November 5, 2006

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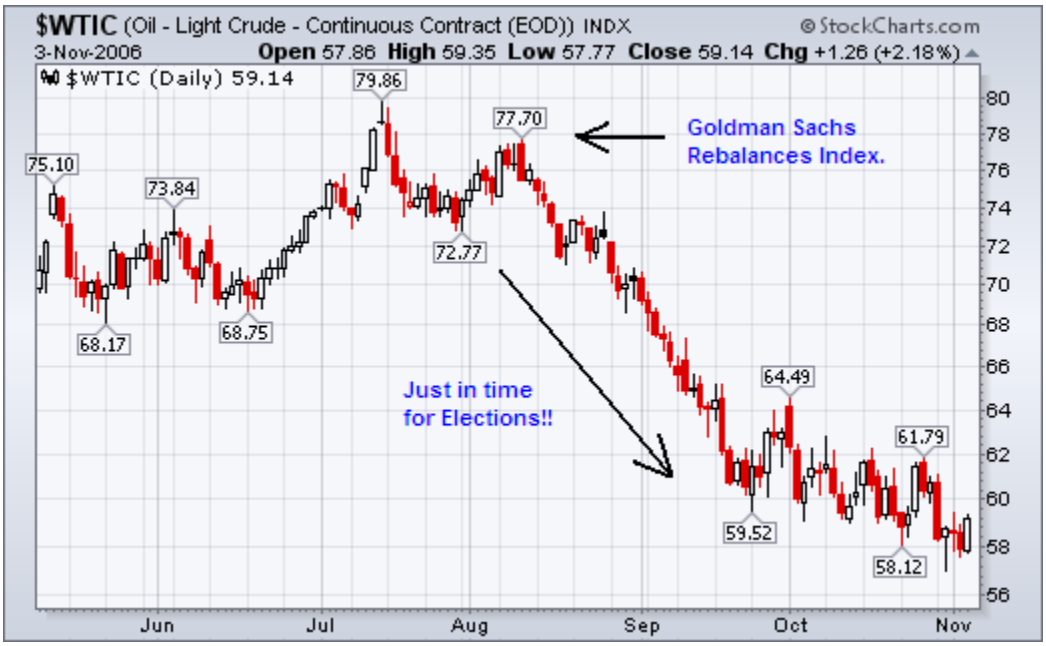
Smoke, Mirrors and the US Economy:
Our investments are about the same place as they were my last update in July. I had felt the government would try to put a smiley face on the economy before the elections, but I did not realize how much effort would be put into meeting that goal. It is common knowledge politician approval ratings are indirectly tied to the price of gasoline. When gas goes up, ratings go down and vice versa. All of you noticed at the pump in late August gas was close to $3.00/gallon and by the time late September arrived gas dropped to the low $2.00 range. Many Americans suspected the government may have had a hand in the rapid drop. I'll go into how their suspicions may have been executed.

Our present Treasury Secretary Paulson is a former Goldman Sach's CEO. Goldman Sachs (GS) is a major market player in nearly all areas. GS has a commodity index fund. Index funds are a way to monitor and/or invest in a basket of items. The GS commodity index has weightings in oil, gas, gold, copper etc. What a big hedge or mutual fund will do is buy all of the commodities in the index per their weighting percentage of the Index. About $100 Billion is tied to the GS commodity index, which is a considerable amount of money. About 8.7% of the GS Index was tied to gasoline futures leading up to July. GS re-adjusted the Index weighting of gasoline futures to 2.6% in July and the change went into effect in August. Now before the change $8.7 Billion was invested in gasoline futures contracts and had to be reduced to $2.6 Billion. Starting in July and lasting through September, over $5 Billion of gasoline contracts were dumped on the market. Consequently, gasoline dropped dramatically. Here's a chart of Crude Oil Futures:



No big financial house will openly admit to government intervention into the markets as they do not want to be labeled as conspiracy nuts. One big Oil and Gas investment group, Raymond James, recently published an article noting the "mysterious adjustment" of the commodity index and its timing. Others have noted there may have been a huge amount of diesel fuel dumped on the market by the US Military over August and September. I will leave it to you to ponder the possibility of "an invisible hand" in the energy market.

The Dow Jones has recently hit an all-time high. It has gone from 10,650 in July to over 12,000. What is interesting is this has occurred with the following economic and geopolitical news hitting the tape in the last six weeks:

1. Housing prices slumping the most since 1970.
2. Home delinquencies surging the most in several years.
3. Sales of existing or new homes the slowest in five years.
4. GDP slowing dramatically to 1.6%.
5. Iraq going closer to civil war.
6. North Korea testing their first nuclear device.
7. Iran accelerating their nuclear weapons program.
8. US trade deficit hitting an all-time high.
9. Wal-Mart having 0.5% same store sales growth and advising November will be flat (usual growth is 2-4%).
10. Inversion of the bond yield curve (accurate at predicting recessions).

