RESEARCH REPORT

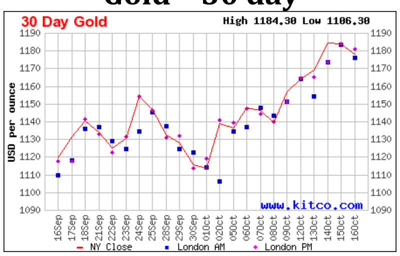
THE CASE FOR GOLD

www.CipherResearch.com

October 19, 2015

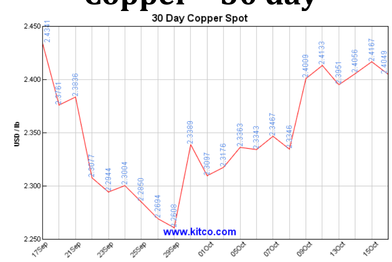
Market Monitor

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

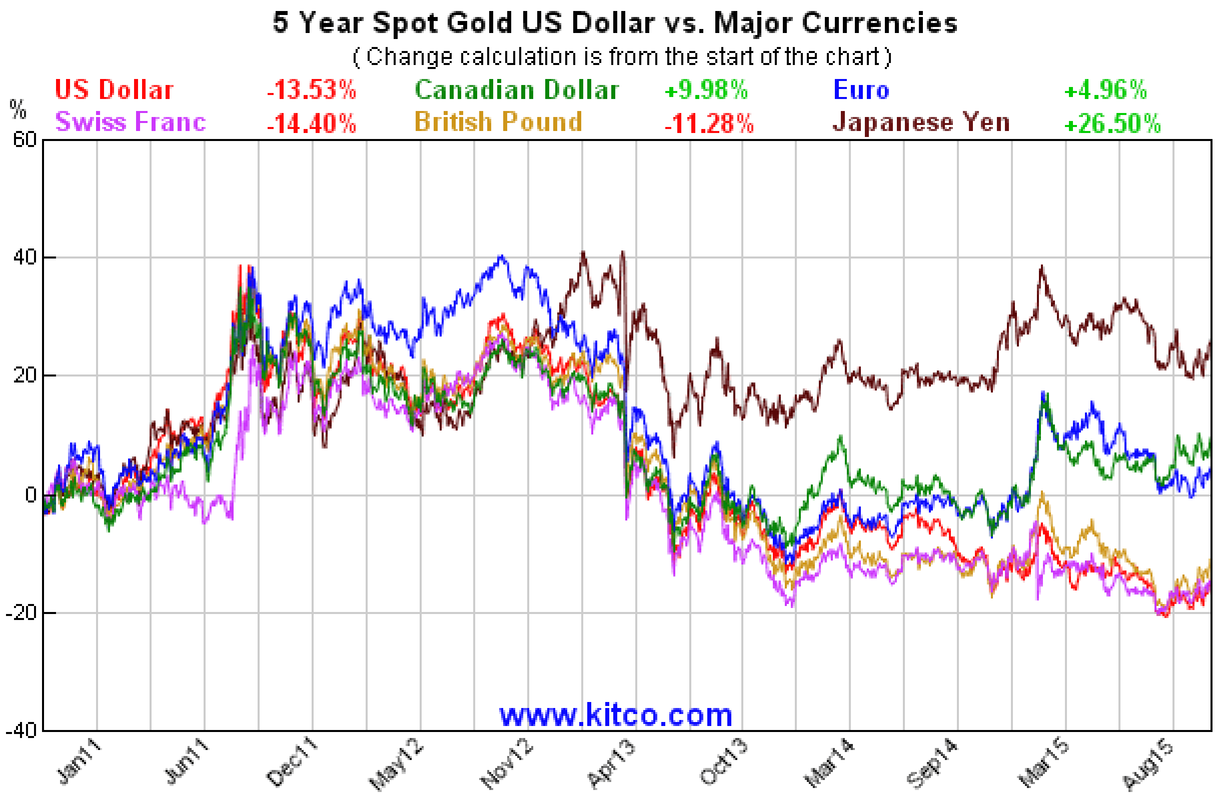
Look for comments on recent PEA, Pre Feasibility and Feasibility reporting in upcoming letters

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.

