The SA Bullion Gold Report

Third Quarter 2010

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Gold Performance to 30 September 2010 (% per annum)

	Quarter*	6 Mth*	1 Yr	2 Yr	3 Yr	5 Yr	10 Yr
Gold in USD	5.1	17.2	31.3	21.6	20.7	22.5	16.9
Gold in ZAR	-4.1	11.3	20.8	11.6	21.2	24.8	16.5

** not annualized for periods of less than 1 year*

Prices

	Gold in USD/oz	Gold in ZAR/oz
30 Sep 2000	273.55	1980.05
30 Sep 2005	473.25	3008.78
30 Sep 2007	743.00	5124.29
30 Sep 2008	884.50	7324.23
30 Sep 2009	995.75	7545.29
31 Mar 2010	1115.50	8192.18
30 Jun 2010	1244.00	9508.89
30 Sep 2010	1307.00	9115.41

Note 1: The above prices are LBMA Afternoon Fix prices.

Performance and Price Action

Following the end of the previous quarter we saw a pull-back in the gold price – a pause that refreshed. In our quarterly report we wrote "support above $1,160 has held so far and the near term target of $1,300 remains on track". This has indeed been the case. Gold closed the quarter at $1,307 /oz and at time of writing is trading around $1,347 /oz.

In US Dollar terms gold has delivered strong returns for the last quarter, six months and year (see Chart 1 for long term performance and trend). Performance in SA Rand has been a little more muted due to strong appreciation of the local currency, but has nonetheless rewarded investors with a return of nearly 21% over this last year (see Chart 2 for long term performance and trend)