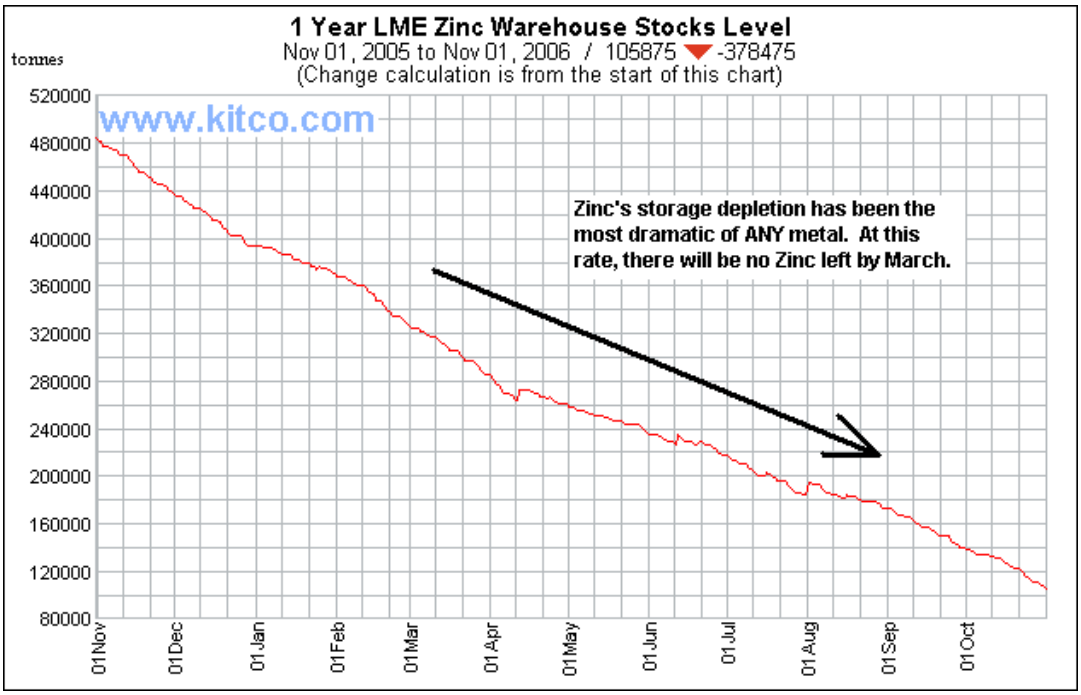
I could list several more reports all with the same conclusion: the economy is rapidly cooling and could go into a recession next year. A note on Item #4 relating to GDP: economists have found the government miscalculated auto inventories and the actual GDP should have been 0.6%. It is interesting a mistake over-estimated GDP growth by 1.3% just before the election.

Markets represent the expectation of what conditions are to be in the future. The Dow, Nasdaq and Amex exchanges are signaling an incredibly bright future. However, 9 out of every 10 economic releases are signaling a very different picture. The recent market behavior has pundits scratching their heads to justify why our markets are doing so well. In the Raymond James article I noted earlier, they said they were puzzled by the "mysterious behavior in the Dow". What they referred to is the typical movement of the Dow going markedly lower during the day and then erasing the majority of its losses in the final hour.

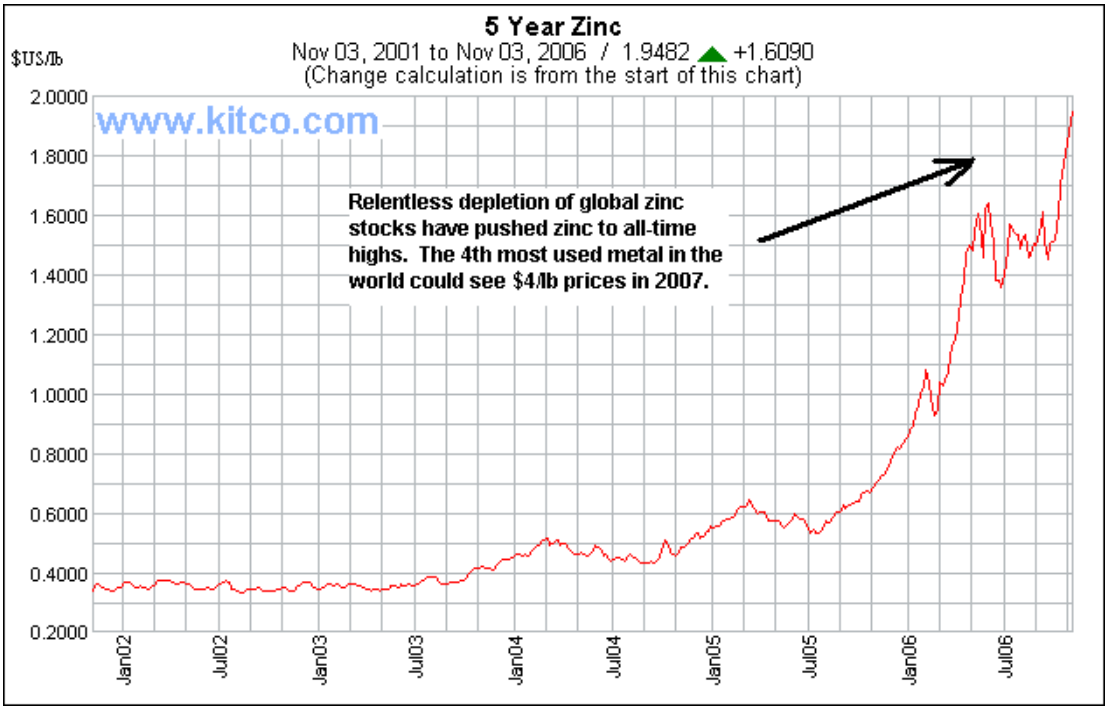
Why do I bring up the Dow now? It's because I am worried about **your** finances in the months to come. I am convinced the run in the markets is a sham to make voters believe the economy is great so they will vote their incumbent back into office. The economic numbers DO NOT justify stock valuations nor do they suggest good times are around the corner. My heartfelt recommendation is for you to sell any growth mutual fund and put it into cash, **ASAP**! If I am wrong and the economy is on the cusp of incredible prosperity, you won't lose money still make a little. If I am right, you may save yourself up to 30% in losses over the next year.

