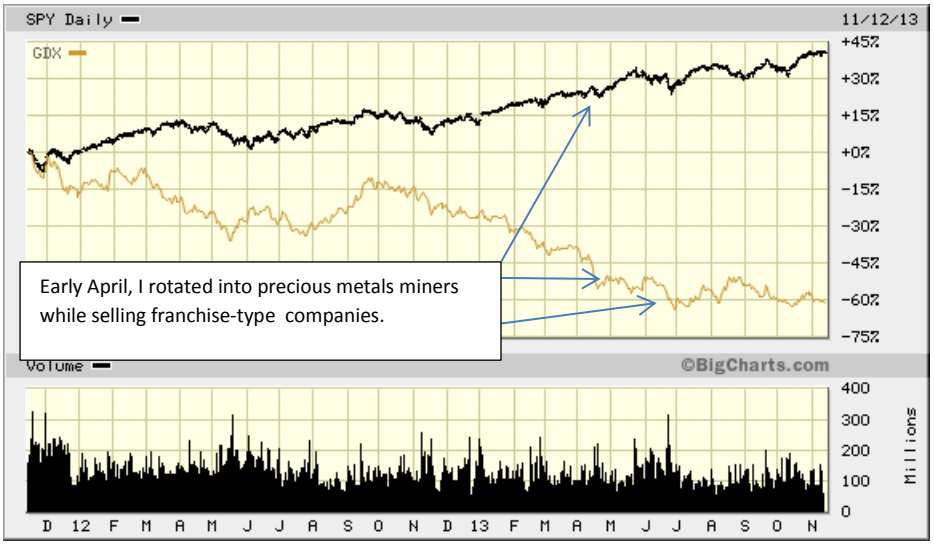
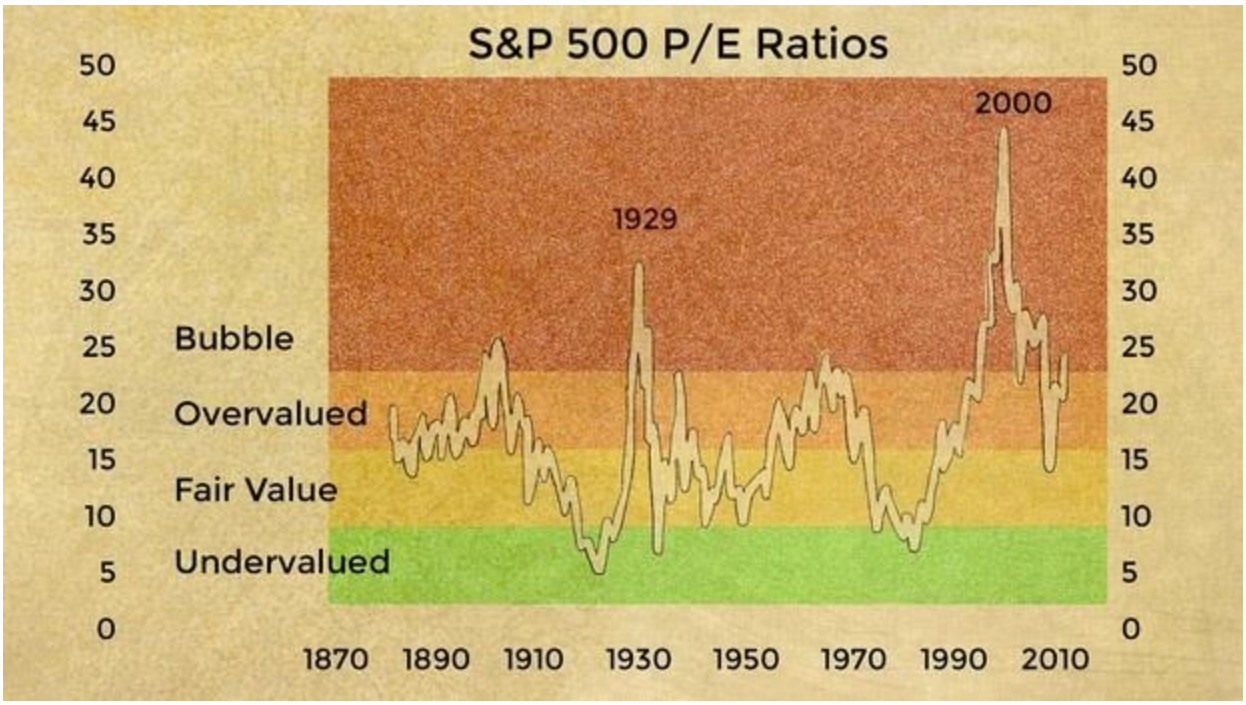
Account Report: November 12, 2013

A colleague asked me yesterday, how my year was. I replied that for the first time in almost twenty-five years I was down in absolute and relative terms to the market. The miners and precious metals have had a tough year while the stock market roars to a record this year.



Here is a longer-term perspective:

The GDX (yellow line) far out-performed the SPY (S&P 500) coming out of the 2008 credit crisis, but as QE has continued, more investors have piled into financial assets, especially stocks. The two markets are mirror images of each other. Investor and pundit sentiment is at all-time highs, margin debt is at a record and the Schiller P/E is near 25.



The problem is that an investor can't easily normalize company valuations if interest rates are distorted by Federal Reserve asset purchases. Where would the market be without the Fed's help? Meanwhile, mining stocks have insider buying while drifting lower. The market has been nearly sold-out but new interest has been lacking. Gold companies have been improving their cost structures and there are straws in the wind that gold stocks are beginning to outperform gold.

But you can see from the huge increase in volume that the market is in a transition since Late April of this year (seven months)—weak hands are selling to long-term buyers.

These past seven months of bottoming/transitioning have been brutal, but if you, as an investor, can find an asset class at an extreme due to investor disgust/hatred and poor prior price action, you have a chance to buy at very attractive levels. The next step is to be sure your companies can make it through the tough times while holding on until the forces play out.

That's all. The difficult part is to muster the courage to hold on when all your senses are screaming that it's a huge mistake, that your investment will never pan out, that today's fool (you) is tomorrow's loser. The mining industry is a critical industry that will not be outsourced nor disappear. The culling of weak companies will make for a healthy rebound for the well-managed and strongly capitalized companies.