THE CASE FOR GOLD

The gold market has always been rather opaque but never quite as baffling as it has been in the last few years. With the continuous strife around the world – conflicts in the Middle East, problems in the Eurozone and uncertainty about the US economy in the aftermath of the unprecedented open market operations – why did gold decline sharply in 2013 and has been going sideways since?
Indeed, this paradox only exists in US currency. 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 (-13.5%), but gained in Euros, Canadian and Yen 5, 10 and 26.5% respectively.



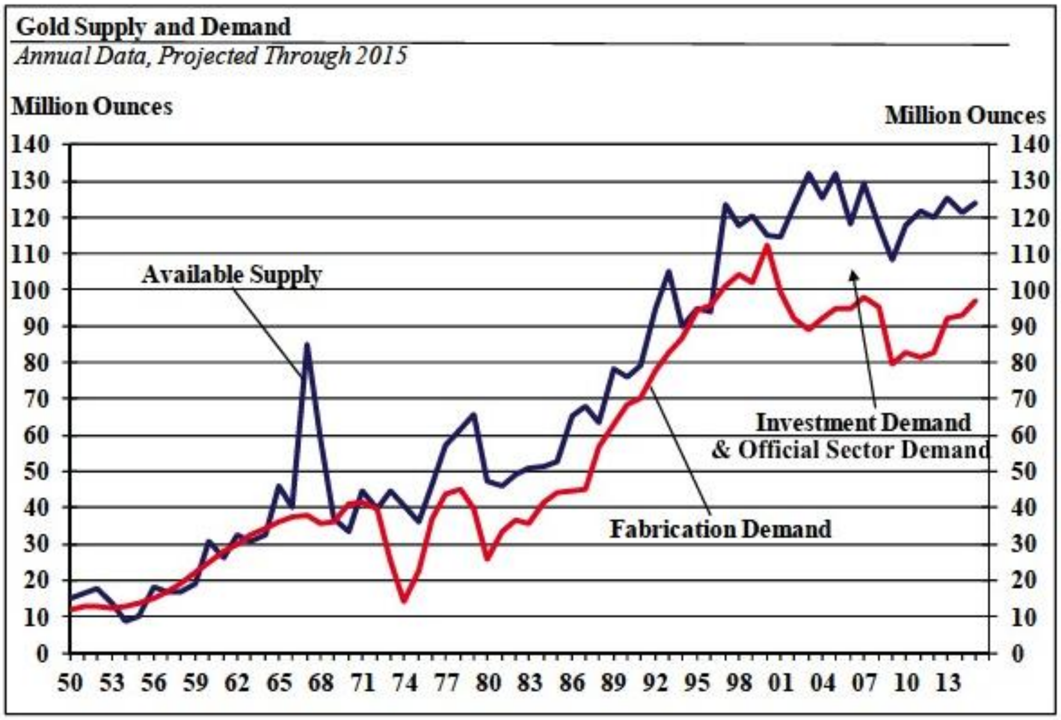
Today many investors are wondering where gold prices are headed? Is buying gold at present a sound investment decision? If so, what is the best way to gain exposure to gold?

This letter is intended to provide a brief overview of the gold markets (there are several) along with some well-documented historic and current gold trends. Our ultimate goal is to aid investors seeking to gain exposure to gold. The focus is on gold equities and is based on our expertise and years of research and analysis.

Gold is used as:

- **Commodity -** used for jewellery and technology (fabrication)
- **Investment** – financial market for gold
- **Monetary Exchange** – central banks and monetary authorities

Over time these different segments have created a balance in the gold market and generated a base level of demand.



Source: CPM Group, Gold Yearbook 2015

Fabrication Demand – Jewellery & Technology

Fabrication demand has always been a dominant area of demand for gold averaging over the past five years (2010-2014), around 60 per cent of world gold demand. India and China are the two largest markets for gold jewellery, together representing over half of global consumer demand in 2014. This demand currently shows no signs of abating and will continue to increase as wealth grows in these Asian countries. By 2020 India and China combined will have one billion new urban consumers. Currently the per capita consumption in China and India is 0.66 and 0.68 grams per person respectively. These numbers are below the weighted average of the top 20 gold consuming nations on a per capita basis (0.93g/capita) and well below the averages in the Middle East (1.55g/capita) and Europe, North America and Australia (1.02 g/capita). If China and India were to reach the top 20 average, the demand for gold would rise by 680 tonnes or approximately 18 per cent of the total gold demand for 2014.

