February 2008 Market Update

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Unknown Quantities

By now, you have heard of the massive amount of write downs by banks and other financial institutions. The year 2007 finished with $100 billion in losses caused by leverage to sub-prime mortgages bundled as investment securities. More losses are being reported on a weekly basis as supposedly banks are “finding” other items on their balance sheet needing to be written down. What banks likely are doing is spreading out their losses to mask the much larger total. I have laid out the case over the last year why the US economy was in trouble. In many aspects, this has been relatively straightforward with ample data available to support my assertions. Today though, it’s the unknowns in the credit markets that make any coherent analysis almost useless. What we are facing at best is a mild recession with a few major banks going into bankruptcy. At worst, the credit market could implode into a major meltdown not seen since the 1930’s.

Federal officials are on record a year ago saying the sub-prime weakness was contained and actively down played any effects of it throughout the year. It is safe to say that they are more concerned with perceptions than making honest assessments of what is happening in the credit markets. The Fed and several investment banks are trying to pin all of the present credit market turmoil on sub-prime mortgages. In reality, the problems extend much further through all credit grades. Prime (AAA) mortgages are seeing an escalation in payment defaults. Markit an independent data source for providing credit derivative information has a widely followed mortgage bond index (ABX). The picture below shows the performance of the ABX for the last two years. BBB credit is the sub-prime market you hear about all the time. It was true sub-prime was the issue early in 2007 although you see by the index that AAA credit began to swoon late in the year.

Historical Look at the ABX Index

[Graph showing mortgage bond values]

Source: Jim Willie of the Hat Trick Letter.
The following table is the performance of 2007 mortgage bonds for the second half of the year, which I began tracking the data mid-summer. The size of the mortgage bond market the ABX represents is approximately $10.4 Trillion. Most of the $10.4 Trillion is AAA prime mortgages. We can estimate the amount of loss in the mortgage market by multiplying the market size, optimistically assuming it is all AAA by the index value. This means sustained losses in the mortgage bond market alone are roughly $2500 billion. Publicly announced losses of $140 billion are a mere fraction of this estimate; more are coming.

<table>
<thead>
<tr>
<th>Credit Rating</th>
<th>July 2, 2007</th>
<th>February 1, 2008</th>
<th>Change (%)</th>
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</thead>
<tbody>
<tr>
<td>AAA</td>
<td>99.5</td>
<td>74.2</td>
<td>-25.4</td>
</tr>
<tr>
<td>AA</td>
<td>98.7</td>
<td>41.0</td>
<td>-58.4</td>
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<tr>
<td>A</td>
<td>82.1</td>
<td>19.8</td>
<td>-75.9</td>
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<tr>
<td>BBB</td>
<td>60.8</td>
<td>14.0</td>
<td>-77.0</td>
</tr>
<tr>
<td>BBB -</td>
<td>54.0</td>
<td>13.8</td>
<td>-74.4</td>
</tr>
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The mortgage bond market is just a small slice of the estimated $500 Trillion+ derivative market. What is beginning to be talked about is the Credit Default Swap (CDS) derivative market. These derivatives exist to insure against default on other financial instruments. The CDS market made insurers billions of dollars over the years because there were very few defaults. What I believe will be the next shoe to drop is that CDS insurers will go into insolvency, exposing Trillions of financial instruments. It has been reported one derivative insurer has $61 billion of bonds it insures. The problem is that they have only 1/10th the value in assets to cover those bonds. This same issue is rampant across several derivative players. The next two pictures show the market size and how a Credit Default Swap works.
Credit Defaults Swaps (CDS) are used by financial institutions to guarantee a rate of return: in theory. Let’s say you have an eager borrower and because his credit worthiness is a little tarnished he is willing to pay you 12% interest. A 12% return is quite good but you want to lock in a sure thing. You lend the money to the borrower and buy a Credit Default Swap by paying 4% to a CDS dealer that guarantees they will pay you the balance of the loan in case the borrower defaults. Everything is great, you get a guaranteed 8% return, the borrower gets his money and the CDS dealer makes 4% on a promise. That’s the way this is supposed to work and does work so long as the CDS dealer has the credit rating and assets to cover a potential loss. Now enter the present day with defaults increasing on many diverse financial instruments.

