

Dear Shareholder,

As most of you are aware, during the Covid hysteria and accompanying lockdowns, we engaged an analyst in Australia and a couple of consultants in the US to help keep on top of the myriad of companies that now make up the gold mining and exploration universe. During the third quarter I travelled to Kuala Lumpur and met with Larry Hill, who had come up from his base in Adelaide, and we met for the first time outside of Zoom in two and a half years! Larry had sent me some ideas to include in this quarter's report to shareholders but, given the difference in our writing styles, I think it best that I stand aside and allow Larry the floor so that he can tell you exactly how he sees the present depressed state of the gold stock market. Larry, having trained as a metallurgist, and run a processing plant in West Africa for some years, is technically much more savvy than I. Whether he can spot the turn in the gold market more accurately than I did is something we will find out!

Greetings shareholders from Larry Hill in Adelaide. Below is the gold market and the implications on gold stocks as I see it.

Over the September Quarter the gold price averaged US\$1,727/oz (-8% QoQ, -3% YoY) with YTD average price of US\$1,827/oz, slightly better than last year which averaged US\$1798/oz. So, while directionally the gold price was steady, extreme volatility saw gold hit a two year low at US\$1,620/oz towards the quarter end as the US Dollar index (DXY) breached a twenty year high above 115. This appreciation had a mark to market impact on Canadian dollar (-7.4%) and Australian dollar (-7.3%) denominated portfolio holdings. All up the PGF NAV retreated 15% for the September Quarter, in line with benchmark indices of major producers (HUI -14%) and the juniors (-12%)

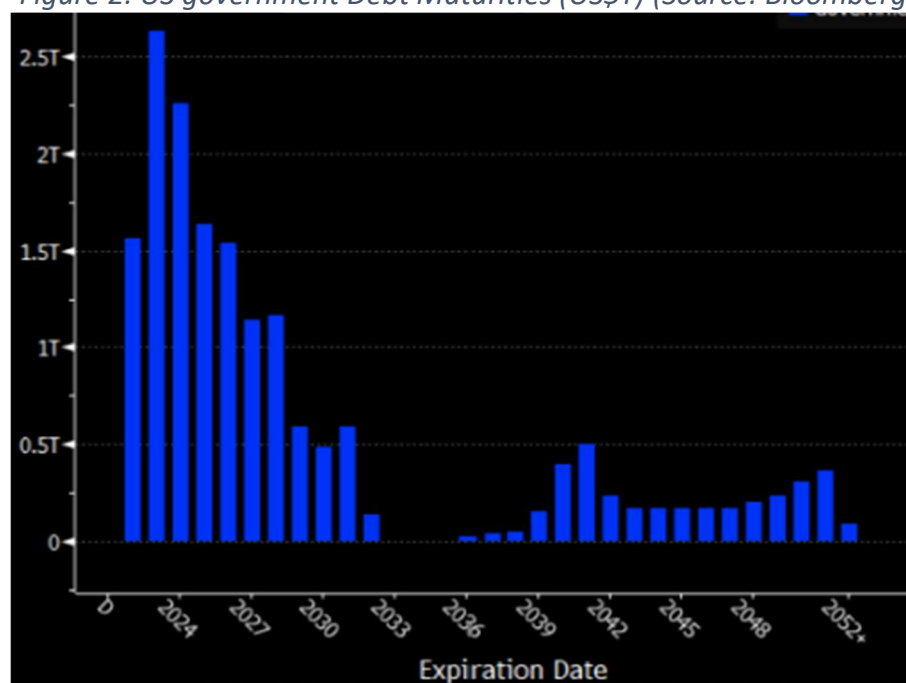
The main headwind to the gold price of the strengthening US Dollar showed little sign of abating with the Fed's most aggressive rate hikes since the early 1980's expected to continue with another one hundred basis points anticipated over the next six months. Placing an ambitious, yet unrealistic, goal of curbing inflation back to the magical 2% target, a hard landing appears inevitable for something will have to give. We view the Fed being limited to how far rates can increase given the short- dated amortization (3 years) of US debt maturities (Figure 2) and its sensitivity to the spread in the two year vs ten year treasury rate (Figure 1).