Gold in technology is used mainly in the electronics industry and across a variety of high-technology industries, including the space industry and in fuel cells. Gold is beginning to create demand within the automotive sector and the chemical industry. A range of healthcare and catalytic applications for gold is currently being developed as the field of nanotechnology expands and will increase the use of gold in technology.

Central Banks

In their effort to diversify monetary reserves currently held in US dollars and reduce currency risk, central banks have been net buyers of gold.

The rate of diversification has been different across countries: Russia, which accounted for 60% of the net purchases of gold in the official sector in 2014, is diversifying away from US assets as they deem the United States as hostile toward Russia and its neighbours. Other countries in the region - also significant buyers of gold - Kazakhstan, Belarus, Azerbaijan, Tajikistan and Kyrgyzstan, share a similar view.

Many Middle Eastern governments use gold as a way to diversify their massive exposure to U.S. dollar inflows due to the countries 's dependence on oil and gas exports for large portions of their foreign exchange earnings and total national output. Many of them also express discomfort over current US policies. One monetary authority that emerged as a buyer during 2014 is the central bank of Iraq.

The largest holders of foreign currencies include China, Japan, Saudi Arabia, and Switzerland, all of which are major export-driven economies. Combined, these countries account for around half of the world's foreign exchange reserves. Our long-term expectation is that central banks will remain net buyers of gold to hedge against currency risk. In the case of China we foresee continued increase in official sector gold purchases as the country steadily shifts from export-based to a consumer-based economy.

Investment

Investment demand, which today accounts for around one third of the total demand, is a critical component of the global gold market and the most important fundamental factor influencing gold price levels.

Investors buy gold as:

- Hedge against inflation
- Hedge against currency market fluctuation
- Safe haven in times of economic, political and financial distress
- Form of savings particularly in countries with less stable financial systems
- Portfolio diversifier
- Commodity, based on gold's supply and demand fundamentals

Investors buy gold in the form of:

- Bars and coins
- Exchange Traded Products
- Futures and Options
- Gold Equities

Gold has unique qualities that enhance risk management and capital preservation for institutional and private investors around the globe. Investors have traditionally perceived gold as a safe heaven asset and seek more exposure to gold when they feel uncertain over economic and political factors such as inflation expectation, currency exchange rates, domestic currencies valuation, stock market trends, banking stability, government deficit and fiscal management and political security among others.

The key reason which has been driving investors to load up on gold since 2000 has been the high levels of uncertainty over various macro economic factors. These uncertainties and fears intensified during the Financial Crisis of 2007 and 2008 and remained strong in the aftermath 2009 – 2012.

In the period after the Financial Crisis, investors were concerned that the quantitative easing introduced by the US government and various banks around the world would bring about high levels of inflation. There was also uncertainty about several key issues such as: US need to raise the debt ceiling and debt and deficit problems of Euro zone countries.

