April 14, 2014: Report to Clients: **Three Steps Forward and Two Back**

The paradox in investing hinges on the tension between having both the strength of one's convictions and the intellectual flexibility necessary to admit, relatively quickly, when one is wrong.

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In the absence of the gold standard, there is no way to protect savings from confiscation through inflation. There is no safe store of value. If there were, the government would have to make its holding illegal, as was done in the case of gold. If everyone decided, for example, to convert all his bank deposits to silver or copper or any other good, and thereafter declined to accept checks as payment for goods, bank deposits would lose their purchasing power and government-created bank credit would be worthless as a claim on goods. The financial policy of the welfare state requires that there be no way for the owners of wealth to protect themselves.

This is the shabby secret of the welfare statists' tirades against gold. Deficit spending is simply a scheme for the confiscation of wealth. Gold stands in the way of this insidious process. It stands as a protector of property rights. If one grasps this, one has no difficulty in understanding the statists' antagonism toward the gold standard. Alan Greenspan (1966) http://www.321gold.com/fed/greenspan/1966.html

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There are two ways to conquer and enslave a country. One is by the sword. The other is by debt. –John Adams, 1735-1826

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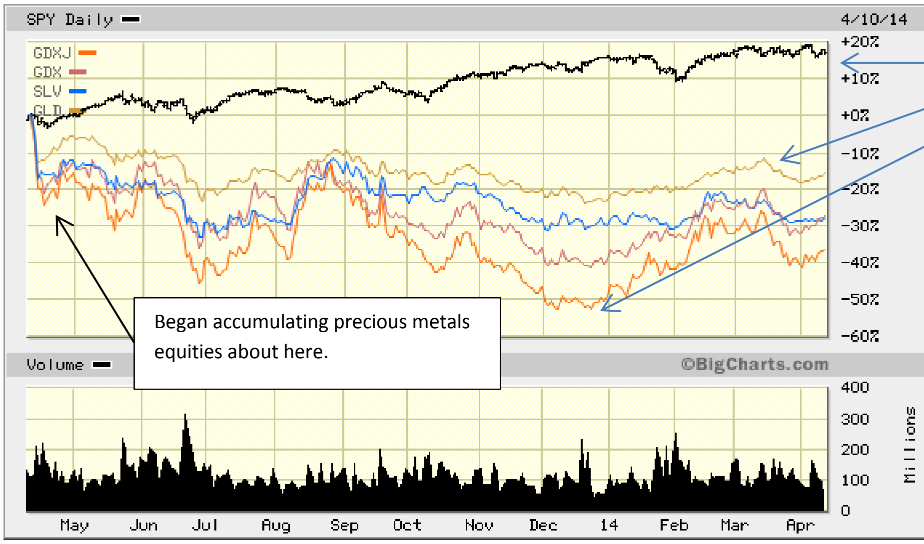
When you consider ***the rate at which public debt is increasing, along with the fact that so many countries around the world instituted their own versions of quantitative easing (i.e. printing money****) while increasing debt levels, these conditions are unprecedented. We have found NO HISTORICAL example of so many major countries simultaneously engaged in quantitative easing. Just ten years ago we would not have thought such an economic environment even possible. --Arnold Van Den Berg Feb. 21, 2014*

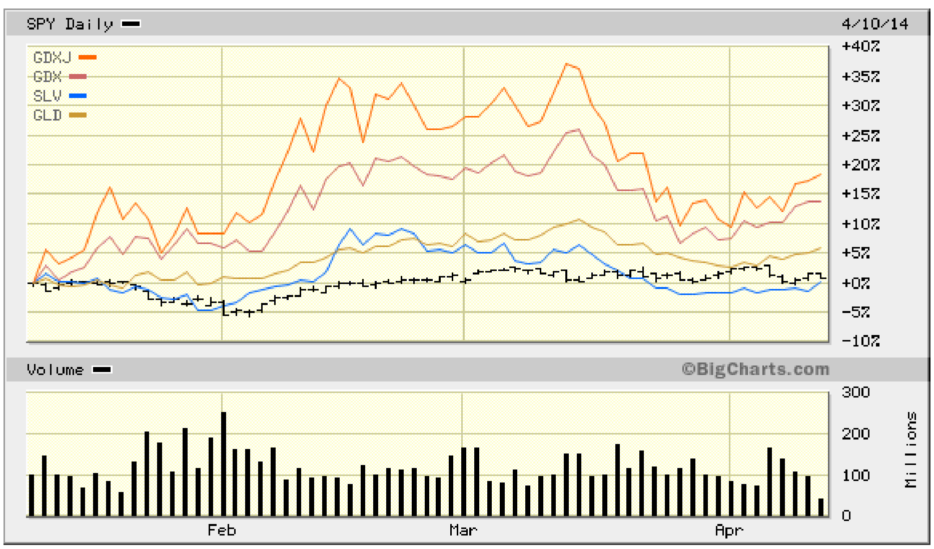
My title describes the progress of your account. We are close to our anniversary since transitioning into mining stocks and gold/silver bullion from quality, franchise-type companies last April (2013). See comparison on the next page. What a tough journey it has been:



SPY rises about 20%, while gold fell 20% and junior, most speculative, miners up to 50% (GDXJ). Lows—tax loss selling.

The Fed's quantitative easing (money printing) helped to accelerate investors' risk appetites to buy financial assets, especially stocks. Western investors sold gold to physical buyers in the East (China) while investors in miners capitulated and sold aggressively, while we bought over the past twelve months.

Within the ten weeks from the start of 2014, your account was close to all-time highs—rising 40% to 50%--before declining about 20% at the end of the quarter, March 31, 2014. I will be including a report on your specific account in a separate email.

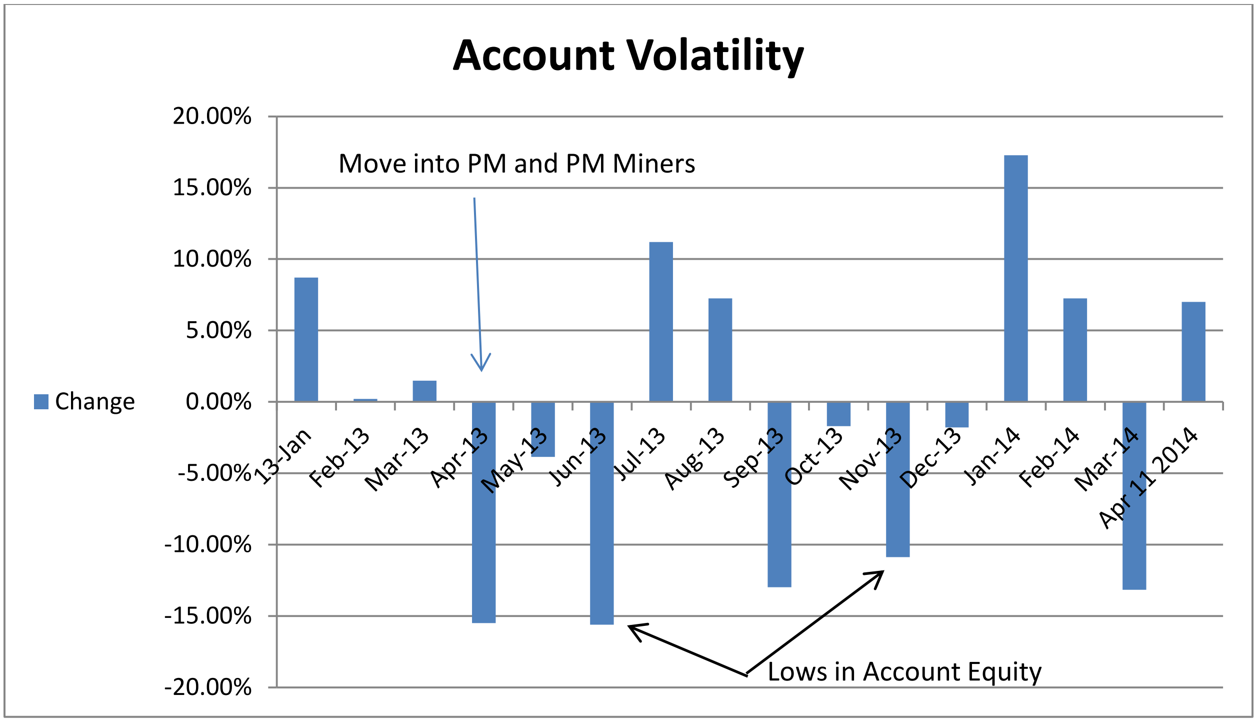


After the heavy tax-loss selling by gold/mining investors, GDXJ-Junior mining index, top line—rose 35% while the S&P 500 (SPY) treaded water.

Gold and miners were the best performing asset class in the 1st Qtr.

If we looked at our accounts using the **traditional metrics of Beta (**http://www.investopedia.com/terms/b/beta.asp**) as a measure of risk**, we would throw up our hands and say, enough! **Is this worth the risk?** We are break-even to down 15% from a year ago while the account fluctuates 20% for the past year. Imagine if you were to hire a taxi to take you across town, but instead you are put in the trunk and driven over bumpy roads for hours before arriving right back where you started worse for the wear.

An approximation of account volatility *(I wasn't kidding)*



Let me state my case as to why we should view our current situation differently through a business person's perspective.

As discussed throughout this past twelve months, we are investing for **absolute returns** given our alternatives. Let me summarize our current situation and what that implies. Then you can go to the links and charts presented to support my summary. Just remember that the future is uncertain and the markets are unpredictable in the short-term. My goal is to find the best values (worth compared to price) relative to alternatives. Over a three to five year time period, our values should be revealed. In the short-term Mr. Ben Graham said the market is a voting machine while in the long-term it is a weighing machine.

