

Session 4: PGMs – The Investor Arena

Michael Sheehan

Portfolio Manager, Red Kite Capital Management Investment

Getting up to speak in front of everyone today, three things came to mind. I tried to prepare myself, and the three things that really hit me were the need to give some idea of the main drivers in our mind of today's platinum price, what the risk/rewards are for the future. The second was giving a presentation that is going to keep everyone interested and have it directly focused at our market; those especially from New York know how brutal this market can be to someone who gives a presentation that sort of takes a path that's not directly focused at their market. The final was since the LBMA and Edelman gave me the honour of having the last presentation we've had to sit through today, I'm going to make this very short so we can all go have a pint together afterwards, because that's what I'm really looking forward to.

As you saw on the title, the gist of this presentation is platinum as a US dollar hedge. We saw the platinum price take a massive decline in 2008, which it has been slowly recovering from throughout this year. The scrap sales from Japan stopped and the economic collapse seems to have stabilised, and that resulted in a very steady rise in the platinum price this year. Simultaneously, we had a steady decline in the value of the US dollar, which therefore resulted in the South African Rand steadily appreciating. This actually resulted in the South African mining companies not being able to realise as many of the benefits of the rise in price. As you can see from this graph, platinum basically has in Rand terms, has spent the year in a relatively narrow range, while the US dollar price has slowly but steadily picked up the charts. And that really is the focus of this presentation, the US dollar, and when it comes right down to it, that's what is on everyone's mind. It's very easy to say we're very bearish to the dollar, or why are you bearish to the dollar, and you really have to dig into what the underlying reasons

for that are. The US dollar index has significantly deteriorated over time simultaneously, while the US national debt has spiralled out of control. At the time that I was working on this presentation, the US national debt was tipping \$11.9 trillion, and actually last week we surpassed the \$12 trillion mark for the first time – an absolutely staggering amount of money. To put it in relative terms of where this is over history, our US national debt is now 84% of our GDP, this is actually very close to going back to post World War Two highs and is becoming very disturbing. The debt as it stands right now, it is manageable, if it was managed in the correct fashion and that's where things start to get a little bit iffy. The average maturity on a US debt, while the outstanding debt has been rising, is now down to 51 months. The US government is exposing itself significantly to interest rate risk in the short end of the curve. The reason this is happening, we have our Federal Reserve leveraging up its balance sheet supporting the back end of the interest rate curve, because without it our housing

market recovery would be next to nothing. So we are borrowing in the front and basically supporting in the back. Despite the shortening of our maturities, any falling interest rate environment, interest payables, interest expense on the national debt has continued to rise and it is continuing to rise at a staggering pace. With the interest rates in the front at close to 0%, we are still spending a massive amount of money to basically support our debt.

Compounding this has been a drastic decline in the budget revenues, which is resulting in trillion dollar budget deficits for the foreseeable future. Many people out here have been speaking about who lends the US government money, where we borrow money, how we borrow money. Many people don't realise that actually the largest lender to the US government is the social security trust and Medicare trust funds. They actually account for over 19% of what the US government borrows. The Medicare trust is supposed to be drained completely by the year 2017, and social security, if nothing is done, is going to be bankrupt by 2037. That is going to cause the US government to have to cap the debt markets even more than they ever have in the past – the combination of their biggest lender going away, not even to mention China wanting to diversify away from the US dollar, but their biggest lender, which is internal, going away and the deficit is going to cause them to have to borrow incredible amounts of money. With our interest rate risk being front-loaded, our average maturity on our debt is now 3.3%, and with that we are barely able to support the interest that is due on it. If inflation starts to rise, which many people see it coming, others do not, but either way, I believe that higher interest rates are coming at some point in the future. There really is no way for interest rates to go anywhere but up, and that is going to cause a very scary situation where the interest expense on the US government, even if the economy were to start to expand, could actually rise faster than revenues. That is a nightmare scenario just waiting to happen.

So when they asked the investor arena why are we investing in gold, why are we investing in platinum? It really comes down to why are we so terrified about the US dollar and that is what I'm trying to sum up to everybody today.

If we were so concerned about the US dollar, it would be very simple to say just buy gold. Not necessarily, and I know that in the previous presentations, they actually correlated that over time that gold is a hedge to the dollar, it is there sometimes and not at other times. Since the year 2000, it is there and it is very much correlated. Platinum is actually just as correlated to the price to the US dollar, as is the price of gold.

We also as Phillip alluded to in his presentation, we are very encouraged about what we see coming out of China with regards to the demand side. We believe that the combination of the very strong demand coming out of China, the fact that from a supply standpoint, the South African producers are operating marginally at best, it provides limited downsides to the platinum market and gives very attractive upside.

Thank you very much.