a return sufficient to counteract inflation so they could keep up with the cost of living if not increase their purchasing power. Savings accounts and mutual funds using dollar cost averaging to generate slow and steady growth have given way to hedge funds, derivatives and ETFs to name a few. Computer programs often replace fund and portfolio managers.

Technology has been changing every aspect of our lives including the way we invest. In almost any and every sector of the domestic or globalized economies, and with regards to any of the asset classes, we now find more variables at play - variables of a more dynamic nature interacting and correlating in a much more dynamic way. We find new elaborate investment vehicles and instruments which, history has shown, can easily get out of hand for even the most seasoned investment professionals.

Yet what is one to do? Not invest? Not trade? Not take any risks? Keep cash under the mattress? Sure but the cash will diminish by the force of inflation. Inflation itself is a complicated measure – it is an ever-changing market basket, which differs across all consumers and producers depending on their exposure – their individual consumption and production of goods. Let's use a Canadian-consumer middle class context to illustrate:

- **Housing:** In 1995 the average price for a single-family house in Canada was CAD $170,000. Today it's CAD $503,000 (3 times)
- **Food:** In 1995, Ground beef cost CAD $1.75/lb, today it costs CAD $5.2/lb (3 times)
- **Energy:** in 1995 Oil averaged CAD $23.00 per barrel. So far in 2015 it has averaged CAD$67.21 (2.9 times)
- **Luxury Good:** In 1995 a Canadian could buy a boat for CAD $20,000. Today that same boat cost almost CAD $60,000 (3.0 times)
- **Money supplies**: In 1995 M2 was 3,631 billion and today it is 12,223 billion (3.4 times), in 1995 the global FX market traded 1,250 billion per day and today it is 5,300 billion (4.2 times)
- **Wages:** In 1995 the average wage was CAD $28,500 was and today it is CAD $49,000 (1.7 times)

While the components in the basket of goods have increased between 2.5-3.5 times, the average person makes only 1.7 times more.

If we are only making 70% (1.7 times) more but the basket cost on average 200% (3 times) more we need to somehow generate gains on our existing money just to break even. In this example we would've needed to make 130% over 20 years or an average return of 6.5% per year. If we add taxes in the equation – we would actually need to generate an average annual return of at least 10% just to break even.

In a near 0% interest rate reality, it is no surprise that debt loads have increased and we need to seek alternatives to savings accounts in order to break-even.

Mutual and Pension Funds are also no longer as secure as they used to be. One of our friends diligently invested her Canadian Retirement Savings Plan contributions into mutual funds recommended by her finical advisor at the bank for over 20 years up until the end of 2007 (just before the financial crisis). Her advisor regularly pointed out the dividends she was receiving from the investments he had made; dividends in turn reinvested back into the mutual fund units. She expected that she would end up with a nest egg for her retirement, however that was not the case. She had been contributing $150 per month for 240 months totaling $36,000. The real value of her Savings Plan in late 2007 totaled just over $36,000 meaning that her overall return was 0%.

It is no longer possible in this day and age to safeguard 100% your pension or savings – they too are subjected to globalized risk/reward dynamics.

**WHAT ABOUT OTHER "SAFE" ASSET CLASSES?**

**US Treasury Bills** – the so-called risk free asset? Not intending to spread gloom and doom but consider this: The Greek debt is 175% of their GDP or 320 billion euros (US $365 billion). The US debt is 103% of US GDP or $18.3 trillion. The 2015 US federal budget deficit alone is approximately $500 billion or 1.37 times the entire Greek debt. How can Greece's relatively insignificant potential default outweigh that of the US in the media? No one is talking about the US debt and their need to adjust the debt ceiling and borrow again in the upcoming months. Another issue is how sustainable is the current strength of the US dollar on the world arena provided there is stability in Europe and the euro - something I would assume we all want to maintain.

**Real Estate Assets:** It sure depends on the location but we all saw what happened with the housing market in the USA, arguably a safer jurisdiction, during the crash in 2008.

**WHAT ABOUT OTHER ASSET CLASSES?**

**Currencies**: They are becoming a function of policies and politics as opposed to liberal (free) market dynamic. While these drivers are not necessarily new, their interplay has never been so intricately woven and determining the destiny of every one of us. From a steel producer in Asia to a petroleum producer in South America to a farmer in New Zealand, most everyone is affected by currencies and their exchange rates and needs to pay close attention to the monetary policies of the county hosting the currency their investment is denominated in. If you live in Germany for instance and invest in US$-denominated assets and the assets rise in value by 7% yet the US dollar loses 15% against the euro, your capital gain is overpowered by the exchange rate loss and you end up with net loss.

Take **Gold** for example. Understanding and predicting Gold is a daunting task.

When Ben Bernanke, one of the most talented Economist of our times says that "no one really understands gold prices", adding he "doesn't get it either" in front of the Senate Banking Committee in 2013 when asked about the falling gold price, how could any one of us attempt to take a strong stand about gold?

