

Precious Capital



EXCELLENCE International: Mr. Schmidlin, Precious Capital AG as a company is only something more than 2 years old. Could you please explain me the reason why you incorporated the company?

HP Schmidlin: Precious Capital was incorporated in September 2005 because of several reasons: First of all, the secular bull market in metals and so mining stocks became adult. Especially Gold and Silver became again an asset for a portfolio manager as it was ignored for more than two decades.

Gold was in a downtrend for over 20 years. Doesn't bring that with it that knowledge in this sector went forgotten?

This is exactly the second main reason for incorporating Precious Capital AG. Knowledge in the mining sector has become very rare. Not only because the geologists lost their jobs in the late 90s because of a huge scandal which shattered the whole sector. Also because all portfolio managers never experienced a bull market in metals, if they are less than 20 years in business. This was the reason that with incorporating Precious Capital we collected the knowledge of 18 shareholders which almost all have big Know How in geology or in investing in mining stocks.

What are the main business arms of Precious Capital AG?

We concentrate on managing the "Precious Capital Global Mining & Metals Fund. We have a specific strategy: We are not eager to chase the last percentage of yield which could be possible. The mining stocks are extremely volatile. Up and downs of more than 5% in one day is not seldom. We would like to calm down a volatile sector and make it ready for the private banking in a way that portfolio managers do not get nervous or scared to invest in this sector. Still we do not want to invest only in big capitalized companies. The real potential is in the mid- and small capitalized companies. The mid sized companies are take over candidates and once they reach the point where a start of production is not anymore far away, we can experience the biggest potential in their stock price. Or the small sized companies, the so called exploration stocks, do nothing else than try to find a new ore body which may be could be mined some years after. These stocks are even more volatile than the other companies. Still, we want to achieve a nice performance which is above the market. So far this strategy works pretty well since we launched the fund in February 2006. Over the whole time the fund has a volatility of about 22% where the market has a volatility of almost 30%. The volatility factor can also be compared with a risk factor. The bigger the volatility, the bigger is the risk.

You just mentioned that the fund was launched in February 2006. Therefore you don't have a long track record.

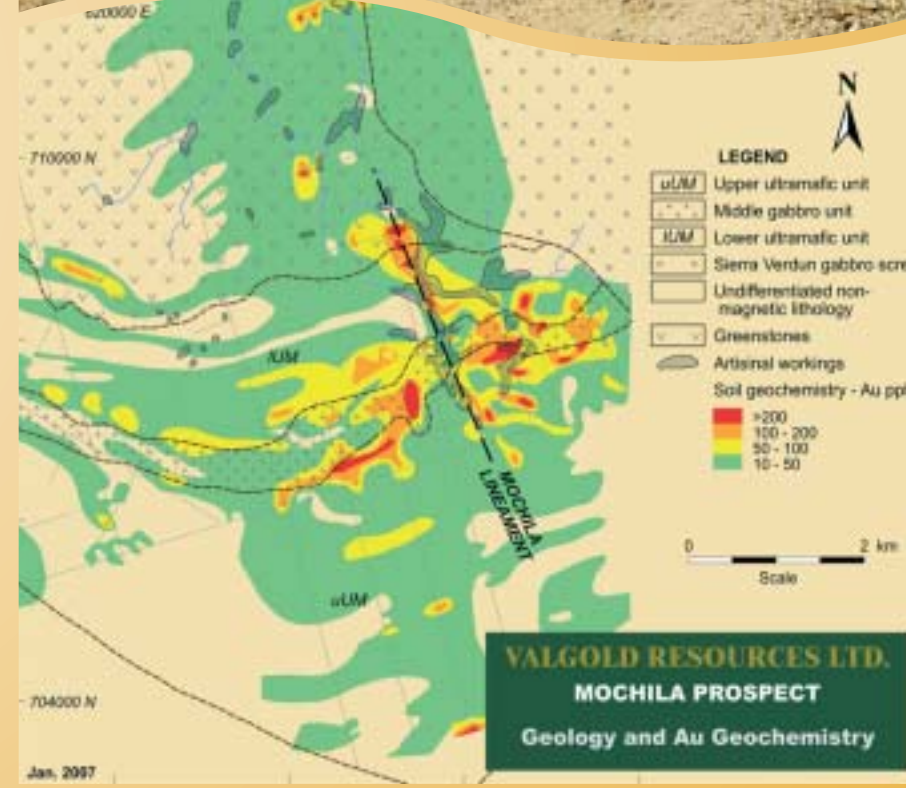
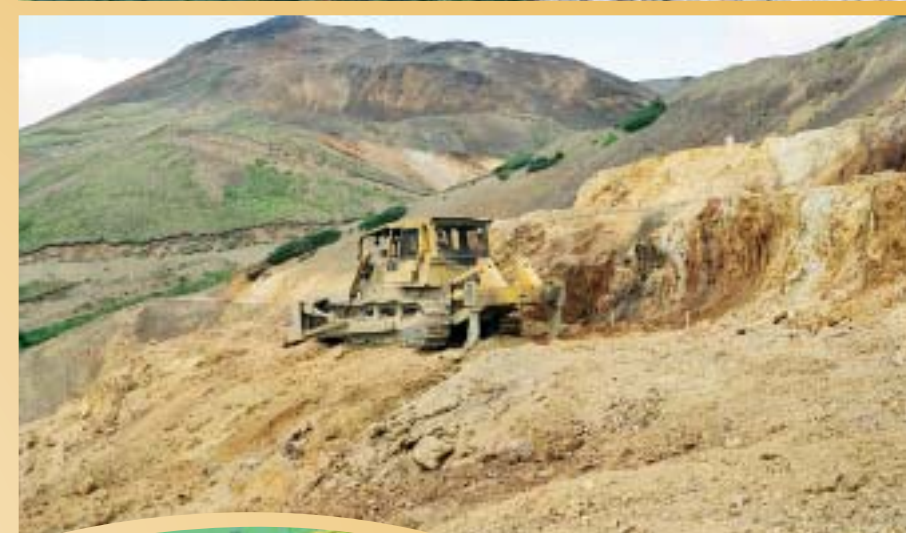
This is true. We do not have a track record of 3 years yet. But we shouldn't forget that the people behind Precious Capital AG have experience in investing in mining companies of up to 36 years each. Then it is also important that a manager of a mining fund has experience in the general market. When the general market jitters, then also the mining stocks could get the virus and loose some of their performance. Myself, I used to be head of equity trading for several years with ABN Amro Bank Switzerland in Zurich. After I quit this job in 2001 I did nothing else than visiting mining companies, mining exhibitions and learning from geologists. The same did most of our partners in the group. Some the three fold of years than me.

