Old West Investment Management, LLC

January 6, 2023

Dear Investor,

The year 2022 will be remembered as one of the most difficult for investors in many years. Normally when the stock market struggles investors find refuge in the bond market. Last year was one of the few where both stocks and bonds had significant losses. From the classic 60% equities 40% bonds allocation, there was a 17.5% loss, the worst year since 1937 and the third worst year in history. The U.S. bond market had its worst year in history with a 13% loss. The 19.45% loss for the S&P 500 was the seventh worst year since the 1920's. The NASDAQ was down 33% last year with bellwether Apple down 27% (off $1 Trillion from it's high), Amazon down 50% and Tesla down 65%.

As you can see in your enclosed statement, Old West clients fared much better than the market. Our long only separate accounts, although negative for the year, beat their respective benchmarks by a wide margin, and our three Limited Partnership's also performed well on a relative basis. The Old West Income Fund was actually up 12.4% for the year, one of the few strategies in the country to post a double-digit gain.

With 2022 in the history book, what about 2023? The stock market has only fallen back to back years four times: the Great Depression, World War II, the 1970's oil crisis and the 2000 dot com bubble. In every case the second year fall was deeper than the first year. When you consider last year's market peak resulted in the most expensive market in history, one should not be surprised if 2023 is very challenging.

At Old West we spend the vast majority of our time researching individual companies, doing deep dive quantitative and qualitative analysis. Having said that, macroeconomic factors and events cannot be ignored, and actually create tremendous opportunities as well as challenges.

After years of low interest rates and little inflation, the big challenge for the Fed will be how to control inflation without damaging the economy. It has been over forty years since the Fed has been put in this predicament, and studying the time period of 1965 to 1980, you learn that inflation can be very stubborn and difficult to control.

Arthur Burns was the Fed chair from 1970 to 1978, and he is best remembered as the Fed chair who was influenced by politics and public opinion in his inability to stamp out inflation. Average wholesale prices rose 4% from 1968 to 1972 and 10% from 1972 to 1978. The year-over-year consumer Price Index rose to 11% in 1974, fell back to 6% to 9% the next four years, and then rebounded to 11.4% in 1979 and 13.5% in 1980. It took the appointment of Paul Volcker as Fed chair in 1979 to raise the Fed fund rates to 20% in 1980 and finally control prices. By 1983 the C.P.I. was back to 3.2%.

Is the current Fed chair more like Arthur Burns or Paul Volcker? Time will tell, but my hunch is Jerome Powell will not give in to political pressure and public opinion, and he will have the resolve to clamp down on inflation. Powell, who was at one time a partner at private equity firm Carlyle Group, does not need this job, was recently re-appointed for another four year term, and will be primarily concerned with his legacy and doing what's right for the country. Perhaps my view is a bit Pollyannish, but Powell is well aware of the persistence and stickiness of inflation. The Fed has created three massive bubbles this century, so it remains to be seen if they have the ability to raise interest rates and drain liquidity from the system without causing a severe recession.

Stock market bulls believe inflation is quickly subsiding and the Fed will soon stop raising rates and eventually begin reducing them. A counter argument would be the other half of the Fed's dual mandate, maintaining full employment. There are currently 10.7 million job openings in the U.S., not far off the record high and nearly two times the number of unemployed people looking for work. A survey of small business owners showed 46% are unable to fill job openings, double the historical average. This will add to wage pressure which will add more fuel to the inflation fire.

A deflationary force that might come into play in 2023 is the state of the American consumer. I keep reading that Americans have trillions in savings, but those trillions might be in the hands of a subset of people. A recent U.S. Bureau of Labor statistics survey found that 41% of Americans are having difficulty paying for essential household expenses versus 29% one year ago. Also, credit card balances rose 15% year-over-year recently, the biggest increase since the 2001 recession. The personal savings rate recently hit a 17 year low of 3.1%. With the consumer being the driving force behind the American economy, a stretched consumer might negatively affect corporate earnings in the coming year.