Commodities and contracts denominated in a single currency around the globe are subject to the inflation exported by this currency– today this currency is the US dollar. The case of Gold is additionally complicated. Gold is a regular commodity and subject to the forces affecting all commodities; but Gold is also an investment – namely a hedge against currencies and inflation; gold is also used as a monetary exchange by the official sector. Let's take a look:

**Gold in USD**



- A 25% drop from US $1,600 to US $1,200 in late 2013
- Since the end of 2013 gold has declined 8% from US $1,200 to its current level of US $1,100
- Over the last 5 years gold has decreased from around US $ 1,300 to around US $ 1,100 a loss of approximately 15%

**Gold in EUR**



- A 25% drop in late 2013 from EUR 1,200 to EUR 900
- Since the end of 2013 however gold has risen by 10% to the EUR 1,000 level
- Over the last 5 years gold has increased from around EUR 970 to around EUR 1,000 a gain of approximately 3%

**Gold in CAD**



- A drop of nearly 25% from CAD $1,650 to CAD $1,250 in 2013
- Since then it's gained nearly 20% to trade around CAD $1,500
- Over the last 5 years gold has increased from around CDN $1,350 to around CDN $1,500 a gain of approximately 12%

**Gold in YEN**



- A drop of nearly 25% from approximately YEN 157,000 to YEN 119,000 in the first half of 2013
- Since then it's gained nearly 14% to trade around YEN 135,000
- Over the last 5 years gold has increased from around YEN 110,000 to around YEN 135,000 a gain of approximately 23%

Since late 2013 gold has only dropped in U.S. Dollars. If an investor purchased gold in Euro, Canadian dollar or Yen in late 2013 and sold it today, they would have made a return of 10, 20 and 14% respectively. Similarly over the last 5 years gold dropped in US dollars (-15%), and gained in Euros, Canadian and Yen 3, 12 and 23.5% respectively.

**Commodity Prices**: while always cyclical in nature they are now increasing in volatility - something that has arguably not occurred since the beginning of global trade in The Age of Discovery. This again is largely a result of technological advancement and globalization of capital markets. Increased volumes of securities trading, many of which derivatives traded on secondary markets and often far removed and precariously related to the underlying assets create opportunities for gains but they also create distortions, market manipulation, insider trading and massive disparity in the gains and losses among participants in the global markets. For those of you who haven't read the highly acclaimed book by Michael Lewis's Flash Boys, it exposes the outrageous behavior in the

US stock market and explains how the market had been organized to benefit financial intermediaries.

It comes as no surprise that Hillary Clinton's proposal for a Progressive capital gains tax reform designed to help promote long-term investment, and discourage short-term trading is met with criticism by the groups benefiting from the status quo. [1]

The reality is that we all need to make investment decisions if we want to safeguard our hard earned money. We need to make investment decisions if we seek additional gains. In a zero interest rates reality we must invest our money in assets other than savings accounts if we want to keep up with the real rate of inflation. Otherwise our purchasing power diminishes over time - effectively we become poorer without making sound investment decisions.

The key to a sound **investment decision** is **information**. No one can guarantee you that their advice is 100% bullet proof - not even Ben Bernanke or Warren Buffet. However, what always creates an advantage is **information and your ability to interpret it** so you can choose your best course of action.

It does not have to be daunting and overwhelming.
Everything, no matter how complex it may seem in the Financial Sector can ultimately be boiled down to 2+2. If you do not feel that you understand something well enough, don't act on it just because your adviser tells you to do so. Seek understanding of the risk/reward profile first and foremost so that you can make your own decisions.

At Cipher we want to help you do just that. We can aid your investment decision process with diligently measured risk/reward assessment of the investment universe and the equities we study and understand. We can share our experience, our statistics and our assessments with you because this is what we aspire to do – to be well informed and to help investors make informed decision.

Our Investment Universe comprises the metals and mining sector and our analysis extends to all macro and micro factors influencing this sector.

The benefit for us?

We believe in cooperation and not in a zero-sum game. We make money when our investments make money; not before and not disproportionately to other investors.

Moreover, it is very much our desire to encourage you to reciprocate by providing us with your thoughts and your opinions so we can all make more informed decisions and are better equipped to predict the markets.

You can always contact us at **info@cipherresearch.com** with your thoughts, feedback, and questions and concerns.

Or simply enjoy the letter and hopefully we can help make your investment decisions better.

[1] https://www.hillaryclinton.com/p/briefing/factsheets/2015/07/24/encourage-long-term-growth/

## ABOUT CIPHER

Cipher Research is a group of active investors in the metals and mining sector who, over many years of experience have developed successful investing strategies. Through diligent research and analysis, we have developed comprehensive valuation models applying the disciplines of Geonomics (**Geo**logy, Engineering, Statistics, Finance thru Eco**nomics**). Combined with our value investing philosophy, our models have allowed us to identify quality investment opportunities and have proven to be successful developing sound investment and trading strategies.

