Precious metals Q&A

In this Insight, Ani Markova, Vice-President and Portfolio Manager of AGF Precious Metals Fund, responds to widely asked questions from investors in the commodity space and, more specifically, precious metals such as gold.

Are commodities making a comeback? If so, are macro events or commodity / company-specific fundamentals driving this?

Investors in the commodity space over the past decade would have experienced strong, broad-based outperformance, driven by steady demand from China and solid global growth. However, now that global growth has decelerated and emerging economies have slowed significantly, performance has become more commodity-specific. For example, a ban on Indonesian nickel exports or technological advancements of natural gas fracking have impacted the supply characteristics of their respective commodities.

We believe that without the tailwind of broad-based commodity demand, each commodity's supply-and-demand characteristics are especially important. This is also true for gold and precious metals today.

What about gold? Is now a good time to be buying gold?

Gold is a commodity that has unique supply-and-demand characteristics. On the demand side, it is driven by jewellery, investments, some smaller industrial uses and, more prominently in the last few years, additions to central bank reserves.

The proliferation of exchange-traded funds (ETFs) saw investors rapidly accumulating gold through ETFs between 2004 and 2012. Last year's flurry of ETF liquidation of 881 tonnes, which represented 17% of total supply, reversed this demand into a new source of supply for gold, driving down the price of gold significantly. ETF holdings have more or less stabilized this year and liquidations have had a reduced impact on bullion spot prices, indicating that investor pessimism may have troughed.

We are also clearly seeing the shift of the demand to Asia with China and India representing 54% of global consumer demand (2013 WGC numbers). This illustrates a trend of accumulation in these markets where gold has cultural value and historic role as a status metal. It is our belief that this gold supply will not be made available anytime soon to western investors, at least not at or below today's price levels. These various demand factors point to increasingly positive conditions for the industry.

The supply of gold is inelastic and is constrained by high capital investment requirements, scarce economic deposits, resource nationalism, the need for social licences to operate and experienced management teams. Currently, gold is trading around the industry's all-in cost of production, meaning that producers cannot afford to invest in new mines and have cut back on their development pipelines, which will constrain long-term supply. Within the next couple of years, the market will most likely start to reflect the scarcity of gold supply given the solid demand characteristics. If they can, we think investors should consider accumulating and position themselves for the next upwards price move.

What's your outlook for gold and resources going forward?

We are optimistic about the mid-term and long-term outlook for gold, silver and other precious resources due to their characteristics as wealth preservation tools in a volatile and unstable geopolitical world with fragile economies and global currency wars.

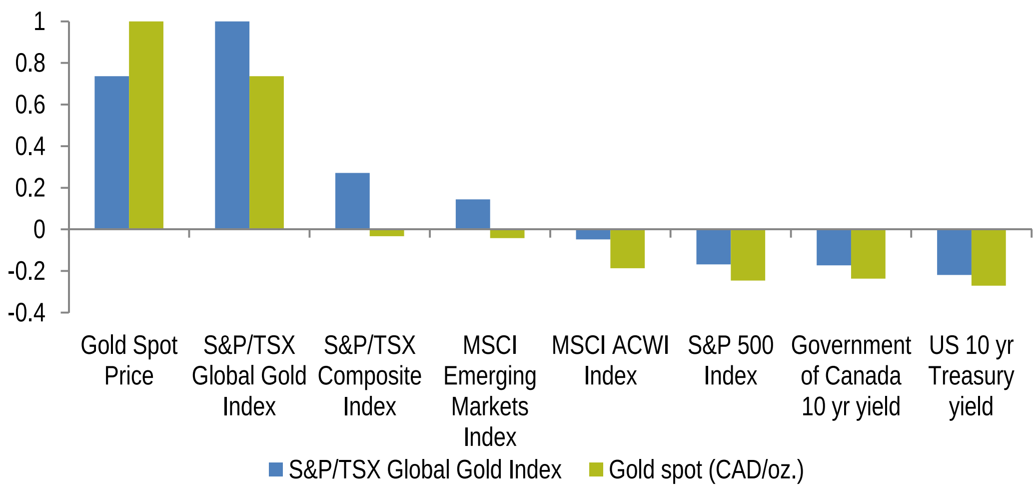
We currently see inviting opportunities in mining equities, which have been underperforming for the better part of the past three years. As measures such as cost containment, closures of unprofitable mines and capital discipline with deferrals of marginal projects are instituted in the sector, miners have the ability to improve profitability even in a flat gold-price environment. The all-in cost has declined from its peak of above US$1,500 per ounce in 2012 to expectations of just above US$1,100 in 2014 (Source: Scotiabank GBM, April 2014). Small changes in the commodity price can provide great leverage to cash flow and thus equity outperformance on the back of historically low valuations.