Where do we go from here?

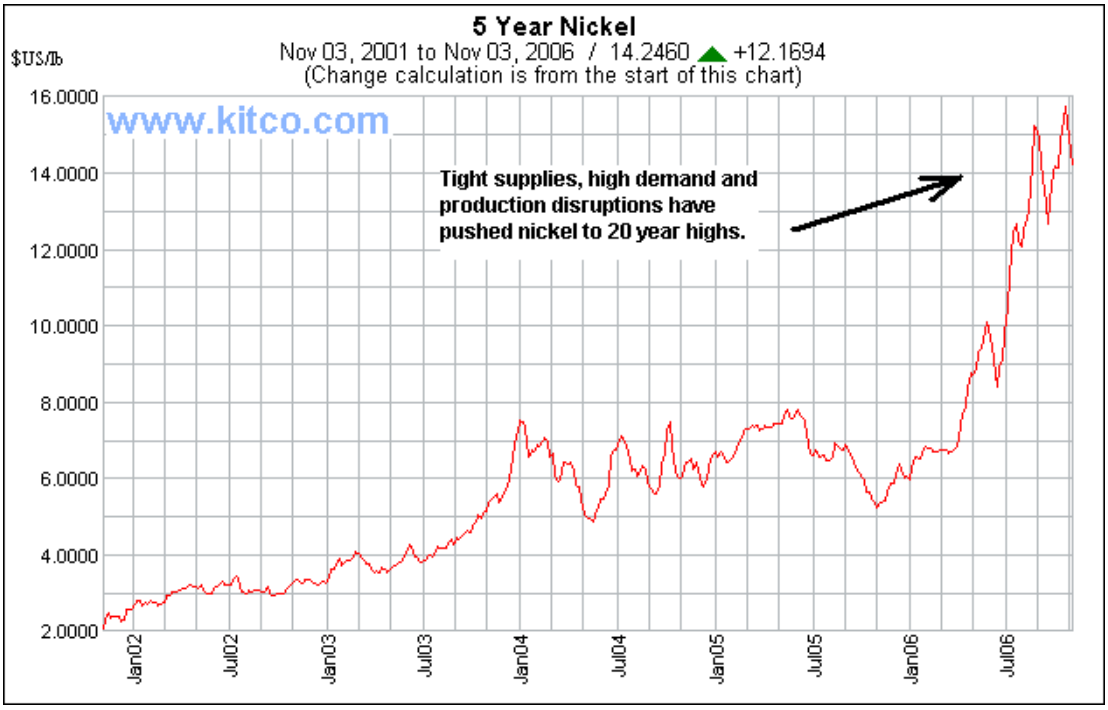
Despite all the banter about a commodity bubble last May, commodities are the hottest sector in the market and for good reason. Several metals such as Tin and Zinc have recently hit all-time highs. The reason is not due to excessive speculation; it is driven by the tried and true Law of Supply and Demand. I have in my last several Market Updates included the storage situation in Zinc. The reason is I have seen a relentless draw-down of global stocks. The chart below shows how dire the supply situation in Zinc has become.