Figure 1: US Treasury Yields: 2 Year (White) vs 10 year (Blue) (Source: Bloomberg)



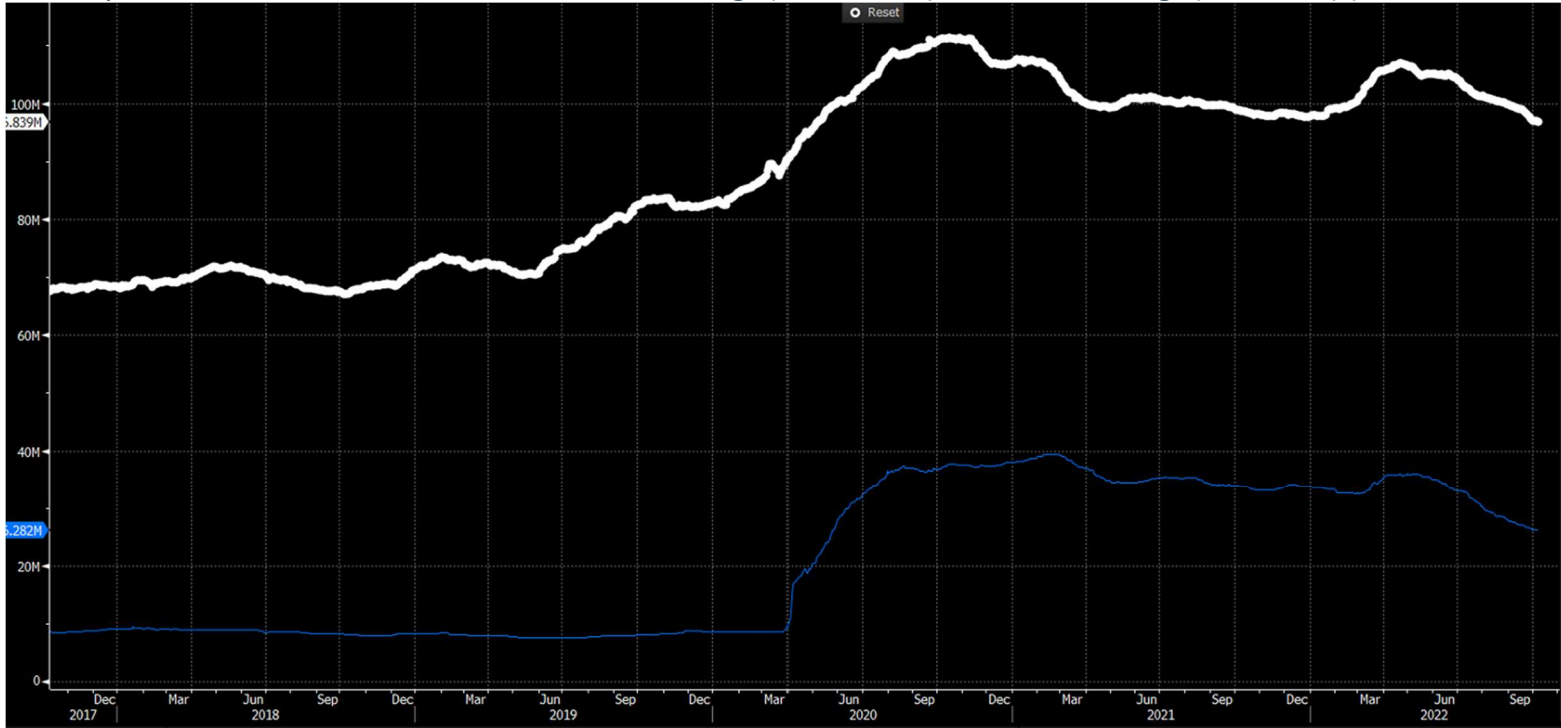
Likewise, the extreme level of US corporate debt (+50% from pre-pandemic) has seen heavy losses to financiers exposed to leveraged buy outs while in the UK, pension funds, which had liability driven investments (LDIs) were exposed to the surge in British bond yields as selling to meet margin calls surged interest rates in a liquidation spiral. The intervention of the Bank of England late in the September quarter calmed markets with the record devaluation of the pound vs the US Dollar reflective of how precipitous the bond market remains.

Figure 2: US government Debt Maturities (US\$T) (Source: Bloomberg)