Wall Street buys and sells CDS instruments on an industrial scale in the Trillions. One of the most attractive features of Credit Default Swaps is they insulate banks from reporting fluctuations in the value of their credit derivative portfolio such as mortgage backed securities, SIV’s (Structured Investment Vehicles) and other exotic financial concoctions. When banks own credit insurance they can report an instrument at full value even when it is not. Banks can write their instrument...
at full value so long as their counter party, the CDS seller has the assets/AAA credit rating to back the default value. In general, the largest bond (CDS) insurers have had AAA credit ratings. Now under fire, credit rating agencies are beginning in earnest to closely go through the books of bond insurers and are in process to down grade bond insurers.

A small company ACA Financial Guaranty Corp. is a case in point of how things are unraveling. ACA only had $425 million in capital and was the counter party insurer of $69 billion worth of credit protection. In December, S&P slashed their A rating to deep CCC- junk. Because ACA no longer had the investment grade credit rating, many financial institutions have had to come to the confessional because the debt instrument they sold has no insurance against default and has to be marked to market. ACA basically going bankrupt has forced Merrill Lynch, CIBC and Lehman Brothers to write down billions.

ACA is a minor player in the CDS market and is one of the first of many dominos to fall. The largest bond insurers, Ambac and MBIA are teetering. Both of these large bond insurers have enjoyed AAA credit ratings and are counterparts to hundreds of billions of municipal CDS insurance. Like ACA, credit rating agencies are noting that Ambac and MBIA have too little capital on their balance sheet to provide adequate insurance for their enormous portfolios. Investors are beginning to take notice. Only six months ago, MBIA’s stock price (ticker MBI) traded at $60/share and Ambac (ABK) traded over $80, now both are under $15. Their low share prices are now making matters worse as they no longer have the ability to raise capital via issuing shares without seriously diluting their stocks. Should either of these companies lose their investment grade rating, Wall Street banks will likely have to fess up to hundreds of billion more losses.

The biggest problem in the credit markets is they are daisy chained together into one gigantic pyramid scheme. A default in one market affects seemingly unrelated financial instrument in another and so on. We small investors are at a distinct disadvantage as the information available to us is happy talk made for the 6 O’clock news. What we can do is look for clues for what the authorities aren’t telling us. As I see it the unprecedented flood of liquidity by the world’s central banks, large commercial banks obtaining capital at junk bond rates and high intrabank lending rates are telling me that the credit crisis is in full bloom.

One piece of market data has been very good at giving investors clues of the health of the US economy and the breadth of the credit crisis. The US Dollar Index is made up only of a small basket of currencies but it tends to reflect the general health of the currency against the larger world pool. The USD is a reflection of many factors affecting the US economy and is an indicator of the faith the rest of the world has in our Nation. The following chart is the USDX. Note when the credit crisis began in earnest in August that the USDX has fallen ever since that time.
Going forward, keep a keen eye on the US dollar. The Federal Reserve is playing Russian roulette with the dollar by lowering interest rates. One of the reasons why I believe the Fed has not been more aggressive in cutting rates is because the US dollar is close to all time (post Nixon) low. There may come a time this year where political pressure forces the Fed to cut once too much. The dollar will react by plunging rapidly if foreign investors hit their breaking point. Please don’t discount this possibility. A rapid fall in the dollar will do incredible damage to both US stocks and bonds.
Dow, Nasdaq and S&P 500

Many reading my Newsletter are not knowledgeable in technical analysis. TA as it's called is the analysis of chart patterns, moving averages and other mathematical models. I have used TA for years, which has made me and saved me thousands of dollars. Professional traders almost live solely by TA. Computer trading platforms exists that buy and sell stocks based upon certain predetermined program levels. In this section, I will be looking at the big three most widely followed indexes in the US market. What I want you to note as you look at these charts is where the resistance points are above the current trading levels of each index. These will be places where the markets will have the most trouble surpassing. In today’s market, the stocks are only rising upon the expectation of future Fed rate cuts instead of solid economic fundamentals. If you have aggressive growth mutual funds you wish to unload, it is better to sell your positions in a rising market than in a falling market. Knowing where points of resistance are and if a market fails to overcome those points, will allow you to time your sell orders to get the optimum value for your holdings.