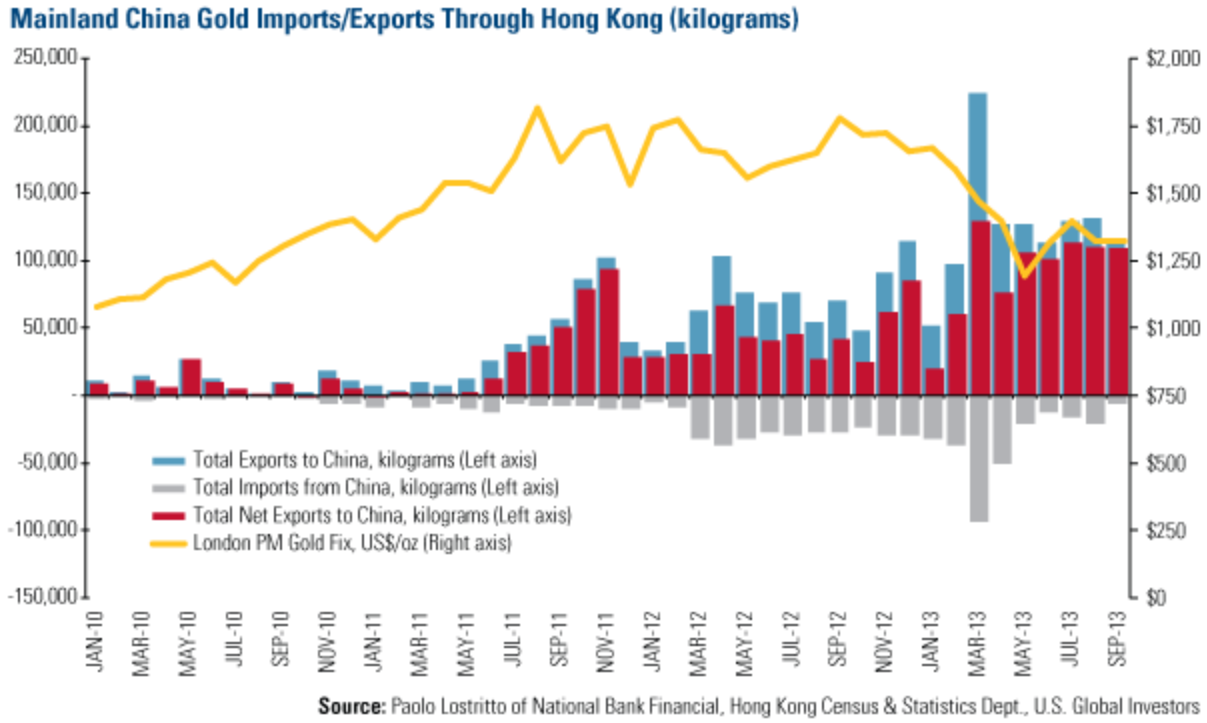
As one professional said, (see www.theaureport.com)

Sean Broderick (SB): The overall pessimism is overwhelming. I was speaking to a mining analyst recently—a sharp guy who has been at this for years. He was so pessimistic. **He was talking about going off and doing something else because he just can't take it anymore. When we see that kind of pessimism in anything, that's a real contrary indicator that things might be about to move the other way.**

There are **three bullish forces for gold.** First is **global stimulus.** We're seeing the world's central banks start to increase stimulus because they're worried about economic growth as estimates have slowly lowered. Now, the banks are starting to pile in more stimulus. That generally tends to pump up the price of gold.

Second is **selling by gold ETFs, which is starting to taper off.** If that does taper off and end, then a major bearish force in the market will be lifted. That could really lift a weight off the price of gold rather quickly.

Third is the **emerging middle class in Asia.** It's enormous. They want all the things we have, all the cars, the air conditioners, you name it, but they have a cultural affinity for gold. They don't trust banks. That's one thing they are going to buy.



You put those three things together and we could have a good year for gold in 2014.

I always look to see what some of the most intelligent investors are doing.

Why are we investing in precious metals and mining stocks.

"None of us know that the level of stock prices would be, what the level of corporate earnings would be, or of course where interest rates would be were it not for all this," Seth Klarman, founder of The Baupost Group, said concerning monetary policy.

I don't know where rates would be if not for all this QE (quantitative easing) and bond buying and expansion of the Fed balance sheet. **So what we come up with over and over is gold, the one place you probably want exposure.**

It is not crazy to imagine that the solvency of the US might, at some point, be called into question, whether people were no longer willing to buy our bonds at all for the yields that were anything like today or maybe ever, because, of course the higher the yields go, the worse we look, gold is the thing that will react. And if gold got discontinuous, if gold went to $3,000, $5,000, or $10,000 an ounce, we think buying options on gold is the most interesting hedge.

Gold mining shares can benefit from a credit collapse since gold will hold up better than the companies' input costs like crude, rubber and other commodities.

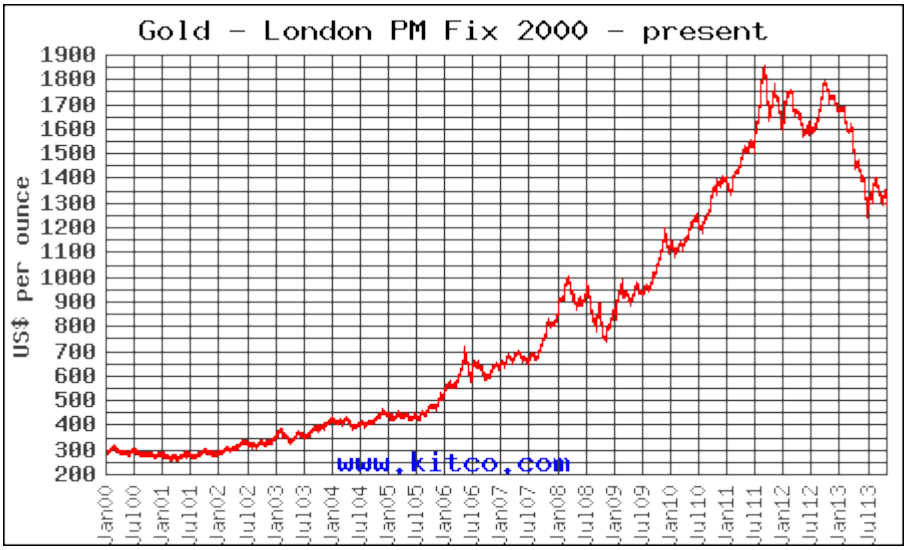
Once an economy becomes dependent on money printing, it must receive accelerating doses to just to remain stable. The central bank must print money faster than market participants expect in order to fool businesses into mistakenly believing that additional savings exist, ready to be deployed.

Paul Singer, founder and principal of Elliot Management, says that in financial markets the past is not necessarily prologue. **The difference today, Singer continued, is the rampant distortion of asset values by quantitative easing and zero-percent interest rates.** "There is a significant degree of bloat in the prices due to central bank actions, and, in my view," he said, it is a particularly bad time to be increasing leverage in in institutional portfolios in an asset—bonds—which have had a 30-year bull market and which would be decimated if a delayed effect of all that QE is a solid and accelerating burst of undeniable inflation.

But not many on Wall Street seem concerned, Singer acknowledged. The fearless ones point to downward wage pressures and to the deflationary force of new technologies, and they ask, "what inflation?"