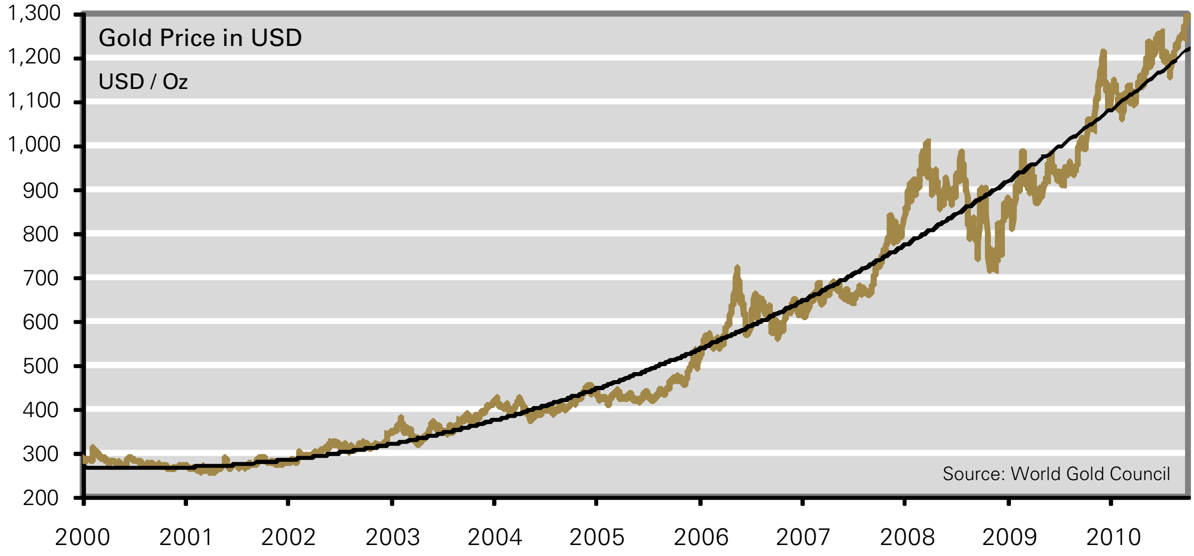


Chart 1

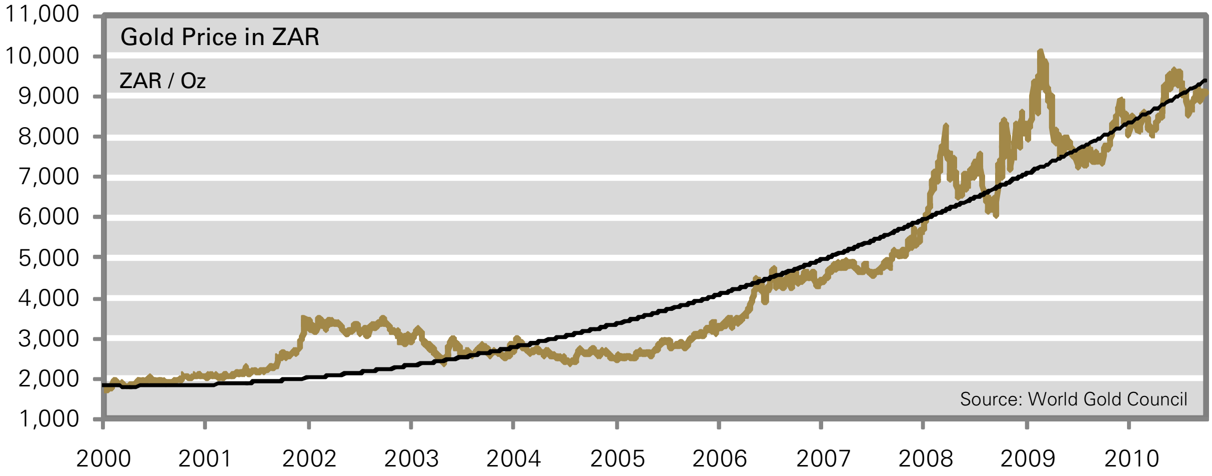


Chart 2

Over short periods of time our confidence in making gold price predictions is low. Over the long term however, we see very strong drivers of gold strength. Our story of reflation has been correct in the past and we are thoroughly convinced of its perpetuation.

Our story is a long term one and we would ask new readers to trawl through our past quarterly reports for a fuller picture. In this report we will focus on currencies, and specifically the Rand. We do, after all, advocate that "in the bad times gold is a currency" and that we are very definitely in the "bad times".

A Brief Review of the Rand's Recent Past

The "Greenback'

The global reserve currency is the United States Dollar, and we start therefore with a cursory look at the recent history of the nearly 100-year old Greenback. Beginning in 2002 the Dollar found itself on a steep decline – for numerous reasons including 9/11, wars, recession, mortgage crises, federal deficits, trade deficits etc. This slide reached 69.9659 on the Dollar Trade Weighted Exchange Index (DTWEXM) on 15 July 2008, shortly before the collapse of several US investment banks set off a monumental solvency crisis and credit contraction.

On that ugly Thursday, 9 October 2008, the Dollar stood at 77.98. A further five months later, on 9 March 2009, the Dollar stood at 86.2912, a phenomenal 23% appreciation in eight months! By 30 September 2010 the Dollar had retreated to 73.5510 – a nearly 15% retracement!

The Rand

The South African unit enjoyed a long winning streak through the mid-2000s and onwards, thanks largely to the global demand for South Africa's mining commodities. By 22 September 2008 the currency had climbed to R7.98 to the Dollar. But that was about to change. As we had remarked to our clients, a massive synthetic short on the Dollar was going to upset the apple cart. A mere month later, on 22 October 2008, the Rand had tumbled to R11.14/$ - a collapse of 40%! Since then the Rand has been steadily climbing and by 30 September 2010 its conversion rate to the Dollar stood at R6.96 – a bull-run of 38%, with more coming subsequent to quarter-end!

We shall rather simplistically attempt to discuss the two key drivers of Rand performance in the recent past.

1. The Search for Yield: The leading nations in the West have flooded their foundering economies with liquidity i.e. money. Simultaneous to this action, the leading nations in the West have slashed interest rates to record lows. See Chart 3 for a 56-year perspective of US Fed Funds rate to see that current rates at 0.25% per annum represent something unprecedented and extraordinary.