Dow Jones
Nasdaq

Just like in 2001, the Nasdaq has fallen harder and faster than the other two market indexes. It’s Fed cut rebound has barely gone over the 38% retracement point. Those in aggressive technology stock funds should consider unloading positions at 2500.

S&P 500

Deep rate cuts have seen the S&P move considerably off its lows. Major resistance lies at 1425 and would be a good place to reduce mutual fund holdings out of aggressive growth funds.
Base Metal Review

Copper Market
Copper continues to enjoy strong demand from Asia despite the housing slowdown in the US. As I have commented before, the last half of a year usually corresponds to storage levels increasing corresponding to a decrease in price. The year’s 2006 and 2007 were remarkably similar in both price and storage level trends. Since this market has matured and accepted historically high prices, I believe we can expect this type of behavior to continue in 2008. The storage level is much more bullish than one year ago as seen in the chart below.

Storage levels on the London Metal Exchange are 30,000 metric tons lower now than one year ago. The lower levels may be from lower production at one of the world’s largest copper mines starting to work its way through the market. What I see for this market is a push-pull between a contracting US economy and booming Asian economies in terms of copper consumed. Some increased copper production will come online in 2008. Demand should increase steadily so long as the credit markets don’t create a huge dislocation in the global economy. For the next 3 – 6 months, I am bullish on the price of copper as this has been a strong trend for the last two years. Investors should keep a wary eye on storage levels for it to continue downwards until mid-summer. Any sustained increases in storage before summer could have a serious impact on prices.
Lead Market

Lead's price went “supernova” rising several fold in 15 months time. The problem with hockey stick types of price moves is they tend to fall rapid until they can find equilibrium. Lead looks to me that it will consolidate around $1/pound for several months, which corresponds roughly to 50% of its meteoric rise. During consolidation periods, enthusiasm in mining producers usually wanes resulting in equity prices going through a slow, grinding downward path.

5 Year Lead Spot

Lead had a meteoric rise going from $0.40 to $1.80 in 14 months. Rising LME levels have caused a price retracement of 50% of the move. Lead may need to consolidate for several months before making any substantial moves.
Lead storage levels reached a bottom last fall and have gradually increased over the last few months. This caused the price of the metal to correct to its present day level. Asian economy demand continues to support the price and keep pressure on storage levels. The real wild card for the lead market is Ivernia’s shipping situation. Ivernia used to supply 3% of the world’s output until its shipments were shut down last year. Australia’s environmental agency has given preliminary approval for Ivernia to ship lead out at another port. The agency has given them a list of items to do before final approval is granted. Ivernia has 28,000 metric tons of lead that it will ship once the port is cleared to go. As can be seen in the following chart, this amount of metal hitting the market is significant compared to LME stockpiles. Lead prices should come under pressure, the question is how much downward movement might there be?

![5 Year LME Lead Warehouse Stocks Level](www.kitco.com)

I am cautiously optimistic about lead’s future. We need to see how Ivernia’s renewed production and shipments impact the market. While I do see some immediate price weakness afterwards, I find it unlikely the price will plunge to any significant degree.

**Nickel Market**

The price of nickel has done a remarkable levitating act in light of huge increases in storage on the LME. Usually the second half of the year corresponds to nickel stockpiles increasing and last year saw a huge increase. Presently storage levels are the highest in over five years. The situation doesn’t get much better. There is a large amount of supply coming from new laterite nickel mines in 2008. I think we enjoyed the sweet period last year with our investments in Liberty
Mines, LionOre and Rio Narcea. Until I can be convinced otherwise that demand for nickel can chew down a 5 year high in stockpiles and the new 2008 supply, I am going to be firmly in the nickel bear camp.