"I have a different view," he said. **"The events of May and June (when fears of Federal Reserve tapering put bond markets into the tank), among other modern episodes, indicate strongly to me that markets can turn on a dime and front-run a new perception well in advance of the phenomenon actually occurring.** If markets smell future inflation and/or lose confidence in paper money and or lose confidence in global or American leadership, and/or perceive a significant acceleration of economic growth, they could react intensely and abruptly. In all of those scenarios, bond prices would be going down. If bond prices go down, then the Fed's balance sheet which is laden with U.S. bonds would deteriorate placing pressure on the U.S. dollar and upward pressure on gold prices.


Trey Reik, chief investment officer of Bristol Investment Partners said 2013 would market the 13th consecutive year of a bull market that many have chosen to forget. What caused it?



Over the course of gold's extraordinary run in nominal terms ($250 to $1,900 and now $1,275), stock prices have both risen and fallen, inflation has waxed and waned, deflation crises have come and gone, interest rates have inched up and down and the euro-dollar exchange rate has lurched between $0.80 and $1.60.

What has lit a fire under the gold price, according to Reik, is the **rising imbalance between paper claims on output on the one hand, and output itself on the other.** "There is too much of the former and not enough of the latter," he said. "Debt and equities are claims on future output. You can't keep increasing claims on future output five or six times faster than output forever. Eventually, the output has to support or amortize those claims. In the last 100 years, there have been only two cases where the relationship between debt and GDP has broken out of this natural 140% to 170% range, and they were the Depression and Alan Greenspan/Bernanke."

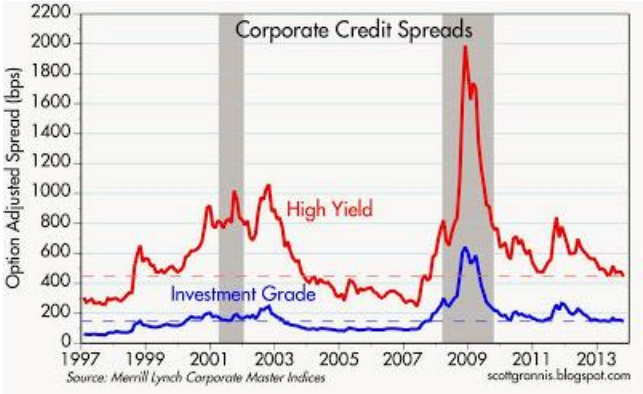
Since the 2000s began, overall debt has risen by $31 trillion, nominal GDP by only $6.3 trillion. This is the story of gold," Reik announced. "This is why gold, on my opinion, increases each and every year, because a growing number of people are deciding that **anything that can't be printed is probably a good place to put some money to get it out of the financial system, because we are increasing and debasing the claims of financial assets on the underlying productive output."** (see page 15 of the attached chart book)

We took a $9 trillion economy in 2000 and we added $31 trillion in debt—supposedly superior claims---and we eked out about $6 trillion in debt—supposedly superior claims—and we eked out about $6 trillion in nominal GDP. If this were a corporation, why should the equity claims be

expected to advance at all in that type of a scenario? Is there any value to the equity in that type of example?"

Debt keeps growing because it must, Reik insisted. Without new lending and borrowing, the credit pyramid would topple. Suspecting as much, the Federal Reserve will think long and hard about "tapering."

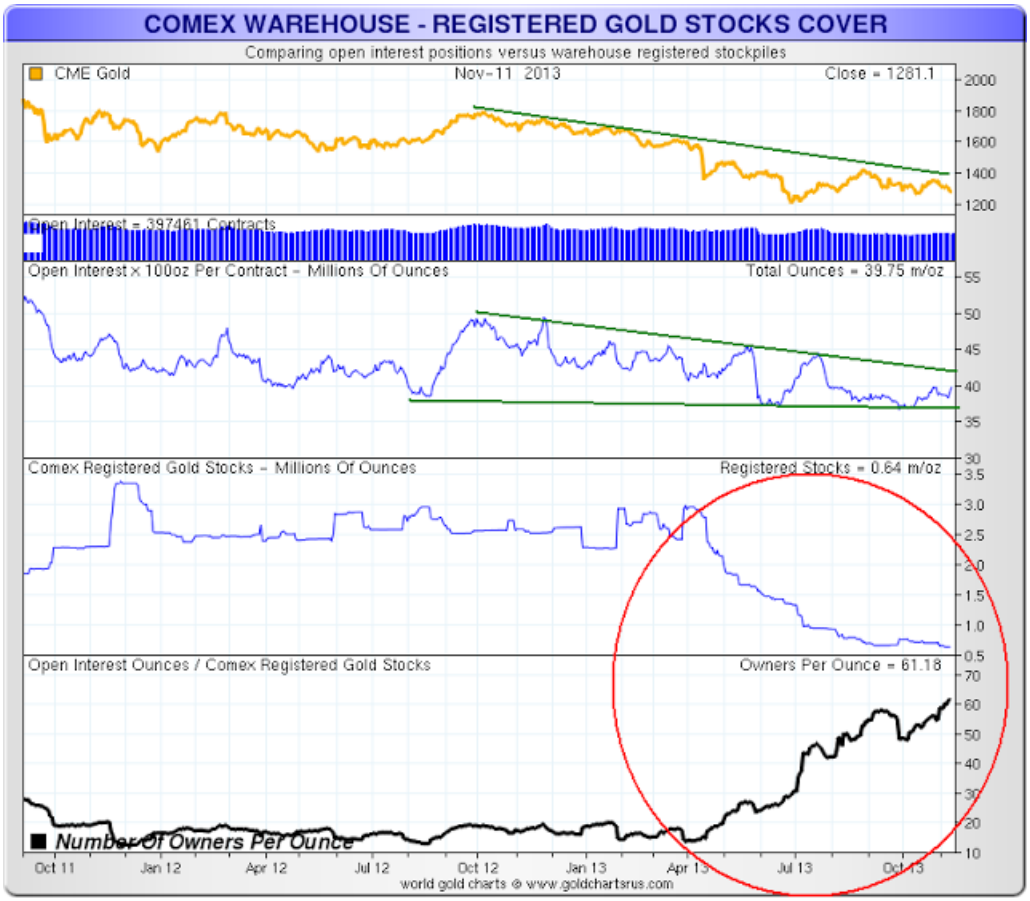
The whole point of QE, he contended, is "to engender—inflict—inflation on the world's most important asset class--BONDS. And when you inflict inflation on the world's most important assets class, all sorts of relationships also experience inflation, like collapsing credit spreads.



America's overseas creditors seem to have taken notice, he went on, because net foreign purchases of U.S. government securities have plummeted. "Unprecedented," Reik called the rate of decline in net overseas buying. Yes, he added, the trend could quickly reverse, but new doubts seem to be surfacing about the quality of American monetary, fiscal and geopolitical management.