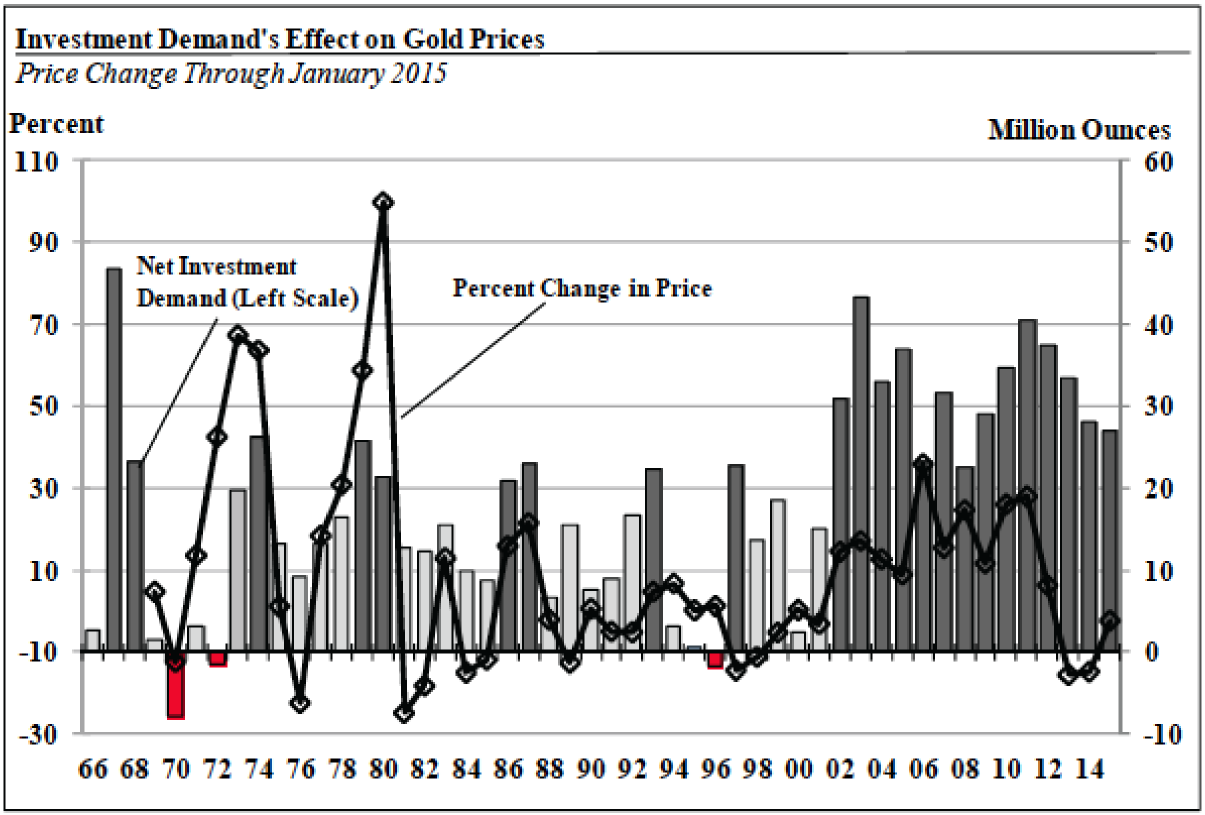
Fears pushed the gold price from $1,500/oz in early July 2011 to more than $1,900/oz in early September of that year. Short-term trend-following investors riding the wave flowed large amounts of money into gold and gold equities. These same investors later sold gold down from 1,600 to 1,200 in the second quarter of 2013.

However, hyperinflation did not emerge and banks and the global financial system did not collapse. The US implemented policies containing inflationary pressure and data started showing weak but steady economic recovery. The European leaders and bankers started discussing a commitment to lend to euro zone countries facing sovereign debt constraints. Investors' sentiments started shifting away from fear of imminent global economic collapse to acceptance of weak but steady growth and surviving economies supported by governments. Funds started shifting away from gold and into US denominated assets; gold price in US dollar declined sharply.

Investors continued to buy gold, but not at all cost. They became price sensitive, waiting to buy gold on weakness. Shorter-term-trend-following investors who tend to buy when prices are rising and sell when prices are falling have been the major force behind the decline in gold prices since late 2011. The biggest sell off was in the second quarter of 2013, and continued in a slow and steady rate through 2014.

On the other hand the accommodative rounds of quantitative easing coupled with near zero interest rates made US equities attractive and promising. Many short-term-trend-following investors moved to US equities to take advantage of the, now 7 year, bull market.

It is very important to note however that investors remain interested in gold, and continue to buy historically high volumes. Since 2011 longer-term investors have absorbed all of the gold that short-term trend followers have sold, and a great deal more. As the following chart shows investment demand has been fairly consistent throughout history showing a noticeable increase with the advent of technology. More importantly changes in gold price appear to be largely a function of the trend in investment demand.