**5 Year Nickel Spot**

Considering the relentless climb in nickel storage levels, the price has done remarkably well. The chart has formed a bearish flat bottom triangle. The measured move is for a price of zero, which is not possible. If storage levels continue to rise, Nickel may revert to its longer term price support around $7.

**5 Year LME Nickel Warehouse Stocks Level**

Last year's darling may be this year's bear. Storage levels are the highest in five years. Add to that more laterite nickel mines are coming online in 2008. Nickel may find it difficult to maintain a double digit price.
Zinc Market

Zinc storage levels contracted just how I expected early last year. The problem is the price did nothing but fall. Now storage levels are beginning to increase again, which usually means the price should fall further. The price is beginning to soften again but the chart has formed a bullish falling wedge. Often these price patterns reverse and move upwards. We have to carefully monitor zinc stockpile growth going forward as it will, like all base metals, experience the dynamic push-pull of Asian demand versus US economic softening. I am decidedly neutral on zinc at this time. We could crunch economic models until we are blue in the face but ultimately supply and demand rule the day from which we can derive clues to the direction of zinc through observing storage.
Zinc has formed a BULLISH falling wedge. Traders last year stifled the price even as zinc storage dwindled. These traders will cover if zinc can manage a close over $1.20 as they will have lost the downward momentum.

www.kitco.com
Precious Metals Market

Precious metals continue to rally strongly, fueled by supply constraints and the continued crisis in the credit markets. Western investors generally get excited when anything breaks through to record territory and this market is no exception. Gold in particular has had a spectacular rally gaining almost $300 from its August lows. Investors are beginning to realize that rapid monetary expansion throughout the world to alleviate frozen credit markets is inflationary. Add to that a weak dollar and the primary ingredients are there for strong performance in gold. Gold has hit all-time highs in almost every currency creating a world wide bull market.

Platinum has by far the best fundamentals of the precious metal sector. Its use is critical for manufacture of about 20% of all consumer goods and essential for cleaning the exhaust of diesel vehicles. The metal is very rare with annual production of 7 million ounces of which 80% comes from South Africa. Last year estimates were the market was in deficit between 200,000 and 500,000 ounces. Projections for 2008 were for a deficit of several hundred thousand ounces. These projections were based upon what producers said they would mine. Then, three major producers just announced reduced output for the year. Soon after those announcements, South Africa’s largest power provider asked major gold and platinum producers to cease mining operations at their largest mines. Rolling blackouts for the entire country have been occurring leaving portions of major cities without electricity. Being that is not entirely popular they decided to shut down the mines instead.

What most people are not aware of is that some of South Africa’s mines are the deepest in the world. These mines are below the water table and have to be
pumped out continuously or else they will be flooded and the mine will be lost. Temperatures without cooling can hit 158 °F (70 °C) so air must be continuously pumped down hole some 2 km below the earth. All of this is power intensive not to mention the power required to keep mining equipment going.

Anglo Plats is the world’s largest platinum producer accounting for 40% of total world output. Their biggest mines are not producing platinum along with other large platinum mines in South Africa. Every week these mines are offline costs world production roughly 50,000 ounces. There are no large stockpiles of the metal like there is gold. Consequently, with the one, two punch of supply restrictions platinum has reached an all-time high over $1750/ounce (roughly $56/gram). An even rarer platinum group metal that is a byproduct of platinum mining, Rhodium, just blew through $7200/ounce ($230/gram). The following chart illustrates the spectacular rise of platinum.

Silver is flying under the radar of its two very talked about peers in the precious metals group. It is undergoing a price explosion and may soon get more attention than gold or platinum. Silver has been in a supply deficit for nearly two decades. World government stockpiles have provided adequate supply over this period of time. The latest numbers out of the Silver Institute indicate that government reserves could be depleted within two years. Silver is heavily consumed by the electronics industry where most of it is lost forever. (The metal is an effective biocide and is known to kill super-bugs where bacteria cannot become resistant to silver’s effects as it kills differently than antibiotics.) There are several reports that buying silver in any kind of size for investment purposes is becoming extremely difficult. The paper futures traders in New York have had
control of this market for over 20 years. Now that physical supply is beginning to
dry up, we should see silver to continue to surge upwards.