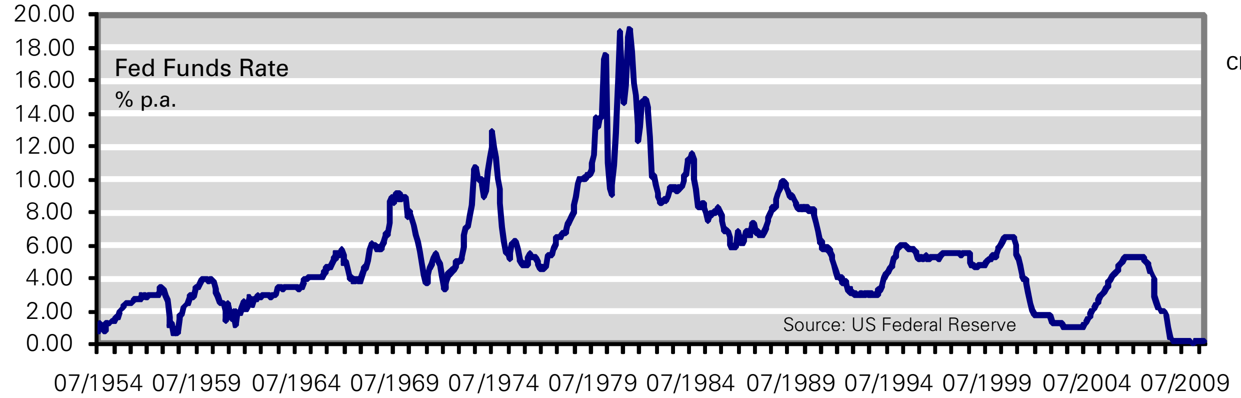
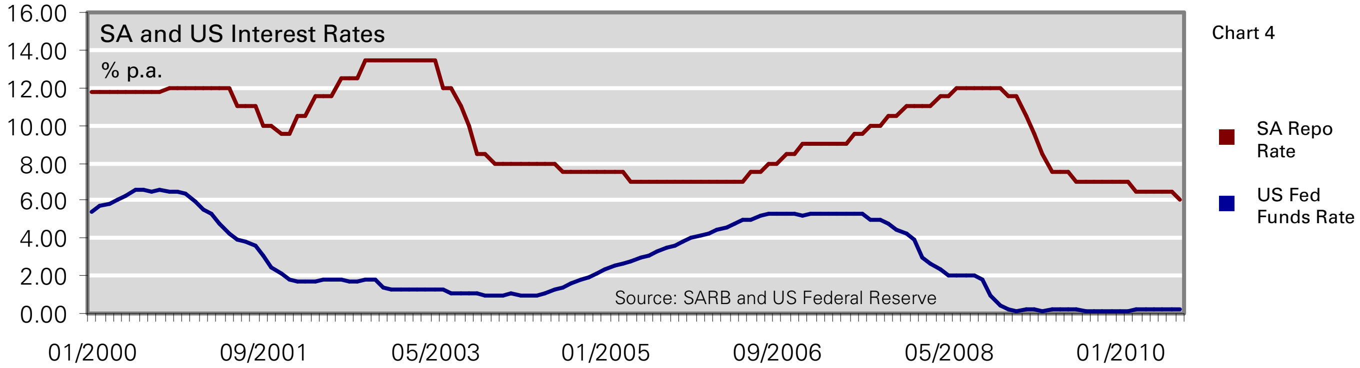


Chart 3

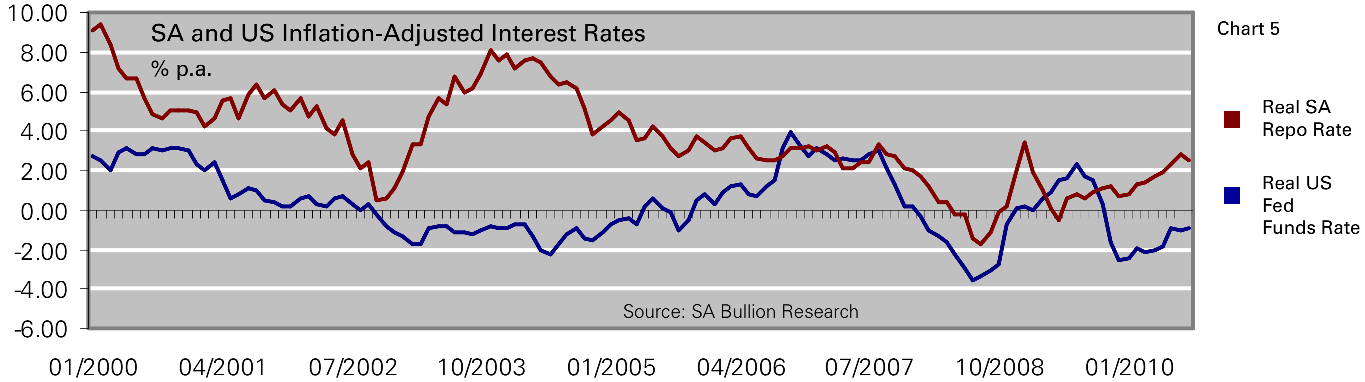
This wall of stimulus money is desperate for yield. In other words, the owners and managers of this money are in pursuit of interest rate returns that are better than a paltry 0.25% pa. South Africa has seen the central bank cut the local Repo Rate from a recent high of 12% to what is now 6%. Although this slashing of rates makes local interest rate investments less attractive on a fundamental basis, on a relative basis compared to US short rates, the Rand is a very attractive destination. Chart 4 illustrates the interest rate differential between these key interest rate policies.



An analysis of interest rate differentials needs to include respective inflation rates. Chart 5 reveals that 'money-in-the-bank' in the US today earns a negative real (inflation-adjusted) return whereas in South Africa the real return is over 2.5%. Furthermore, the chart demonstrates that this massive interest rate disparity has existed since October 2009. It's no coincidence that net foreign investment into South African bonds has surged in recent times, thereby aiding and abetting Rand strength, viz.

2008	2009	2010 year to date
-R16bn	R24bn	R67bn

Source: JSE Limited



2. ***The Flight to Commodity Currencies:*** The past year has seen commodities experience a dramatic bull run. Petroleum products, metals, agricultural commodities – have all escalated remarkably in price. Underlining this price appreciation is a downwards revaluation of industrialized nations' currencies, largely due to ongoing stimulus in those countries. The commodity-currency countries have benefited not only from their commodity sales boom, but also by virtue of being generally well-financed and prudently managed. Together these factors have resulted in a pursuit of commodity currencies so as to benefit from their price appreciation.

