



September 2007

Hinde Capital Limited was incorporated on April 10th 2007. It received its FSA Registration on September 14<sup>th</sup> 2007 to operate as the Investment Manager to Hinde Gold Fund, incorporated as a professional fund in The British Virgin Islands on September 28<sup>th</sup> 2007. The Fund is to be launched on October 15<sup>th</sup> with estimated starting assets under management of US\$5-8m.

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[The Golden Hinde](#) returned from its epic global circumnavigation laden with pure fine gold, chests full of jewels and tons of silver valued reputedly at £600,000 in modern day parlance. This equated to over 14,000% return on the original investment of £4,000 for the voyage. No doubt Sir Francis Drake the daring sea captain of the Hinde could not guarantee, nor dare to dream of such returns, for fear of jinxing them. There are no guarantees but already in the gold arena we have experienced 14,000% returns in Aurelian resources. But to speak of such return is imprudent. They are not the norm.

Hinde Capital Ltd as Investment Managers to Hinde Gold Fund has been established to enable investors to have exposure to gold and silver within a low leveraged, highly liquid and actively managed fund. We aim to navigate the turbulent waters of a rapidly globalising world, by offering investors a tangible asset class with which to both protect and appreciate their capital. Hinde Gold Fund was set up in the belief that we are at a Monetary Juncture.

[At a Monetary Juncture](#)

Monetary episodes are varied throughout history, and represent the tiniest fraction of the relevant historical facts about money systems. But we can learn from this history.

The episodes are not easily comparable with modern states of today. But perhaps the circumstances in Kublai Khan's China (1271-94) were similar to our own times. Its borders were secure, it was enormously confident in its institutions of state; it had enjoyed a prolonged period of considerable economic success, and built its civic and commercial infrastructure on what amounted to capital issued for nothing. Credit - in the form of state and corporate paper - had been injected in quantities which had never previously been imagined. It left a population of savers holding paper promises of wealth, of which there were such a massive number that everyone was happy.

What seems to have happened in China is that a large and confident population worked harder than usual to accumulate a currency whose respectability was backed by the apparent integrity of a secure empire. As long as people strove to accumulate this money the state benefited from the productivity gains of a motivated population, which cost the state nothing. The empire's infrastructure was constructed on credit, its economy expanded on credit. This growth came from the power of a belief held by its citizenry that their labour was being validly remunerated in the token form of this Chinese imperial paper.

In Khan's China the very best living standards were enjoyed - not surprisingly - when people worked for something which it cost the state almost nothing to put into circulation in ever greater amounts. To be possible this required near unanimous confidence in the system, and not surprisingly the period was recognised as one of enlightened economic management - a view which persisted for several decades during a period of steady currency inflation.

Yet the most prosperous and confident period preceded rapid financial and political decline. When the confidence in the currency gave way there was wholesale destruction of the value of savings in almost all forms at once, and the popular energy required to sustain the empire rapidly disappeared. As its hitherto reliable institutions imploded the state itself was overthrown from the inside within a few years. At that time the few holders of gold - which had no formal monetary role whatsoever - saw their personal purchasing power increase quickly. "Are bells starting to ring?"

A previously successful credit based system will eventually collapse under the weight of its historical circumstances and the excesses of credit which it is sucked into at the time of its greatest success. As the process of collapse unfolds one monetary store after another demolishes savers. If they hold notional long term obligations like pensions the underwriters fail. If they hold institutional debt the issuers fail. If they hold bank notes the banks fail. It takes very few failures before the population starts to see risk in every credit based construct. Their **faith** in their institutions evaporates, and they become acutely aware of the dangers of anything intangible, and anything whose supply can relatively easily be expanded. This is when they begin to think **obsessively** about things whose supply is subject to some fundamental limit.