Precious Metal Stocks
Precious metal stocks (HUI Index) have roaring off their August low of 284
reaching a peak of 489 a few weeks ago. While having any index roar 72% in 5
months is quite impressive, gold and silver equities are actually lagging relative
to their historical relationship to gold. On Friday, the ratio of the price of gold to
the HUI stands at 0.50. The HUI stands at 450 with gold at $910. Usually, one
would expect the ratio of 0.55 with the dramatic rise in gold thus far. This means
the HUI should be trading close to 500. Gold and silver stocks become over-
bought when the ratio exceeds 0.62, which today would place the HUI as “too
rich” at an index value of 564. Many have argued that the muted response of
gold and silver stocks (see chart below) to the corresponding rise in the metals is
due to rising costs. However, during the first half of 2007 the HUI/Gold ratio
averaged about 0.50 when gold averaged roughly $650; precious metals stocks
should be higher now. Mining companies are often highly leveraged to the price
of the metals. For example, if a gold miner cost of production was $550 when
gold was $650 they would earn a $100. The gold miner’s margins would double,
triple or quadruple with gold at $750, $850 and $950, respectively. Earnings and
cash flow growth increase rapidly. In the past, the market has readily recognized
this and bid precious metal equities up in rapid fashion. What I believe is going
on is investors are casting a wary eye on the convulsions in the broader market.
No major entities are willing to appreciably bid up any equities until volatility
settles down. My expectation is precious metal stocks will begin to move up as
the market begins to see how the large moves in gold correspond to rapidly
increasing cash flow and earnings. Gold also needs to prove to the market that it can sustain $850+ prices.

Many readers probably feel they have missed THE move in precious metal stocks, but in actuality the party is only getting started viewing it in historical terms. The following chart is a historical picture of the HUI since the gold bull market began in 2001. There have been several growth spurts followed by long consolidation patterns digesting the substantial gains. Each growth spurt has moved approximately 125 points for each of the three that have occurred. What is clearly indicated in the chart is the most recent move in the HUI is barely underway.
I have made mention in previous Newsletters that precious metal stocks move up in distinct phases. The first phase is where major producers and some mid-tier producers stocks begin to move, while everything else does not. The second phase is where mid-tier and small producers begin to rise in earnest. In the third phase, small and micro-cap producers move. The final phase is where exploration stocks move. Each phase corresponds to an increasing magnification of stock gains with exploration stocks achieving gains in excess of 1000%.

What we have been witnessing is a first phase move in precious metals stocks and very little movement in smaller miners. In fact, it appears the micro-cap miners (< $100 million) and exploration stocks are going in reverse. This market is unlike any we have seen since the bull market in precious metals began in 2001. I believe the huge amount of volatility we have seen in the broader and precious metal markets has left investors and institutions gun shy about taking on any level of risk irregardless of positive or even stunning fundamentals of many small miners. If anyone told me that many precious metals shares were trading where they are today with $900 gold, $17 silver and $1750 platinum, I would have thought they were living in a padded room. Recognizing that the present market is not ready to embrace micro-cap stocks I am refraining from recommending three promising small producers: Castle Gold, Coronado Resources and New Guinea Gold.

Silver has risen 54% off its lows in August. Silver equities are the darlings of the precious metal sector. Producers get the highest earnings and cash flow multiples of the entire mining industry. I have not really found out why but it could be that there are very few primary silver miners in the world. The lion’s share of silver is produced as a byproduct of lead or zinc mining. Therefore,
getting exposure to an entity with high leverage to the price of silver is rewarded. Just like its gold producing cousins, small silver producers are getting absolutely no respect. Even worse many micro-caps are falling like a stone even as silver marches to nearly three decade highs. Only a few silver stocks have enjoyed any significant gains with silver’s huge 5 month increase. I believe this will soon change because silver should be hitting $20 this year. As the metal approaches this level, investors will begin to scramble towards silver equities. In the past, once silver stocks begin to move, they blow away any other precious metals class. The reason in part is due to their highly rewarded cash flow and earnings multiples they command. I would highly encourage all investors get some exposure to this dynamic sector as you may be handsomely rewarded.

