PHOENIX GOLD FUND LTD

19th October 2016

Dear Shareholder,

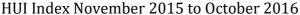
If I had written this report in a timely manner at the end of September, it might have been very different; for on the 4th October the gold market finally suffered the large sell-off that it had avoided for so long and dragged the gold stocks too back to their 200 day average. I had been surprised that, despite the record speculative long positions on the Comex futures market in New York, the gold price continued to trade in what was essentially a sideways consolidation, finding good support just above \$1300. However, the "commercials", who are the other side of the speculative long positions, have all the advantages on Comex and therefore are a little like the 'house" in a casino. They hold the stoploss orders and know where they have to drive the price in order to trigger the stop loss orders. Emboldened by the closure of the Chinese markets for the "golden week" holidays during the first week of October, very aggressive sellers on Comex drove the price down from \$1313 to \$1267 in one day with over 35 million ounces traded in the active month. That is over 1,000 tons of "paper gold"! The Shanghai market is a physical market where one has to be able to deliver gold whereas on Comex, where the margin requirements are tiny, trading is almost always settled by reversing the position and settling the difference in cash. Thus the "commercials" can effortlessly sell immense quantities of gold that they do not have knowing that as the price falls through the speculators' stop-loss limits, they will trigger large sell orders which will enable them to cover their short sales very profitably.



This is a very healthy development in a bull market as flushing out the speculators, who do not have the means or resolve to hold the investment long term, takes it from the weak hands to the strong. Indeed, the commitment of traders report on Friday $14^{\rm th}$ showed that at close of business on Tuesday $11^{\rm th}$

October, the long speculative positions had been reduced by 106,000 contracts (10.6 million ounces) resulting in the sharpest reduction in trading positions since records began to be kept, ten years ago. The excuse for the sell-off in gold was that the Federal Reserve was going to raise interest rates in December. The truth is that the Fed should have raised them long ago for dollar interest rates in the Eurodollar market have been trending sharply higher now for a year. The 6 month LIBOR rate, which is the basis on which most bank lending is set, has risen from 0.5% in October 2015 to 1.26% today. So keeping Fed Funds at 0.5% is simply a measure of how nervous the Federal Reserve is about the robustness of the economy. However, oil has now bounced over \$50 a barrel and other commodities are gaining ground so we are likely to see an uptick in inflation forcing the Federal Reserve to raise rates. Perversely, we believe this will be good for gold; for there is virtually no chance that the Federal Reserve will raise rates by more than a token amount even if faced with a large rise in inflation so that real interest rates will almost certainly remain negative. Such a scenario is consistent with a strong gold market as bond investors struggle to keep up with inflation.

While the bullion market retreated by 10%, the gold stock universe had a mixed showing. Some of the stocks which had enjoyed exceptional gains during the first half of the year fell back dramatically, falling as much as 50%; others have held most of their gains. The HUI Index retreated from a high in August of 286.05 to 195.49 on 11th October for a decline of 31%. Your fund did not escape the retracement but at end September had contained the retreat to less than 5% (from \$840.51 at end July to \$801.40 at end September). However, it has given up further ground during the weak October market and is today valued at \$738 (12% from its highs).





As you will notice, the latest trades have taken the level of the index back above the 200 day moving average, perhaps suggesting that the correction is complete. The bullion market too has seen prices firm and today it has also passed again above the 200 day average. While it seems likely that there has been enough of a correction in prices to squeeze out the loose holders, there might have to be another month or two of consolidation of these levels before we can expect to see the gold stocks and the gold bullion price make new highs for the year.

In the portfolio we have made a few changes by reducing some of the stocks that have made exceptional gains and disposing of those where management, we felt, was too quick to issue more stock at deeply discounted prices. A new listing in Australia (Egan Street) came with free options and provided a low entry cost into a promising resuscitation of a mine. With hindsight, we should have sold more but we were wary of selling too early into the very strong rise. If, as we expect, the secular bull market in gold has now completed its five year correction, then we probably have begun the final, and almost always, parabolic stage, where the general public finally joins the fray thereby making trading more and more frenetic as we pass the previous highs. Certainly the background is set for such a scenario, with the global economy clearly struggling despite, or more likely because of, the trillions of dollars of debt created by the Central Banks.

We continue to believe that the only solution to the stagnant global economy is a massive devaluation of the outstanding debts that are suffocating it and that the only feasible way this can be achieved is by dramatic inflation. If we are correct, then we will see much higher gold prices and gold mining shares will be every investor's favourite sector.

Yours sincerely,

David Crichton Watt