You're company is already pretty well known in the mining sector itself but less among investors. How does that come?

First we need a contact to the mining sector before we can deliver a good service to the investment world. We launched the fund 20 months ago with only CHF 6 million. Now we have something more than CHF 40 millions of assets in the fund. This amount is still too low for some of the investors. Certainly a fund should have a certain size so it won't be hurt if a big investor joins or leaves. This point is absolutely true. On the other hand I don't understand it specific to our sector.

Why not? Where do you see a difference?

As already mentioned, the mining sector can be separated in the three levels. Big-, mid- and small capitalized companies as other sectors. But in the mining sector the differences are much bigger: The big caps have become buyers of the mid caps. And the small caps do concentrate on finding new discoveries. The performance of the big ones is not really amazing over the last years. They have a big problem with rising production costs. Better did the companies which grew from an exploration company into a mid sized company. And exactly there lays the big potential to reach an outperformance. Even more potential you'll find among the exploration stocks. But a manager needs first the capability, the network and the knowledge to pick the right ones among over 2000 companies. And when you pick such a stock and you add it into the portfolio of the fund, these companies normally do not have a market capitalization of more than USD 50 millions. This size of a company wouldn't be even of interest for a fund with more than CHF 500 million of assets. It would be way too small for the asset allocation. But this also guides to the point, that mining funds with large assets have it really difficult to invest into the exploration companies which actually are the pearls.





So you are not interested to get more than CHF 500 million of assets in your fund?

No, not really. If we reach a level like CHF 200 million we certainly would close it for new investors and probably launch an additional fund either with a similar strategy or a slightly different approach such as overweighting exploration stocks to get a higher leverage on investment. Our vision for the company is to become a leading provider for mining investments.

Let's change the topic to the metals itself. I do assume that you are bullish on the metals. What makes you so sure?

