GRANT'S
INTEREST RATE OBSERVER®

Vol. 36, No.18e — Two Wall Street, New York, New York 10005 • www.grantspub.com — SEPTEMBER 21, 2018

Golden primer

Credit, the promise to pay money, competes with money itself—principally, for most people, most of the time, paper money. Paper money competes with alternatives, eternally with the precious metals, lately with the cryptos. We write in expectation that gold, for many years not competing with much of anything, will re-enter the fray.

This is a sermon for the choir, and there is nothing impartial about it, or us. Your editor has spoken for pay for one of the sources quoted herein. He owns many of the stocks mentioned, or incorporated by reference herein. The Columbia Journalism School would gag, but the suppression of interest rates, the heaping up of doubtful debts and the radical methods of modern central banking spell trouble. The readers of *Grant's* need a hedge.

Not a hedge, actually, but an option, or an investment. Gold is an investment in monetary disorder, and the disorder exists, not over the horizon but on the Bloomberg terminal right now. No matter if, to many, it's invisible. It's why the gold stocks are cheap.

Pretium Resources, Inc. (PVG in Toronto and New York) is one of these stocks, but it's hard to call it cheap. We regard it as a good, albeit controversial option on a much higher gold price. Also on the editorial agenda are a pair of gold mutual funds, the physical metal itself and exotic gold-storage options.

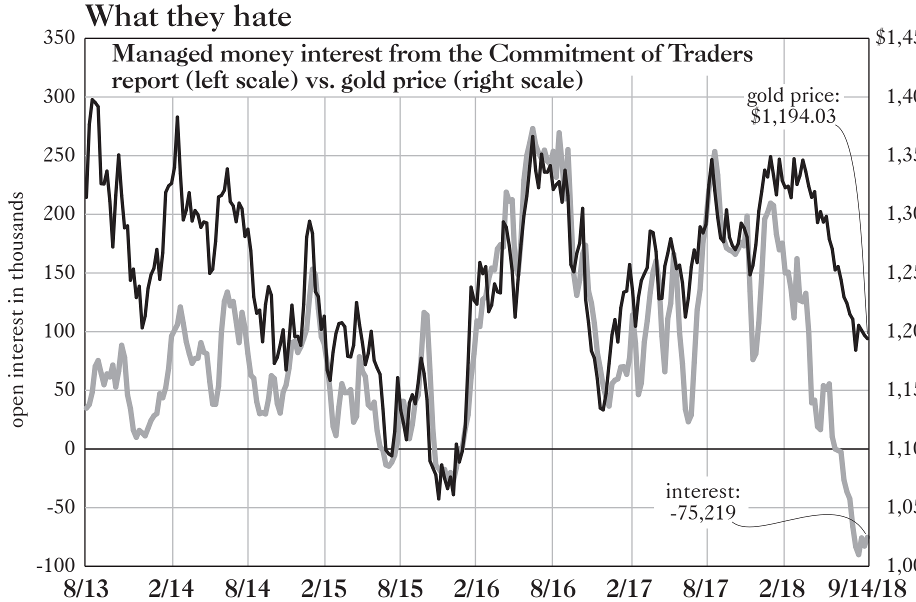
Pretium manages the 100%-owned Brucejack Mine in northwestern British Columbia. An underground mine currently operating at 2,700 tonnes (i.e., metric tons) a day, it's famous for its high-grade, nuggety gold deposit with 8.1 million ounces of proven and probable reserves. Critics were calling it a hoax five years ago (*Grant's*, Dec. 13, 2013). It is not a hoax. The only question is whether the operational and monetary stars will come into alignment.

Insider trading activity has not exactly helped to build investor confidence (there have been C$4.45 million of sales in the past 12 months). Lingering concerns regarding the nature, location and extent of the deposits likewise have sown doubts, as does the occasional bear raid. Pretium trades at $8.10 a share for a $1.5 billion market cap, which sits on top of $650 million of net debt.

