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From the Sixty Third Issue

Mini-Lesson: Why You Could Make More in Gold Equities than in Gold Itself

Important: This Mini-Lesson appears exactly as it did in 2003. While the arguments presented proved to be true for a considerable period after its original writing, *more recent trends have favored investment directly into the physical metal or into a CEF (Closed End Fund) or ETF (Exchange Traded Fund) which purchases the physical metal.* There are several reasons why this would be true, but that discussion belongs in a more comprehensive lesson than will be presented here. *The key point here is learning and applying the concepts of leverage and P/E ratios to investment trends,* not that other forces became dominant to investing in this commodity and reversed the preferred investment to the commodity itself instead of the producers.

Why could purchasing gold equities outperform investing in the metal itself? It has to do with *leverage.* Gold generally costs about \$250/ounce to produce. With the market price where it was prior to April 2002, (between \$265 and \$300/ounce), gold mining companies were generally break-even at best.

However, as the price of gold goes up, company revenue and profits go up with it. But profits go up much faster than revenues at these levels. Consider this example:

Unhedged Gold Miner

Gold Price:	\$300/Ounce	\$350/ounce
Production:	1KK ounces (KK=million)	
Revenue:	\$300KK	\$350KK
Costs:	<u>250KK</u>	<u>250KK</u>
Pretax Net:	\$ 50KK	\$100KK

As you can see, while revenues went up 17%, *profits doubled.* That's powerful when pricing an equity in the stock markets. If you bought the metal, you would realize the same 17% profit the gold miners did in their revenue. But, the likelihood of a stock price increase of 50-100% is high when the profit picture of a company doubles. This doesn't even consider the increase in stock price when buyers consider the value of the inventory on the miners' balance sheets. Imagine what the stock price does if gold goes to \$400. \$500? \$600?

If the current macroeconomic and market forces continue to work as I anticipate, you may look back on gold equities as some of the best investments you ever had.

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