## CORE VALUES

- Independent proprietary research by investors for investors
- Value driven disciplined investment philosophy
- We look for opportunities, we don't wait for them
- Our success depends on the integrity of our research and our investment decisions
- We make money with you, not from you

## HOW WE ARE DIFFERENT

- **Independent**: Cipher Research does not and will not provide coverage paid for by a company, which allows us to maintain our independence and ensure our interests are fully aligned with the interests of investors.
- **Diligence and Discipline**: Cipher's analysis team comprises industry professionals with a long history and experience in all areas within the metals and mining sector. Our models are backed by strong quantitative analysis and our model portfolio has been proven by the test of time

## CIPHER'S PROVEN SUCCESS

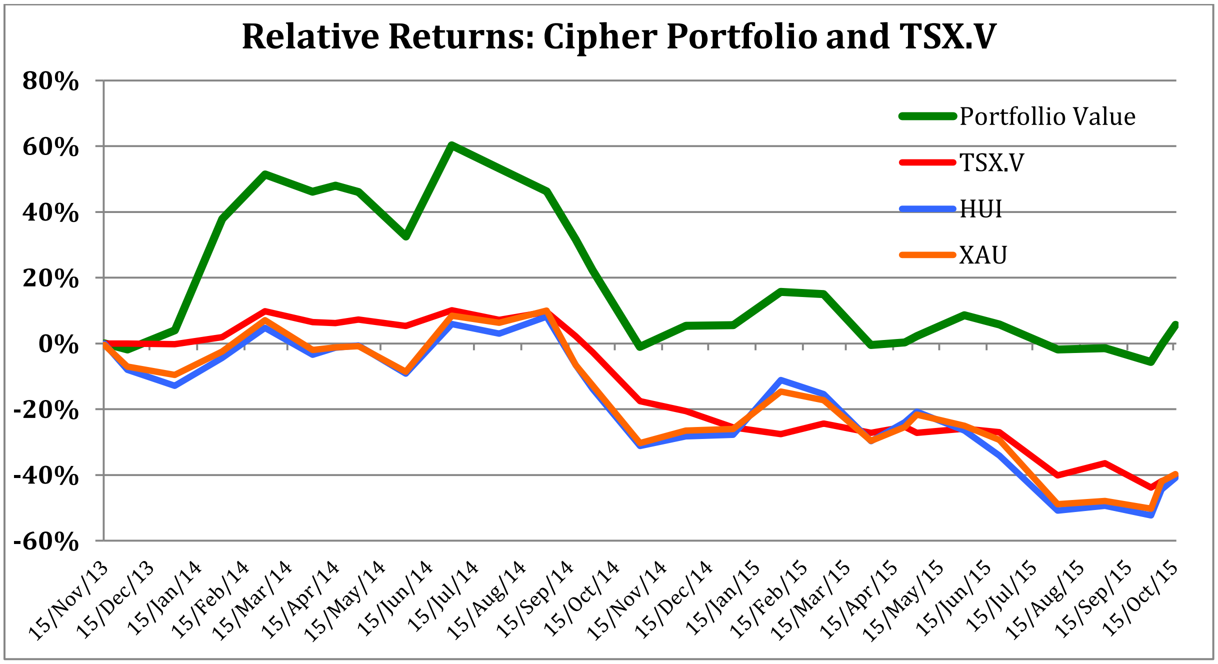
The Geonomic model we developed for Exploration and Development companies has proven extremely successful in identifying top quality projects:

- We identified 250 companies with engineered resources from the investment universe of over 1,500 exploration and development companies
- Only 44 of the 250 passed our rigorous analysis, of those:
  - 16 were subsequently taken-over, 5 commenced production, 14 have received significant financing and 2 joint ventures with other companies
  - 7 highly prospective targets remain in need of significant financing

20 of these companies formed Cipher's model retail portfolio in November 2013. Most of these companies are well financed and actively progressing towards the next significant value milestone.

The Cipher Geonomic model we developed for Exploration and Development companies has proven extremely successful:

- up 18% to Oct 2014 (12 months)
- up 40% in first 6 months
- peaked at +60% after 8 months
- **Up 6% to Jun-15 vs TSX.V down 27%, HUI down 34%, XAU down 29%**
- **Up 6% to 15-Oct-15 date vs TSX.V down 40%, HUI down 41%, XAU down 40%**
- **Select individual companies up 80-100%**




Cipher's model portfolio has also outperformed several leading precious metal funds:

| | 1 mo | 6 mo | 1 yr | 3 yr |
|---|---|---|---|---|
| **Cipher Model Portfolio** | **11.3%** | **5.3%** | **6.7%** | **5.6%*** |
| Sprott Gold & Precious Metals | 10.2% | -8.0% | -16.0% | -25.2% |
| US Global Gold & Precious Metals | 0.0% | -17.7% | -21.8% | -64.3% |
| BMO Precious Metal Fund | 11.5% | -14.8% | -14.5% | -22.7% |
| DJE Gold & Resource (Europe) | 14.8% | -21.2% | -10.4% | -41.7% |

* Cipher Model Portfolio was established in Nov 2013 so this is 2 yr performance

The portfolio maintains excellent value investing potential and individual stocks are monitored for trading opportunities.

We look for opportunities in all the segments of the metals and mining sector. In addition to exploration and development companies, we have developed investing and trading strategies for:

- Major gold mining companies (detailed review of 7 miners)
- Streaming & royalty companies and their underlying mid-tier gold mining companies

To learn more about our research and opportunities, please contact us at:

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