It becomes possible to understand why gold re-materialises as the only good money in times of such great economic distress. During such a period the most valued asset is the one which is incorruptible, and because the scarcity of gold is almost uniquely beyond the power of men to change (and because it can be discreetly owned) it is gold which re-appears as the agent of wealth storage and transfer at the junctions between the much longer episodes of representative money.

At these relatively rare junctures, as the wheel of optimal monetary solutions turns through its phases, ownership of gold is what empowers a bold and contrarian few to take control of large amounts of capital. Even as gold comes back into vogue, so the seeds of the new representative fiat currency system, which will subsequently replace it, start to germinate, for the simple reason that there is never enough gold to finance the opportunities for growth in a potentially successful economic state.

When the economic conditions are right for productive work and useful business development, gold is an inferior form of money. Given two neighbouring currency systems, one gold based and one fiat, and with a decent variety of opportunities with underlying demand, the fiat system will comfortably outperform the gold system. Braver businessmen will back several ventures at once, rather than the single project which gold allows, and they will usually win the race to the top of the economic pile. It is important to appreciate that there is no permanent best monetary system, and that ultimate success depends on being flexible enough to profit from a return to a fiat system.

#### "Alarm Bells ringing?"

Does this all sound all too familiar? By now many investors are awakening to the rude fact that **faith** in the integrity of money and politics should be questioned. Inertia or ignorance is no longer an excuse not to examine the role of money and government. Bank run's on Country Wide in the US and the UK's fifth largest mortgage lender Northern Rock and the authorities handling of both situations have by now given people great cause to **obsess** greatly about the construct of money and credit.

The current global climate is one of concern, whether it be sub-prime, CDO's or people queuing outside Northern Rock. The tightening of lending conditions will threaten deal flow and property prices alike if the central banks don't manage the situation correctly. Unfortunately their only known tool to affect asset and goods prices is to slash rates and flood the system with "helicopter money". The fact that the Dow is within 1% of its all-time high in this environment is surprising unless you realise that the most likely cause is that inflation is surging. While the governments of the world would like us to believe that is not the case and that inflation is 2% or less, people in most countries are experiencing loss of comparable purchasing power at a far greater rate. While property and share prices have long been a beneficiary of this in many countries, factors are clearly changing that makes these assets vulnerable, suggesting that we need a better and cheaper inflation hedge.

Take a **Federal Reserve Note is a dollar bill –not a dollar**. After all it is just a piece of paper fiat debt-money. People are accepting the unacceptable in other words. People are placing their **faith** in a financial future that is a lie. Governments confiscate a nation's wealth and more relevantly our wealth by destroying the purchasing power of "money". Money is but a medium of exchange used to buy and sell goods and services. You inject more money and you have greater supply driving prices higher, the purchasing power of that dollar bill (let's say) has gone down, as more units are required to buy the same amount of goods and services. So if the alternatives are not money we look yet further a field again.

## Outstanding Value and Returns

Any investment may be good or bad depending on entry and exit points. Most asset classes have provided outstanding returns at some time in their past. The consistency of some returns can be in sharp contrast to the incredible short lived returns of others. Our recent history is littered with examples. Japanese stocks were a stellar performer from 1980-1989 and since then have lost 75% of their value. Gold rose from \$35 in 1971 to \$880 in 1980 only to spend the next 20 years declining. London property so far has increased in value every year this decade, and likewise the price of carrots has kept pace with Chelsea real estate. One could list many more examples.

Jim Rogers once said you just have to find the right asset for the next ten years and watch it go from cheap to ridiculously rich before selling it and moving to the next one. He said that way you could keep your brokerage costs down and spend the rest of the time doing more interesting things. Obviously it helps to have enough un-leveraged money to make it worthwhile. He also failed to mention the constant work in monitoring the markets and the current global conditions which would enable you to make these investments in such a timely and accurate way. Notwithstanding the patience required to wait to buy when things are cheap and the courage to hold on until the asset has completed its move. The average investor often has the understanding but does not have the time or inclination to actively manage their assets. We aim to actively manage the portion of one's assets that should now be held in gold.