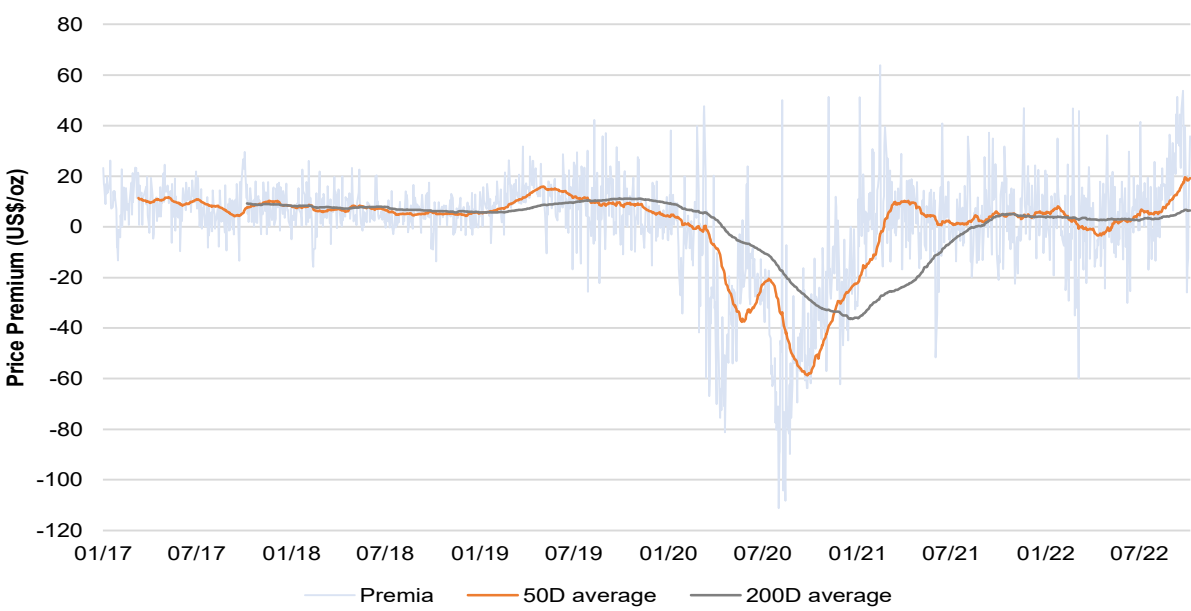
In this environment, any supporting evidence of continuing inflation, such as infinitesimal uplifts in US labour conditions, or the persistence of core inflation, trigger swift reactions in the gold price as quantitative based trading and the influence of Comex are more pronounced than ever. With the ability of traders to leverage contracts with low cash coverage (sometime as low as 5%!) short term price manipulation is unavoidable.

Figure 3: Reported Gold Inventories: Total known ETF Holdings (White, Moz) vs Comex Holdings (Blue, Moz) (Source: Bloomberg)



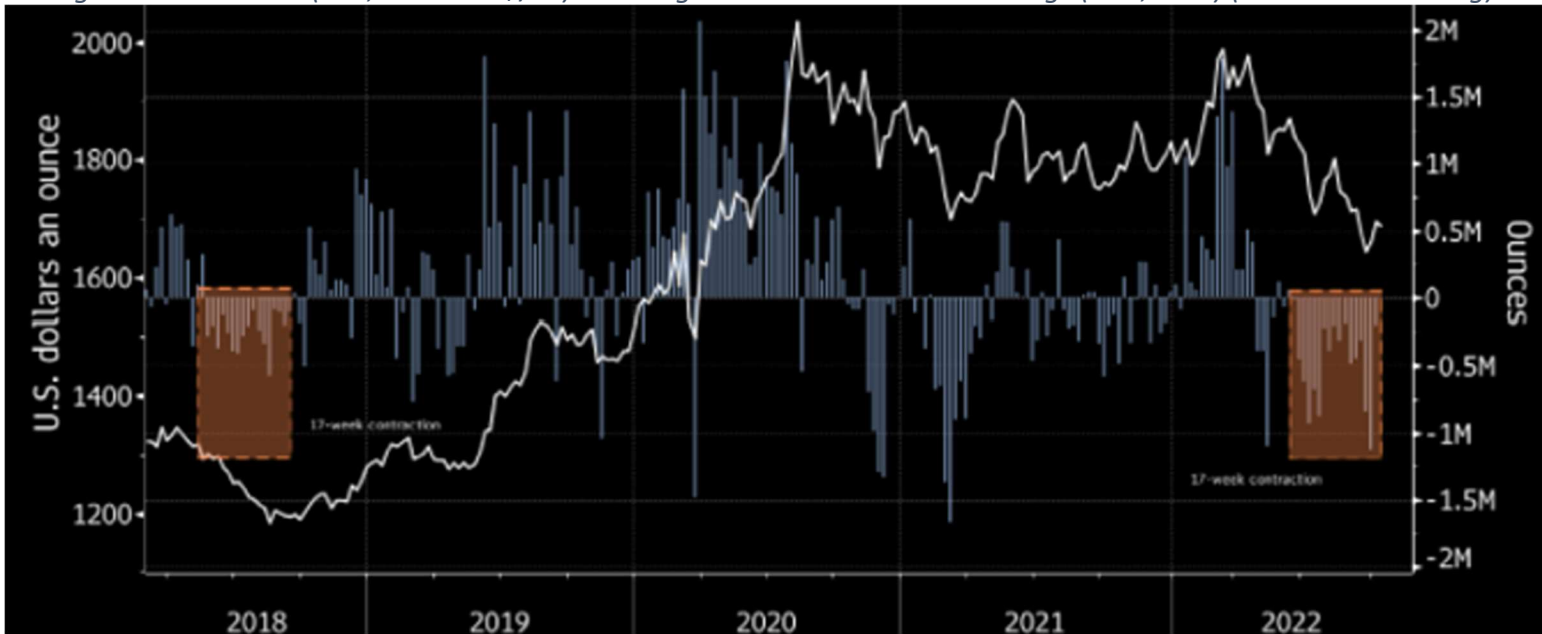
Comex inventories (Figure 3) having built up at the start of the pandemic to cover future positions, continued to be drawn down mostly to meet the strong demand particularly from Asian buyers with net imports into China at a four year high. To acknowledge settlement of physical bullion (often as a 1kg bar) on the Shanghai Gold Exchange gold has often traded at a premium. This currently sits at US\$35/oz (Figure 4), the highest monthly average since the last substantive downturn in the gold market in 2013.