SUMMARY

- Compared to our investment alternatives: cash, bonds and stocks, our diversified but focused investments in precious metals equities are one of the **cheapest areas of the market both in comparative and absolute historical terms.** Our equities are long-dated call options on money, gold, that can't be debased like fiat currencies. Our mining equities trade as if gold was priced at $800 per oz. On any valuation metric of cash flows to book values and to gold, our stocks have never been cheaper except in 1939, just before WWII. We are at generational lows in mining equities. Famous value investors like **Arnold Van Den Berg of Century Asset Management** are taking notice. Please read: Van Den Berg's analysis of gold and gold mining shares:

✓ http://centman.com/insights/2014/02/**inflation-gold-and-gold-mining-companies/**
✓ http://centman.com/insights/2014/03/century-managements-**gold-valuation-analysis/**

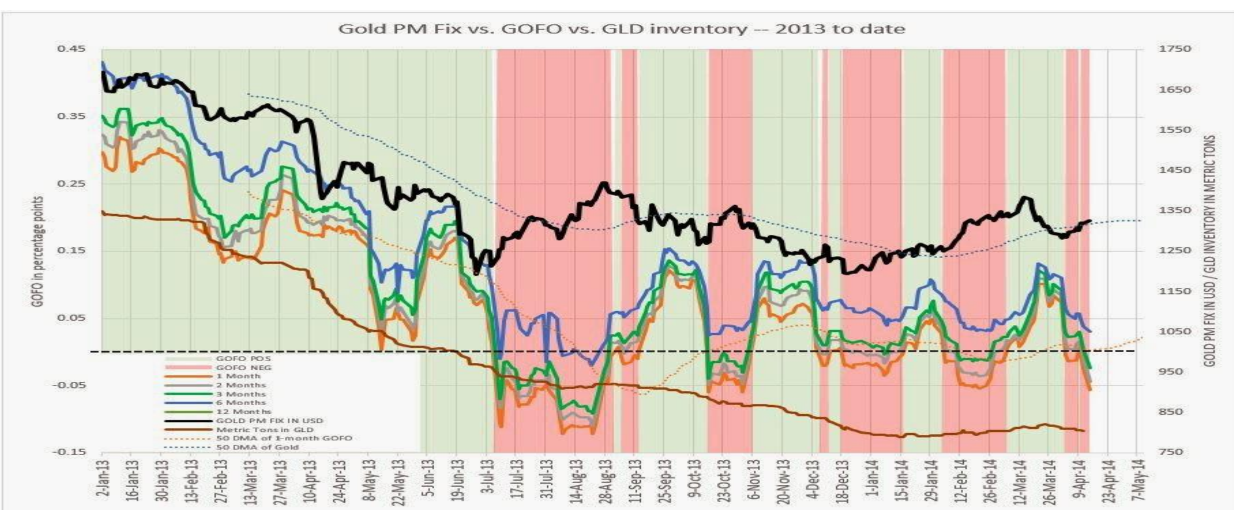
- ✓ **Video** (Investing: Areas of concern) [http://centman.com/**insights/2013/12**/play-all-arnold-van-den-berg-from-the-2013-austin-client-review/](http://centman.com/insights/2013/12/play-all-arnold-van-den-berg-from-the-2013-austin-client-review/)

Meanwhile, mainstream Wall Street analysts like Goldman Sachs continue to be negative on future gold prices due to a faulty premise—gold will weaken because the U.S. economy will continue to strengthen leading to decreased deficits and Federal Reserve easing. http://www.kitco.com/news/2014-04-14/Goldman-Reiterates-1050Oz-Gold-Call-Sees-Potential-For-PGM-Supply-Disruptions.html.

We are watching bond defaults in China, a plunging Baltic Dry shipping index, falling currencies all over the world, and other signs of contracting credit and contracting manufacturing I wonder how the US economy can strengthen on the back of just monetary printing. The U.S. and Europe suffer from structural problems like high regulatory burdens, high taxes, inflexible labor markets and artificially low interest rates that punish savings, the mother's milk of investment. Until structural reforms are made, QE can't help. If I print up $1 million and then buy a stock that rises 5%, but don't buy an item in the CPI, the government says the inflation rate is unchanged. Our price indices don't capture the rise in prices of financial assets.

Conversely, stocks, in general, are expensive, especially compared to normalized profit margins. Current stock prices imply about a 3% annual return over the next decade (See http://www.hussmanfunds.com/wmc/wmc140414.htm)—not a prudent risk in my opinion. Cash and bonds face inflation risk which is increasing.

- **The straws in the wind are beginning to lean in our direction.** Time is on our side. Gold has low investment interest. In fact, most investment professionals remain negative towards gold. In fact, negative Gofo rates (See http://www.lbma.org.uk/pricing-and-statistics) (to be explained later) indicate stresses in the bullion market where investors would rather hold gold than cash at higher prices ($1,300) than earlier in the year ($1,200).



- The underlying economic indicators for higher gold prices in terms of fiat currencies like negative real interest rates, growing sovereign debt, increased U.S. government debt and lack of restraint on government spending continues unabated. The monetary base continues to grow much faster than the growth in gold supply. The Fed continues to finance our growing federal debt while the off-balance sheet liabilities like Medicare and other entitlements compounds ever higher. Congress raised the debt limit and shows no inclination to slow spending. And why should they? The Fed is keeping interest rates near zero so the cost of our debt burden seems low (for now) and the Fed is the major purchaser of U.S. debt. Some experts estimate our debt per capita is about $250,000. There is no way our debt can be repaid in real terms (today's value of U.S. dollars).

- Commodity prices are firming while the US dollar weakens which is usually a harbinger of stronger gold prices. Equity prices, especially the most speculative names, are rolling over. Investors may now be concerned with risk and thus look to gold which is money with no counterparty risk. With a U.S. dollar you take the risk of debasement (inflation) through government money and credit creation. Investors' risk perception may be changing toward holding non-financial assets.
- The mining industry is beginning to consolidate. Merger activity is increasing (Goldcorp's bid for Osisko http://www.osisko.com/), private equity investors are becoming serious about investing, quality value investors are accumulating miners, and weak, promotional speculative companies are closing or leaving to pursue other activities like medical marijuana (See http://www.reuters.com/article/2014/03/27/canada-mining-marijuana). Mining companies wrote off about $25 billion in assets in the fourth quarter using a $1,200 per oz. year end (2013) gold price. A lot of bad news is priced into the mining market while the stock market has little risk priced into it.
- The main negative we face would be the amount of easy credit and money that has lengthened the mining cycle. Our stocks are bottoming in a l o n g cycle so we must be P A T I E N T. It will be agony. Why? Instead of more companies going bust during the 2008/2009 credit crash, mining companies that should have exited the industry received capital. I believe the speculative money slowed the market-clearing process. The mining industry is strengthening and consolidating but our cycle is elongated. Our patience will be tried, but our stocks have already declined 65% to 90% from their highs so a lot of price risk has been wrung out. The world's growing debt burdens are deflationary while the central banks of the world try to offset those deflationary pressures with fiat money creation. Deflation would benefit mining equities because their input costs would decline more than gold/silver prices. Also, insiders have been bullish on their shares over the past year, buying about 2.5 times more than they are selling. (See http://www.theaureport.com/pub/na/ted-dixon-what-gold-stock-insider-trading-tells-us). They may be early but they tend to know the value of their companies better than outsiders and Wall Street.

I believe the outperformance in the first quarter of 2014 of our equities compared to the general market and other assets **will continue but be volatile**. In fact, **if there is a selling stampede in the stock market** for whatever reason, we could see gold and our mining shares sold by investors to raise cash. But, in the wake of the Federal Reserve's response to flood the system with more money, our stocks should rebound sharply.

John Hathaway, manager of the Tocqueville Gold Fund believes investors will begin to recognize the stock market risks and turn to gold:

> We observe that many investors who understand, and may well have been deeply committed to the investment rationale for gaining exposure to potential currency debasement, have been **scarred by two extremely difficult years of negative performance and are therefore on the sidelines looking for a comfortable point to reenter the sector** *(gold and mining stocks)* **.** In the meantime, we have witnessed the entry of contrarian value investors *(like Van Den Berg mentioned above)* whose rationale can be summed up as **viewing gold mining shares as an inexpensive way to protect capital in the event of a broad correction in equity and capital markets.** It seems highly certain to us that the positive returns generated by equity markets over the past two years have represented a substantial barrier for capital to reenter precious metals. We therefore believe that a **bear market in equities would constitute a catalyst to drive gold and precious metals equities sharply higher**.
>
> http://www.tocqueville.com/insights/tocqueville-gold-investor-letter-1Q14

Here is another famous value investor and his views on the stock market and gold:

Jean-Marie Eveillard

> *Because many equity markets have soared significantly higher, particularly in the past year or so, and many of them have doubled or tripled over the past 5 years, today there are relatively few opportunities. There are a few opportunities in emerging markets,* ***but it's a time to be cautious because stocks have gone up considerably and trees don't grow to the sky."***
>
> Eric King: "Jean-Marie, what about the gold market?"
>
> Eveillard: *"In hindsight, the problem with the gold market at $1,800 or $1,900 was that you had a lot of people chasing an asset which had done well for quite a while. These late-comers had no particular conviction one way or another about gold as money or whatever. Gold had been going up for a while and so they jumped on the bandwagon and hoped it would go up forever.*
>
> ***But today all you are left with in the gold market is the true believers. These people understand that gold is money and that for 40 years we have been on a pure paper money system, and that the history of pure paper money systems is disastrous.***
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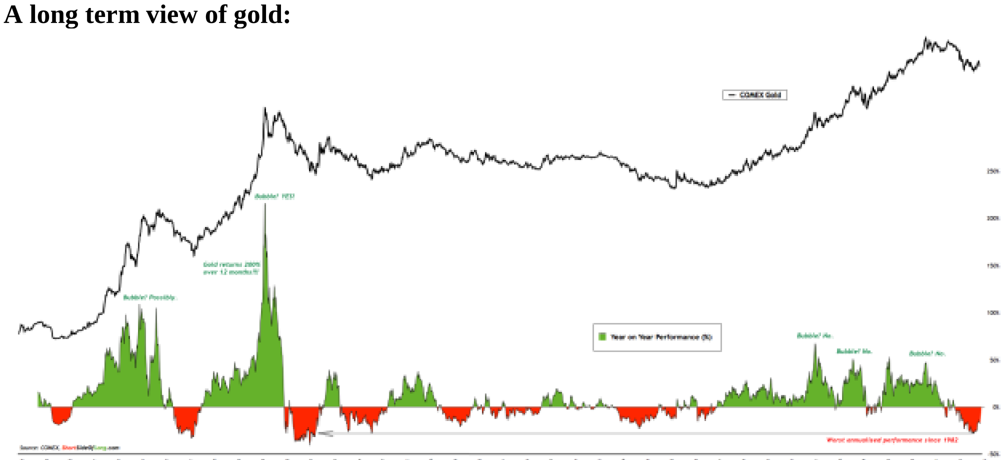
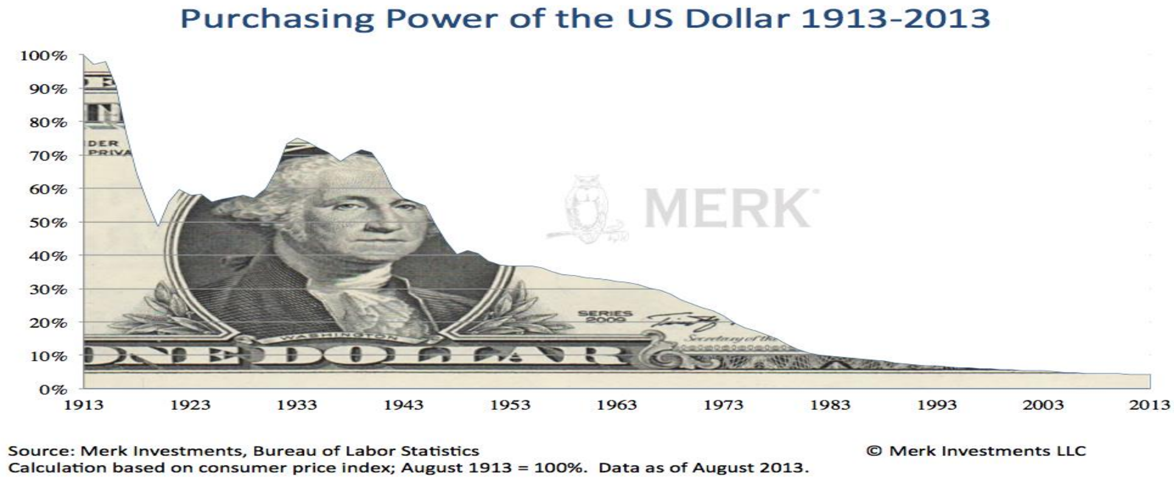
> **--**