The Gold ETFs have lost an estimated 700 metric tons of bullion since the 2012 peak, those tons went into the possession of other investors, especially those in Asia, and more particularly, the official investors of the People's Republic. Reik said that, by his reading, the Chinese intended to accumulate $10,000 metric tons and are about half way home.

As it is, said Reik, gold is setting up for a better day. Witness plunging gold stocks on the Comex



and the soaring premium Indian buyers are willing to pay above the world price for the monetary asset of which their government disapproves. “When a country starts telling its citizenry not to buy something because they want to protect their currency,” said Reik, “what does that country’s citizenry turn to? What the government is telling them not to buy.”

Jesse at Cafe Americain looks at the current supply and demand dynamics of the Comex Gold Supply and Demand and reaches pretty much the same conclusion I do. Though he does go a bit further and speculates that a squeeze may occur in the physical gold market, possibly starting in Asia:

"The point is that when the market turns, how high must prices go to clear supply against demand.

"**There is 'plenty' of gold at the Comex and in the world. Unfortunately not much of it is for sale at these prices.**

"That is the key. If prices were falling in an environment of ample supply and slack demand, then it would be a different story. But they are not. Demand worldwide for physical bullion is high historically, and supply is thin. And yet prices have decreased. And there is plenty of evidence of market manipulation. How hard is this to understand?

"As I have said any number of times, the Comex is not where the market is going to break. The physical market is not centered on the Comex, which is the locus of paper price fixing.

"If and when the Comex breaks it will be because there is a general default in the physical market, most likely in Asia and the LBMA that triggers a run on the bullion banks, and then on the Comex.[...]

"So to summarize, as leverage becomes outsized, any reversion to the mean, also known as unwinding, becomes more difficult.

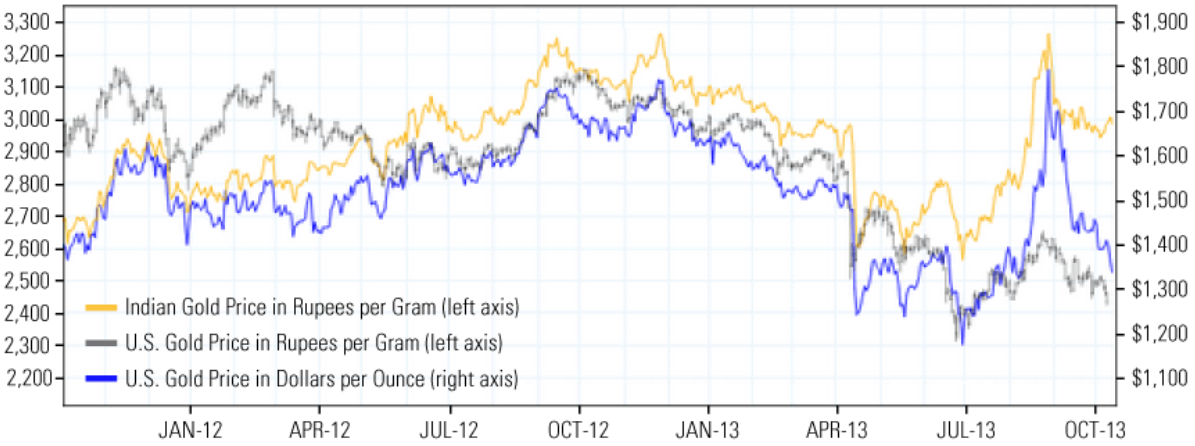
"Every time the registered gold inventory has reached these extreme lows there was an intermediate price trend change within six months. This time it could be six months, or nine, or twelve. The longer a divergence from natural market dynamics continues, the harder it will be for players to unwind their short positions and obtain real bullion to cover. And in a market break, inventory will evaporate almost overnight.."

See more: **More detail on gold being moved from West to East (strong Asian hands who will more likely be long-term holders)**

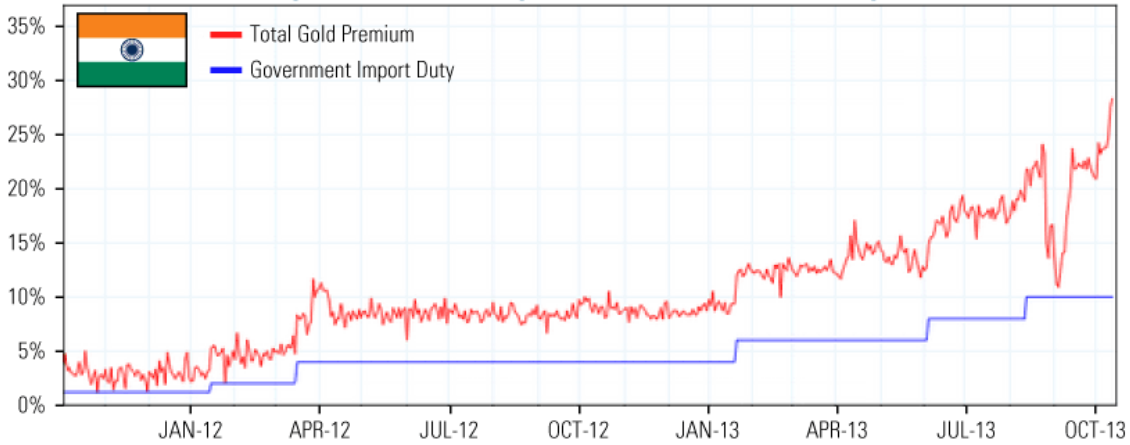
http://jessescrossroadscafe.blogspot.com/2013/11/claims-per-ounce-of-deliverable-gold.html