Figure 4: Average spread between Shanghai Gold Exchange and Comex per bullion ounce (Source: World Gold Council)



Gold EFTs saw the most outflows since January 2014 over Q3'22 (Figure 5). Sentiment appeared at extremely bearish levels, with net short positioning the heaviest since November 2018. In the event of a small catalyst such as a slowing US inflation or softer labour market conditions, we view the conditions as well set for a strong rally in the gold price as traders clamber to cover established short positions.

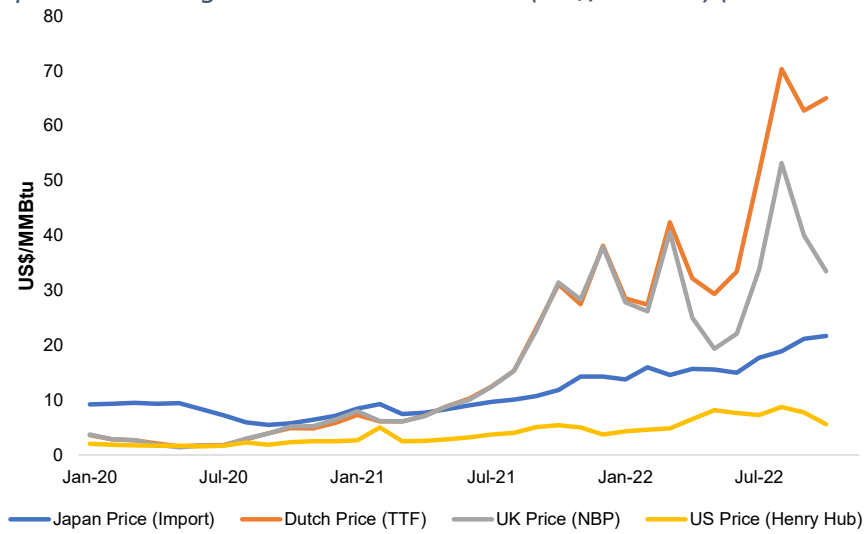
Figure 5: Gold Price (LHS, White US\$/oz) vs change in known Gold ETF Holdings (RHS, Moz) (Source: Bloomberg)



Looking further into the unabated strength in the US Dollar vs the gold price (Figure 6) the index (DXY) composition of Euros (57.6%), Japanese Yen (13.6%) and British Pound (12%) certainly piqued our interest. Given the significant increase of LNG purchases to cover curtailed Russian supply, one only needs to examine the current LNG market pricing arbitrage (Figure 7) as the demand is settled in the requisite USD. We view these dynamics lie at the foundation of Putin’s efforts to stymie US hegemony with recent success in settling a quarter of gas supplies to Turkey in Russian roubles and similar examples in trade with India and China.