In 1980 it took only 170 ounces of gold to buy a 5 bedroom house in Chelsea. Today it requires 5000 ounces to buy that same property. Likewise one ounce of gold would have bought over 80% of the Dow points while now it barely buys 5%. Whether the ratios will ever return to the 1980 levels only time will tell but history has an uncanny way of repeating its cycles. In the early 80's everyone knew a commodity trader, up until very recently you couldn't find one or get someone to admit to being one if your life depended on it. At the end of this bull market we imagine the commodity departments in most investment banks will be the most populated and then it will be over.

## Gold Bull Market

Gold started its current bull market around the turn of the century. The sky high values of never-to-be profitable dot-coms and Gordon Brown selling the UK's gold stock at \$250 (the "brown bottom") were a million miles apart. Over the last 7 years or so, gold bullion has risen 200%. Whilst developed stock markets have failed to match these gains, emerging markets and property prices in many countries have outstripped it. The difference with the current conditions is that gold remains cheap while no one would argue otherwise that the nose bleed levels of London property or Chinese stocks do not make a good entry point for investment. In 2001 when gold traded at \$250, the total extraction cost averaged \$100-150. Today the average cost is rising rapidly far exceeding government inflation index. According to The World Gold Analyst, costs across the globe for extraction rose by 25% in the last 12 months with some countries experiencing 50% increases. These costs arrive from all angles; labour, concrete, rubber tyres, permitting, specialist mining equipment and energy to name but a few. Average costs are approaching \$400-450 but by-product credits are shielding the truth that some top ten miners like Harmony have costs in excess of \$600.

The various gold ratios' all forecast much higher prices and whether it is \$1,800, \$3,000 or \$10,000 per ounce such prices seem as ludicrous now as if someone had told you that the dot-coms or Chinese equities would trade at 100 times "earnings". A friend of my father's once confided in me that in late 1979 he sold his £30,000 of gold and bought a 3 bed flat just off the King's Road because property seemed ridiculously cheap relative to the gold he had held for several years. His daughter was to reside in this flat throughout her student years. Last year his last daughter got married, so he decided it was an opportune time to sell. So it was, as he was able to take the £1.8m he made and reinvest in gold receiving considerably more ounces than the original amount he had sold some 28 years earlier. He is now in his seventies living comfortably overseas. I haven't seen him for many years but I know he would tell me something like this; "all things are there to barter with!"

It's up to you to choose wisely when you need to change one asset class for another. At some stage in the future some assets will be at vastly different prices from where they are today, whether in actual terms or relative terms or both. The dollar might very well continue to slide to unimaginable levels as America's hegemony expires just as all great empires come to an end. Property prices in the UK might crash or be outstripped by a factor of ten by German real estate which has barely budged since reunification. Oil might well go to \$200 and throw many countries into recession while the continued march of globalization will see many countries, whether it be Brazil, India or even Nigeria do considerably better than the "rich" developed nations. The world is not going to end on all this but there will be a transference of wealth from asset class to asset class and from developed country to "developing" commodity rich countries.

## Mourinho's Black Swan

John Mauldin a profound investment writer scribed recently of “the Black Swan”. The term black swan comes from the ancient Western conception that all swans were white in color. In that context, a black swan was a metaphor for something that could not exist. The 17th Century discovery of black swans in Australia metamorphosed the term to connote that the perceived impossibility actually came to pass. As Mauldin writes, it has also come to mean an event or discovery whose existence was not predictable from the available data, and whose effect on society or the markets yields surprising and unexpected results. They can be good or bad events. But invariably they are bad. For example the September 11, 2001 attacks were such an event.

I was reminded of the phrase when I heard the re-run of an interview with the engaging Mourinho, the former Chelsea Manager. When pressed on how he felt about the “inevitable” stress that was imposed by the threat of his nearest rival Sir Alex Ferguson and his team Manchester United, he retorted “I am more scared of bird flu than football. What is football compared with life? A swan with bird flu, for me, that is the drama of the last two days...”

