

# Setting sail

Mining Journal presents the 17th in a series of interviews with investors in the resource sector

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**H**INDE Capital Ltd is regrettably nothing to do with the editorial director of *Mining Journal*. Instead the fund-management company takes its name from the Golden Hinde, the Tudor warship in which Sir Francis Drake circumnavigated the world in 1577-1580.

Established in March 2006, Hinde Capital manages a gold fund for institutions through to high-net-worth individuals (the minimum investment is US\$100,000). This fund is held and managed through Hinde Gold Fund Ltd, which is incorporated in the British Virgin Islands and described as an open-ended multi-class investment company.

Hinde Capital was founded by Ben Davies and Mark Mahaffey. The pair worked together at Greenwich Capital (before its acquisition by National Westminster then by Royal Bank of Scotland). Mr Davies began his working career as a bond trader before branching out into managing macro portfolios, focusing on foreign exchange and commodities.

Messrs Davies and Mahaffey had collective misgivings about the growth in financial intermediation that they were experiencing first hand. It was evident to them that excessive fiat paper and credit production were fuelling an unsustainable global asset boom.

Fearing for the viability of the financial sector they resigned from their senior trading roles to set up Hinde. Mr Davies went one step further, selling his family home at the end of 2006 (placing the proceeds in the euro class of their newly launched gold fund).

Hinde Capital was launched, according to Mr Davies, with a "clear strategy" to outperform a benchmark portfolio performance of 50% precious metals equities and 50% allocated gold bullion. The fund had a long bias but exposure could be reduced below 50%. This facility was offered in three currencies (euro, sterling and the US dollar).

In October 2008 the Hinde Gold Fund changed its benchmark from 50:50 equity:bullion to 100% gold bullion. The fund can facilitate an investment in small-capitalisation mining equities (for up to 25% of total assets) beyond the bullion holding, and will occasionally switch into other precious metals (for up to 20%).

## GOLDEN COMFORT

As with most of the other fund managers interviewed in this series, Mr Davies takes great comfort from the activities of the Chinese. The country is already the world's largest gold producer but Mr Davies comments that they are also set to become the largest consumer. As a result, he describes them as a "floor under the gold price".

Mr Davies, a disciple of 'Austrian' economics, suggested there is not enough adherence by mainstream economists as to what 'money' is, and its role in society.

He says: "Money and credit are no more than a convenient means to facilitate and register the productive effort of an exchange of goods and services required between entities. Unfortunately modern day banking (both Central and Shadow banking systems) has facilitated too much 'easy' credit for products entities don't need."

Mr Davies believes that higher prices are a reflection of an increase in the money stock. The Austrian viewpoint: it is a monetary phenomenon.

He suggests that recent equity rallies are actually symptomatic of an inflationary environment. In this regard, he cites Zimbabwe as a microcosm of what is happening in the global economy (the Zimbabwe Industrial Index was the best-performing equity index last year; up over 30,000%, which was initially a rise far in excess of the CPI rates). It was the invisible effect of currency debasement before it became visibly manifest.

## "Hinde Gold Fund claims to be the cheapest risk adjusted way of investing in bullion"

Mr Davies suggests governments have three alternatives: cut spending/raise taxes, repudiate on their debts (neither being politically expedient) or "as all but my dead dog has by now worked out, they can inflate their debt away". Mr Davies added: "Clearly the authorities have chosen to reflate in the hope of stabilising the financial system, and hope the populace maintains faith in the value of fiat currency."

The conundrum for most has been why gold prices and equity prices have been rising seemingly in tandem. Mr Davies suggests this is just a feature of inflation, and also notes that we must distinguish between deflating sectors (experiencing a contraction in money and hence falling prices, eg housing in Spain and Ireland) and inflating sectors (such as equities, with a claim on real assets, and commodities).

Mr Davies believes that "money has found its way into risk", and that emerging markets will substantially outperform developed countries as a result over the next decade ("barring a major rise in interest rates by the Asian Central Banks").

The key point he makes it is that overleveraged and indebted sectors will remain moribund, while indices with small floats (a small supply of equity) and commodities, particularly those with a restricted supply, will soar in value. Both in nominal and real terms.

There is a need, according to Mr Davies, for investors to focus on "real assets", or at least claims on real assets. Gold, he says, "could be money again" and, even if not, the metal is likely to continue to perform well – he notes that gold has managed an average annual 'real' return of over 7% since 1971 (in a basket of seven currencies). In this current cycle this has risen to over 14%.

Indeed, Mr Davies told *Mining Journal* that "gold has done what it should have done, performing in real

terms" (ie adjusted for inflation), and he believes that we are at a serious inflexion point, when gold can be expected "significantly to outperform the developed stock markets".