To wrap up this section, I am presenting the gold stock index divided by the Dow Jones index over the last two and a half years. While on a day to day basis it may seem precious metals shares follow the Dow intimately, the chart clearly shows since the trouble began in the Dow last August, precious metal stocks have significantly outperformed the index.
Stock Recommendations

New recommendations will have the Company name highlighted in blue. A short description of each stock is given to make you aware of the company’s highlights. Simple charts are presented to give a snapshot of the trading picture of each stock. Red is used to denote resistance and blue is generally used to highlight support. To the right of each Canadian listed stock, is the symbol US investors use to purchase the stock online.

We now have seen gold rally over $300 since its lows in August and there is plenty of upside left considering the wholesale debasement of currencies the world over. I have made mention in the past that gold stocks move in phases. The first phase is where large cap miners (e.g. AEM, AUY, KGC) move in earnest while the others yawn. In the second phase, mid-tier producers (market cap $400 – 5,000 Million) begin to move. Mid-tier stock movements usually outpace majors by a three to one margin. Finally, small cap juniors and explorers move. This group although late to the party, make stock price moves in all others look like chump change. Since August, major gold producers have stolen the show with some mid-tier/large juniors more recently beginning to move. I believe we are starting to see the torch being passed to the mid-tier producers (e.g. GSS, IAG).

As an investor, you should have exposure to all tiers of precious metal stocks. The trick is to have your portfolio more exposed to the group that is having its day in the sun. If you are heavy in the majors, now may be a good time to reallocate your position into some smaller names and make that group where most of your investment money is exposed.

In the Gold producer section, I have one platinum producer just to place it in a category. I have not found a second platinum producer trading in the western hemisphere meeting my requirements of acceptable liquidity. There is a platinum junior to keep an eye on but I’m not currently recommending Anooraq Resources who is taking advantage of the black empowerment laws in South Africa wherein they are buying a bunch of production. Anooraq trades on the Amex under the ticker ANO. At issue with Anooraq is they are buying production from a major South African mine. How the large mine is affected by the power crisis is unknown at this time. This may explain why the stock has been so weak as platinum converges on $1800.

ALL stocks in the base metal section are not recommended at this time. However, there is one copper producer I am now recommending. The base metal companies represent some of the best juniors in their respective metal niches. The major problem is all the unknowns in the broader market due to the credit fiasco. Thus far, base metal producer stocks have not decoupled from the broader market. If the Dow goes down, base metal stocks have been going down more. If the Dow goes up, base metals have been weakly rallying. Until
base metals prices and miner equities decouple from the general markets, I don’t see any reason to have any large exposure to the group. Eventually, this group will begin to rally irregardless of what the broader market does. For now it seems they are stuck with the perception a lower Dow equals lower Lead, Nickel, and Zinc prices.

I took my own advice in November’s issue once I could see my base metal holdings were getting killed with the Dow and exited all my base metal positions mid-November. Now we see that since the beginning of November many quality junior miners have been cut in half or more. Their most recent lows correspond to the time the Dow made lows a few weeks ago and now they have rebounded strongly. I would like to see that once the Fed’s market junky fix (rate cuts) have lost their glamour and the Dow begins to swoon again, that base metal miners will be able to finally shake loose the broader market’s intoxicating influence. Should that occur to a larger degree and be sustained for several weeks, entering the stocks should represent an excellent time to buy.
1) **Dundee Precious Metals (DPM.TO, DPMLF):** Dundee has the most unique business of all the gold producers in this report. They were founded by precious metal mutual fund managers a few years ago. Gold operations and mine development in Bulgaria is funded by their appreciable earnings from gold mining equity investments. The company is guiding 130,000 ounces gold production at a cash cost of $55 (net of copper credits) for 2008. Dundee is largely off the radar of investors; just the way I like it. Today, their income is derived via investments and their one Bulgarian mine. They have two promising properties in Bulgaria where they could bring their total production to 300,000 ounces gold per year fairly quickly. The biggest hurdle they are facing is iron curtain style political issues. Company Website: www.dundeepreciousmetals.com

2) **Eastern Platinum (ELR.TO, ELRFF):** Eastern Platinum based upon its industry’s valuation metrics is severely undervalued with a market cap of under $20 per PGM ounce in the ground resource. All other platinum producers are valued in excess of $60 per PGM ounce in the ground. New producer stocks generally take time to reach peer level valuations. This is likely due to the transition from hype to showing you can achieve solid operating numbers.