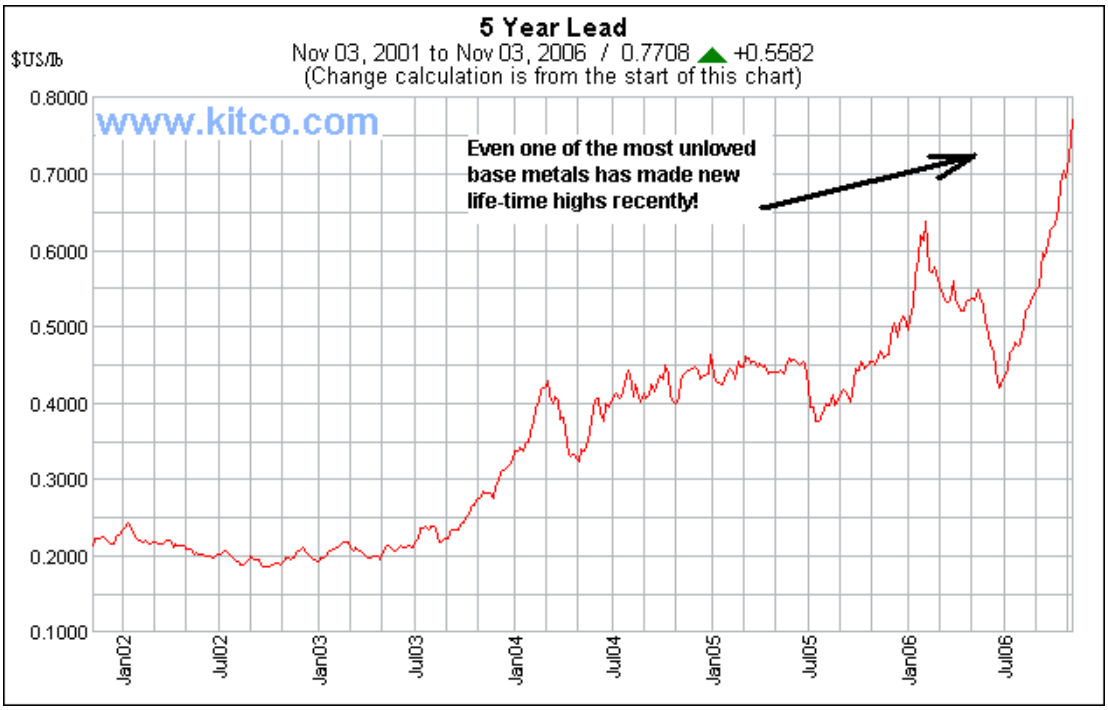
The price of Zinc is now beginning to respond after a multi-month consolidation:



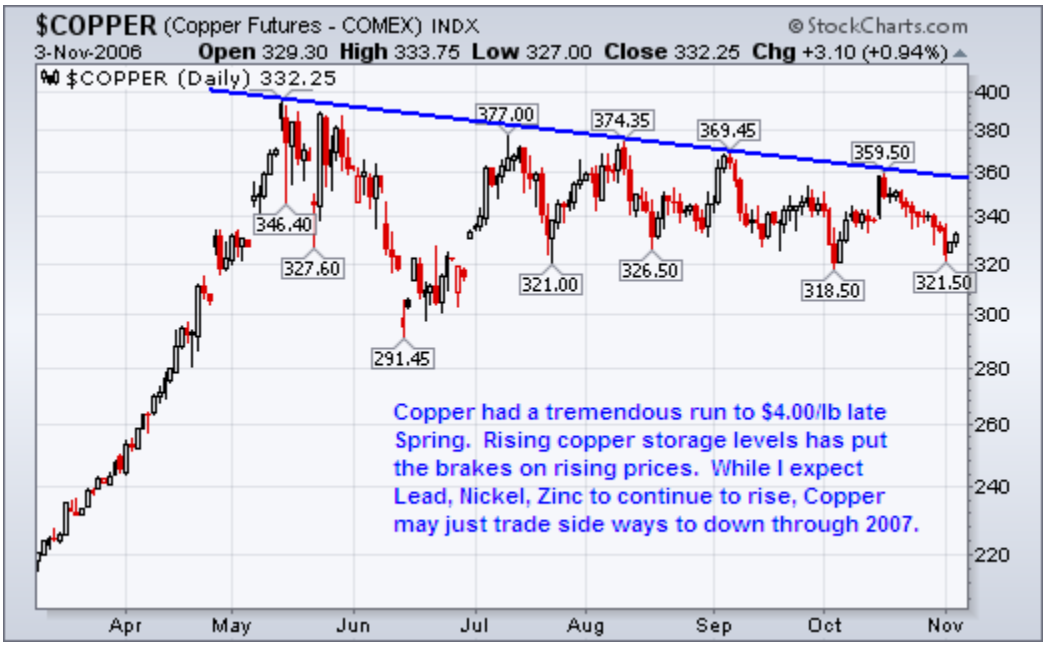
The storage depletion and rapid rise in price is not confined to Zinc. Nickel has exploded this year and the storage level of nickel is now less than a few days of world demand. Here's a price chart of nickel:



There has been a world-wide effort to eliminate the use of lead in electronic components. One would think that Lead, long recognized as being a health hazard, would not be subjected to the same conditions that have driven so many metals to their highs. Guess What? Lead hit an all-time high last week.



We witnessed earlier this year copper shooting up to record price levels. Copper is one metal that actually may not follow other metals up. Storage levels have stabilized and have been increasing for the last year.