Indian Gold Premiums Surge to All-Time Highs

Gold in Indian Rupee vs. U.S. Dollar



Indian Premiums and Import Taxes Bring Equivalent Gold Price to $1,632 per Ounce



Source: www.goldchartsrus.com, U.S. Global Investors

US Debt Clock.org

Gold Demand By Country in Ounces

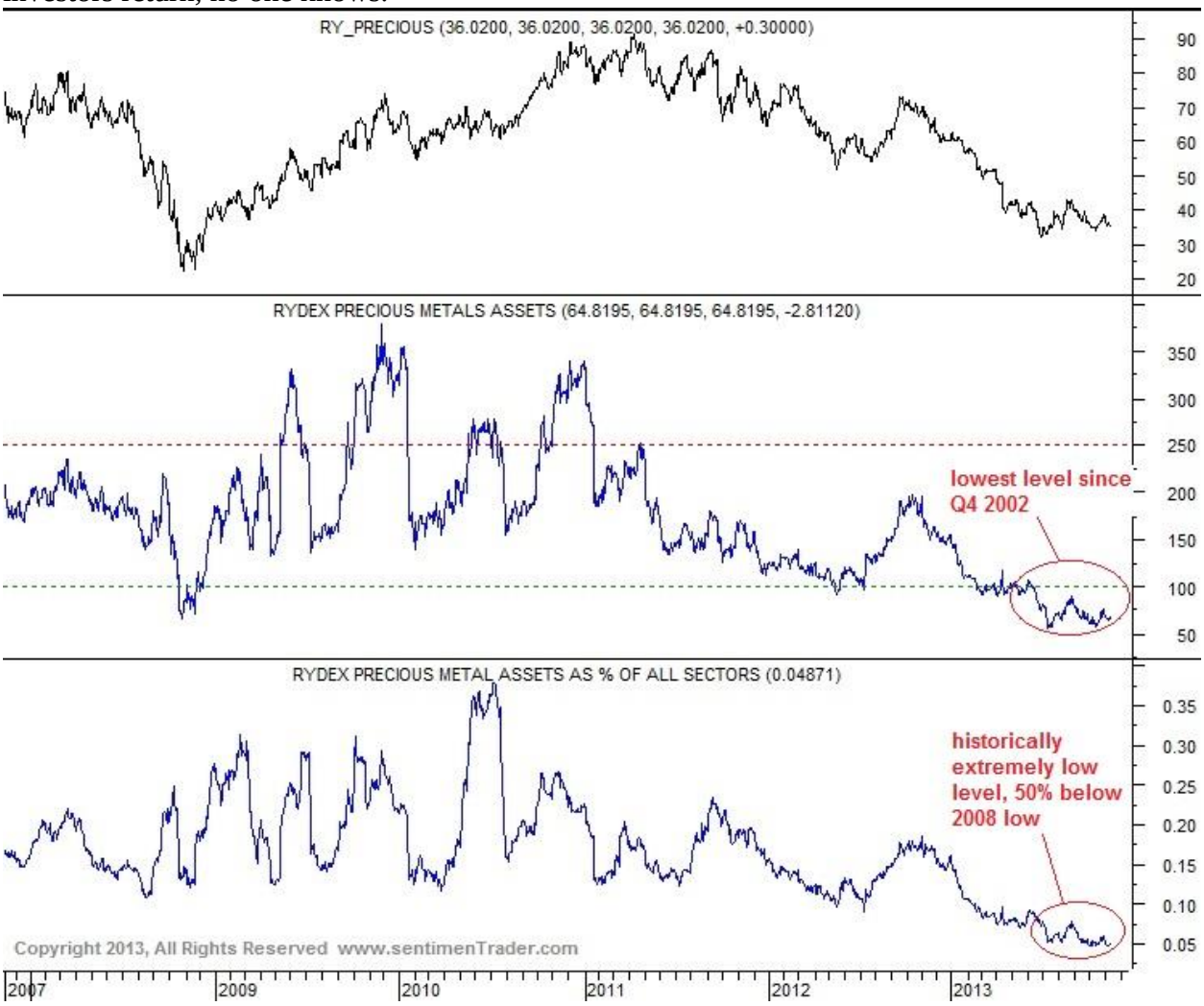
CHINA	35,536,253
SAUDI ARABIA	2,454,690
EGYPT	1,902,914
SOUTH KOREA	456,466
FRANCE	16,166
SWITZERLAND	1,979,907
GERMANY	3,612,203
TAIWAN	650,760
HONG KONG	1,270,418
THAILAND	3,204,363
INDIA	40,579,344
TURKEY	5,603,053
[illegible]	1,954,949
UAE	2,452,763
ITALY	700,879
UNITED KINGDOM	696,455
JAPAN	727,739
UNITED STATES	6,355,588
RUSSIA	2,554,520
VIETNAM	2,365,520

Gold Demand by Sector in Ounces

JEWELRY	80,633,108
INDUSTRY	13,389,122
DENTISTRY	1,174,961
ELECTRONICS	9,210,201
OTHER	2,990,010
TOTAL INVESTMENT	33,360,340
BAR DEMAND	26,469,805
COIN	8,398,841
MEDALS	6,850,888
ETF'S	-13,498,122

RECYCLED GOLD	GOLD PRODUCTION	TOTAL GOLD DEMAND/SUPPLY
48,420,095	103,739,582	153,346,302

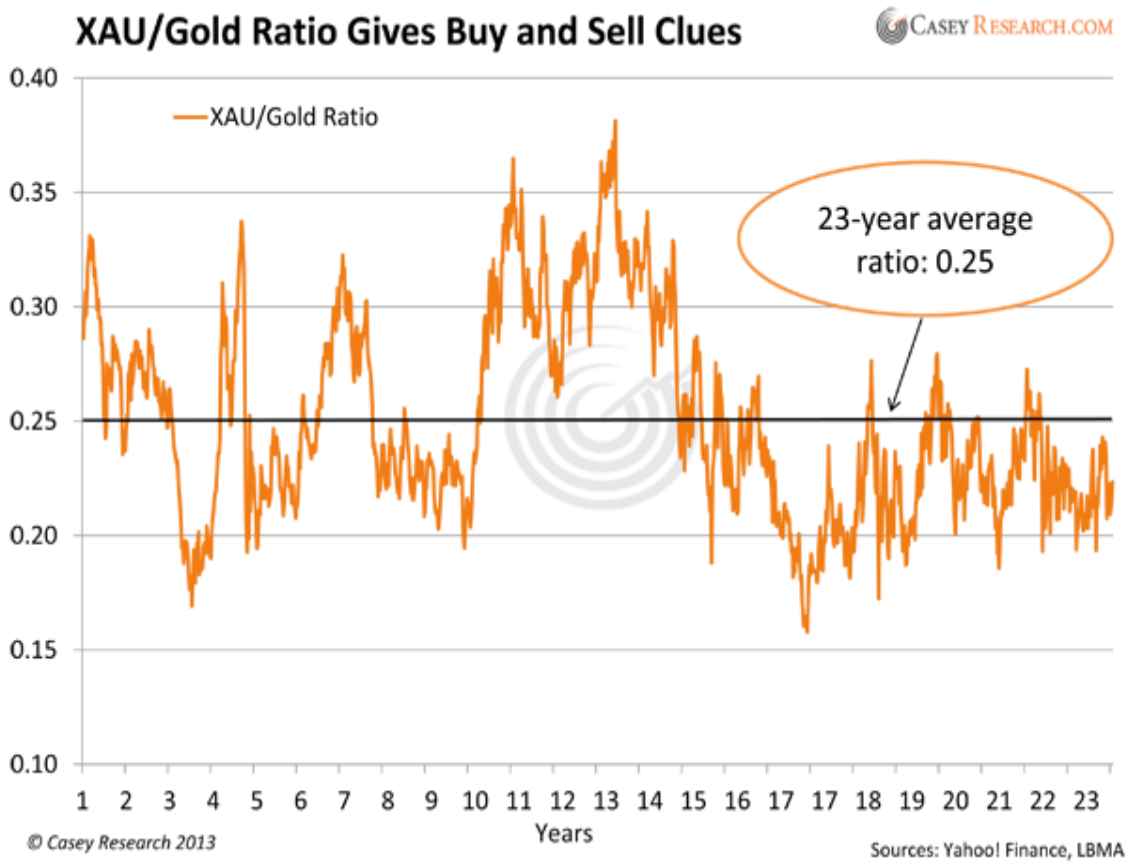
The previous chart shows that India and China are the two main factors driving gold demand. Western investment demand has declined over the past two years. Note the **record low asset level** in the chart below. Western investors have left precious metals and currently show little interest. That is good news in the sense that there are good values in the sector, but what makes investors return, no one knows.