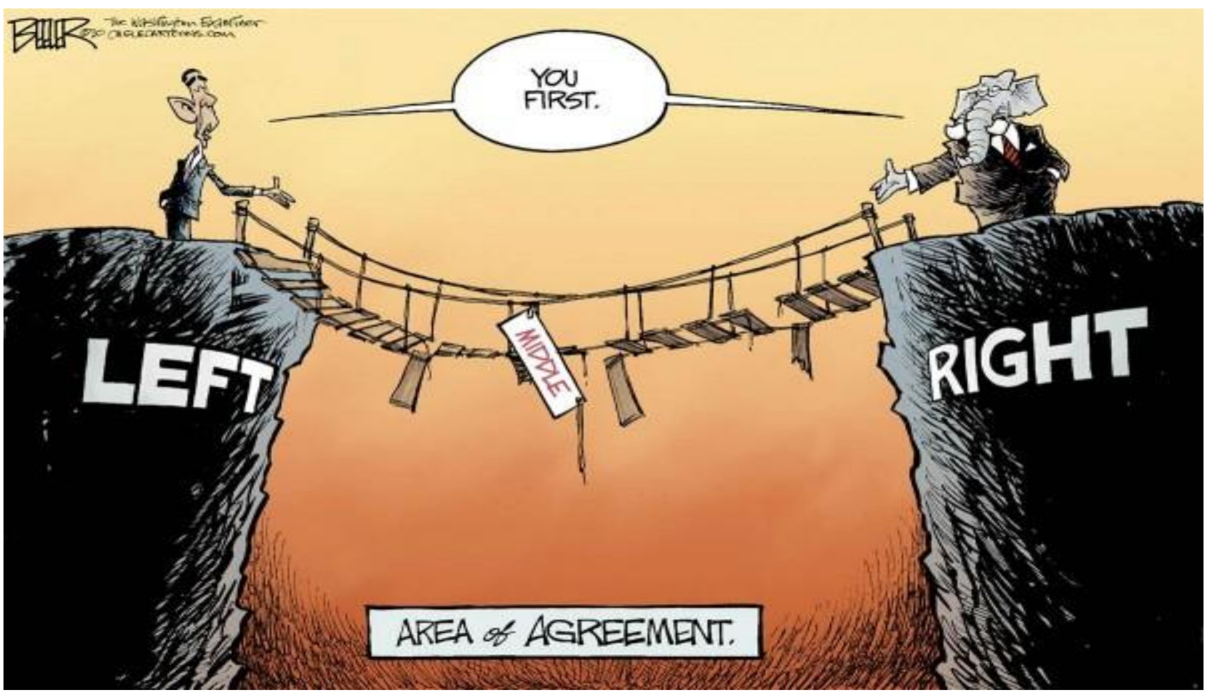
Now, I may only be quoting investors who agree with me, but if you peruse the general press, you will not find many friendly towards gold or mining stocks.

A long term view of gold:



The Gold price in dollars rising inexorably simply reflects this:





America's fundamental problem is how to come to terms with spending, entitlement reform, taxes and property rights. There is no way with our current growth in entitlements like Medicare, Social Security and pensions that the American taxpayer can fund them through taxes.

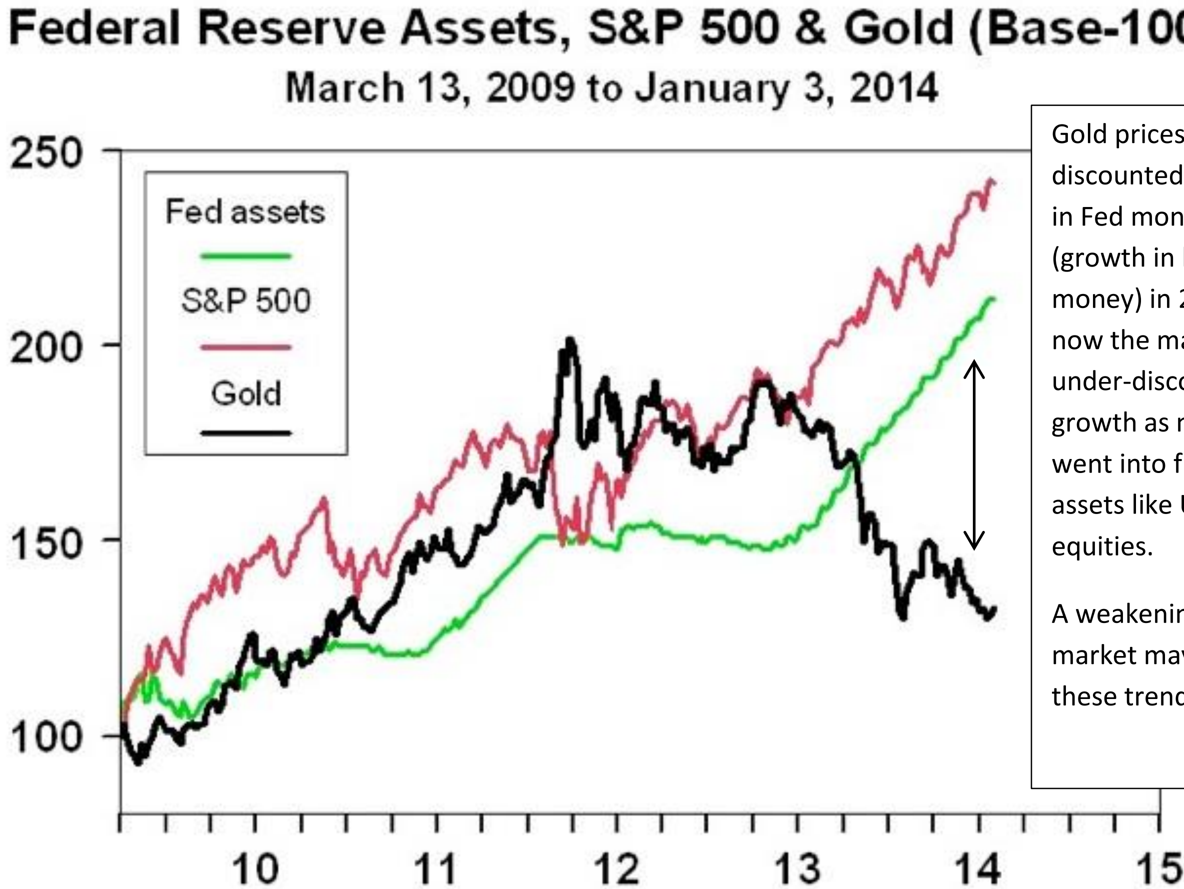
Without stable money and an adequate return to savers, there is no way for the economy to grow fast enough in real terms to generate enough income and thus taxes to pay for our deficits. The Fed is trying to support the Too-Big-To-Fail Banks and the Federal Government's growing debt by printing up money to buy US debt from US Banks while also suppressing interest rates—a financial repression against savers and those on fixed incomes. The Fed is trying to "taper" or slowly remove the amount of debt they purchase, but this will lead to a financial market crash. As the Austrian economist, Ludvig Von Mises (1881-1973) said, "The boom can last only as long as the **credit expansion progresses at an ever-accelerated pace.** The boom comes to an end as soon as additional quantities of fidcuairy media (dollar bills) are no longer thrown upon the loan market."

The FED is trapped. Expect gold to rise when the Fed returns with an ever higher dose of money printing—or whatever they call it.

All the gold ever produced. The high stock (166,500 tons) to flow (2,500 tons per annum) creates a stable supply which is ideal for use as a store of value and medium of exchange.

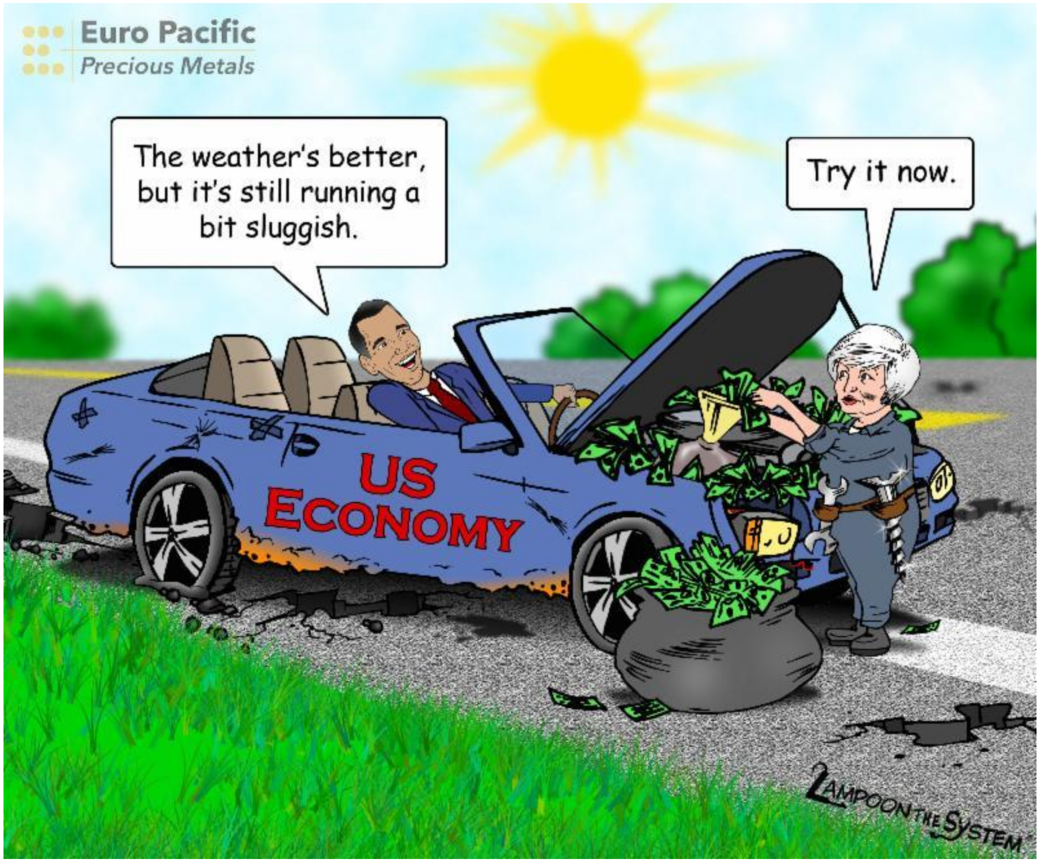
Which seems set to accelerate due to this:

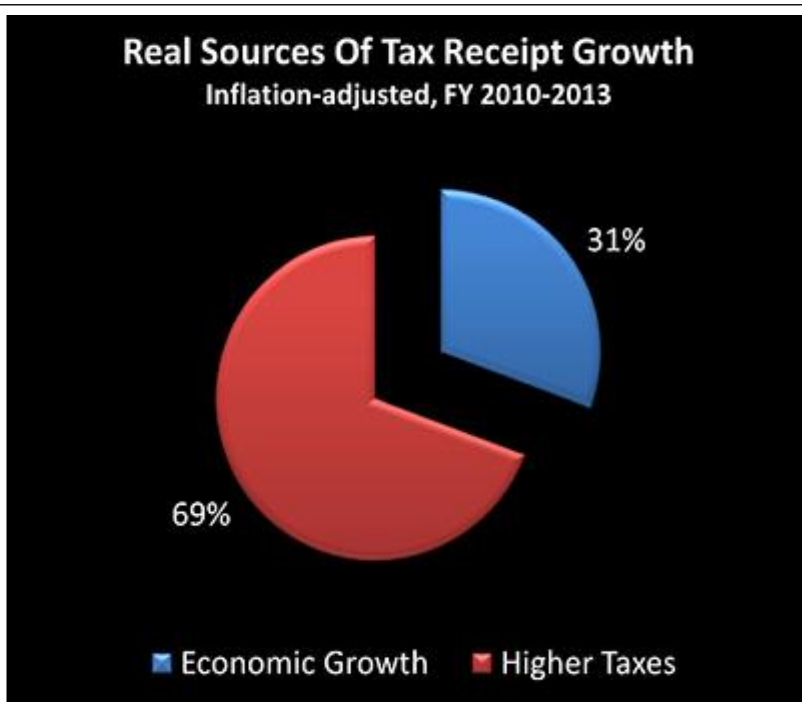
Gold tracks M2 albeit with leads and lags.



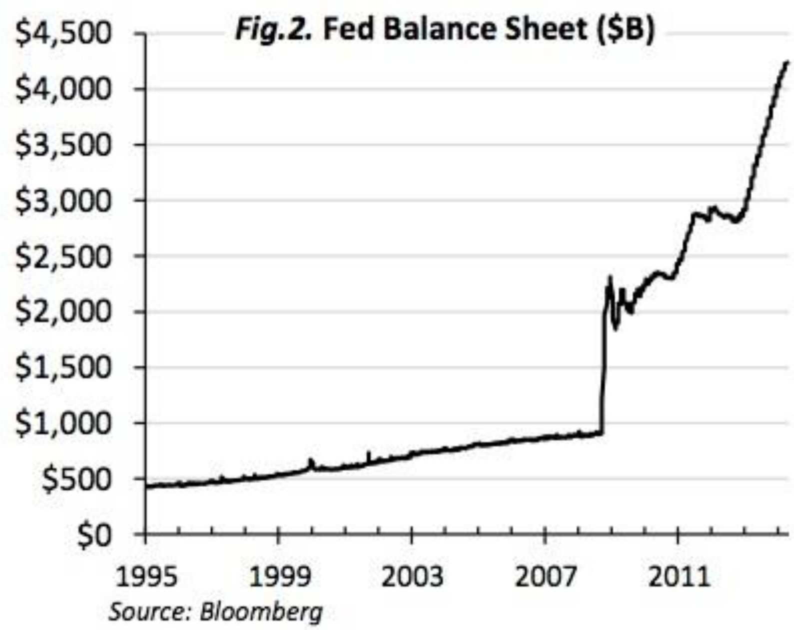
Gold prices over-discounted the growth in Fed monetization (growth in base money) in 2011 and now the market is under-discounting the growth as money went into financial assets like U.S. equities.

A weakening stock market may reverse these trends.

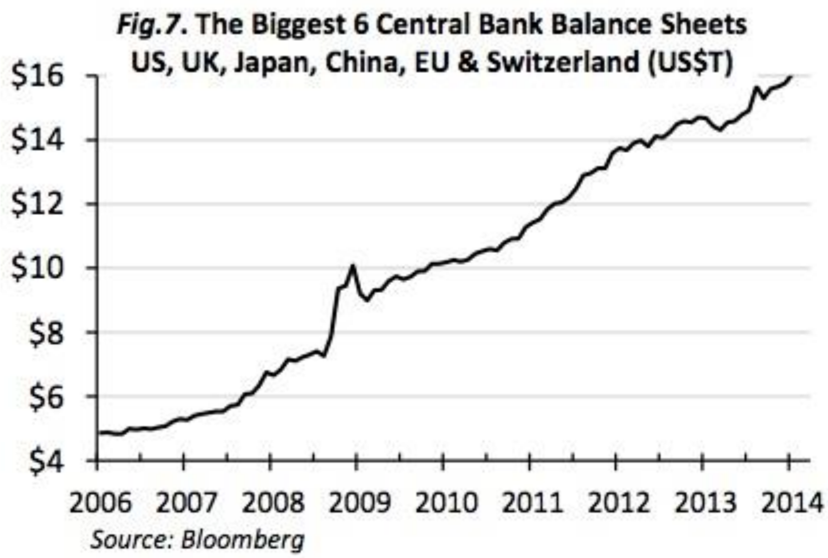




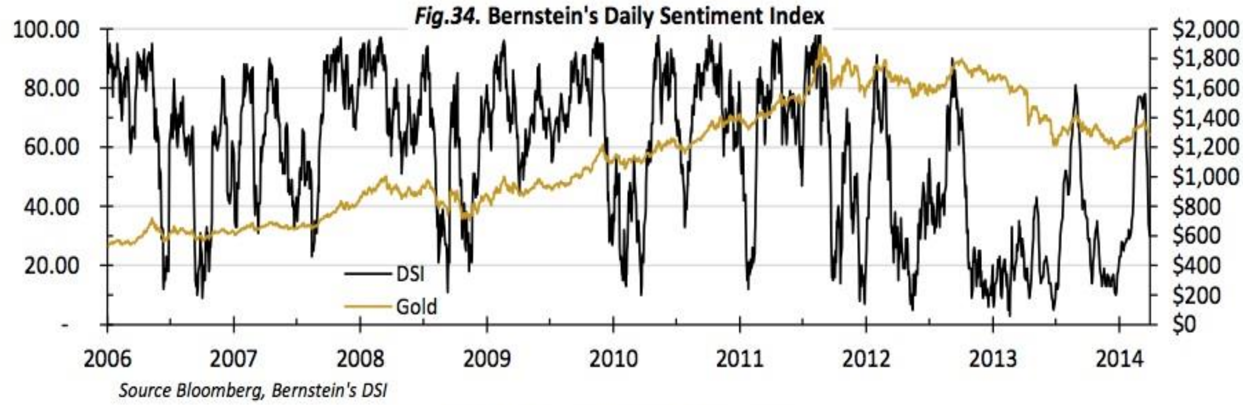
This recent trend can't continue without snuffing out real economic growth.

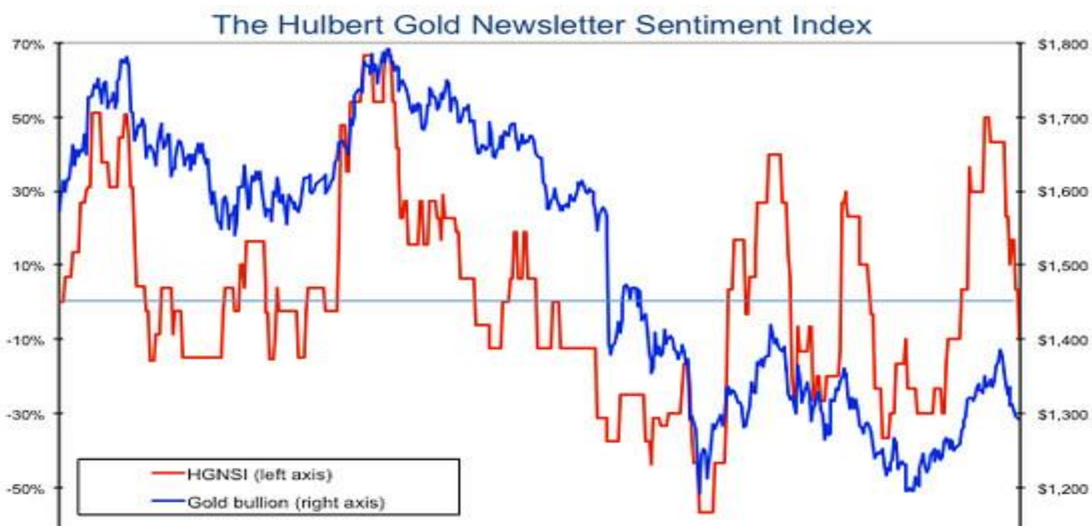


Governments are relentlessly monetizing their debt to off-set the deflationary forces of high debt levels.