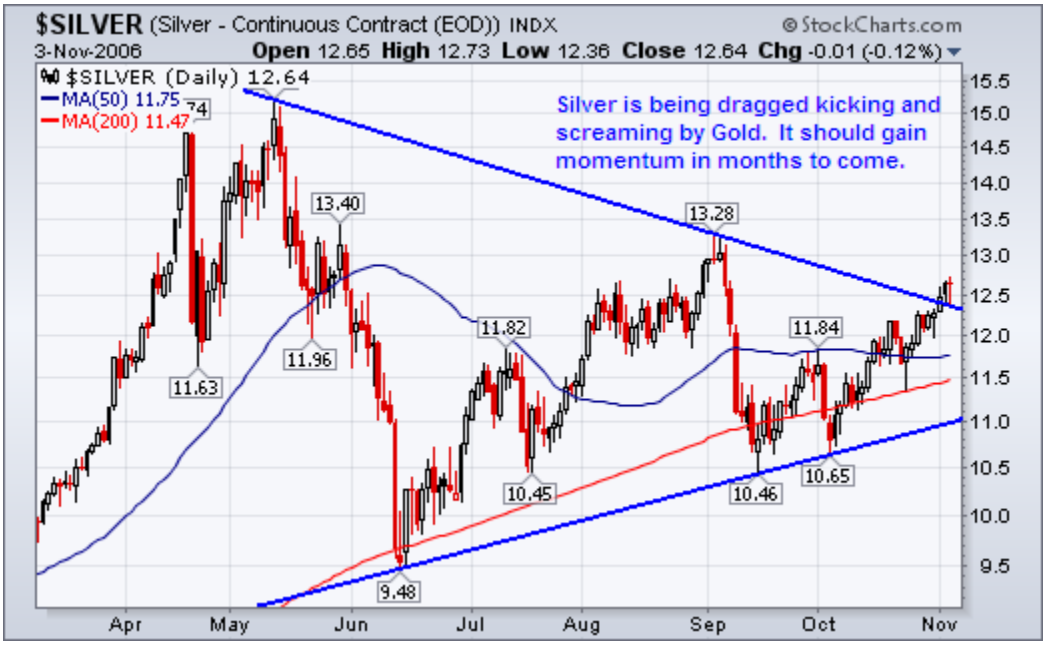


There is another influence on commodities most people are unaware affecting prices: the US dollar. All commodities are priced in the US dollars. When the dollar strengthens, commodities tend to go lower in price and do the opposite when the dollar weakens. The dollar has resisted pressure in going lower for the last several months. All of this should change once the elections are over and traders begin to focus on the economy going into a recession and the likelihood of the Fed cutting interest rates.

Here's the latest chart of the dollar:

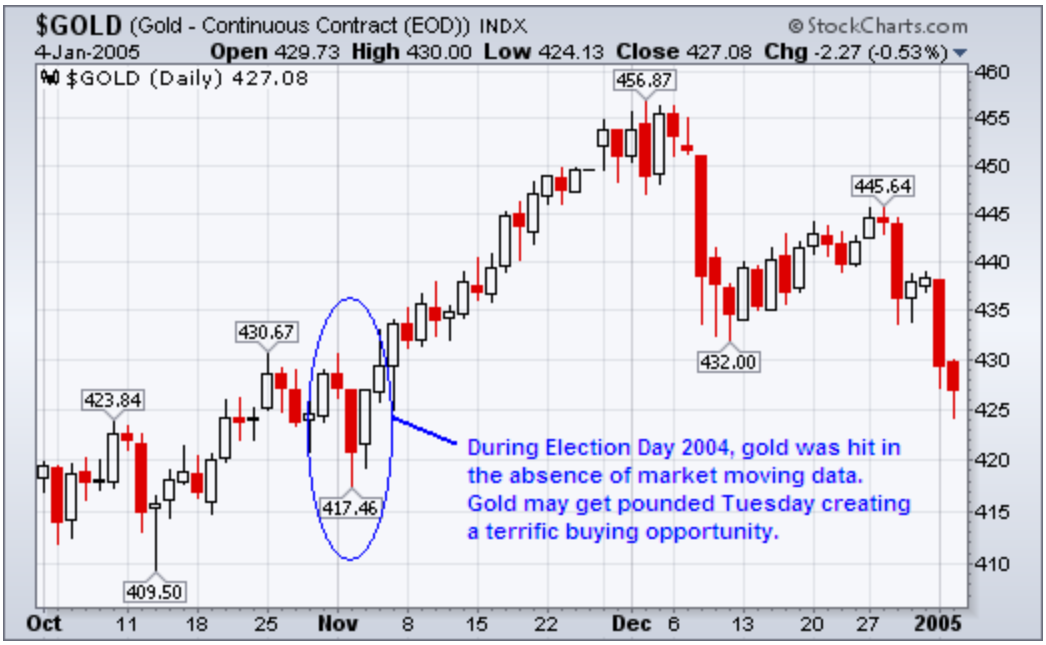
Gold and Silver have been relentlessly sold down since May. Gold broke through a major down trend line in early September. The next day the Gold Cartel went into action pushing it down over $40 in subsequent weeks. A rising gold price raises red flags about inflation, economic health and the vitality of the US dollar. The official sector simply cannot allow the age old canary sing trouble when an election approaches. Consequent to the pounding of gold, mining shares were shorted in concert. What is very peculiar is the most recent trading of gold over the last 10 days. Gold has risen the most consecutive number of days since 1986, convincingly breaking the down trend line established in May. It appears that smart money is buying gold in anticipation that the downward manipulative pressure on the metal will ease, and economic reality will begin to settle in after the elections.