Source: CPM Group, Gold Yearbook 2015

Cipher's Gold Price Forecast

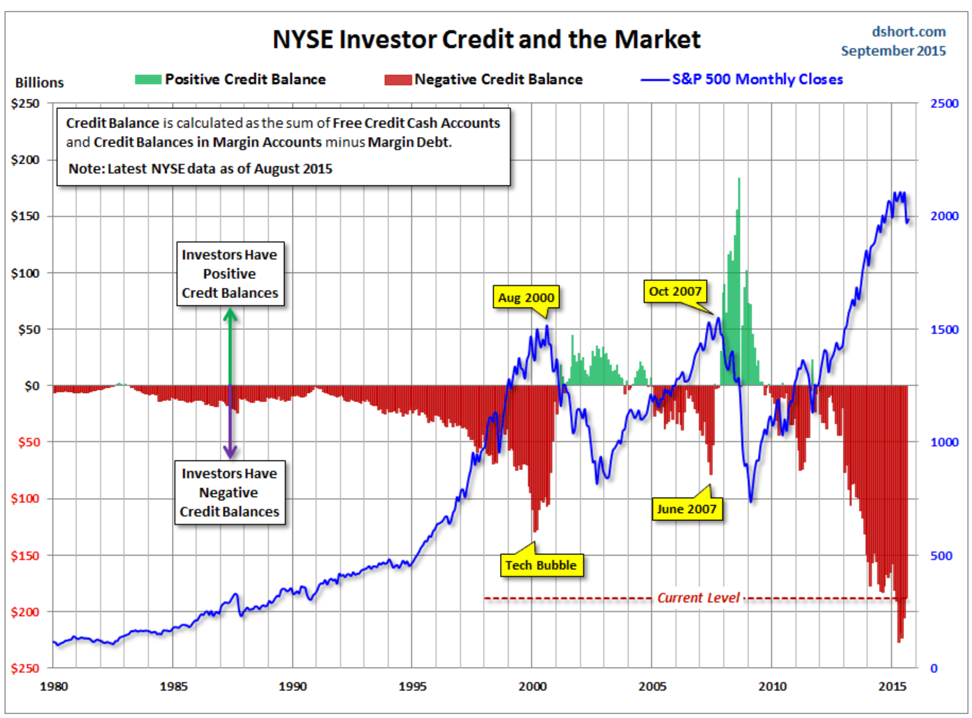
We believe that gold is unlikely to break below the 2014 lows of approximately US $1100/oz. This expectation is supported by strong fundamentals indicating $950-$1000 to be the price at which supply and demand will balance with no investor purchases.[1]

Furthermore we expect gold price to benefit from the imminent weakening of US equities. On one-hand expectations for possible increase in interest rate is already built into the gold price. On the other hand that does not seem to be the case for US equities which remain near record high levels in an ongoing 7 year bull run.

The following chart shows that Price-to-Earnings Ratios are nearing the levels they reached in May 2007 before the last major correction. Only two other times in history have P/E ratios been higher.

[1] CPM Group, Gold Yearbook 2013

Recent global market activity is pointing to the build up of negative sentiments toward US equities. The U.S stock market fell roughly 6% in the past three months (big sell off in August) lowering the total return for the S&P 500 Index over the past year to less than 1%. The drop in the demand for US stocks in August 2015 was heralded by the fall of the NYSE margin debt (over 6% in July and August) below a seven-month moving average. Margin debt, compiled monthly by the NYSE, reflects the credit extended by brokerages to clients to buy stock. It correlates closely to indexes such as the S&P 500 because equity is used to back the loans. As share prices rise more margin is extended and more shares can be bought. The contracting of margin debt is a sign of a decline in investors' confidence in US equities. The chart below illustrates this correlation.



If we look at the S&P 500 chart we see:

- Bull runs in the stock market followed by significant corrections
  - Jan 1995-Aug 2000 - 5.75-year bull followed by near 50% correction
  - Sep 2002-Oct 2007 – 5-year bull followed by over 50% correction
  - Feb 2009-Jul 2015 – 6-year bull followed by …

If we look at the levels of margin debt in the chart below we see:

- Increasing levels of margin debt followed by a few years of positive cash balances before the debt levels rise again:
  - Jan 2000 debt levels reached a peak before the Aug correction
  - Jun 2007 debt levels reached a peak before the Oct correction
  - Mar 2015 debt levels reached a peak before (*initial)* Aug correction

The recent decline in margin debt could very well be a leading indicator for a sell-off in US equities. A potential interest rate increase would add additional pressure on the prices of these equities, as it would make any borrowing to cover margin accounts more expensive, resulting in the need to liquidate more shares to cover the margin debts. A significant "margin call" now would greatly exasperate any sell-off.

