November 20, 2005

November 2005 Market Update

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Economic Overview:
If you look at the Dow, Nasdaq and S&P 500, you'd think the economy is roaring, inflation was tame and interest rates were falling. Meanwhile back in the real world, our paychecks are being eaten up by inflation, several big name companies are in bankruptcy and wage growth is waning. Rising interest rates are now taking a bite out of the real estate market with several big markets beginning to experience price declines. The real estate market is about the only reason the economy isn't in a deep recession. Home owners have been using their places as cash machines. Rack up credit card debt. Refinance the house, payoff the credit card balances with mortgage debt, and then repeat the process later. With the 30 year mortgage rate over 6% on its way to 7%, how many home owners do you think will want to refinance? One article I read stated some $360 Billion in consumer spending is due to refinancing.

I have been a bear on the general markets for the last couple of years. All of the ingredients are there for stocks to be much lower than they are now. One thing I have not counted on is an "invisible hand" intervening in the markets to keep them propped up. Since 1920, there have been only 6 years where the Dow has not had a single 2% down day in a year. Guess what? Since May 2003, the Dow has not had a single 2% down day (200 point loss or higher). Intervention in the last couple of months has been almost comical. The Dow drops during the day and is some 160 points down, then in the last 20 minutes of trading it magically rallies to finish down 60 points. I have seen this repeated many times this year.

Our government says inflation the past year was 4.7%. They also say housing prices are on average going up 4% per year when everyone knows most markets are in the double digits. The government performs all sorts of statistical gimmicks to make inflation look tame. In some circles, the Consumer Price Index (CPI) is known as the Constant Price Index. High inflation is why I think our national savings rate is negative, which is the first time since they started measuring them in 1959.

There is a bull market in nearly all commodities with oil being the most notable (and painful for the consumer). The last time commodities were on fire was in the 1970's. Back then, we had a war without end, escalating inflation, increased budget deficits and a weak dollar. Today we have everything mentioned except the weak dollar. Our trade deficit is running over $700 Billion per year and the Fed is about to stop raising interest rates. The dollar will be road pizza next year.

I now believe we won't see a big drop in the general markets. The invisible hand will not allow them to fall particularly when the party in power has an unpopular leader and elections are coming in November. TV pundits will be absolutely dismayed with an economy in the gutter yet indifferent/roaring markets. This

year the lowest the invisible hand would allow the Dow to come down is to the 10,200 level. Every time it has hit that level, the Dow suddenly rallies. If the Dow stays under 10,000 for more than a month or the Dow loses more than 400 points in a single day, that will be the signal the jig is up and the markets are going to get slaughtered.

Like the 70's, commodities are the area that thrives in the economic environment we find ourselves. Many commodities have taken off in the last couple of years. Copper has gone from 75 cents to over $2.00 today in the last three years. Oil was $12/barrel four years ago and just a few months ago hit $70/barrel. This is a theme that has played over and over with some spectacular gains in metals like Indium, which was $18/lb four years ago and has recently hit $1200/lb. Gold and silver have had some healthy gains but not as much as their peer group. Both have now broken out in all currencies. It used to be gold and silver would only go up as the dollar went down. Now they are going up by themselves as investors are diversifying away from paper assets world wide. Gold just hit an 18 year high last week and should print over $500 by the end of the year.

Gold is the nemesis of Central Banks and they do not want investment interest in it. This makes the gold and silver mining sector volatile with wild swings, particularly with abrupt sell offs. Gold stocks for the last two years have sold off in December. The gold and silver mining index, the HUI, is at 245. If it can't break and close over 260, it is likely there will be a sell off this year in December. There are signs this trend may be broken, but I am cautious. Always remember to buy gold stocks on weakness.