Diamonds are another precious resource we are optimistic about. We believe that long-term economic conditions will be positive for diamond companies, helped by growing demand for large quality stones from emerging markets such as China and India (through demand for engagement rings and other jewellery), combined with the return of consumer confidence in developed markets. Supply will be tight, similar to gold, due to the scarcity of discoveries and the depletion of major mines in the next few years.

Should investors invest tactically or make a long-term asset allocation to gold?

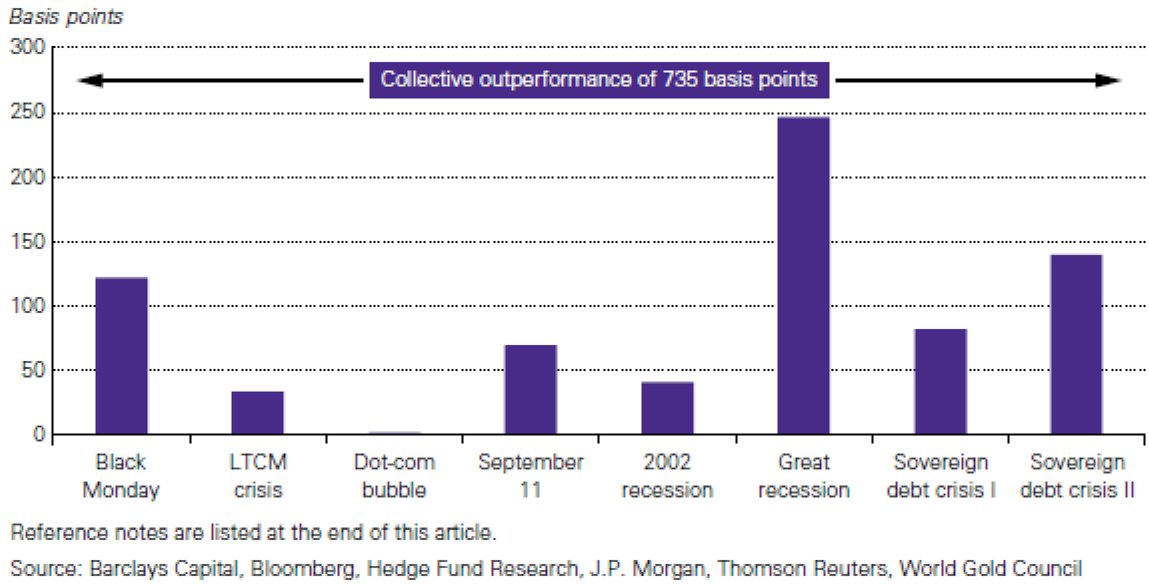
Short-term tactical calls on commodities, such as gold and silver, are always difficult to assess correctly on a consistent basis due to ever-changing market factors. Over the long term, however, gold's historic role as money, reserve asset and status metal has demonstrated it is an attractive asset from a broader portfolio construction point-of-view, as it has value that does not move in step with other asset classes, such as highly correlated equity markets. Thus a long-term allocation may be appropriate for many investors depending on their investment goals.

Monthly Correlations, CAD (31 Oct 2000 to 31 May 2014)



Source: Bloomberg, as of May 31, 2014.

Gold reduces portfolio losses during tail-risk events



Source: World Gold Council, Gold Investor - Volume 5, March 2014.

Gold prices also tend to move higher during periods of low or negative real interest rates and rising inflation expectations, which makes it a desired hedge in environments of systemic stress. While all investors do not have the same risk tolerance and investment requirements, we believe that the typical investor should always have a small exposure to gold and precious metals that allows for portfolio diversification. Proper allocation of bullion and selected equities with exposure to the sector should provide investors with a tool for wealth preservation, especially during extreme market events.

Speak to your Financial Advisor about AGF Precious Metals Fund, or alternatively, visit AGF.com for more details.

Performance

	6 months	1 year	3 year	5 year	10 year	PSD*
AGF Precious Metals Fund★★★★ (net of fees)	11.1%	-6.5%	-24.5%	-4.8%	3.8%	6.7%
S&P/TSX Global Gold Index	5.9%	-16.0%	-22.9%	-12.0%	-1.1%	-
Excess return	+5.2%	+9.5%	+1.6%	+7.2%	+4.9%	-

Source: AGF Investment Operations, as of May 31, 2014.

Morningstar Ratings reflect performance as of 5/31/2014 and are subject to change monthly. The ratings are calculated from the fund's 3- , 5-, and 10-year returns measured against 91-day Treasury bill and peer group returns. The Overall Rating is a weighted combination of the 3-, 5-, and 10-year ratings. The top 10% of the funds in a category get five stars. For greater detail, see www.morningstar.ca. The star ratings and/or number of resources funds for each period are as follows:
AGF Precious Metals Fund (Precious Metals Equity): overall 4 stars (35 funds), one year 4 stars (44 funds), three years 4 stars (35 funds), five years 3 stars (29 funds), ten years 4 stars (14 funds).
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