"It's a potentially really rich deposit, but we don't really know what's there and there's been conflicting opinions about the grades that are found," John Doody, editor of the *Gold Stock Analyst*, tells colleague Fabiano Santin. "There's an old saying in the business that you never know what you've got for a deposit until you've mined the whole thing."

At around $250 per tonne, the cost of production is running well above the previously estimated $177 per tonne. "Everyone is focusing on the grade, and the grade is important, but one of the other most important aspects from my standpoint is the cost per tonne," a hedge-fund manager remarks. "If you assume that the cost per tonne is $200, it makes a big difference to what the equity is worth. Combine this with the grade [uncer-

What they hate



source: The Bloomberg

tainty], it's very difficult to actually know what this company is worth."

"To offset a lower-than-expected-grade deposit," Santin relates, "Pretium intends to ramp up mining to 3,800 tonnes per day, a 40% increase from the current level, subject to permitting. I've crunched some numbers to get a sense of value. At the new production rate and the current price of gold, if Pretium is able to extract 9 grams per tonne through its 18-year mine life at an all-in sustained cost (AISC) of $750 an ounce, the shares would be worth around $5.90 when the cash flows are discounted at an 8% rate. Hence, equity would have a 28% downside. However, if AISC and grade were $700 an ounce and 12 grams per tonne, the shares would be undervalued by 28%."

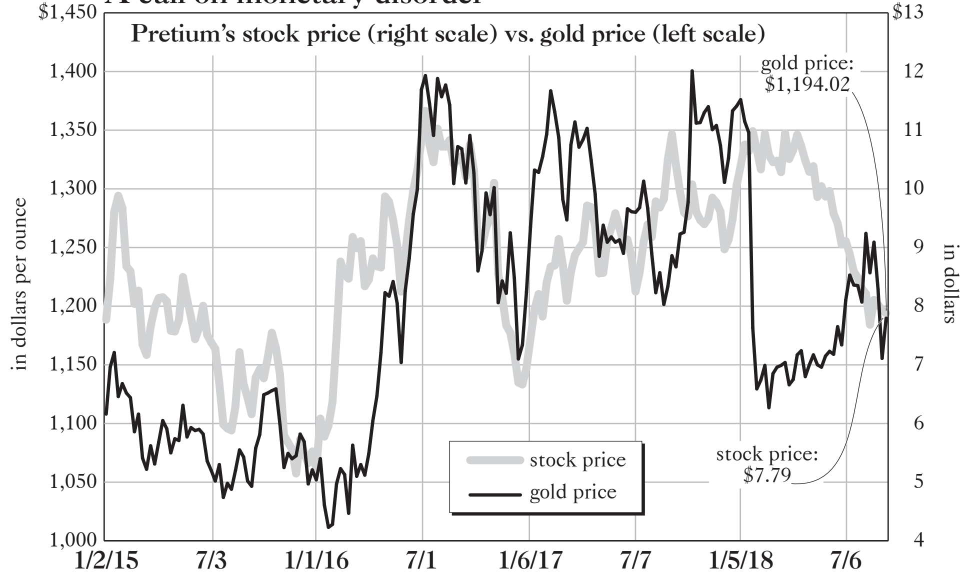
Sprott, Inc., the Canadian natural-resources investment firm (your editor has spoken to Sprott-sponsored audiences), has no current investment interest in Pretium but is investigating the property in the course of deciding whether to write a check to refinance some $423 million in maturing Pretium debt. Rick Rule, president and CEO of Sprott U.S. Holdings, Inc., tells Santin that that he will know a lot more about Pretium once Sprott completes its due diligence. What's already clear, however, is that the mine is unusually well-positioned to capitalize on a much higher gold price.