Interest rate cycles last 20 to 40 years, and rates bottomed in 2020 when the ten-year treasury hit 0.54%. That was the end of a long bull market in bonds that began in 1981 when the ten-year peaked at 15.3%. We are more than two years into a bond bear market as the ten-year has risen to 3.6%. The U.S. has a $26 trillion economy, and we currently have $31.4 trillion of government debt, giving us a 122% debt to GDP ratio. The debt to GDP ratio was 34.7% in 1980 and 55% in 2000. With the recent increase in interest rates, the U.S. government interest expense on its debt is up 87% year-over-year. This will increase the borrowing pressure on the U.S. Treasury to fund this expense, not to mention the fiscal onslaught of spending including the recently passed $1.7 Trillion omnibus spending bill. The need for capital to fund spending is not unique to the U.S. European Union countries have outlined greatly expanded borrowing needs for 2023, as has Japan and China. All of this borrowing will keep upward pressure on interest rates in the coming year.

To tie all of this together, I do expect the Fed to continue raising interest rates to get a handle on inflation which may dramatically slow the economy and negatively affect corporate earnings.

For the past decade, trillions of dollars have poured into the stock index funds and investors have done very well with passive investing. There may have been a sea change the past year where active investing comes back in favor. Our portfolios are full of companies selling at large discounts to their intrinsic value with bright prospects, regardless of the macroeconomic risks I have discussed in this letter.

## Gold and Our Top Gold Mining Companies

For the past 25 years central banks around the world, led by the U.S. Federal Reserve Bank, have manipulated interest rates (the cost of money) and dramatically increased the supply of money. At the same time, governments around the world have taken on sovereign debt to the point solvency has come into question. At Old West we have for many years seen gold as a stabilizing investment in a world lacking fiscal and monetary discipline. It is for these same reasons cryptocurrencies were developed. However, as gold is truly limited in supply and very expensive to find and produce, thousands of cryptocurrencies sprung up and they became symbolic of the Roaring 2020's era of free, easy money and rampant speculation. The gold price was flat last year while cryptocurrencies were decimated along with so many other speculative investments. Gold acted as a true store of value.

Rather than invest in physical gold or gold ETF's where we don't have much of an edge, we invest in companies that produce the precious metal. That way we can employ our investment process of looking for companies run by great owner/managers, companies with strong balance sheets, track records of profitability and the ability to produce free cash flow. Listed below are the companies we have chosen across our portfolios.

### Agnico Eagle Mines, LTD (AEM)

Agnico is the third largest gold miner in the world with mines in Canada, Australia, Finland, and Mexico. Although we have long respected the company, we became shareholders when they acquired our portfolio holding, Kirkland Lake Gold. Agnico chairman Sean Boyd is one of the most respected executives in the mining industry. He was appointed CEO in 1998 and was recently appointed Executive Chairman. Boyd is a large shareholder and perfectly fits our owner/manager role. This year the company is projected to make nearly $1 billion in net income on $5.8 billion in revenue with $758 million of free cash flow. Net income has been growing 15% per year for several years. Agnico has a fortress balance sheet with $1.3 billion of long term debt, which is only 2 times EBITDA, and $820 million cash in the bank. The stock trades at $55 per share, which is 26 times earnings with a 2.9% dividend yield.

### Barrick Gold Corp (GOLD)

Barrick is the second largest gold miner in the world, with operations in the U.S., Canada, Africa, South America and more. Barrick is also a major copper producer. Former Goldman Sachs executive John Thornton took control of the company in 2012 and quickly realized he wanted someone with a mining background to run the company. Mark Bristow, at that time CEO of Randgold, was considered one of the best gold mining executives in the world. Thornton wanted Bristow so badly Barrick bought Randgold in 2018. Bristow who is South African, had extensive experience operating mines throughout Africa, and in fact would fly his own single engine plane to visit mines. He has his PhD in Geology, and he has flourished running Barrick the past five years.