There are different arguments that the metals will have a long lasting uptrend in the coming years. First of all, finding new deposits is getting more and more difficult. Mining companies have to go more and more in politically instable countries to find new resources. The development of the technical skills certainly helps but still it is very difficult to find a deposit of 1 million ounces of Gold for example. It might happen once a year out of 2000 companies. Therefore: consumption worldwide is rising strongly but supply is very limited and actually falling. The big companies are struggling to keep up with past years concerning production. On the other hand we have to get conscious about that exactly the countries do have a huge hunger of resources which profited most of the rising economy over the last years. These are China, India and also Arabian countries like the Emirates. Gold represents an important asset in their culture. The same with the two other regions: Chinese do have to build up their infrastructure to avoid social imbalances and did also reach a standard of living where luxury goods see a rising demand. We do speak here about more than 1 billion humans. Or India: Almost half of Indian people do have an age of below 25 years. These people get married and in India the demand of Gold rises immediately with the wedding season. This Gold seldom comes back on the market. It gets directly into the family treasure where it normally stays. And again, we speak here about a second fifth of the world's population. Over the last years, India alone imported more than a third of the worldwide yearly production. And with the reason mentioned before it is pretty obvious that the demand will grow over the next years.

What are the other arguments?

The Gold price is now pretty good protected to the downside. The mining costs did rise so fast over the last years that if the Gold price would fall back to 600 Dollars lots of Gold deposits couldn't get mined anymore as it wouldn't cover the production costs anymore. The supply immediately would get smaller and therefore keep the price up.

The last time Gold had a long lasting bull market was in the 70s. Do you see any similarities?

A good point. It is not taken from far away to compare today's situation with the 70s. At this time we had a strong rising Oil price. A strong market in real estates. And we had a recession and very nervous currency markets. Just like we have it today or where it could end up. The balloon of the US real estate just burst, the oil price is on an all time high, the US economy faces a recession and the currency markets just have a crazy time. Not only the US Dollar.

After Bretton Woods was given up by President Richard Nixon at the beginning of the 70s, Gold prices was USD 35 an ounce. It exploded in less than a decade to over USD 800. To reach that level on an inflation adjusted basis, the price of Gold should reach a level of more than USD 2200. Mentioning the Bretton Woods contracts: The French

wanted to exchange their US Dollars into Gold as the US Dollar was still a currency with Gold standard. President Nixon had to choose between giving the Gold to the French or abandon the Bretton Woods contract. He did choose the second. This means nothing else than the US President preferred Gold to the own currency, the US Dollar. The outcome of giving up Bretton Woods was pretty clear and it became real pretty fast: A first big crisis in the US Dollar.

Gold is in a bull market for almost 6 years now. Do you think it will last for some more years?

Absolutely. Most of the investors are still not invested in this sector. The worldwide market capitalization of all Gold- and Silver companies is somewhere between USD 150 and 250 billion. This is nothing in today's world of private banking. Lately I just made an easy calculation: Swiss private bankers which were already in this profession in the 80s respected an unwritten law: 5 to 10% of each portfolio assets are invested in Gold or mining companies. I checked the managed assets of 7 big banks in Switzerland. Among them UBS, Credit Suisse, Clariden-Leu, Bank Julius Baer, Bank Vontobel, Banque Pictet. 5% of their managed assets would be more than CHF 1 trillion. It's easy math to find out that they are not invested in mining stocks: If they will begin to add these stocks again in a way they did in the 80s, the value of the mining stocks should be at least 10 times higher. But they are maybe invested in certificates. But remember again: This is just paper. At the London Bullion Market they trade the yearly production of Gold in a day. But 95% of it is paper Gold.

It seems that Gold plays an important part in your fund portfolio. In which other metals do you invest?

Gold and Silver right now do represent about 75% of the funds assets. Beside we invest also in Nickel, Zinc, Copper or Uranium. We also invest in metals not so known like Molybdenum, Cobalt or Tungsten. They all have an own situation. At this moment we have Gold and Silver more weighted than in past times because base metals could suffer temporarily from a possible recession in the USA.

Don't you think that the base metals should profit from the Chinese economy?

This is what most investors believe. But my friend Paul van Eeden, a well known economist in the mining sector, explained it very understandable: What we follow is nothing else than a transfer of production of goods. What was produced some years ago in Europe or Northern America will now be produced in China. Certainly the number of the rising demand of base metals in China is far bigger than the number of US demand which is falling. But we talk here about two different sizes. In quantity it might not be such a big difference. And we shouldn't forget: If the US consumers get hurt by a recession, the Chinese will produce fewer goods.

A last question: What would you recommend to a general private investor?

10% of the portfolio should be invested in Gold or Silver. If you have a fund available which is like the Precious Capital Global Mining & Metals Fund also free to change its allocation in different metals, go for this one. Or you might have the possibility to invest partly in a Gold fund and another part into another fund.

If your readers have questions about our fund or the sector, we appreciate to answer questions mailed to info@preciouscap.com.