"If you look at some of the holes, the Hail Mary holes that they drilled and hit," says Rule, "it is obvious that there's an awful lot of gold in the system. . . . There is a sort of 6- or 7-million-ounce current resource that I think ultimately will be a 12-to-15-million-ounce resource along the 14-kilometer-long trend of the Brucejack fault. And if you just talk about that resource at $2,500 gold, all of the discussions that you and I are having right now about the variability of a grade on faces disappears."

The Tocqueville Gold Fund, with about $1 billion in assets, founded in 1998 (high marks for timing: the pioneers almost caught the bottom), has returned 8.3% per year since inception, handily beating the 1.0% for the Philadelphia Stock Exchange Gold and Silver Index. The fund is down by about 18% this year.

First Eagle Gold Fund, founded in gold's wilderness years, has returned 3.5% per year since its early 1990s inception, though it, too, over time has outperformed the Philadelphia Gold and Silver Index (-2.1%). With assets of $1.1 billion, it is down 22% this year. Incidentally, neither Tocqueville nor First Eagle owns Pretium. Matthew McLennan, co-manager, with Thomas Kertsos, of First Eagle, tells Santin that his partner and he favor "scale producers that are well-positioned in the cost curve with longer-duration assets, so they have more resilience than the more-marginal miners."

A call on monetary disorder



source: The Bloomberg

As to the real McCoy, one might own bullion via the Sprott Physical Gold and Silver Trust (CEF on NYSE Arca). As of Sept. 18, the fund held $2.71 billion of assets, 65% of which were gold and the balance silver. It traded at a 3.8% discount to net asset value, near the widest figure since Sprott took up management duties in January.

The IRS affords preferential tax treatment to the trust, which is considered a Passive Foreign Investment Corporation (PFIC) under U.S. tax rules. This means that long-term gains are taxed not at the 28% collectibles tax rate but at the long-term capital-gains rate of 20% for high-income taxpayers.

"There is no system of human endeavor where backup is designed to rely on the primary system, except in finance," says Simon Mikhailovich, co-founder and lead manager of Tocqueville Bullion Reserve. "The backup generator is never plugged into the grid. If you get on an aircraft, the backup steering system is plugged away from the primary system. How would you feel if you knew that the Boeing engineers designed the engine so that if the right one shuts down, then the left one also shuts down? Yet, people feel that it is okay to buy protection from the same banks that would be failing when you need to be paid."

Starting at $100,000, Tocqueville manages gold stored in private vaults in the United States, Switzerland or Singapore—it's the investor's choice. It's a fiduciary structure that affords access to the global commercial gold chain, meaning refineries and global logistics firms that typically don't provide services to individuals, and away from the financial supply chain, says Mikhailovich.

A 3% redemption fee will discourage high-frequency traders (even if the fee declines to zero over three quarters). Management fees start at 1.25% for investments between $100,000 and $500,000, but scale down to 0.35% for amounts over $5 million. Add 40 basis points in expenses including storage, transportation, NAV administration, audit (storage and financial) and insurance: investors@bullionreserve.com, or (212) 792-2178.

Another possibility is DIY storage. Your editor buys his treasure through Manfra, Tordella & Brookes. MTB, founded in 1957, is one of a few authorized dealers of the major sovereign mints such as The Royal Canadian Mint, U.K.'s Royal Mint, and the U.S. Mint. You can place orders starting at $25,000 for physical delivery or storage at the firm's own vault, an official COMEX Depository, in Midtown Manhattan: info@mtbcoins.com, or 1(800) 535-7481.

Like Mikhailovich, James P. Hunter, managing partner at gold-trading and -storage firm Alps Precious Metals Group, espouses holding one's bullion off-grid and far from the madding financial crowd. Triple-A-rated Liechtenstein is his choice of domicile, and Liechtenstein Precious Metals Group is his partner. Cost of storage, including insurance, is 1.2% a year for up to $5 million, and declines to 0.6% for investments above $20 million. Investments start at $500,000, says Hunter, with some possible wiggle room: jhunter@alpspmg.com, or (251) 377-2197.

•