According to the International Monetary Fund ("IMF") it is not only investors who are pursuing the commodity currencies but central banks as well. The IMF reports that "other" currencies (i.e. not major currencies) held by central banks as currency reserve holdings constituted 1.5% of total holdings at the start of 2000. Today this proportion stands at 3.6%. The major beneficiaries being the Canadian Dollar, the Australian Dollar, the South African Rand, the Brazilian Real and the Norwegian Krone.

Looking Forward - Key Drivers of the Rand

Currencies are enormously complex instruments that are affected by innumerable factors, but we will look here at what we believe to be some of the most important drivers of the Rand in the near future.

1. ***Trade Balance:*** South Africa's Rand is regarded as a commodity currency which means that the nation's trade balance (which is a component of the current account, which is in turn a component of the Balance of Payments) is of keen interest to investors. If commodity prices and export volumes are high, then the nation generally does well, both in terms of economic activity and in terms of taxes raised. The converse is also true.

South Africa's trade balance is not very healthy, but fortunately it is looking less unhealthy than in previous years (see Table below). Imports far exceed exports, which ultimately means that the country relies on the other main component of its Balance of Payments, namely the Financial Account, to balance its finances and thereby maintain Rand stability. The predominance of commodities in the South African export mix makes the Rand very vulnerable to global economic growth conditions.

Year	2006	2007	2008	2009	2010 to 31 Aug
Net Trade Account	- R68.6 bn	- R69.9 bn	- R71.6 bn	- R25.8 bn	- R12.2 bn

2. *Financial Account:* Previously called the Capital Account, this account measures the cross-border flow of funds for assets such as shares, bonds and property. Herein lies extraordinary risk for South Africa and the Rand. Foreign liquidation possibly presents the largest single risk to the Rand.

Foreigners are very, very substantial holders of South African shares and bonds. Foreign capital has flown in steadily since 1994 and domestic capital has flown out steadily. The following table of Net Foreign Trading in South African equities and bonds is instructive:

Year	Net Foreign Purchases of Equities	Net Foreign Purchases of Bonds
2006	R73.7 bn	- R8.9 bn
2007	R63.3 bn	- R0.8 bn
2008	- R54.4 bn	- R16.0 bn
2009	R75.4 bn	R23,9 bn
2010 to 2 Oct	R19.8 bn	R67.1 bn

The issue is who will acquire these shares and bonds if there is a mass sell-off by these foreign holders? The assets would be sold down to prices where they are bought by local investors. It is no coincidence that the great JSE lows of 2002/3 and 2008/9 occurred at times of foreigners exiting South African markets *en masse*. Needless to say, the Rand suffered along with the JSE as Rands were dumped for Dollars.

We keep a close watch on the data and currently have some slight concern as to developments in the last four weeks. Net Foreign Trading is recorded as thus:

Week ending	Net Foreign Purchases of Equities	Net Foreign Purchases of Bonds
10 Sept	- R0.9 bn	R4.1 bn
17 Sept	- R1.5 bn	R0.6 bn
23 Sept	- R2.6 bn	R4.4 bn
01 Oct	- R1.0 bn	- R9.8 bn

The negative Trade Balance of South Africa requires a positive matching Financial Account in order to maintain Rand stability. We would be surprised if there aren't many foreign investors looking at the current high level of the Rand as a great exit opportunity. Should they act in growing numbers, their action could precipitate sudden and dramatic weakening of the Rand.

3. *Interest Rate Policy:* The South African Reserve Bank uses the Repo Rate as their weapon of choice in managing interest rate policy. Since 2008 the Bank has taken the rate from 12% to 6%. The Bank has done this owing to steeply declining inflation rates and a weak economy. With the inflation rate trending below 3.5% there would certainly be room for the Bank to cut the rate yet further – with such an action further closing the real Repo to real Fed Funds gap, an action that could sway some foreigners to take their profits and run out through the Financial Account gate, thereby inducing Rand weakness.

Further Rand-drivers for discussion another time include public debt levels, economic performance, political uncertainty and Reserve Bank open market operations. Whilst important, these factors would not seem to predominate at the moment.

Conclusion

At time of writing the South African Rand is in a strong strengthening trend. We would not advocate a big bet against such a trend. However, we would suggest that this is a good time to be phasing some Rands into Dollar-denominated gold so as to 'bank' some of that 38% Rand appreciation that we have enjoyed. And just to add weight to the proposal, we would like to point out that Rand risk was very low a year ago – but it's rapidly rising. Watch that Financial Account!