Prospecting for winners in Victorian gold rush 2.0

TIM BOREHAM

For the best part of 50 years Victoria's historically rich goldfields have been a basket case, given lack of government support and disastrous big-ticket attempts to revive the underground Bendigo and Ballarat mines.

Now, the region is in the midst of a latter-day gold rush, thanks to the efforts of Canadian miner **Kirkland Lake (KLA, $63)** at developing the Fosterville mine into a 600,000-ounce-a-year, 46-grams-a-tonne monster.

Kalamazoo (KZR 62c)

"There's never been a better time to be in gold right now in Victoria," says Kalamazoo executive chairman Luke "ScoMo" Reinehr. "Kirkland Lake changed everything."

Fosterville was considered a low-grade and difficult mine until legendary Canadian mining investor Eric Sprott got involved with Kirkland Lake, resulting in an aggressive drilling program that uncovered riches much deeper than expected.

Reinehr notes that at Fosterville the lustrous stuff is also being produced at an "all in" cost of $318 an ounce, which with an Aussie gold price of about $2100 an ounce implies that the mine is spitting out more than $1bn of free cash flow annually.

Can Kalamazoo emulate the Kirkland Lake miracle? Well, Sprott himself thinks so, this month taking up $4m of Kalamazoo shares in a placement. The TSX-listed Novo Resources, of which Sprott is a director, took up a further $4m.

Enthusiasm for Victorian gold among deep-pocketed folk is proving more infectious than the mysterious coronavirus in a Chinese transit lounge.

Last year, Victorian explorer **Navarre Minerals (NML, 12c)** raised $9m in a share placement to Canadian fund manager 1832 Asset Management, which became a 7 per cent shareholder.

Other notable investors along for the Navarre ride are Kirkland Lake (with 10 per cent of the register) and the Victor Smorgon Group (9 per cent).

Gina Rinehart's Hancock Prospecting has also invested $7.9m in **Catalyst Metals (CYL, $2.82)**, which now bears a chunky $242m market cap.

Meanwhile Chalice Gold Mines is 17 per cent-owned by exec chairman Tim Goyder, brother of erstwhile Wesfarmers and AFL supremo Richard.

Although Kalamazoo has its roots in the Pilbara, Luke and Matt Reinehr had closely monitored their own turf and cottoned on that Castlemaine Gold — the operator of a Ballarat mine acquired from Lihir Gold in 2008 — was being forced to relinquish its ground because it was not fulfilling its minimum exploration spending commitments.

Castlemaine paid $10m for the Ballarat mine, after Lihir (now Newcrest) sunk $700m into it.

Reinehr says Castlemaine Gold's new owner, Lion Gold, had been "sucking every dollar out of Castlemaine and that means ending exploration".

Not only did Kalamazoo win the ground for no more than an application fee, but the friendly Castlemaine also bestowed a database and the results of an 80,000m diamond core program.

"If someone were to buy that today I would hate to think what it would cost, the diamond samples have a $20m replacement value," Luke Reinehr says.

Earlier, Kalamazoo raised $7m by selling a WA prospect called Snake Well to former Asciano chief Mark Rowsthorn and his business partner, Nathan Mitchell.

Given the fancy headline number, Kalamazoo has been allowed to pay in instalments.

Dual-listed in Frankfurt, Kalamazoo shares remain tightly controlled by the Reinehrs, who hold 32 per cent post placement (the Sprott and Novo camps each hold 8 per cent).

In the meantime, the Victorian government is due to announce the winner of a new tenement grouping called Block 4, which abuts the Fosterville mine. To describe the tender as hotly competed is an understatement, with all the key players expected to have competed in the Dutch auction process. "We are going in hard, we think we have a good chance," Reinehr says.

Chalice Gold (CLN 27c)

Meanwhile, Chalice bears the rare honour among explorers of returning $36m to shareholders, after $107m of asset divestments (most recently the $12m cash and scrip sale of its Canadian prospects).

The still cashed-up Chalice's efforts are focused on its "highly prospective but essentially unexplored" Pyramid Hill project, in the northern part of the Bendigo zone. Not surprisingly, the company is targeting a "Fosterville-style" discovery of five million ounces-plus.

The company is part way through a 25,000m air core drilling program — followed by a diamond drilling program — that will determine how many ounces the old timers left behind.

But with a Victorian government survey suggesting a 32 million ounce undiscovered "gold endowment" in the northern Bendigo zone, the company won't die wondering.

Chalice is also doing early-stage stuff at its King Leopold nickel sulphate project in WA's Kimberley region, in an area where Buxton Resources and Independence Group also have been sniffing around.

Here's an explorer not putting all its golden eggs in the one basket. Goyder notes that tier-one gold projects (those worth $US1bn-plus) only account for 2 per cent of discoveries globally.

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How did your portfolio really go?

So you had a good year last year ... compared to what?

SUE DAHN

Having spent some time on end-of-calendar-year investment portfolio housekeeping and calculating your returns for the year, you will no doubt be pleased at the performance of your portfolios. 2019 was a great year for investors.

But how did you really go? What are the correct calculations to do? What benchmarks are the appropriate comparators?

In my years of advisory and consulting practice I have often encountered comments such as we did very well in our portfolios over a given time period accompanied by the complete inability to answer the next, probably more important question — compared to what?

As investors, we all make an explicit or implicit choice to be active or passive investors in each asset class.

Passive investors choose to invest in the whole asset class as represented by a particular index such as the ASX 200 in Australian shares. Choosing "passive" will deliver the return from the index — all 200 shares in that case — minus a small fee for the product provider. There is little need to ask the question how did you go? There will be neither luck or skill involved. The outcome will be I got what the market got less a smidge for fees.