Like Jose we invariably do not fear the predictable but we fear the volatile, unpredictable black swan and when that fear manifests itself in mass participation, hysteria and panic take over. The events of Northern Rock seemed hysterical, although in reality it was quite rational as Meryvn King declared to the Treasury select Committee for people to protect their savings, (even if they did not quite understand why they had got to this place.) By having an investment in a tangible asset such as Gold we hope to protect you and ourselves from this Black Swan.

What does seem predictable? If you buy gold today, no doubt at some time in the future you will be able to swap your ounces for something else that you think is cheap and worth the barter. A fiat currency is merely a claim on resources, and it is a liability of the Central Bank, (while its credit based and government bond holdings are its assets.)

**GOLD is GOLD.**

**It is not anyone else's liability and has zero default risk. Owning Gold is not only advisable it is a MUST**

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**See Gold Equity Watch on page 5**

### References

**Rogers 2006**

**Mauldin 2007**

**Galmarley 2007**

## Gold Equity Watch

Gold mining equities continue to demonstrate their volatility despite having seemingly little in the way of variables. The rapid 800% rise from 2001-2004 occurred as the underlying metal rose from the ashes only for them to trade in an 18 month sideways range interspersed with bursts higher and often severe corrections thereafter as the range was mapped out. Why? Too much too soon. Share prices were too high relative to the price of gold and earnings became impinged by escalating costs (even the producers of the ultimate inflation hedge are not immune from the tide of rising prices.) Costs have bitten into the profits and reduced the net present value of future extraction profits relative to the Adjusted Market Capitalisation (share price including debt minus cash) from a heady average ratio of 3.0 to somewhat closer to 1.0.

While many mining indices and stocks are unchanged from early June it has been a roller coaster ride as the risk reduction and general margin call liquidation hit the gold stocks as hard if not harder than the general market despite a more or less unchanged gold price and the down trade has been followed by just as aggressive recovery. This power of de-leveraging in a potentially disinflationary environment only too readily highlighted the immediate issues of owning fiat paper assets. But lest we forget these companies assets are gold. If gold moves higher the return on equity they provide will still be there, assuming unchanged cost base.

Large and small miners alike are up an average of 40% from the absolute August lows, but more pertinently only up 14% since the start of the year. See table for gold and gold stock index comparisons.

Index	% yoy	% Aug 16 low to Sept 21 close
Gold	16	14
Gdx	14.4	40
Hui	17.7	40.4
Spx	7	11.4

The gold price move from \$650 to \$740 and the recovery in the overall market with the Fed cutting an unexpected 50bps all underpin this equity rally but as one can see from the year on year percentage change in the table they have not redressed their undervalued status. They remain as cheap as ever in spite of the recent gains. Indeed with the higher cost base adding to the gearing of the miners potential market cap they continue to look even more attractive on all models within the rising gold price scenario.

Despite strong physical demand, including a reputed 1,000 tonnes of gold purchase by India (over 40% current annual mine supply) the speed of the ascent makes for overbought readings across the board.

Evidence of short-term top? The front page of this weekend's Telegraph had a large picture of gold bullion plastered across it with the accompanying article extolling the virtue of gold. This is good long-term as the populace will need to become increasingly aware of this undervalued asset class. Short-term we would take this as an interim top. Certainly this week as well we move into a new year for the Washington Agreement (limits on central bank gold selling), we may well see these major players who have been absent in the last month or so come back in to sell? While we have sold most of our general holdings in gold equities here and replaced them with upside calls we continue to own companies that seem undervalued in the sector, even if we get a setback in the gold price.

However the need for constant monitoring is crucial. Gold stocks are volatile and we have learnt over time not to overstretch or get married to them. They are not an heirloom but a trading vehicle, and even allowing for the current rally they remain as cheap as they were relative to the gold price in 2001.