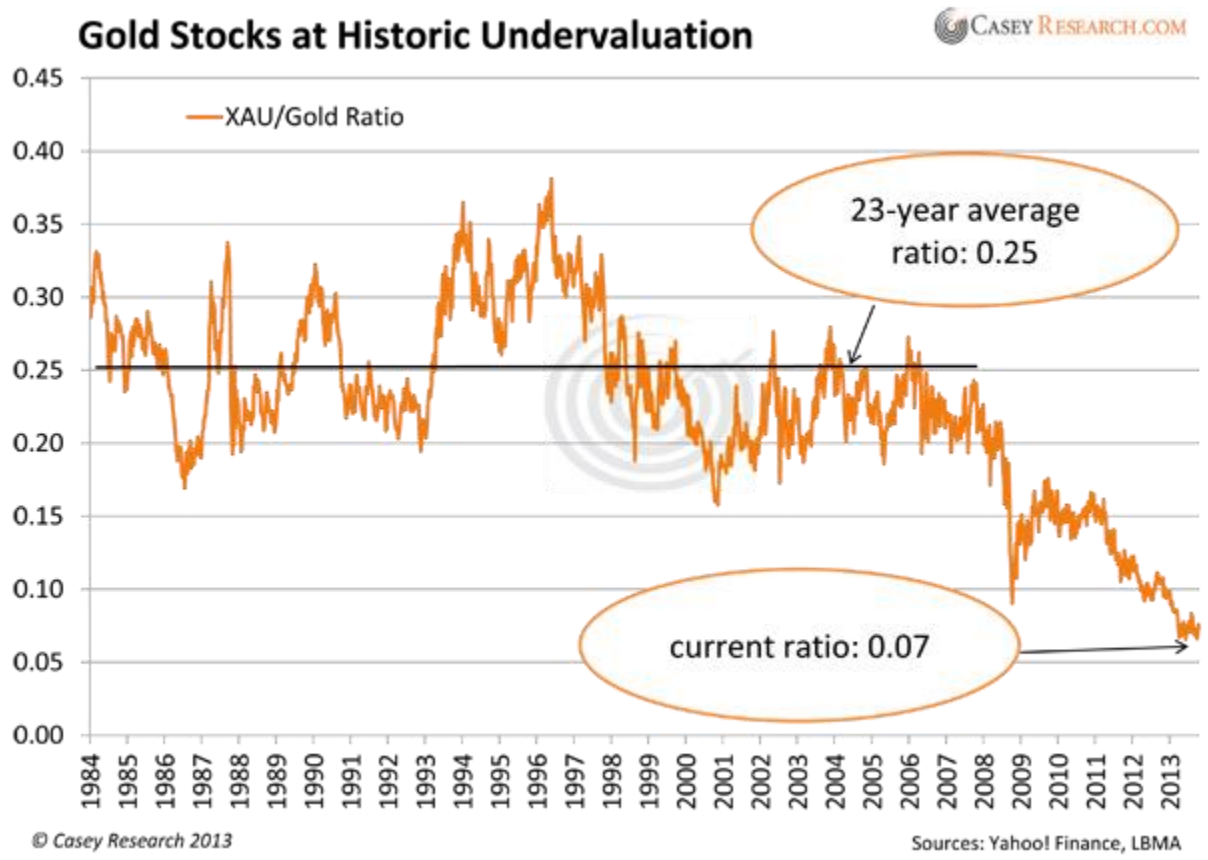
But currently, the sentiment is at **historical extremes**. Witness the discounts on physical bullion in this closed-end fund:

Investors are willing to sell bullion at a 5% to 7% discount.

There are signs, on the margin, that interest may be returning for precious metals miners



Above and below are two charts showing an index of gold and silver miners the (XAU) relative to the price of gold.



Today, the XAU/gold ratio is at a historic low of 0.07.

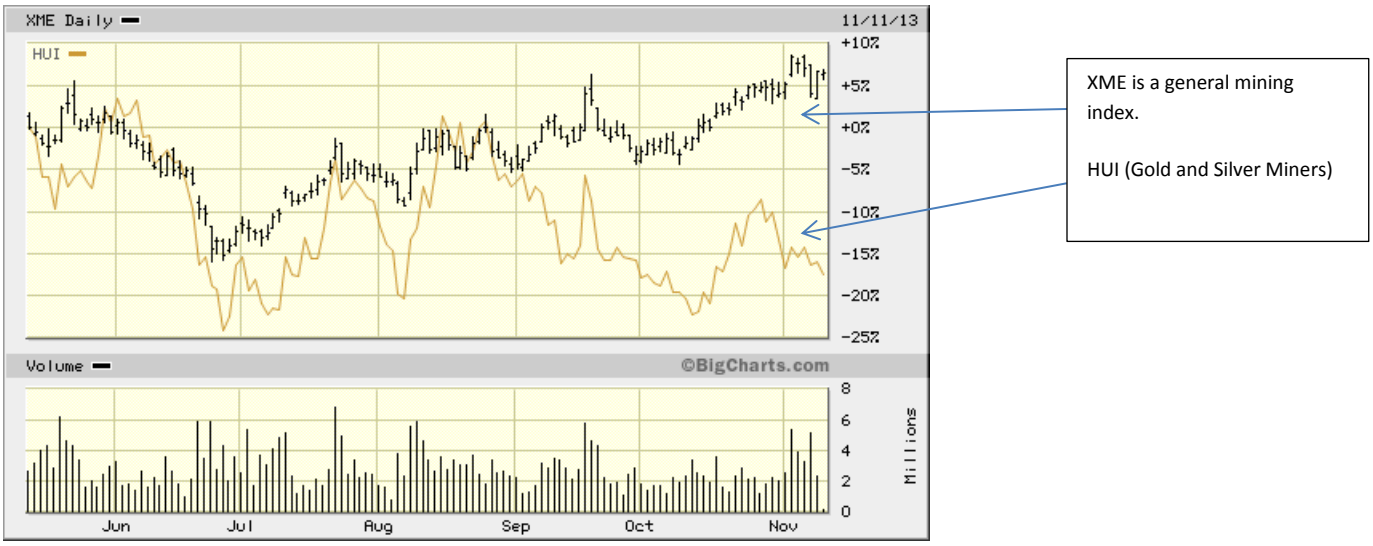
To fully appreciate what this means, look at these former lows for comparison:

- It's lower than the 2008 gold stock selloff;
- It's lower than the "nuclear winter" of the mid-'90s;
- It's lower than the very beginning of the gold bull market in 2001.

