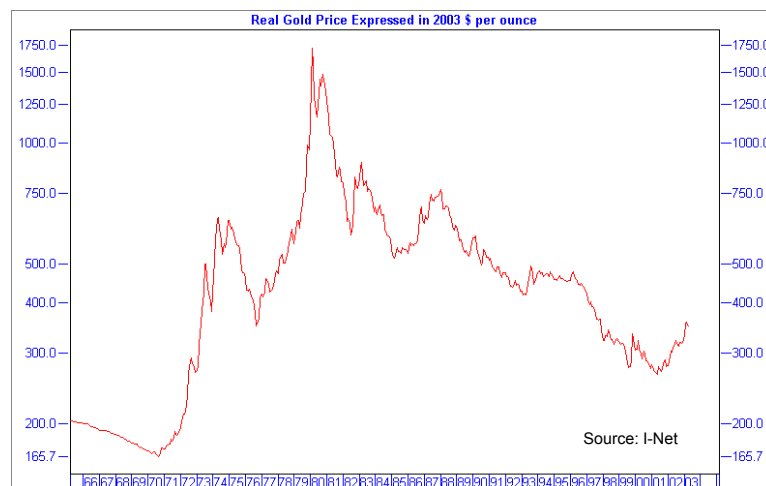


GOLD

Currently, the subject of gold is not only a topical issue but also one foremost on investors' minds. So what is the reasoning behind it all, how long will it last and what is Allan Gray's view?

Central banks hold 1,042 million ounces of gold, equivalent to about 10 years consumption, a legacy of the era when the world was on the gold standard. During the 1990's increasing mobilisation of these reserves depressed the gold price. Official gold entered the market in two ways. Firstly, there were direct sales by central banks, which were of the view that gold no longer was an appropriate reserve asset, or at least that gold formed too large a proportion of their foreign exchange reserves. Secondly, as the price fell, gold mines made ever larger forward sales in an effort to protect their profits against what was perceived to be a perpetually declining price. Forward sales involve borrowing gold from central banks and selling it in the spot market. By mid 1999, mines had sold forward 108 million ounces equivalent to 1.3 years future production and the price had fallen to \$260.

This situation was unsustainable because at such low prices mine production could not have been maintained for more than three or four years before falling dramatically. Currently at least \$350 is required to justify the development of new capacity to replace the continual depletion of reserves. After 2008 production from existing mines will start declining precipitously and even higher prices will be required.



Since 1999 the gold price has been rising again, reaching a six-year high of \$383 on 5 February 2003. Initially this was caused by the announcement of an agreement among European central banks to co-ordinate their selling programmes so as not to depress the price. More importantly the mining industry was forced by shareholder pressure, and a change in the attitude of bullion banks to the credit worthiness of gold producers, to reverse their policy of selling forward. Last year over 11 million ounces were delivered into hedges, effectively reducing new mine supply by that amount. Whereas previously mining companies were selling more gold than they produced, now the situation has reversed with a significant proportion of output being unavailable for sale to consumers. This has been the most important cause of the upward trend in the price and is likely to continue to have a positive effect on gold for some time to come.

Recently the improving fundamentals for gold have been reinforced by a renewed interest in it as an investment asset. In the two decades following 1980 investors were net sellers of gold. This has now changed. Central banks in the U.S., Europe and Japan have pushed interest rates to the lowest levels since the 1930's, in an effort to prop up global growth. Monetary policy is extremely lax and fiscal deficits are ballooning. The \$500bn US current account deficit is particularly worrying for the Dollar but there also is a lack of confidence in the Euro and the Yen. The global bear market has made investors cautious about equity markets. Even bonds seem more risky following the collapse of some large corporations. It is not surprising that the weaker dollar and concerns about the stability of the global financial system have generated renewed interest in gold as a store of wealth, and with interest rates so low it has never been cheaper to hold gold. The last great gold bull market was driven by similar concerns and lasted 10 years between 1970 and 1980. Given the scale of the world's problems it is possible that we are in for another long period where the gold price will be on a rising trend.

In conclusion gold, after being in a bear market since 1980, has now turned up strongly. Although the gold price is notoriously difficult to predict, our view is the background has become very favourable for the metal. Notwithstanding its recent rise, the real gold price is not high in context of its history since the end of the Bretton Woods System in 1971 (which pegged gold at \$35 per ounce). It is presently at the same value it traded at in 1973 and less than 25 per cent of the real value it attained in 1980. Importantly it holds an inverse relationship with world financial markets and provides a risk diversification for portfolios. Accordingly we continue to favour selected gold shares.