The following two charts are the most recent trading of both gold and silver.



Both charts illustrate the bullish trading action in both the metals with gold leading the way. Despite the bullish behavior of the last two weeks, I believe both metals will be hit tomorrow and Election Day. Why? Perhaps it is paranoid delusions or wishful thinking to buy mining shares on the cheap? Actually it comes from viewing the history of gold and the gold mining index (HUI) in the last major election cycle. The official sector, as I believe, has gone to great lengths over the last several months to paint a rosy economic picture prior to the

elections. I expect one last hurrah to bolster “don’t worry, be happy sentiment”. The following two charts illustrate the gold and mining share index at the last major election cycle in late 2004.



I remember the last election cycle well. Out of the blue gold and the shares were hit the day before and day of the election. There was no economic data nor any early election results to influence either gold or mining shares. Gold trading

closes at 1:30 PM EST and stock trading closes at 4 PM EST. I expect (and actually hope) the shares will get bopped so I can buy some blue light specials.

My last chart is of the HUI Index. As you can see below, the Index has done well in the last month but has not followed gold up as strongly as it should. I believe mining stocks are climbing a wall of worry after the shellacking they have taken off and on since May. Once the Index can close over the down-trend line formed since May, the measured move is over 120 points higher.

Stock Recommendations:
I am modifying the way I'm recommending stocks. Stocks will be listed in three sections: Prime Picks, High Growth and Moderate Growth Stocks. My investment philosophy is to buy stocks I believe will double in a year. The first two categories will have more information presented than the last category.

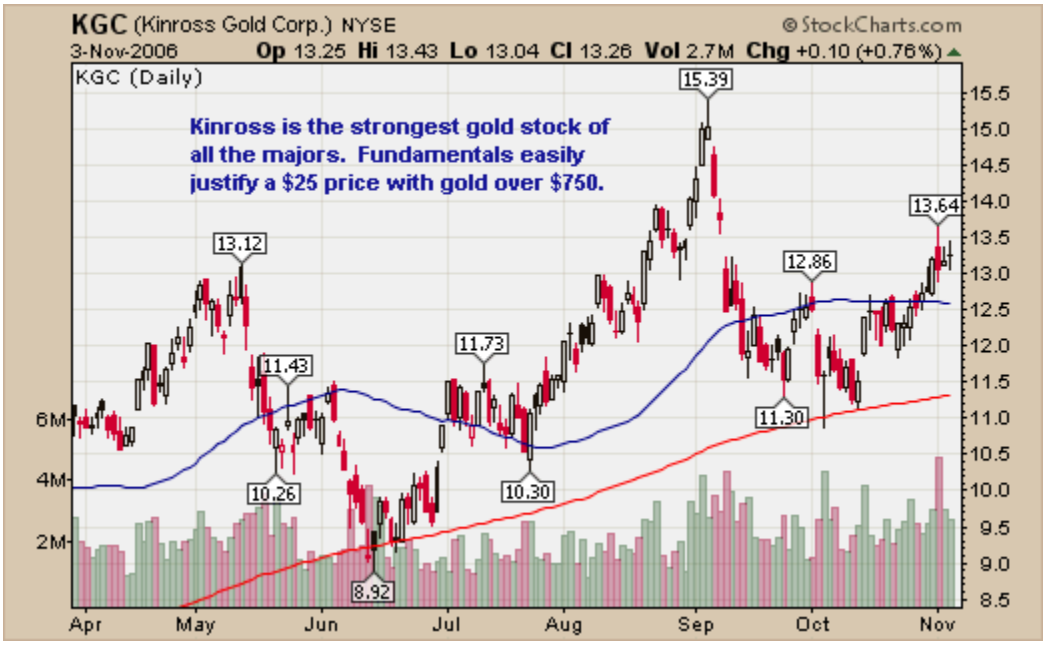
Prime Pick Stocks:

1) **Yamana Gold (AUY)**: Yamana is rapidly growing gold production and could be the next Glamis (with a high P/E). 2006 production is slated to be north of 350,000 ounces at a cash cost of under $280/oz. I expect a good earnings report despite their recent spat of average numbers. Look for Yamana to challenge its lifetime high of $12.42 soon, unless they should disappoint on the earnings front. **NOTE: Q3 earnings will be released on Nov. 7th.**