## FUND OBJECTIVES

Hinde Gold Fund was launched in October 2007 with investments of only US\$5 million. Mr Davies says that he and Mr Mahaffey had spent three months preparing for launch and as D-day came they were "desperate to launch" as they saw gold was "trend ready" – at the time it was trading at US\$675/oz. A week later, when the fund launched, it was US\$775.

Mr Davies says that the fund "seeks to offer investors preservation of capital against erosion of the purchasing power of money". He adds that "capital growth is by necessity an important, yet secondary, objective".

Hinde Gold Fund provides exposure to an appreciation in precious metals while "smoothing out the downside volatility". This is done by altering the allocations to gold (the physical holdings of which are kept in secure vaults in Zurich). The fund's holdings regularly vary from 75% to 125% of assets, and the exposure will on occasion fall as low as 50% or rise as high as 150%.

Hinde undertakes macro analysis, and uses both a series of proprietary macro and technical models to help the managers decide on the appropriate level of gold exposure. The trend model has seven to ten inputs, and Mr Davies says that he is proud of its performance last year. Until October 2008 the model had returned a positive investment (even during the mid-year rout). Indeed Hinde Gold was only down 18% for the year even though the fund was 50% invested in equities for much of the time. (Gold stocks at that time were down on average 70%.)

In defence of such technical evaluation methods, Mr Davies notes that the model is "purely a mechanical representation of our years of investment knowledge and experience". He adds that it "reduces the emotion in investing that can hinder the process".

The fund targets a yield (above that of changes in the gold price) by changes in the allocation given to the metal, and switching out of bullion into correlated assets (including equity and other precious metals).

For example, in October 2008, it was "evident", according to Mr Davies, that the global market system was grinding to a halt (he referred, as an example, to "commodities piling up in ports"). At that time, Hinde Gold Fund moved to a 100% weighting in physical gold – even though the macro model described bullion (then trading at US\$930/oz) as 'expensive'.

Ben Davies

## GOLD BULLION TRADING

The fund originally had a greater bias on 'absolute' returns. Mr Davies notes that "although we were never short, we could at times be under invested by 50% and, in extremis, more". Such a light exposure to the gold price carries the risk of missing rapid price increases. Accordingly, the Hinde Gold Fund has now developed its models to maintain its exposure to the gold price but to reduce risk, especially when the perceived rate of return is likely to be slim or negative.

The fund treats the mining-equity sector "as a leveraged adjunct to the gold price, to be used in trading rather than as a separate asset class". Mr Davies claims that, as a result, the fund has "begun to provide investors with a significant return above the gold price".

Mr Davies argues that there are "early signs of inflation in the system", and (when interviewed early last month) commented "generalist stocks are not as vulnerable to a correction as many people feel". Gold-mining equities are consolidating ahead of the seasonal 'buying' period, and he advocates purchases on equity weakness, which he believes will be short lived.

"Right now", according to Mr Davies, margins for mining companies are "looking attractive for the first time in the past decade". However, the larger companies are "unable economically to replace ore resources". For this reason, Hinde Gold is focused on the smaller companies, and Mr Davies describes the potential return on juniors as "fantastic".

The fund holds, on average, 15% of its assets under management in junior companies, with a maximum allocation of 25%. These investments are chosen on a 'bottom-up' basis but Mr Davies diversifies his equity holdings geographically. He has a bias towards West Africa (Ghana in particular), South America (Ecuador and Mexico), as well as the Canadian gold belts.

Hinde Gold sees around two mining companies per week at its London office. Mr Davies says that he is particularly focused on value creation. For that reason he tends to look mainly for companies that are 18-24 months from production, or small producers that are exploring and planning to grow organically. Great weight is given to the integrity and experience of the management team.

As examples of his current equity selections, Mr Davies names Ventana Gold Corp and Canuc Resources as having potentially exceptional deposits. Likewise, Exeter Resources Corp and Rubicon Minerals Corp, where he considers the geology and management team are very competent.

He mentions that the "beauty of the gold market is little gems slip through the net". Some miners got unfairly punished in the deleveraging and this has provided opportunities. One such is NWM Mining

Corp, a start up producer in Mexico which is grossly under valued – "it's worth less