Barrick is estimated to have $1.6 billion of net income this year on $11.5 billion of revenue. Net Income has been growing 15% per year. The stock trades at $19.00 per share which is 16 times forward earnings, and the stock has a 3.15% dividend yield. Barrick has a fortress balance sheet with $5.7 billion in cash and $5 billion of long term debt, which is only one time EBITDA.

**Novagold Resources Inc. (NG)**

The previous two mining companies are industry leaders with solid production. The next two companies have no production or revenue but are sitting on huge deposits. We were initially attracted to Novagold because of the track record of success of company chairman and largest shareholder Thomas Kaplan. Kaplan has become a billionaire investing in silver and platinum mines in Bolivia and South Africa. Besides his investing in mining, he owns the world's largest collection of Rembrandt's works.

Novagold is co-owner of the Donlin mine in Alaska, along with Barrick Gold. The Donlin mine is on track to be one of the world's largest gold mines with 39 million ounces of measured and indicated reserves with an average grade of 2.24 grams of gold per ton. A major hurdle is Donlin is located in a remote area of Alaska, and the estimated cost to bring the mine to production is $7.4 billion. That is a huge expense but at today's gold price the mine has gross revenue potential of $72 billion. Obviously the higher the gold price goes the easier the decision to begin construction. The U.S. government is supportive of the project as are the local Alaska Native stakeholders. Novagold has $120 million of long term debt offset by $142 million of cash. The market cap is $2.2 billion, and the company is burning $11 million of cash per year. It is widely expected that Barrick, who is always looking to buy high quality assets, will purchase Novagold's 50% interest in the world class Donlin mine.

**Seabridge Gold, Inc. (SA)**

Seabridge was founded by current chairman and CEO Rudi Fronk in 1999. To say Seabridge is Fronk's life work would be accurate. Fronk, who has two degrees in mining and minerals, is a top shareholder of the company. Seabridge owns the KSM project in northwestern British Colombia. KSM has proven and probable reserves of 47 million ounces of gold and 7 billion pounds of copper. Seabridge also owns attractive deposits in Nevada and Northwest territories of Canada, although much smaller than KSM. The average grade of KSM's gold deposit is less than one gram per ton, but there is good accessibility to the site, and it is in the safe jurisdiction of mining friendly Canada.

Seabridge's market cap is C $1.5 billion, they have no long term debt and C $200 million cash. They have been burning C $75 million of cash per year. The company is openly looking to partner with a major miner to develop their properties.

**Wesdome Gold Mines (WDO CN)**

Some of our best gold investments have been in smaller companies with growing production, as this gives them a way to grow earnings separate from movements in the gold price. Wesdome is a one such producer with two very high grade mines in Canada.

Their Eagle River mine in Ontario has a reserve grade of 15 grams per ton, over 10 times the world average. Their Kiena mine in Quebec began producing last month and is expected to ramp up to 100,000 oz per year in 2024.

We think the combination of extremely high grade and attractive jurisdiction make this an interesting one to watch in 2023.

**Minera Alamos (MAI CN)**

Minera Alamos is another junior producer with three mines in Mexico ramping up in succession. The first mine, Santana, began production in late 2021 and is now running at 35k oz per year.

The second mine, Cerro de Oro, is expected to come online this year and ramp through 2024 to add another 60-70k oz per year, taking them to over 100k oz of annual production. They recently released a preliminary economic assessment for the project showing a robust return profile with low capital costs and a short payback period.

Their third mine, La Fortuna, is expected to come online next year and by 2025 produce another 50k oz per year. Combined the three mines are expected to produce 150k oz per year at an all in cost below $800/oz.

Our team at Old West is very excited to see our research and hard work pay off in the coming year and continue to give our clients market beating performance. Thank you for your loyalty and continued support and we wish you and your family a healthy, happy, and prosperous 2023.

Sincerely,

Joseph Boskovich, Sr.
Chairman and Chief Investment Officer

## Disclosures

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