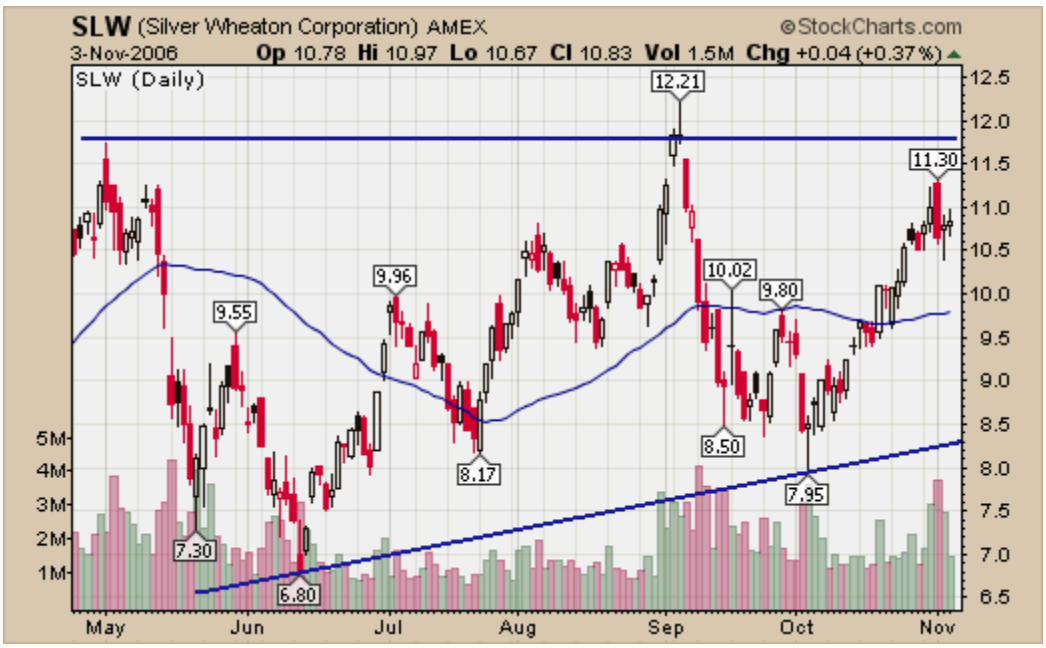
2) **Randgold Resources (GOLD)**: I like to value miners by how their market cap and earnings compare with their peers. On these two metrics, Randgold offers an exceptional opportunity. Meridian Gold (MDG) has a market cap of $2.75 Billion and just reported earnings per share of $0.18. Meridian's annual gold production for 2006 is forecast to be 260,000 ounces. Compare this against Randgold. Randgold has a market cap of $1.5 Billion, 2006 production should be north of 450,000, and, earnings are higher than Meridian's.

3) **Rio Narcea Gold Mines (RNO):** Rio Narcea has tremendous upside potential this year. They produce 18 million pounds of nickel per year along with copper and gold. The market will begin to reward the stock going forward as more players begin to realize the huge amount of earnings and cash flow coming from their nickel production. I strongly recommend adding Rio Narcea to your holdings. **NOTE: Q3 will be released after market close on Nov. 9th.**

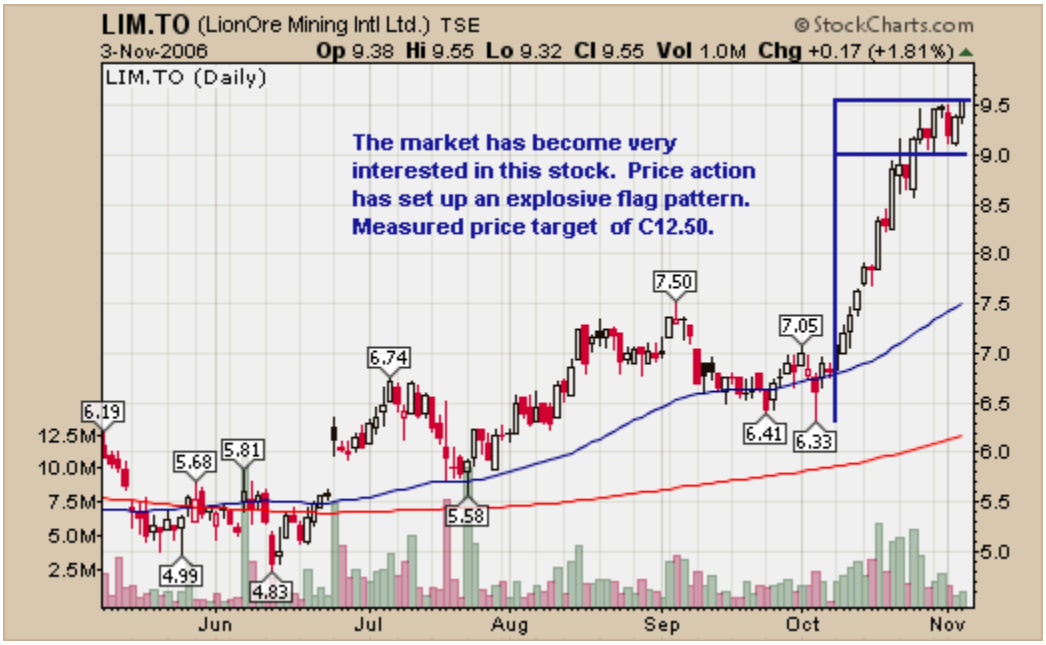
4) **Kinross Gold Corp (KGC)**: Kinross is a major producer of gold with an annual production of 1.6 million ounces. I consider Kinross my new Gold Corp. It has stable gold production and is profitable. Relative to its peers it is presently under-valued by a factor to two. The market has begun to recognize this fact and Kinross' stock trading action is the strongest of all the majors.