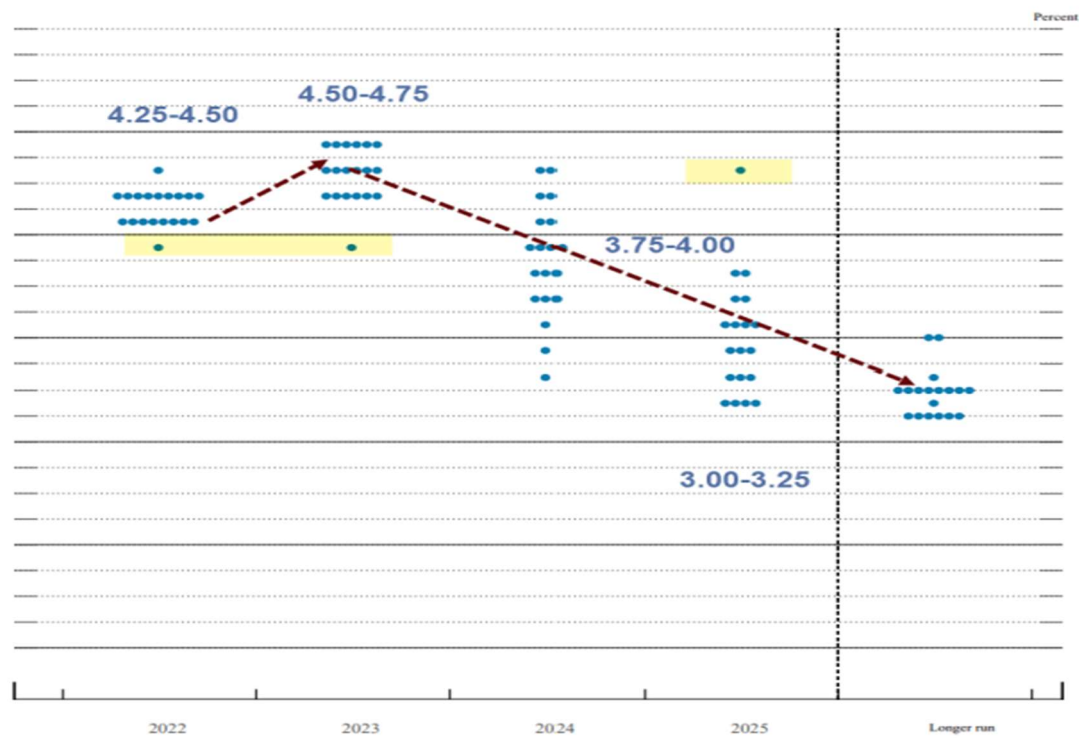


Figure 7: Spot LNG Pricing across various Markets (US\$/MMBtu) (Source: Bloomberg)



Any expectation of a pivot by the US Fed from its hawkish plan to move Fed Funds towards 4.5% has been squashed in the short term given there is little sign that inflation is easing as cost pressures shift from the goods to the service sector. This is most evident in the labour market as the full effects of the ‘great resignation’ bite, managers enforce a return to the office, and skilled migration slowly ramps up. Core inflation, with the volatility of energy prices stripped out, remains stubbornly above 6% and will shape monetary policy with the market pricing in at least another 75bps rise at the next Fed meeting and the prospect of any tapering unlikely to eventuate until mid-2023 (Figure 8).

Figure 8: Dot Plot of FOMC participant expectations of target federal funds rate (Source: US Federal Reserve minutes, September 2022)