Eastern Plats is set to rapidly increasing production and expects to be producing at a rate of 185,000 oz/year of platinum at the end of 2008 followed by 320,000 oz annual rate of production in late 2009. Soaring platinum prices will increase interest by US investors for which Eastern Platinum should benefit greatly. Eastern Plats being a small producer in South Africa should not be affected by the power crisis as the authorities have only required large, deep underground mining operations to cease production. Company Website: www.eastplats.com
3) **GBS Gold International (GBS.TO, GBSFF):** GBS is an off the radar gold miner with operations in Australia. The company is presently producing at a rate of 140,000 ounces per year and has another 50,000/year mine going into production this year. I like the fact that GBS is one of the few mining companies where insiders actually own 20% of the stock. GBS is a high cost producer as it ramps up production but with gold at present prices easily justifies a much higher stock price. Jaguar Mining is going to produce 170,000 ounces in 2008 and has a market cap of $775 million. GBS will likely produce 160,000 this year and its market cap is under $150 million. Granted GBS cash costs are $200/ounce higher than Jaguar’s it does not justify a factor of 5 discount. Company Website: [www.gbsgold.ca](http://www.gbsgold.ca)
5) **Golden Star Resources (GSC.TO, GSS):** Golden Star is the most undervalued gold producer in the HUI (gold stock index). They recently gave the market 2008 and 2009 guidance. I was a little disappointed but understand what they are trying to do: exceed guidance for a change. Guidance for 2008 is 400,000 ounces gold at a cash cost of $520/ounce. 2009 production is expected to improve to 530,000 ounces at a cash cost of $450/ounce. While their cost to produce gold is higher than its peers, Golden Star’s market cap is 3X lower. I believe 2008 will be a terrific year for the company’s share price. GSS has a real solid chance of closing 2008 over $10, since I believe gold will surpass and hold over $1000/ounce later this year. Website: [www.gsr.com](http://www.gsr.com)
6) IAMGold (IMG.TO, IAG): A few years ago there were two no respect gold producers named Meridian and Randgold. Every quarter they came out with solid earnings, worked their business plan well and their stocks went no where. Then, out of the blue both at their separate times took off and never looked back. IAMGold I believe is the next big mid-tier producer that is about to see its stock take off. IAMGold is expecting to produce 920,000 ounces of gold at a cash cost of $460/ounce in 2008. They have several producing mines on three continents. Q3, 2007 the company reported operating cash flow just under $30 million. Q4 should see cash flow closing in on $50 million since gold was $109 higher. IAMGold produces twice the amount of gold, has higher earnings and cash flow than Randgold yet its market cap is 20% lower. If you are looking for a conservative gold stock with good growth potential, IAMGold is it. Company Website: www.iamgold.com

7) Kinross Gold Corp (K.TO, KGC): Kinross gold production is growing the fastest of the major producers. Gold production for 2008 and 2009 is projected to be 2.1 million and 2.6 million ounces, respectively. This rapid growth in production begins this coming summer when two mines begin production. Kinross just had two series of warrants expire removing some sell side pressure off the stock. The stock has attracted investors who have bid up the stock to new all-time highs. For those wanting some leverage to Kinross, I would recommend investing in their B series warrants. Company Website: www.kinross.com
8) **Randgold Resources (Nasdaq: GOLD):** Randgold has had an enormous run and has doubled in share price. The stock is richly priced and I’d recommend holding or adding on significant dips. 2008 gold production should come in shy of 500,000 ounces at a cash cost around $350/ounce. Cash flow and earnings are likely going to justify Randgold’s lofty share price as the rapid rise in gold price is going almost directly to their bottom line. Company Website: www.randgoldresources.com