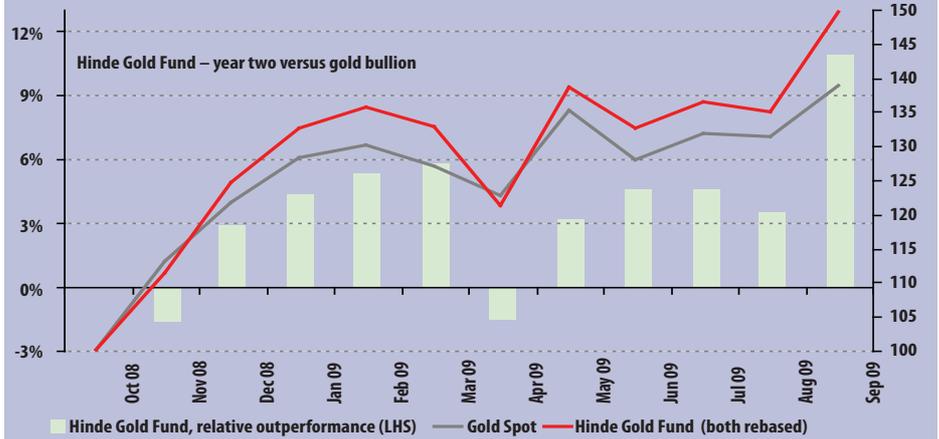
## PERFORMANCE

The fund lost 18% last year, but Mr Davies notes that gold equities suffered a rout during this period. He described last year's crisis as "the equivalent of a war for fund managers".

Mr Davies explains that Hinde Gold Fund has

adjusted to the new market conditions by adopting "closer adherence to the gold price to reduce volatility".

In the previous year (to the date of the interview), gold had risen 40% and the Hinde Gold Fund has risen 54% (after fees).



than the fire sale of all its fixed assets". The CEO and his team are also highly tenacious and competent – and Mr Davies expects a significant re-rating.

In the mid-caps he thinks very highly of Joseph Conway's team at IAMGold and similarly that of the management at Eldorado Gold Corp. He also singled out Randgold Resources Ltd as a company that has demonstrated the value-creation he is looking for in a mining investment. Randgold, he says, has been especially adept at remaining focused on building shareholder value.

## "Mr Davies questions the ability of investors to achieve delivery of allocated gold through ETF ownership"

He accepts that Hinde Capital's strategy of targeting development companies and producers means he misses some of the initial uplift in value that can come with exploration companies but argues that this is balanced by the sharply lower risk profile.

### POOR ALTERNATIVES

Mr Davies describes gold exchange-traded funds (ETFs) as "paper assets, and thus exposed to fiat demise in the same way as paper currencies". He dismisses them as "merely a pledge in paper form", and warns that the viability of ETF structures has "not been tested under stress". He says the degree of intermediation of an ETF (custodians, sub-custodians and trustees) creates a legal ownership minefield.

Mr Davies says "at best one should use ETFs as a speculative instrument; to be in and out of market. Medium to long-term they are just not a safe, realistic

investment proposition." Other risks associated with the ETFs lie with the regulators. In the US the largest bullion ETF, GLD, is overseen by the SEC. He suggested if they can ban shorting on bank stocks and ETFs, they can create restrictions on any instrument.

Mr Davies questions the ability of individual investors to achieve mass delivery of allocated gold through ETF ownership. He notes that the failure of an ETF provider will leave investors as creditors, and the counterparty risk is high for most ETF providers ("remember AIG").

There are exceptions. For example, Mr Davies has respect for the Swiss-based ZKB. This is one of the few ETFs with 100% bullion backing that he trusts. However, he notes fees are high.

Physical holdings of gold are more secure but are costly for individuals, according to Mr Davies. He notes that if individuals want to buy bullion or gold coins they are inevitably charged a retail mark-up of at least 5-10%.

The Hinde Gold Fund, in contrast, has an annual management fee of 1.5%, a 20% performance charge and no subscription or redemption charge. It also has a very liquid dealing policy. Any redemptions requested by the 21st of the month will receive the dealing net asset value of that month end, which he describes as being of "significant attraction for investors".

Gold equities are not without their risks. Mr Davies says that "balance sheets are impossible to read and evaluate accurately", and blames regulators for allowing accounting principles to be "perverted". He claims, for example, that there are far too many off balance sheet items. He cites Barrick's hedge book as an example.

However, in Mr Davies view, many mining companies are currently only valued in terms of their certain future cash flow. As a result, many are undervalued. But he warns that the average return on equity has been historically low, at 3% – "disastrous". In going for the "wrong type of growth", many companies have "diluted shareholders out of existence".

In summing up, Mr Davies felt he wants investors to consider Hinde Gold as a viable alternative to their medium to long-term savings accounts.

"While we are in negative real-rate territory, gold should be considered as money, as it once was, and possibly will be again. We encourage our investors to take out their annual returns, especially individuals who need to fund their everyday lives," he says.

## HINDESIGHT

A prolific writer, Mr Davies produces a regular *HindeSight* newsletter. The August document, entitled *Aurophobia*, ran to 26 pages, and incorporated a review of the World Gold Council's recently republished *Golden Constant* book, comments on market seasonality, golden facts from the 1970s and a note on Zimbabwefication.

The previous interview in this series, with Galena Asset Management's Cédric Choné on September 11, was incorrectly labelled as the 15th.