Many mining executives at major producers like Barrick, Kinross, etc. have been replaced in the past three years because of poor capital allocation and growing without regard for shareholder returns. Managements are focused on cash flows at the majors and not just growth. There has been a wake-up call over the past three years.

Early signs of interest?

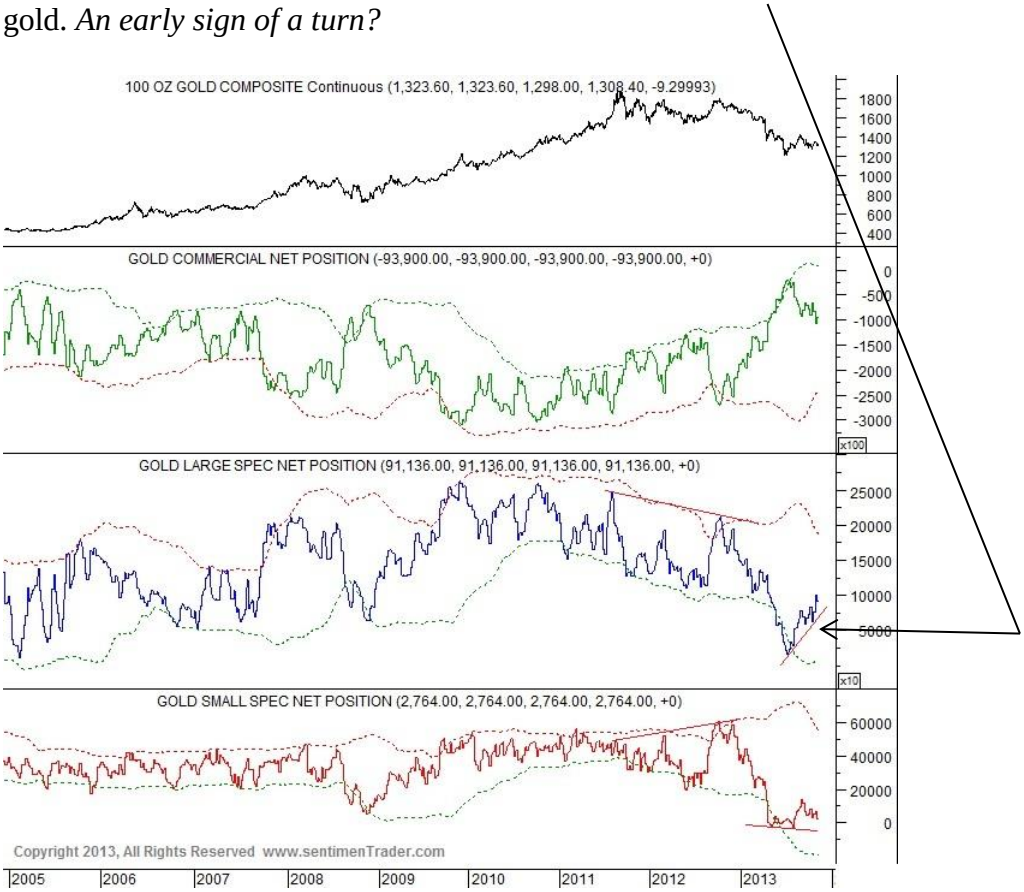
General mining stocks are beginning to lead gold stocks. Cyclical stocks may begin to outperform.



Also, gold stocks are beginning—albeit very slightly--to outperform gold.

Why? Perhaps, because input costs for miners like labor, materials and fuel are declining relative to the gold price. See the chart of crude oil to the gold ETF (GLD)

Also, for the first time since 2012, large futures speculators have taken a small interest in owning gold. *An early sign of a turn?*



Also, **POSTED ON** OCTOBER 23, 2013 **BY** CEO TECHNICIAN

The best investment opportunities usually present themselves when the market fundamentals & technicals align in the same direction. Such is the case with the Toronto Venture Composite Index (TSX-V):

The TSX-V is testing double-top resistance from May, if it can break above 972 it will trigger upside targets of 1020 and 1080. Perhaps more importantly, we will have the beginning of a nascent uptrend.

Gluskin Sheff Chief Economist and Strategist David Rosenberg agrees, citing the fact that the TSX Basic Materials Index ***"trades at a 40% discount to its historical average and a 35% discount to where it normally has traded in the past relative to the total market."***

Throw in the fact that private equity firms **(notoriously shrewd bargain hunting investors)** havebegun getting aggressive in the resource space and we have one of those rare moments in which the technicals & fundamentals are in near perfect alignment. Such opportunities usually do not last for long before the proverbial train departs the station.

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A recent technical overview of the gold stock market: Click on the various short videos: **http://www.321gold.com/editorials/sfs/hubbartt110813.html**

An insider's view of the mining sector--Rick Rule Interview:
http://classicvalueinvestors.com/i/2013/11/rick-rule-why-not-hang-around-for-the-gain/

All the charts above are like footprints in the snow. Pieced together they give clues but not a definitive picture.

The criteria for investors in judging the value of gold shares cannot be how they have performed recently, but rather whether the macro conditions that have driven the gold market thus far have ended.

The main drivers of the gold markets are state and societal debt levels, the two factors that put pressure on the state to debase the currency. **So far, there is no sign of reducing government**

spending, deficit spending and debt levels. The Fed continues and may be forced to increase QE indefinitely.

Put another way, will deficits decrease and the sovereign credit of the U.S improve with $17 trillion and growing debt not including the trillions of off-balance sheet obligations for Medicare and Social Security? If not, then gold should be supported by the dollar's debasement. However, in the near-term quantitative easing has herded investors into financial assets like the stock market. Western investors have sold their gold because they feel more confident in the Federal Reserves' handling of the economy.