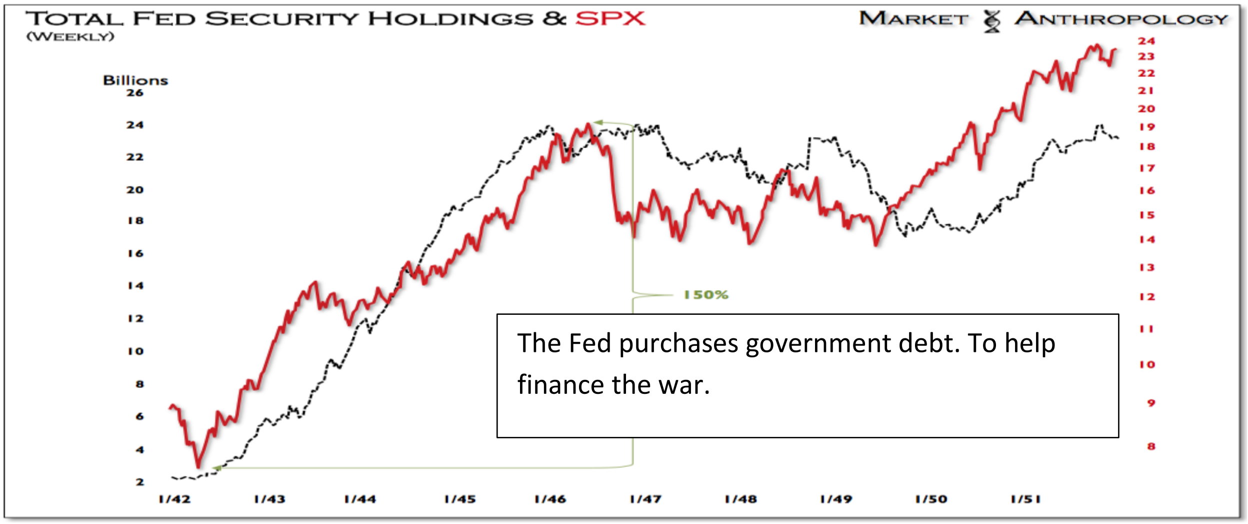
Gold stocks are cheap compared to gold. Only two other times in history—2001 and 1939 have they been as close to being as cheap.

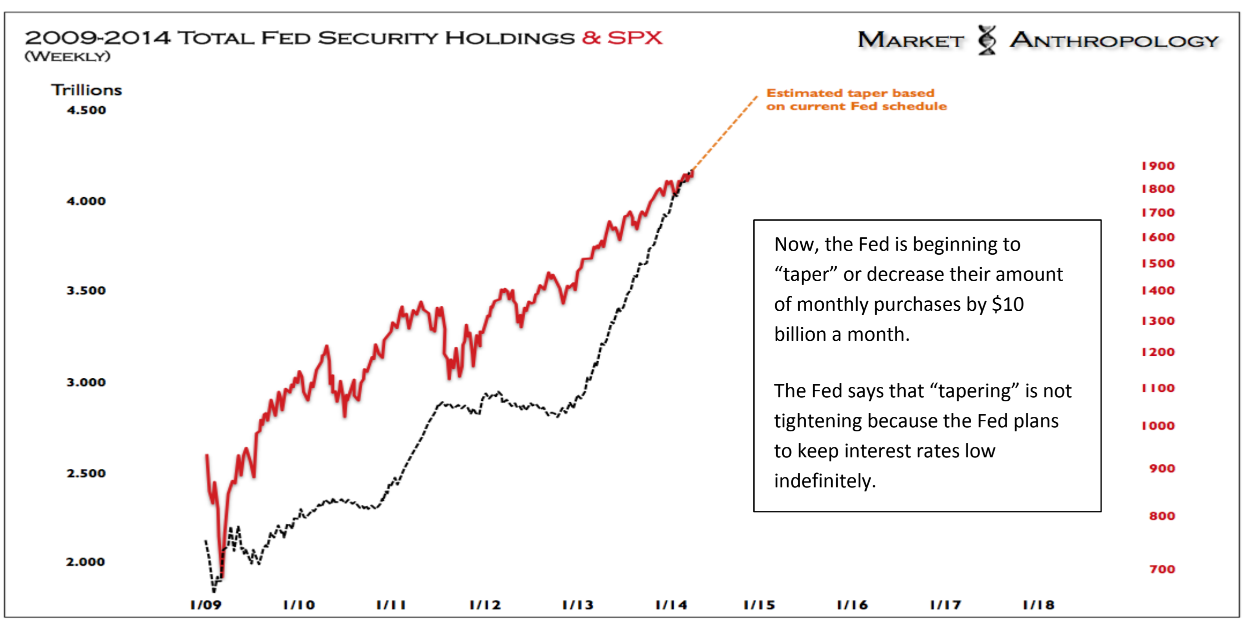


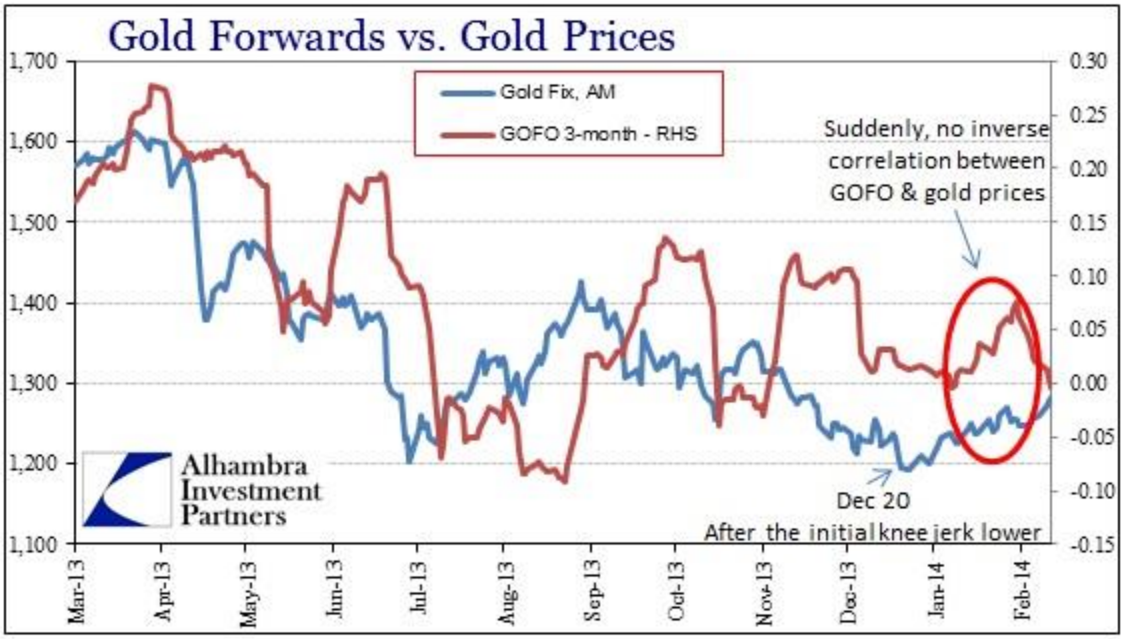


Investor sentiment remains low so there is currently low speculative risk in gold. But for prices to rise above their current $1,400 to $1,200 range, Western investors will have to return to the market. Perhaps investors will return once they realize that the Federal Reserve can't continue to taper without the whole edifice of speculative credit collapsing.

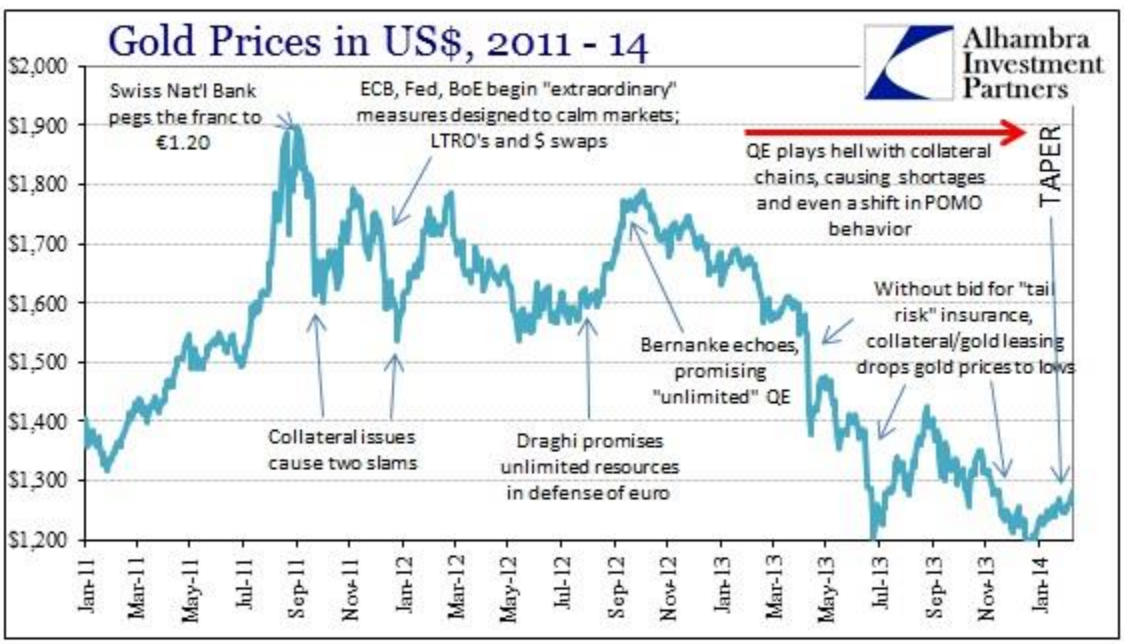
There has been a 90% correlation between the growth of the Fed's assets from quantitative easing and the surge in the S&P 500 since the bull market began in 2009. Actually, the market is repeating what the Federal Reserve did in the 1940s.   The Fed held interest rates artificially low to help the government finance its WWII debt. Note next page