We expect any future decline in the US equity markets to have a positive effect on the gold price.

Currency market volatility is also expected to be a primary driver of gold investment demand. There is an increased effort for loosening of monetary policies in other countries while the US is shifting toward normalization and potentially tightening of monetary policy. This reality is expected to increase currency volatility and stimulate increased interest in gold from investors focused on currencies.

Opposite to popular belief, it is not at all uncommon for gold and the dollar to rise at the same time. This was the case in 1979 and at times during the recent financial crisis in 2008, for example, and it has been the case in parts of 2014 and 2015. Gold and the dollar are seen as the two ultimate safe haven investments. Heightened uncertainty in the world drives investors to turn to gold and the dollar simultaneously.

In conclusion while we don't expect the US to plunge into a recession, we do see the potential for a significant stock market correction as well as currency volatility.

What does this mean for investors?

It means that diversification is more important than ever. Gold has proven over time to be one of the best portfolio diversifiers.

Research has shown that a modest allocation to gold makes a valuable contribution to the performance of a portfolio by protecting against downside risk without reducing long-term returns. We expect to see increased investor purchases of gold as a form of savings as well as a portfolio diversifier.

Our long-term view on gold remains bullish because of unresolved economic, financial and political issues facing the world, which will continue to drive long term investors towards gold.

In addition we expect mine supply to decline in the near to medium term (beyond 2017) since weakness in gold prices since 2012 resulted in many expansion and exploration projects being placed on hold or deferred indefinitely.

GOLD EQUITIES

Many investors buy gold mining equities as a substitute for gold. Investors have traditionally been wary of investing in commodities, but are more comfortable with equities. Gold equities have a stronger correlation to gold than they do to the broader equity markets (such as S&P 500). Simply put shares of gold companies act more like gold than anything else.

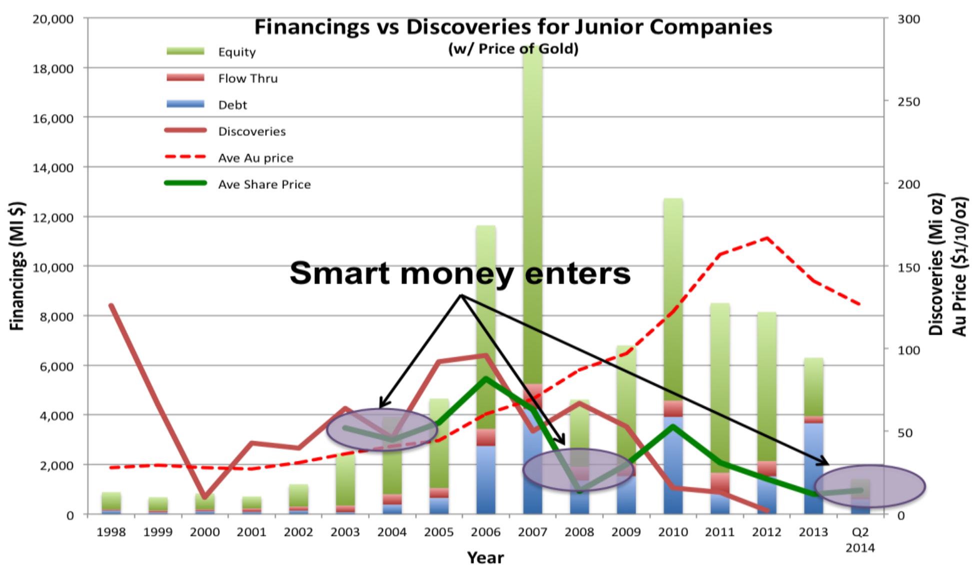
Gold equities typically offer exposure to gold at a greater discount often making them very attractive for investors. Gold equities are not gold, however, and investors who buy these stocks need to be aware that they are exposing themselves to risks, which are different from the price risk of purchasing gold bullion.

Commodity prices are highly cyclical and timing is a common risk for both gold and gold equities; rising prices will provide returns for both. The most important risk in gold equities is Project Risk. The key to successful investing lies in selecting quality assets. Companies with quality assets provide maximum leverage in bull markets and can offer significant returns even in bear markets. Cipher has spent years researching and analyzing projects and has developed models for valuing projects and companies and strategies for successful investing. In the rest of this letter and the upcoming ones we will share our methodologies and investment strategies.