Stock Recommendations:
The majority of the stocks I follow are primarily miners. I have spent the last two years in this sector and have learned much more about the markets than any other. The mining sector is not on the radar screens of market participants and it is times like these you want to buy. Once mining (of gold, silver, copper etc.) become household names, then it's time to sell. Here are my top picks:

1) **Goldcorp (GG)**: Goldcorp took over Wheaton River last April, but Wheaton's brilliant CEO is running the show at Goldcorp. Copper prices being so high have now made GG's cash cost to produce and ounce of gold to be negative. Most miners cash cost is between $200 - $350 per ounce. GG applies copper revenue towards their costs and is why they are negative. GG offers the best value of any miner and the stock is undervalued compared to its peers (P/E of 22 vs. 40+).

   Goldcorp is going to buy approximately 1 million ounces of gold production for $1.3 Billion. This will make GG a 2.1 million ounce producer next year. The additional 1 million ounces will cause their cash costs to go up to an average of $100/oz. Assuming gold averages $500/oz in 2006, GG's yearly earnings will be around $500 million or roughly $1.40/share. With a

peer average P/E of 40, GG could see a share price of $56 this time next year versus the $20 it trades today. This stock is my main holding and it should be yours as well.

2) **Glamis Gold (GLG)**: Glamis is well liked by the market. It has a P/E of an internet stock. There is a reason for the high value given to them. They have several mines that are beginning to produce. GLG will produce 425,000 ounces of gold this year and then over 650,000 ounces in 2006. They have low cash costs of around $230/oz. The large growth in production will bring in massive profits. GLG trades at $22/share today but it could easily double next year. GLG moves very well with increasing gold price. I'd recommend it as a good tradable stock.

3) **Yamana Gold (AUY)**: Yamana is rapidly growing gold production and could be the next Glamis (with a high P/E). Yamana was able to earn $3 million with only 31,000 ounces of gold sold in the third quarter. They have no debt and some $170 million dollars cash. 2006 production is slated for 260,000 ounces at a cash cost of under $280/oz. Production for 2005 is going to be about 125,000. Yamana trades around $4.50 today and has the potential of being over $10 next year. I like this stock and will be adding on price weakness.

4) **Silver Wheaton (SLW)**: Silver Wheaton is the brain child of Goldcorp's CEO, Ian Telfer. Silver Wheaton buys 10 million ounces of silver from two mines at a fixed cost of $3.90/oz. They then sell it at the spot silver price (today at $8.03). Their transactions are done in the Cayman Islands and thus there have virtually no income tax. Silver miners get much higher P/E's than gold producers. Each $1 rise in silver translates to $10 million in profit making SLW about the most highly leveraged silver miner in the world. It appears the tight supply of silver will push silver's price over $10 in the next six months. Silver Wheaton is a must have for your portfolio.

5) **Randgold Resources (GOLD)**: This is a miner I once held in 2003 and now I like a lot. GOLD is producing 270,000 ounces of gold at a cash cost of under $160/oz. in 2005 and will be producing 470,000 in 2006 due to a new mine starting up this month. Through nine months, GOLD has earned $0.44/share and should do $0.60/share this year. Next year they should be well over $1.00 EPS. Trading under $16, this stock is a steal and I will be adding on price dips. This is one stock that could easily be over $30 next year.

6) **Northgate Minerals (NXG)**: Northgate has had a rough go of it over the last 6 quarters. They have finished mining low grade ore and now for the next three years will be mining high grades. They will be a 320,000 gold ounces producer next year and are presently cash cost negative. Their stock is way, way undervalued and is an excellent candidate for buy and

hold. I own 10,000 shares in my retirement fund. It trades at $1.44 and could easily double next year. This stock may be the most undervalued of all my picks.

7) **Chesapeake Energy (CHK)**: Chesapeake is a solid stock for those who want exposure to oil and natural gas. Oil makes its lows during late November to early December time frame. CHK hit a high of $40 this year but due to the softness of the price of oil, it presently trades under $29. I rate this stock a screaming buy under $26 around its 200 day moving average.

Final Thoughts:
Contrarian investing is quite difficult where you buy when no one is buying and sell when the herd piles in. We could very well be at the base of a very large move in commodity stocks (Oil, Gas and Metals) as market participants realize there is no basis for the lofty stock prices of the general market.

Happy Trading,
Toby