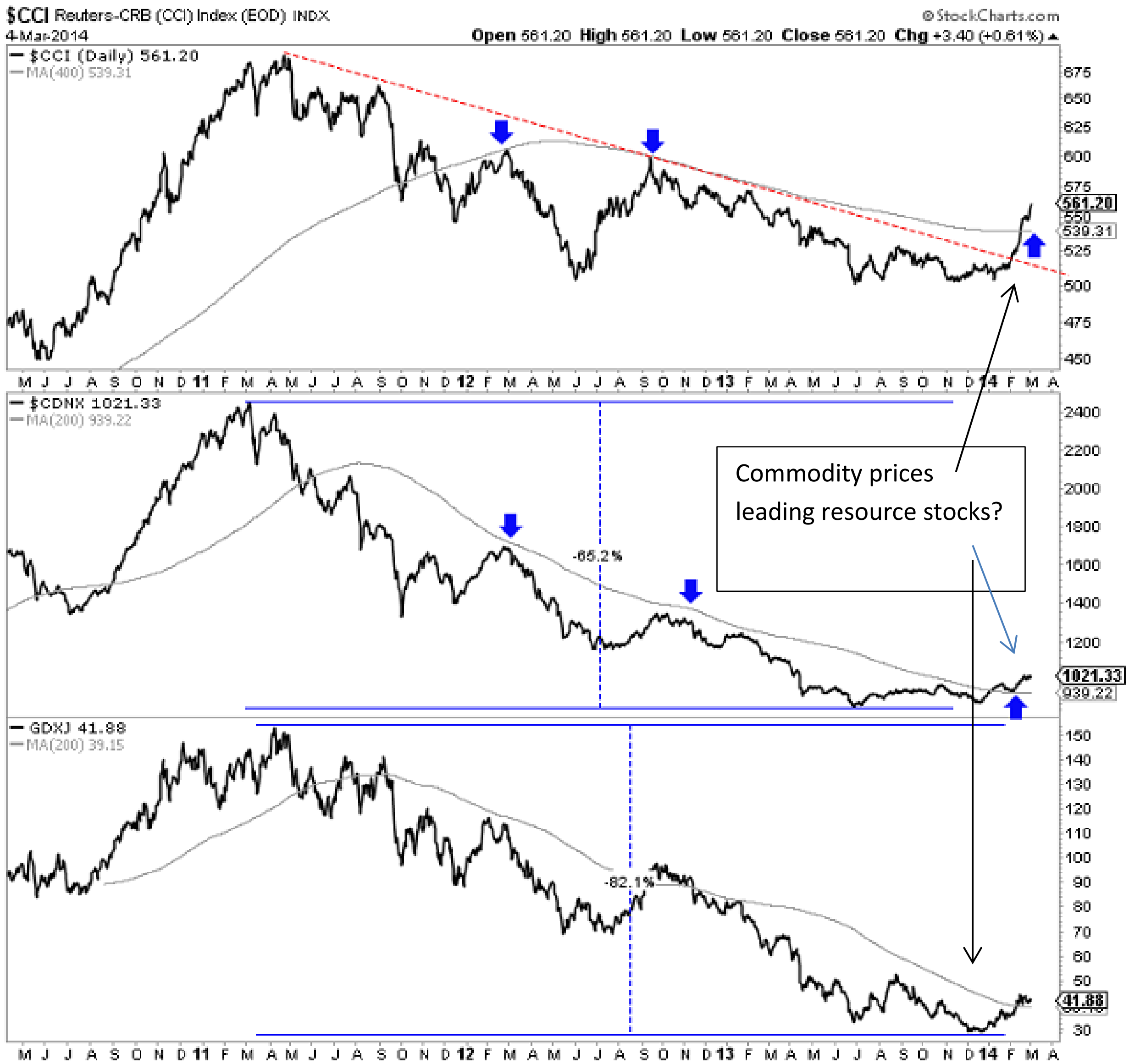


GOFO rates are the lease rates for gold. When investors would rather hold gold than cash then investors must pay a premium to swap gold for cash. It indicates stress in the paper gold market.

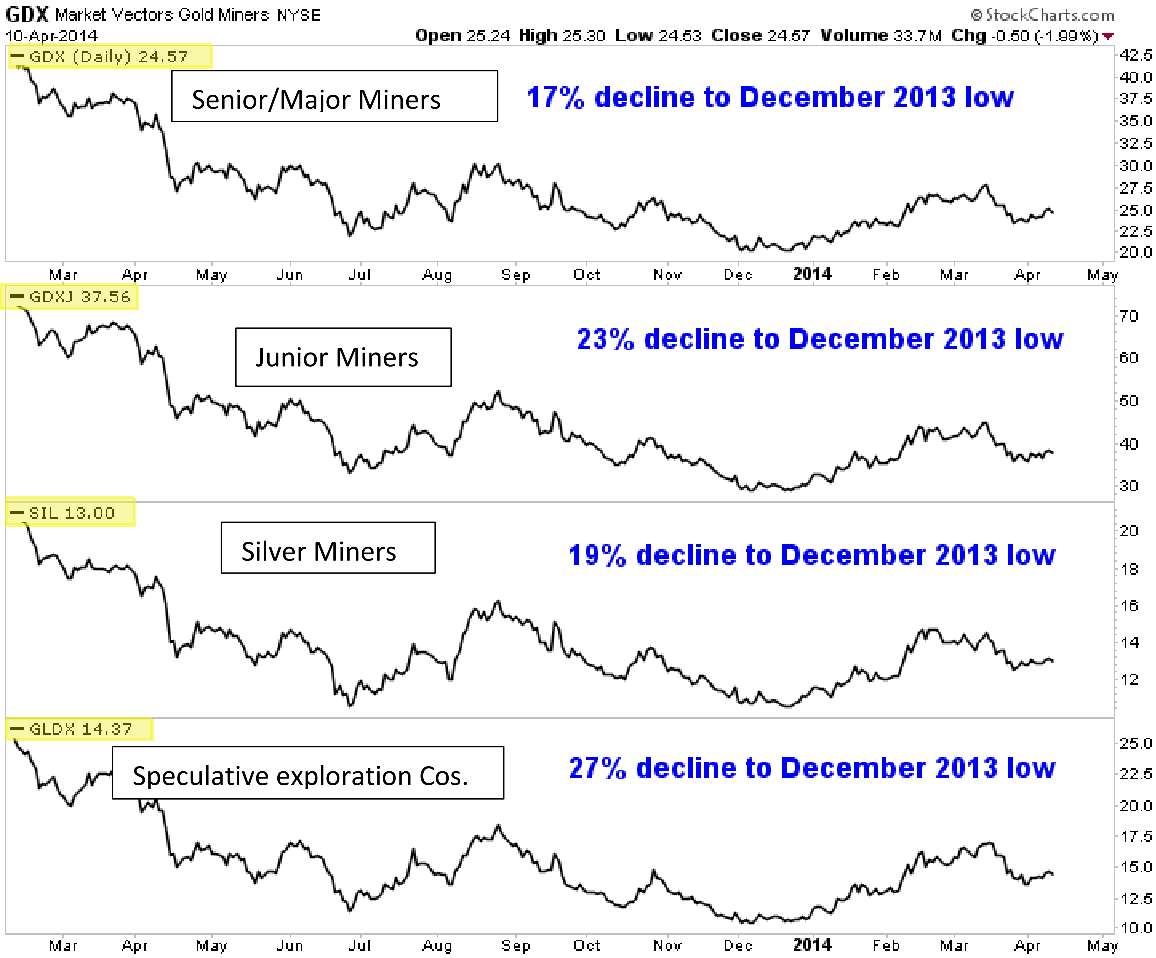


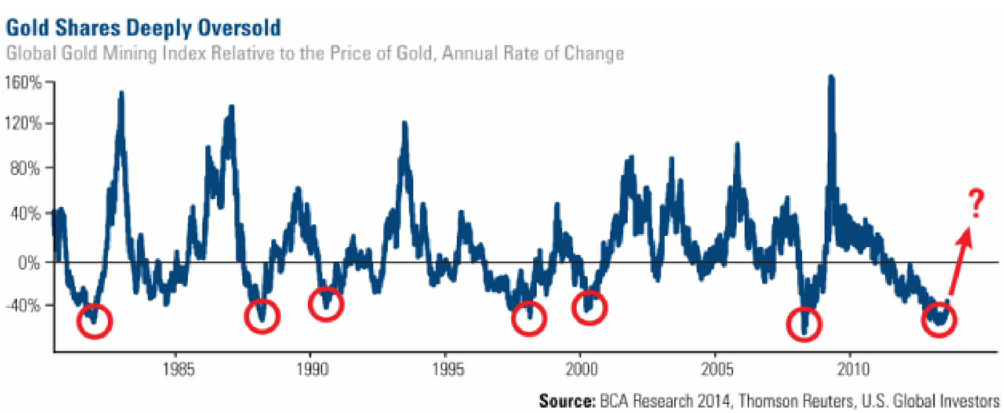
The decline in Gold ETF holdings indicates a decline in floating supply of gold bullion. Since Western (U.S.) investors and institutions sold their gold while Eastern investors like China took delivery and took the gold bullion to the East. That supply is likely to remain in China, so there is less bullion available at today's prices.

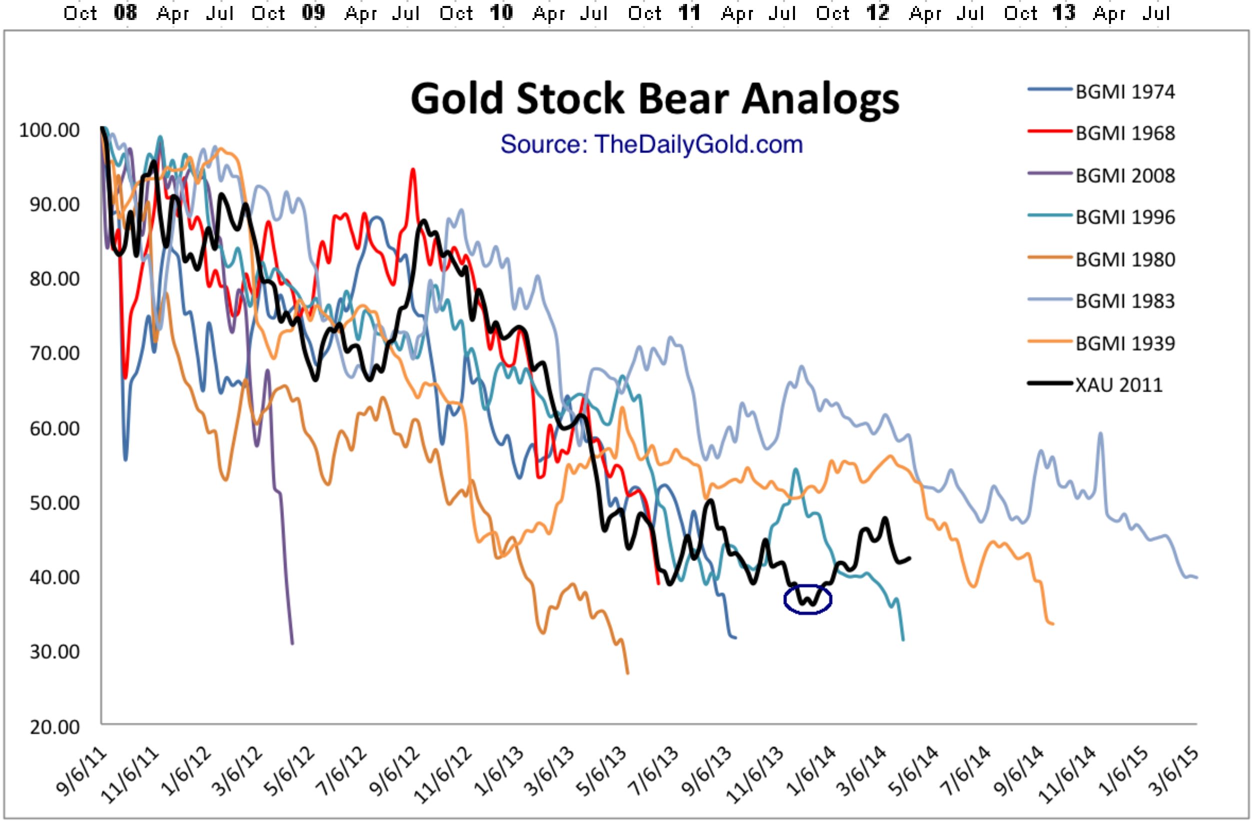
Even though other countries like China and Japan are aggressively printing, the dollar shows little signs of strength. A weak dollar may indicate higher commodity prices and gold prices.