Let's take a look!

TIMING

The following chart illustrates the importance of the entry point in the highly cyclical metals & mining sector. Smart money enters when equity values are low.



Source: Gamah International; TSX.V; Cipher Research

The best indicator of future behavior is past behavior:

- Entry in 2003-04 exit in 2006-07 when rising commodity price resulted in over exuberant markets exploration and development equities

- Entry in 2008-09 exit in 2010-11 when commodity prices reached their peak
- Based on historical performance it appears another excellent opportunity has formed in 2014-15.

INVESTMENT UNIVERSE

The following table shows the number of companies, listed on either the Toronto Stock Exchange or the TSX Venture Exchange, in each segment of the metals and mining sector.

Category	Number
Gold/Silver Streaming or Royalty Companies	7
Gold & Silver Producers	87
Gold & Silver Developers	144
Gold & Silver Explorers	233
Gold/Silver Generator Model (no resource)	27
Gold/Silver Grassroots Explorers (no resource)	800
TOTAL INVESTMENT UNIVERSE (TSX and TSX.V)	**1,298**

* information collected from www.goldminerpulse.com

The challenge is identifying the top quality companies in these key segments from a global investment universe containing over 2,000 companies.

Cipher divides the metals and mining sector into the following segments: coverage in these following segments:

- Exploration and Development - Typically an exploration and development ("E&D) company sets out to make a discovery, drill off the discovery into a resources, engineer the resource to determine the amount that can be economically extracted (reserve) and then either raise money to build a mine or sell the asset to an existing mining company.
- Mid-tier & Major mining – These are companies that are already in production. They are mining, processing and ultimately selling those economically extracted (reserve).
- Streaming and royalty companies – Streaming & Royalty companies make agreements with exploration and development and mining companies to purchase all or part of their production at a low, fixed, predetermined price. The mining company gets much needed capital by immediately monetizing part of its future production and the streaming company buys metal at fixed prices without having to invest in exploration, development, or operations of the project.

The following table shows the performance of gold, key indexes and a cross section of companies in these segments:

MARKET, SECTOR and SELECT COMPANY PERFORMANCE 2002 - 2014					
	OPEN	**HIGH**	**CLOSE**	**CHANGE to DATE**	**CHANGE to HIGH**
DOW	9750	17400	17360	78%	78%
TSX	7800	15685	14400	85%	101%
GOLD	**310**	**1900**	**1170**	**275%**	**513%**
Major Miners:					
Anglogold Ashanti	25.17	62.20	10.12	-60%	147%
Barrick	20.25	56.00	11.92	-41%	177%
Newmont	13.50	72.00	19.00	41%	433%
Yamana	2.78	20.61	4.45	60%	641%
Agnico Eagle	14.30	76.60	27.93	95%	436%
Goldcorp (mid-miner in 2002)	3.00	53.31	18.85	**528%**	**1777%**
Randgold (mid-miner in 2002)	3.65	124.80	60.79	**1565%**	**3387%**
Eldorado (E&D company in 2002)	0.27	21.96	6.03	**2133%**	**8033%**
Mid-Miners					
Primero (IPO in 2008)	4.00	9.05	3.95	-1%	126%
Luna Gold	0.12	8.45	0.30	60%	**6942%**
Canam Group	8.00	15.98	9.71	21%	100%
Alamos Gold	1.40	21.00	7.50	**407%**	**1400%**
Aurico Gold	0.50	21.50	4.50	**800%**	**4200%**
Exploration & Development					
TSX.V (used as measure of all E&D companies)	1100	3372	760	-31%	208%
Cipher Pick 1*	0.10	9.25	1.78	**1680%**	**9150%**
Cipher Pick 2* (taken over in 2014)	0.30	5.00	1.29	**333%**	**1567%**
Cipher Pick 3*	0.25	13.14	3.26	**1204%**	**5156%**
Cipher Pick 4* (since Nov 2010)	6.00	9.00	7.17	20%	50%
Streaming & Royalty Companies					
Sandstorm (CPC shell in 2007)	0.25	15.00	4.00	**1500%**	**5900%**
Silver Wheaton (started in 2005)	0.25	45.50	20.00	**7700%**	**18100%**
Franco-Nevada (Newmont spin-out 2007)	14.00	61.50	45.00	221%	339%
Royal Gold	8.00	99.00	65.00	**713%**	**1138%**