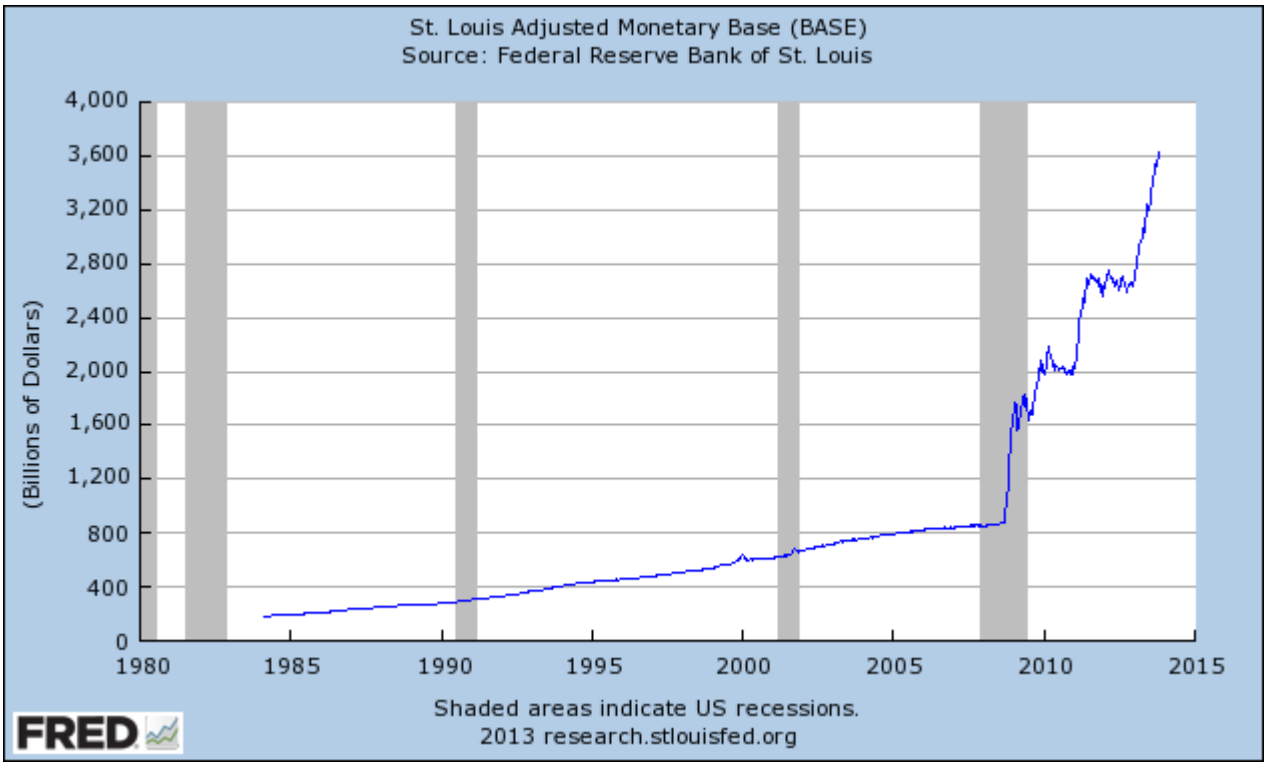
However, **Race to bottom resumes in currencies as central bankers ease anew**

The global currency wars are heating up again as central banks embark on a new round of easing to combat a slowdown in growth.

The European Central Bank cut its key rate last week in a decision some investors say was intended in part to curb the euro after it soared to the strongest since 2011. The same day, Czech policy makers said they were intervening in the currency market for the first time in 11 years to weaken the koruna. New Zealand said it may delay rate increases to temper its dollar, and Australia warned the Aussie is "uncomfortably high."

"It's a very real concern of these countries to keep their currencies weak," Axel Merk, who oversees about $450 million of foreign exchange as the head of Palo Alto, California-based Merk Investments LLC, said in a Nov. 8 telephone interview. ECB President Mario Draghi, "persistently since earlier this year, has been trying to talk down the euro," Merk said.

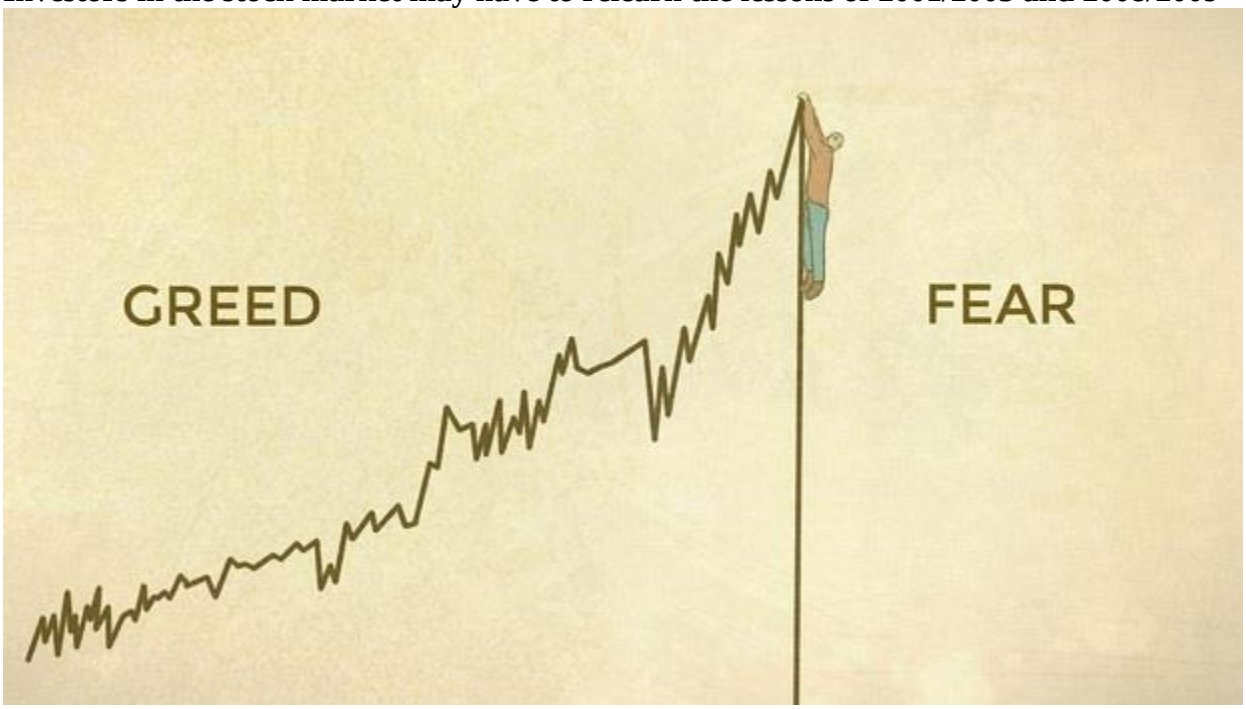
In Summary



This chart gives us reason to own gold and perpetual call options on gold (mining shares). The adjusted monetary base represents the asset purchases (bonds) that the Fed has made to suppress interest rates and herd investors into riskier financial assets like stocks. But where is the inflation? In the bond market. If bonds decline despite the Fed's QE or because of tapering, then the Fed's balance sheet will become impaired because the value of its bonds will decline. The dollar will face pressure due to the Fed's weakening balance sheet. Gold and gold-mining related equities should benefit.

Whenever I feel like losing patience, I look at that chart.

Investors in the stock market may have to relearn the lessons of 2001/2003 and 2008/2009



Please call with questions,