5) **Silver Wheaton (SLW)**: Silver Wheaton since its inception has continued to increase silver production. The combination of high silver prices and increased production has made Silver Wheaton the most profitable in its industry. I highly recommend the stock.



6) **LionOre (LIM.TO)**: LionOre is one of the most exciting new stocks I am recommending. LionOre is rapidly increasing nickel production in a rapidly increasing price environment. Typically miners producing base metals like nickel are valued by the market based upon a multiple of 7 – 10 times cash flow. LionOre for 2007 with a nickel price of $15/lb should have a cash flow of $800 million. A year from now using the industry cash flow multiple places LionOre's stock price 3 to 5 times higher than today's. Don't let the recent run up dissuade you from buying the stock. I should also mention that LionOre has a big red X on its back as a take over target. **NOTE: Q3 will be released after market close on Nov. 7th.**



High Growth Stocks:

1) **ECU Silver (ECU.V):** ECU is a Gold, Silver, Zinc and Lead producer. They have discovered a world class ore body on one of their properties. ECU should break out of its most recent trading range once Silver begins to soar again.

2) **Breakwater Resources (BWR.TO)**: Breakwater produces several million pounds of **zinc** and is bringing two more zinc producing mines online next year. They recently released good earnings and at present are undervalued by 2 – 3 times based upon their cash flow. With zinc rapidly depleting and its price rising, Breakwater is the best play we have found.

3) **Liberty Mines (LBE.V)**: Liberty is a very small cap nickel and cobalt producer. While I did not mention Cobalt, it is presently trading around $20/pound with a bright future ahead of it. Liberty's most recent presentation projects monthly cash flow of $5 million using a nickel price of $10/lb in the second half of 2007. Assuming this is accurate, Liberty is undervalued by over 5 times to its present stock price.

***Moderate Growth Stocks*:**

Symbol	Company	Comments
CDE	Coeur D' Alene	The stock was once considered a Prime Pick. However, a court in Alaska has stopped development on a big gold mine and Bolivia may nationalize their large silver mine. Both strikes on expanding production have made CDE an average silver producer.
CHK	Chesapeake Energy	Chesapeake is a solid blue chip producer of oil and gas. Natural gas is at its maximum storage level ever going into winter causing the price to drop. A cold winter and a rebound in crude oil will make the stock very attractive.
CMM.V	Century Mining	Century is one of the most under-valued gold stocks. The trouble is they have been slow to increase production. This stock may be moved up to the Prime Pick category early next year.
GG	Gold Corp	My favorite gold stock for over three years has fallen out of favor with my aggressive stock growth strategy. Gold Corp recently over paid for another company. The combination of Gold Corp and Glamis Gold has created the second largest market cap gold company in the world. The problem is the market does not reward large caps. Instead of being able to double in the next year, GG will be lucky to appreciate 40%.
NXG	Northgate Minerals	Northgate is a profitable Gold and Copper producer. They have a limited life mine and lower production growth prospects. Since I believe copper will not do much next year, NXG should do well but may be discounted with a falling copper price.
RVM.TO	Revette Minerals	Revette was a Prime Pick but they have not been able to hit their guided production targets. Consequently, RVM will do well in an increasing silver price environment, but will not see large gains.
UUU.TO	UrAsia Energy	Uranium just hit $60/lb last week, nearly doubling since the first of the year. UrAsia is producing uranium and will have two new mines online in 2008. The stock is fairly valued so large percentage gains are unlikely.

Final Thoughts:
Even if you do not purchase any of the recommended stocks, please seriously consider selling those growth mutual funds you hold in your retirement fund. My primary motivation of writing this update today is to warn readers of the high probability of a general market decline in the months to come.

For the rest of the readers who do buy the stocks recommended here, look out we may be in for a tremendous run!

Happy Trading,
Toby

Disclosure: The author has not been paid to write this article, nor received any other incentive to do so. The author holds a position in the company and will benefit from any increase in the company's share price. Disclaimer: The author's objective in writing this article is to promote potential investor interest in this stock to the point where they are encouraged to conduct their own research. Neither the information, nor the opinions expressed should be construed as a solicitation to buy or sell this stock. Investors are recommended to obtain the advice of a qualified investment advisor before entering into any positions in the stock.