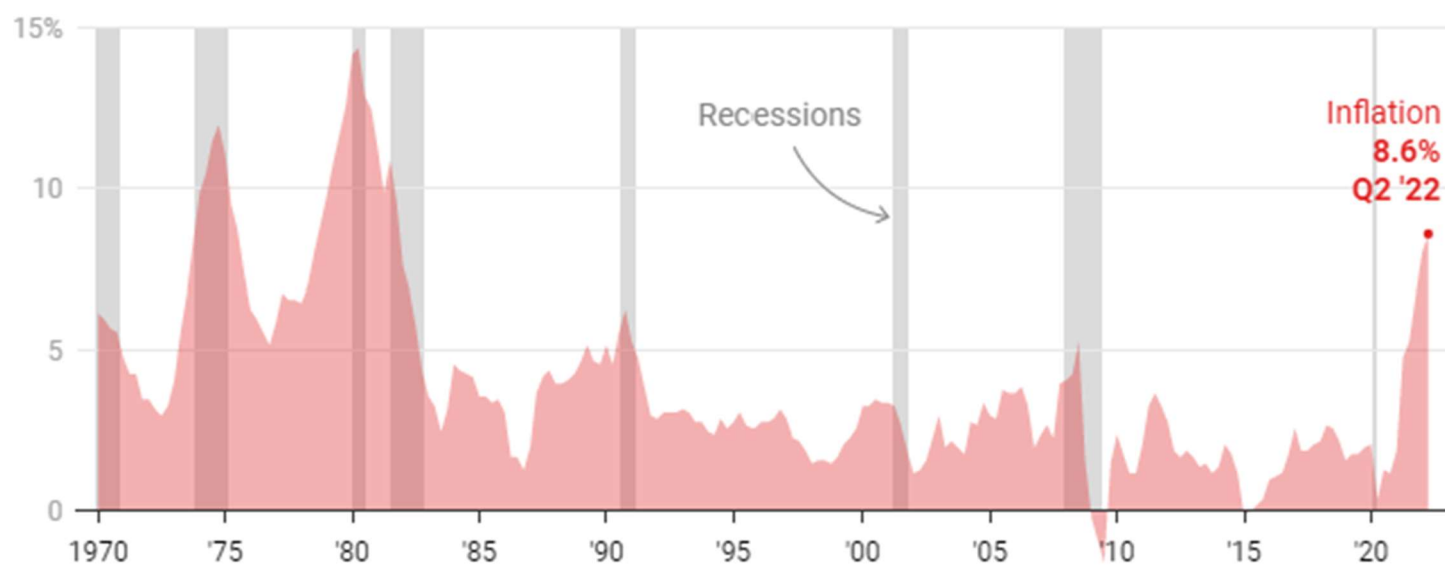




The synchronization of curbing inflation and the requisite rate rises will drive real rates and ultimately the opportunity cost of holding bullion, which has driven weak investor sentiment. We however view it as unlikely the Fed can navigate this objective without the risk of a hard landing and the very real possibility of stagflation in the US economy. Having been a foreign concept since the Paul Volcker era of extreme Fed rates (+15%) of the 1980's, economic conditions are like that experienced during the onset of stagflation post the oil shocks of 1973 (Yom Kippur War) and 1979 (Iran Revolution).

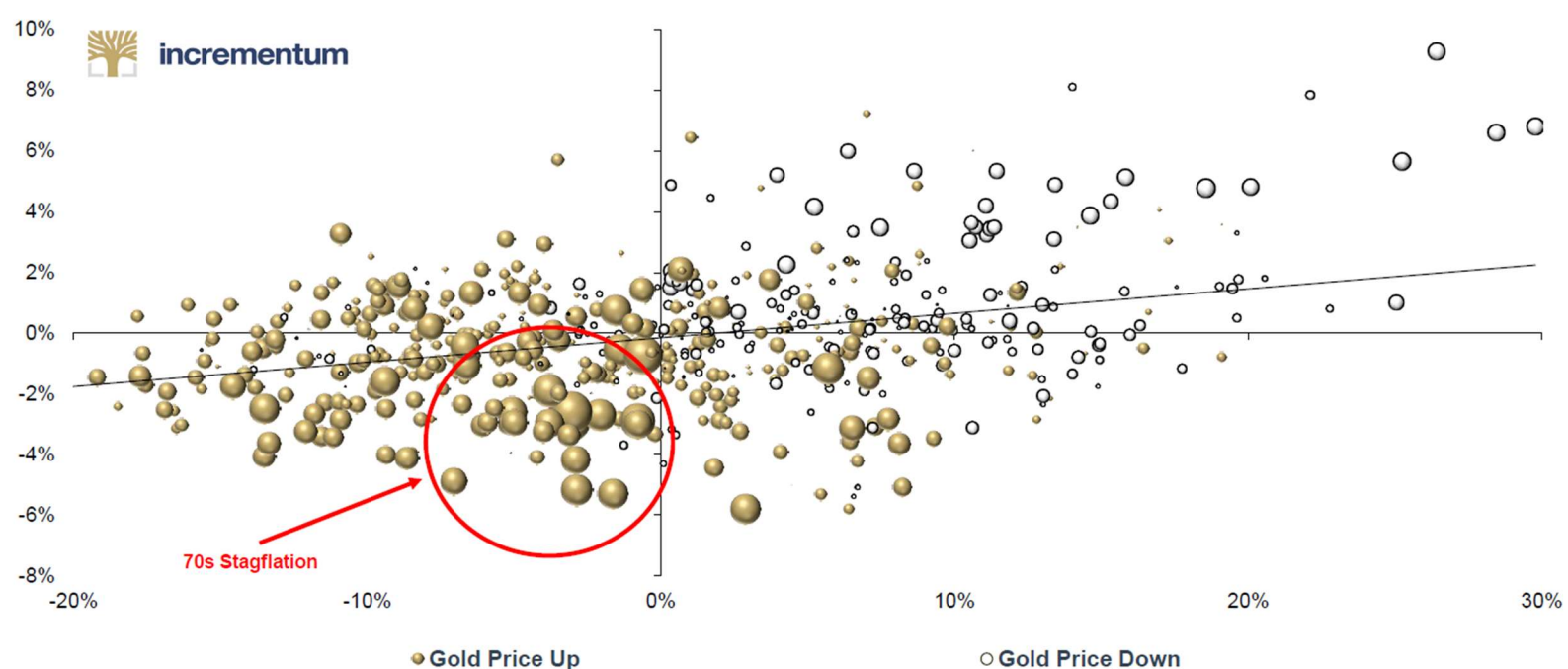
As seen now, supply led inflation (reduced labour supply, logistic bottlenecks, energy security) tend to have a more pronounced stagflation impact with the last fifty years (Figure 9) indicating a recession will be difficult to avoid. We have already seen the havoc created by rising rates in highly leveraged bond markets in the UK, Japan, and the US, where there is US\$17 Trillion in corporate bonds as well as US\$31 Trillion in Federal debt and US\$10.5 Trillion of mortgage debt cannot be immune to the eventual chaos.