$CCI Reuters-CRB (CCI) Index (EOD) INDX
©StockCharts.com
4-Mar-2014
Open 561.20 High 561.20 Low 561.20 Close 561.20 Chg +3.40 (+0.61%)
$CCI (Daily) 561.20
MA(400) 539.31
$CDNX 1021.33
MA(200) 939.22
-65.2%
GDXJ 41.88
MA(200) 39.15
-82.1%
Commodity prices leading resource stocks?

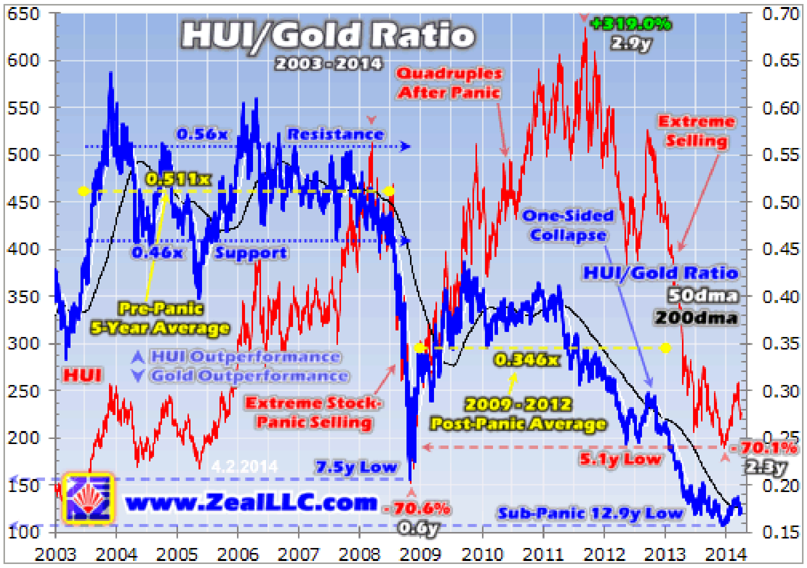
13 month charts of bottoming miners (indices)







The black line indicates the current market for miners compare to the worst bear market in the past 100 years. The worst market, 1980, was couple with huge hikes in real interest rates by Paul Volker, Fed Chairman. Today we have negative real rates and an accommodative Federal Reserve Policy.



The HUI is an index of mining shares.

The chart on the left compares miners to gold prices.

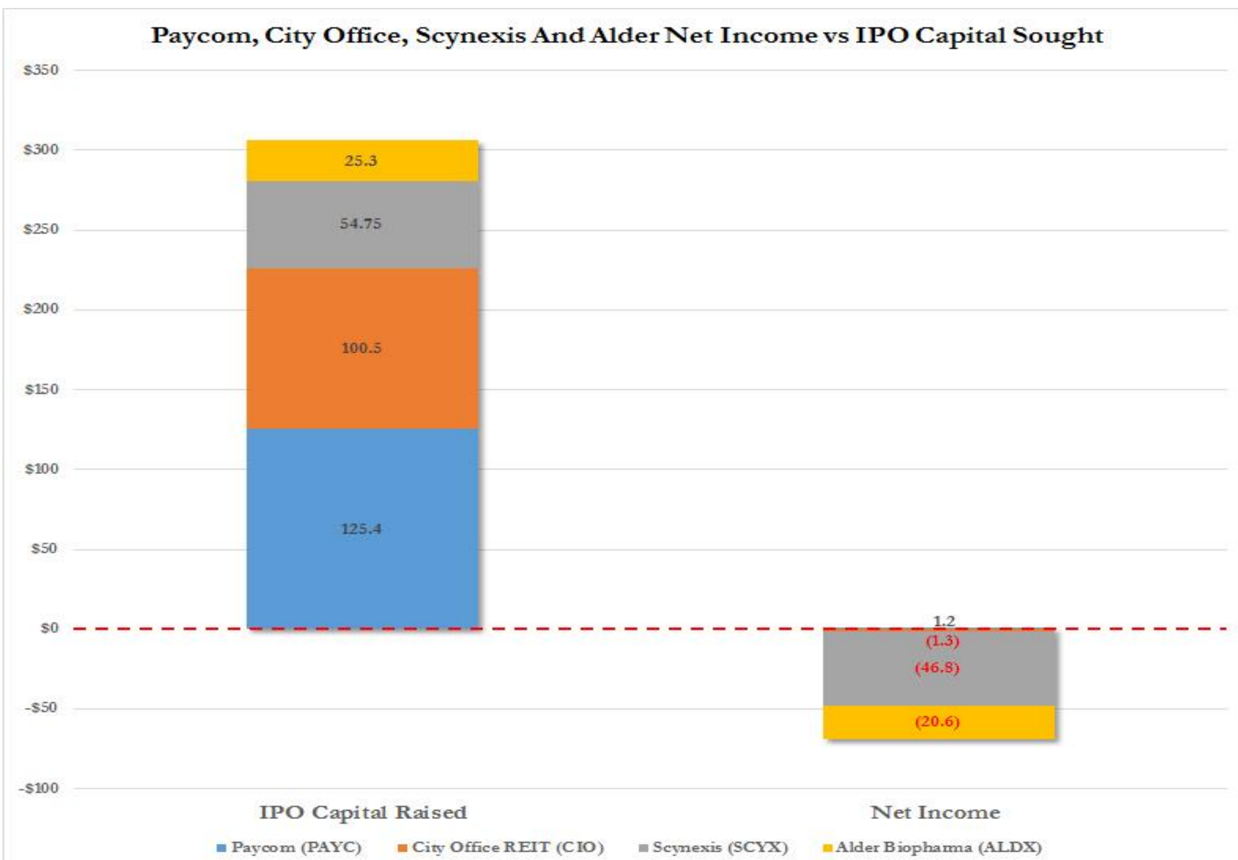
Comparison of Gold to various Asset Classes

http://shortsideoflong.com/2014/04/golds-short-vs-long-term-view/

Investors are beginning to sense the risk in the stock market

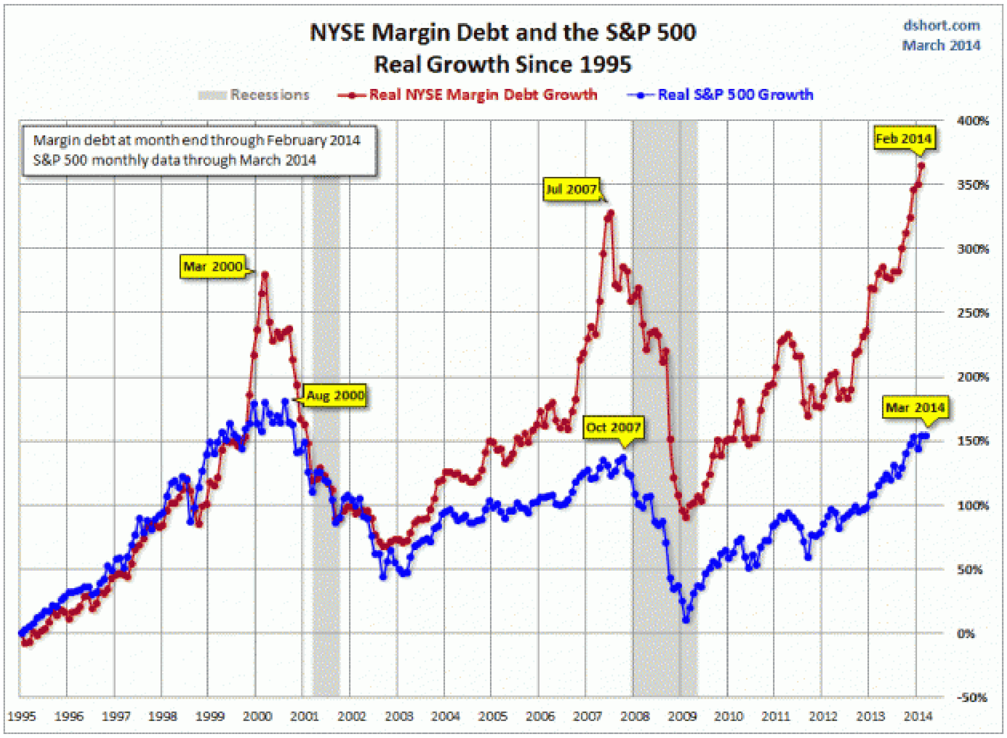
Some speculative stocks are extremely high-priced based on history.

Recent IPOS seem to be of low-quality, a harbinger of high risk in stocks.