But most of us are still "active" investors in part if not for our whole portfolios. We make active security selections, participate in capital raisings, invest with active fund managers or select investments that are not in any index.

The outcomes of these selections will be different to any market-constructed index and the comparison will be informative.

For example, if you invested in equity markets during 2019 you would compare your results with the relevant markets in which you were invested. There are a range of widely accepted and followed market indexes issued by credible and respected market providers.

Most published index returns are price movements only, so again it's important to be comparing apples with apples.

One exception is the Australian All Ordinaries Accumulation Index, which incorporates dividends as well as price movements. You can see from this just how important dividends are as part of total return for equity investors — over 10 years the total return for All Ordinaries investors is nearly three times the price-only return.

Exercise caution here on the significant impact franking credits have for Australian equity investors, too — franking credits can add 1-2 per cent to the after-tax return for Australian equity investors but are not included in the conventional indexes.

Which index should I choose as the appropriate comparator?

The answer is the one that most closely resembles your underlying portfolio. The All Ords, for example, reflects the 500 largest listed stocks. Other commonly used measures are the ASX 300, the ASX 200, the ASX 100, the ASX 50, the Small Ordinaries (companies in the ASX 300 but excluding the ASX 100) and the MicroCaps (companies ranked between 350 and 600 by market capitalisation).

Other available indexes that may be appropriate comparators are sector-specific at a high level such as ASX Industrials and ASX Resources. Investors who specifically exclude resource stocks from their portfolio might find this index a useful one to consider when evaluating that exclusion decision.

Some investors have very concentrated portfolios, say with only a handful of stocks, and they may be best served comparing the performance of their portfolio with a sector index that reflects those underlying stocks.

Last year, for example, saw the healthcare sector strongly outperform all other sectors and the banks underperform all other sectors. Investors with portfolios concentrated on either of those sectors would have results vastly different to the All Ordinaries.

Most other asset classes besides equities also have widely accepted indexes that you can use to assess the performance of your portfolios — unlisted property, bonds, credit, hybrids, cash and alternatives all have established indexes available.

If you are an advised investor, your advisers will prepare a customised appropriate comparator performance calculation for you to discuss in your next review meeting. If you are a self-directed investor you may need to do the hard work yourself.

Or as a proxy you can use the higher-level aggregate performance benchmarks published by the agencies that monitor and tabulate the performance of the countries' largest super funds.

My experience working in investments for superannuation, not-for-profits, philanthropy and private wealth is that there are numerous lenses to the "how did we go?" question.

Benchmark comparisons have their place, as do peer comparisons, but the more long-term and self-accountable the investor is, I have found, the more fixed or floating objectives or targets become the prevailing benchmark rather than market or peer comparisons.

For example, cash plus 5 per cent or CPI plus 5 per cent might be a long-term objective or target for an investor who cares less about what others are doing or thinking.

Whatever your target or objective is, it pays to keep it front of mind and to remember not to judge a fish by its ability to climb a tree.

Sue Dahn is a partner at Pitcher Partners and was recently voted No 1 among Australia's top financial planners in The List: Australia's Top Financial Advisers.

Never forget interest rate influence over asset prices and valuations

ROGER MONTGOMERY

While I take it for granted that falling interest rates exert a positive influence on asset prices, it is perhaps not as obvious to others who might allow their investments to jump at the shadows of trade deals, Trump tweets and Brexit concerns.

As the year begins, it is worth keeping in mind the power exerted on asset prices by interest rates. As we witnessed in 2019, that power exceeds all the fears that might have inhered in short-lived geopolitical and financial machinations.

It is vital first to separate price and value. Price is what you pay for an investment. It's the figure that is advertised broadly and it's the figure from which your future return is derived. Value, however, is something else entirely. Value is what something is truly worth. If price is what you pay, then value is what you get. Your job as an investor is to pay a lower price than the value you receive.

Interest rates affect both values and prices.

The way interest rates exert their force on valuations is through the present value calculation. By way of example, the present value calculation seeks to answer the question, "what is $10 in 10 years' time worth today?" We don't need to answer that question here, but we do need to appreciate that at high interest rates we can invest a low amount of money today and obtain $10 in 10 years' time. At low interest rates, we have to invest a higher amount of money today to obtain $10 in 10 years.

In other words, when interest rates are low the present value of a future $10 is high. When interest rates are high, the present value of a future $10 is low.

Through the present value methodology we see that rising interest rates act like an increasing gravitational force on asset values. As interest rates go up, the gravitational force gets strong and the value of an asset comes down. But if interest rates fall, so does the gravitational force. Asset values are then free to float up.

But, of course, price and value are two different things, so how do interest rates affect asset prices? One transmission mechanism and arguably the most important is the migration of money by investors from one asset class to another based on relative yield.

As interest rates on cash and term deposits fall, the relative attractiveness of other asset classes improves, and investors migrate their portfolios to those more attractive options. In the last few years, as interest rates have fallen to punitive levels, cash and term deposits have become virtual liabilities and the migration to property and shares has accelerated — pushing the prices of those assets, and many others, to record highs.

History demonstrates that low interest rates are supportive for asset prices. Unless you see evidence that short-term or long-term rates are rising in 2020 there is no reason to expect the supportive picture for equities to change. The reality is the prices are already elevated and imply low future returns. However, capital is at risk in the stockmarket so even though low rates are supportive for equities, the risk-adjusted return available in the market today is becoming less and less attractive as the market rises.

And don't forget that asset prices are not immune to falls even in a low rate environment. For example, even though interest rates have been declining, property prices in Australia have experienced a bout of weakness.

Through the transmission mechanisms I have described, low interest rates help to elevate values and prices — but they do not defy other investment laws.

The primary law that will remain immutable is this — the higher the price you pay, the lower your return.

Roger Montgomery is founder and chief investment officer of the Montgomery Fund.

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