Figure 9: Inflation rate (YoY% change in CPI) 1970-2022 with recession periods following steep inflation. (Source: Federal Reserve of St Louis)



An interesting piece of recent [analysis](#) from Incrementum AG (Figure 10) indicated that gold was a strong performer during the stagflation periods of the 1970's as investors sought safe haven from prevailing elevated business risk, high inflation and falling real rates. Given the flight to the US Dollar (index +20% YTD) as the "least dirty shirt in the laundry pile" there remains a strong likelihood for the gold price to start to find support at the current levels as generalist investor sentiment is renewed.

Figure 10: US Dollar Index (x axis) vs US real bond yield (y-axis) vs YoY Gold performance (bubble size) 1972-2022 (Source: Incrementum AG)

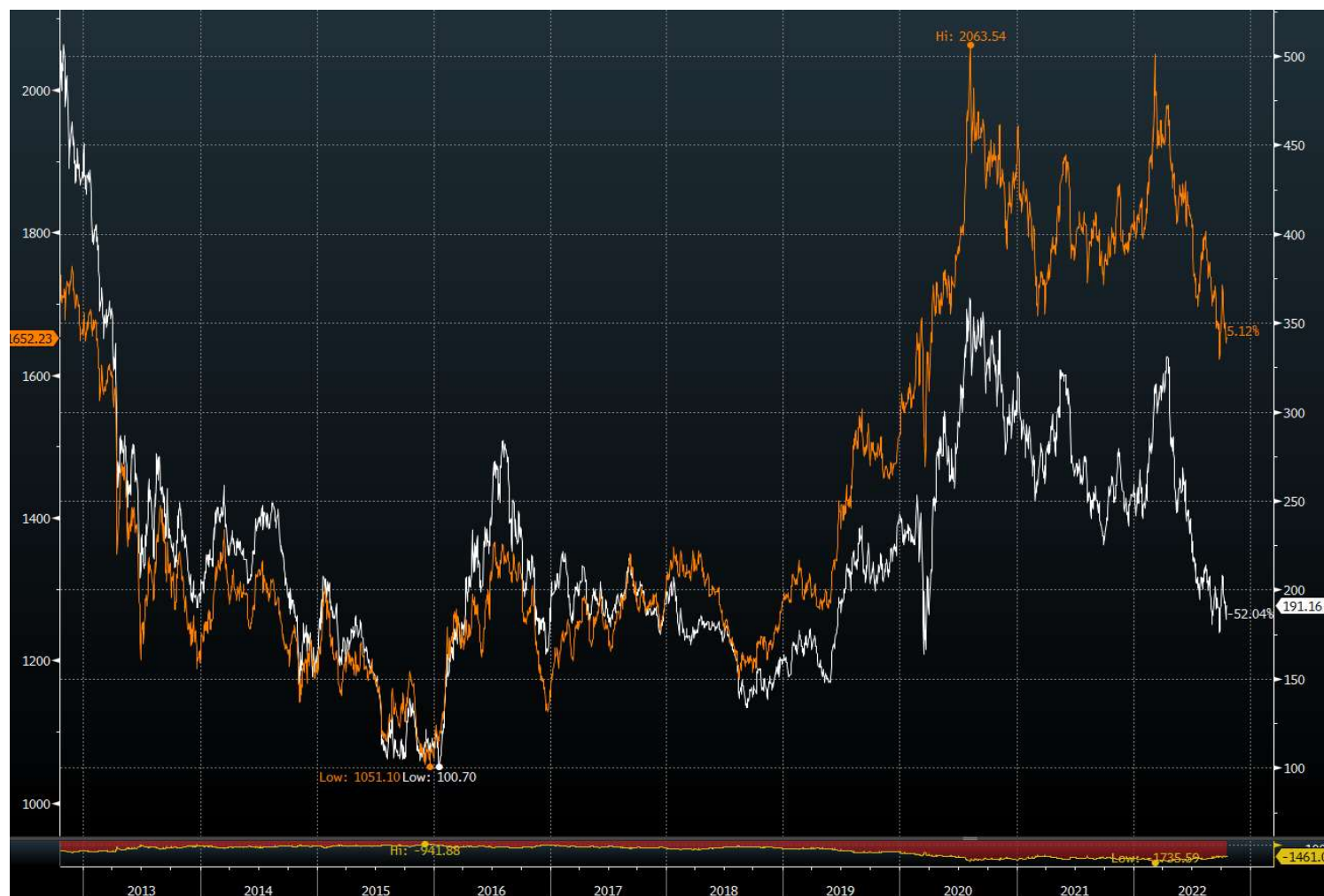


#### Portfolio Update:

As mentioned previously, gold equities over the quarter continued to retreat, with the spread between the benchmark HUI index and the gold price the most pronounced it has been since 2010 (Figure 11). As economies have reopened over 2022 and key consumables (steel, reagents, explosives) prices level off, producers are generating decent free cash flow and trading on appealing yields of +15%. While amongst the large and mid-tier producers (+US\$1B market cap), balance sheets are also generally in very good shape (Net Debt/Equity <0.3x) a string of capital expenditure blow outs on recent builds and poorly executed ramp ups at large projects has dented any potential appeal to the marginal investor. This has trickled down to the junior end where despite some genuinely impressive drilling results, little attention is being given.

Alas in such a market portfolio positioning has been a frustrating exercise as there is often insufficient liquidity to take profit on the back of a positive catalyst nor enter a higher quality stock at the excellent value on offer. Rather than a gripe, we make this point as an observation as to the gyrations of junior gold stock investing and have used the weak market conditions to participate in several financings at more favourable terms inclusive of warrant offerings.

Figure 11: Gold Price (LHS, Orange) vs HUI Index (RHS, White) Price 2012-2022. Note Spread is at historical levels



During the quarter we attended several conferences in Australia (Kalgoorlie Diggers and Dealers) and the US (Denver Gold Forum and Beaver Creek) with investor sentiment cautious and the attention mostly focused on the need for further industry consolidation off the back of the current C\$6.7B acquisition of Yamana by South Africa's Goldfields. Sovereign risk continues to weigh heavily on large and mid-cap producers project