* The four companies are part of Cipher's model stock portfolio. Since the creation of the model portfolio in November 2013 these companies increased 81%, 82%, 53% and 107% respectively

As the table shows:

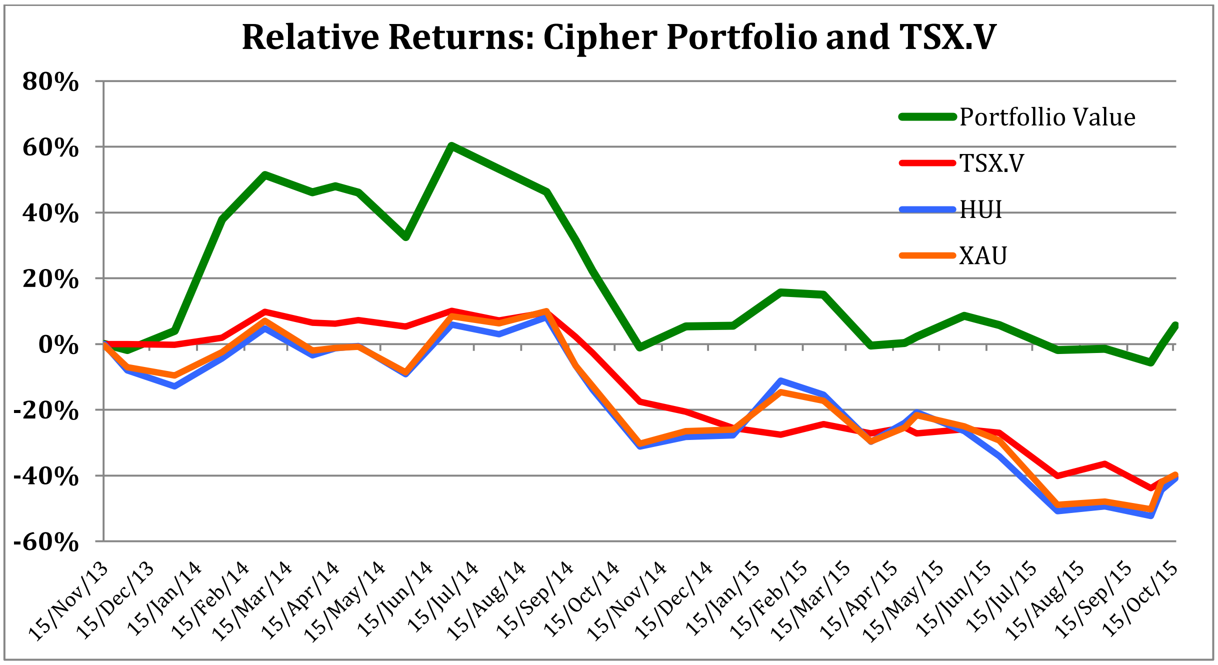
- Gold outperformed all of the key indexes for the period 2002 through 2014
- **The streaming & royalty segment of the metals and mining sector is the only one to outperform gold for this period**
- Select companies within each of the other segments outperformed gold and most streaming and royalty companies for the period
  - **Selection process is critical for success**
- Cipher identifies the best strategies between 2002 and 2014 to be:
  1. Invest in streaming companies early in their history
  2. Identify and invest in the top quality E&D companies and grow with them
  3. Identify and invest in the "next major miner":
     a. An E&D company with the right project and strategy to grow, or
     b. A mid-tier miner with the right project and strategy to grow
  4. Trade quality companies between depressed and exuberant times

In upcoming publications we will examine in detail each of these market segments beginning with Exploration and Development companies. The following a brief introduction to our model and it's success.

CIPHER'S PROVEN SUCCESS

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.

Stay tuned for the next publication, which will be dedicated to our methodology for valuing advanced gold explorers and developers. We examine a 24-year history of mergers and

acquisitions to determine the real value of gold in the ground and to incorporate that value into our project and company valuation models.

Disclaimer