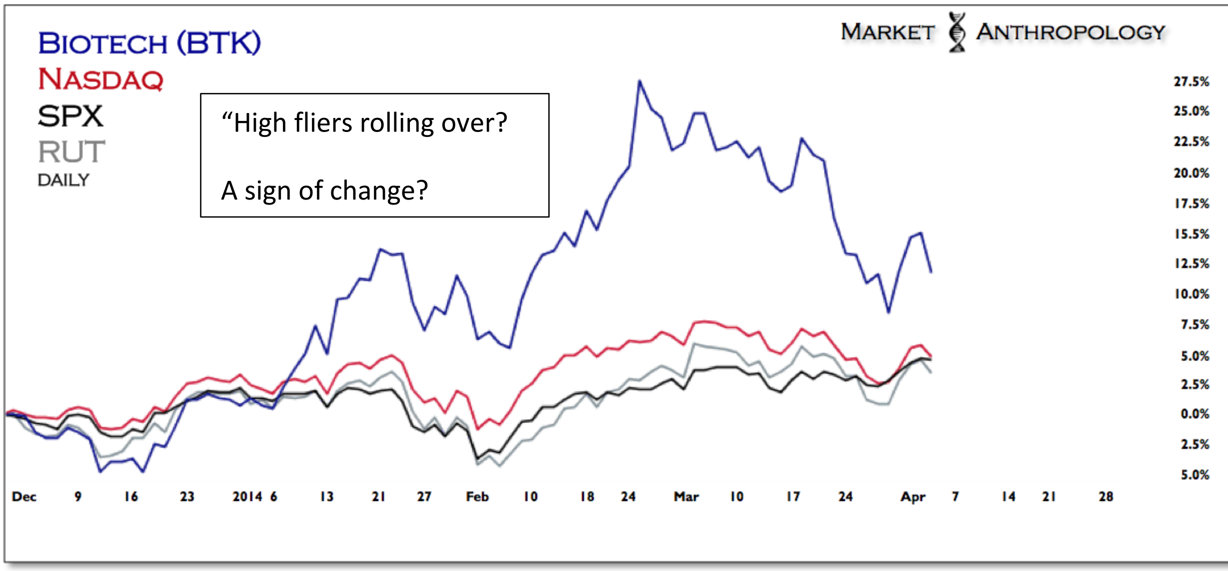


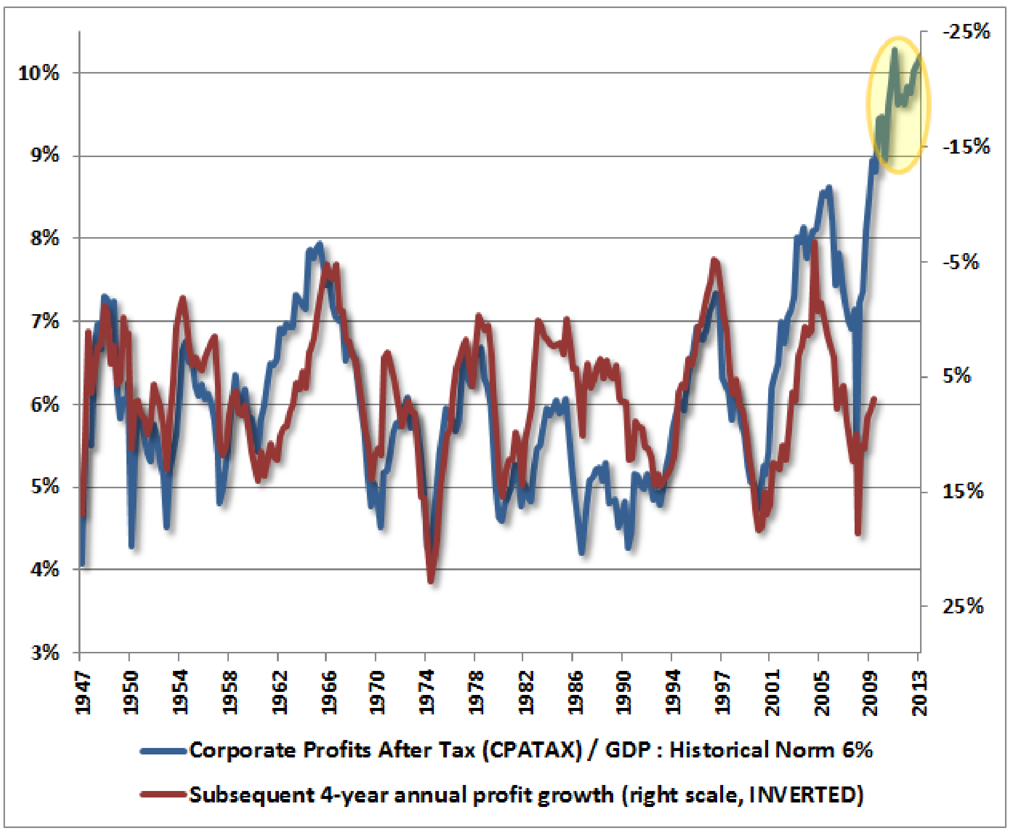
Caught: http://www.caseyresearch.com/articles/listening-to-the-canary

No inflation? http://www.economicpolicyjournal.com/2014/04/the-there-is-no-inflation-report-beef.htmlfs



Increasing margin debt can be bullish for stocks until the trend reverses. High margin debt increases the risk of permanent capital loss for investors.

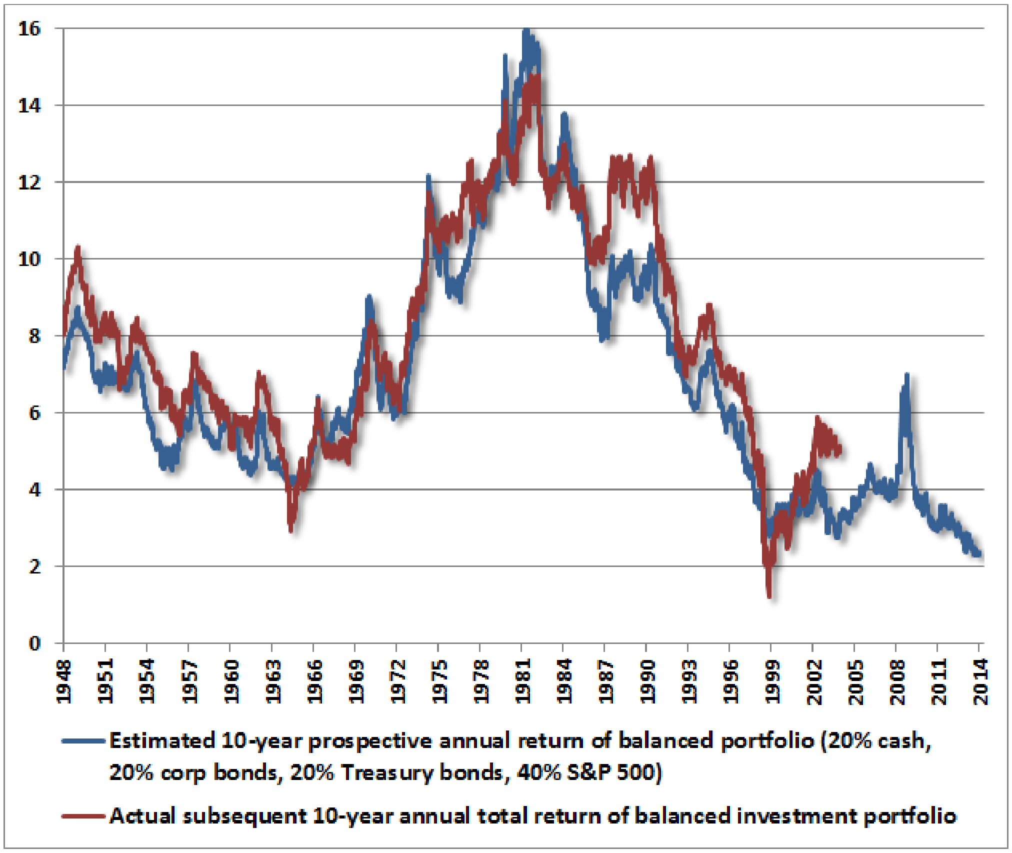


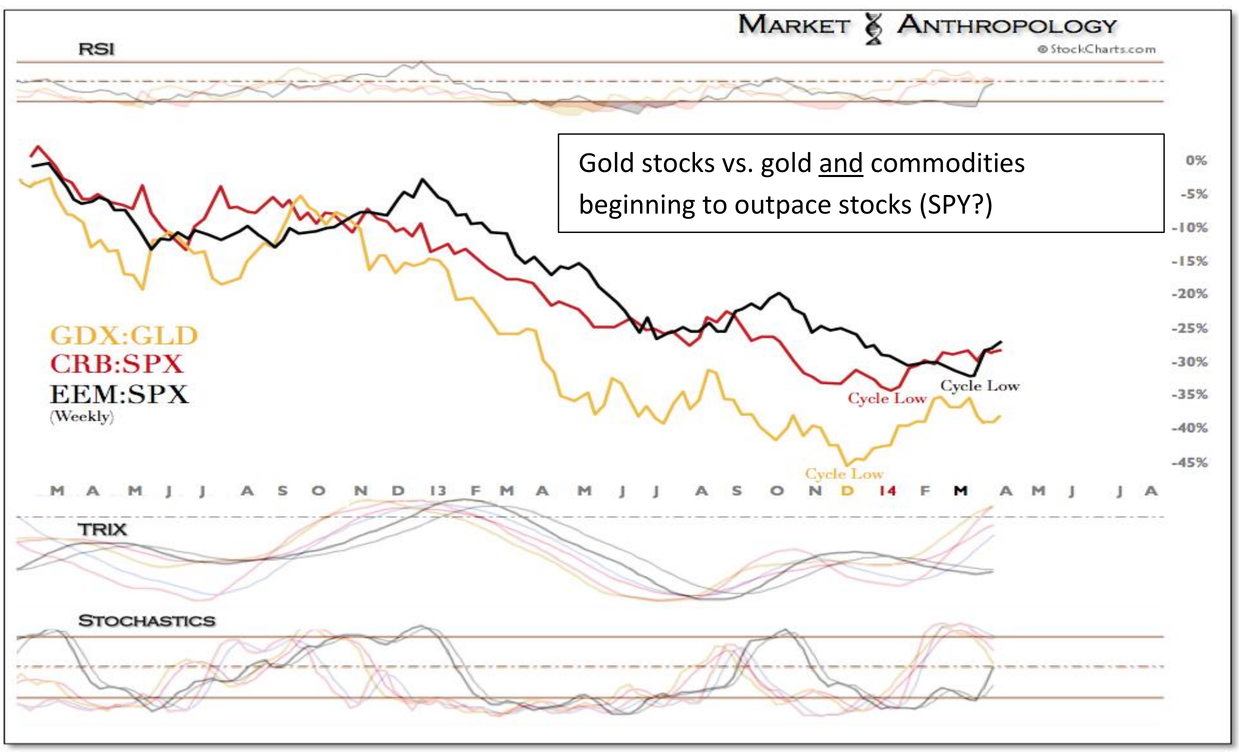


High profits margins are being driven by deficit government spending and ultra-low interest rates. Sustainable? I doubt it.

High profits margins combined with high earnings ratios may indicate low FUTURE returns in the stock market.

See www.hussmanfunds.com





RISKS

So what are our risks?

Right below. Mining is a difficult, capital intensive commodity business. Thus we are diversified in more than 20 companies with a bias towards those with experienced management, low costs and well-capitalized balance sheets. However, we do have a few high cost miners that can substantially rise on higher gold prices. Most of our companies are not dependent upon higher gold prices.

END:

Thank you and please call 203-622-1422 or email: aldridge56@aol.com with any questions or comments.