filters with established global miner Kinross selling off projects in Russia and Ghana to pursue Canadian based projects such as the Great Bear discovery in Northern Ontario and Newmont selling its stake in MARA project in Argentina and acquiring the GT Gold project in British Colombia. As a result, we expect that competition for advanced Canadian based projects will be healthy and have positioned within the portfolio several high-quality projects that have likely takeover potential.

Sovereign risk had a detrimental impact over the quarter to several of our holdings in well-established mining jurisdictions. This came in the form of the newly elected Chilean ministry rejecting one of the final permits of Rio2's (RIO-TSX-V) Fenix project resulting in a 75% decline. Additionally, established gold producer West African Resources (WAF-ASX) having seamlessly ramped up the first two years of the Sanbrado Project in Burkina Faso saw its second coup d'état in nine months in September with twitchy investors selling off the stock 30% despite the good potential for the company to again deliver to the top end of operation guidance. We continue to be nimble for opportunities where companies can work within a jurisdiction that is discounted as too difficult to advance projects, an example being the encouraging first 12 months performance of Thor Exploration's (THX-TSX) Segilola project in Nigeria. With political stability in scarce supply across many regions we do however caveat that the rules can change and often not for the better!

Consolidation has also been evident with the gold royalties sector with our prior work concluding that a number of smaller lower quality businesses could no longer justify corporate overheads that were out of step with near term revenue. We initiated a position in Osisko Royalties (OR-TSX) earlier in the year based on its growth outlook, progressive dividend policy and close alignment and royalty size on two of the better underground projects (Canadian Malartic and Windfall) in development in Canada. At a -10% YTD return we are somewhat scraping the barrel to declare this as one of better contributors for the year but illustrative of our strategy to increase our weighting of royalty companies within the portfolio strategy.

With the global markets expected to be turbulent and the bell to toll imminently on how the US will tackle its ballooning debt, we continue to remain of the view that the scene is set for gold equities to outperform from this compelling entry point. We continue to act on improving the quality of the portfolio to be best positioned for this and thank you for entrusting us with this responsibility.

Yours Sincerely,

David Crichton Watt

Larry Hill