Randgold is one of the best performing stocks in the HUI. The market is rewarding the company for solid production numbers and profitability.
9) Semafo (SMF.TO, SEMFF): I have had my eye on Semafo for quite sometime. I debated with myself about putting it on my recommend list but felt now offered a good opportunity. Their story is similar to that of Golden Star Resources. Poor decision making on the management level coupled with missed promises caused their stock to plummet. In 2007, the stock price hit a high of C$2.50 early in the year only to find itself at C$0.73 in late December. Semafo has two small West African mines in operation at a present rate of 100,000 ounces gold per year. What is compelling Semafo expects to begin production at a third mine by the end of the present quarter. Guidance for 2008 is producing 180k – 200k ounces gold. Semafo’s market cap is $270 million, which is approximately half of its peer group. I should point out that Semafo does have a small residual hedge at $375/ounce from a loan of several years ago, which will weigh on earning results as gold rises. This company could be a tasty morsel for three other larger West African producers: Golden Star, Red Back Mining or Randgold. Company Website: www.semafo.com.

10) Yamana Gold (YRI.TO, AUY): Yamana is benefiting from their take over of Meridian and Northern Orion. They are now projecting 1.3 million ounces of gold production for 2008 and 1.6 million in 2009. At present gold prices, Yamana’s 2008 cash flow will be over $1 billion. Their peer group currently fetches a price to cash flow (P/CF) multiple of 25 indicating a year from now Yamana’s share price could be over $40. Yamana offers the investor excellent share growth potential with the security of a large, diversified mining portfolio. For those seeking added leverage, I highly recommend Yamana’s C series warrants. Company Website: www.yamana.com.
Yamana spent two months digesting its acquisitions. The market is beginning to wake up to what a cash generating machine the company is. Once the market recognizes this, we may never again see AUY under $20.
Silver Producers

1) **Coeur D’ Alene (CDM.TO, CDE):** Coeur has been a company that country song writers sing about; “if they didn’t have bad luck, they’d have no luck at all”. They had a one, two sucker punch over a year ago. A promising gold mine in Alaska got held up (and still is) in court over where to place their tailings and, Bolivia began making left wing proclamations over the mines in the country. The Bolivian government finally passed legislation with higher tax on miners in their country but there is no longer the threat they will nationalize mines. Coeur’s Bolivian mine is now ramping up production at a massive 8 million ounces/year.

Management isn’t something to write home about but they have now positioned the company to be the largest primary silver producer in the world next year at 29 million ounces/year at a cash cost under $1.80/oz. Coeur recently acquired two explorers with large silver resources. With one of their acquired properties, they are building a huge silver mine in Mexico with an annual production estimated at 9 million ounces beginning in 2009. Coeur does have some political risk operating in Bolivia but they are diversified with several operating mines. Their stock often looks like it is played with by financial entities; however, investing in the company with a 12 month+ horizon should reward your portfolio. Company Website:  [www.coeur.com](http://www.coeur.com).

2) **First Majestic (FR.TO, FRMSF):** First Majestic is a rapidly growing Silver producer that still has not been rewarded by the market. The Company does not actively promote itself but getting a TSX listing is a big plus. First Majestic 2008 production is expected to be over 6 million ounces of silver at a cash cost of $6/oz. Their production numbers are up over 200% from 2006, yet the stock is roughly at the same price. I use as one of my valuation tools for stocks
comparing companies with similar production. Hecla (NYSE -HL) has a flat production profile of 6 million ounces per year for the next several years. Their market cap is $1.1 billion. First Majestic’s current market cap is under $300 million. Where the mining industry is consolidating, First Majestic screams as a takeover candidate. Company Website: www.firstmajestic.com.

2) Silvercorp Metals (SVM.TO, SVMFF): Silvercorp is a highly profitable blue chip Silver, Lead and Zinc miner. All of their operations are in China where they are mining some extremely high ore grades. Using Lead and Zinc byproducts against costs, Silvercorp cash costs are now -$13.60 per ounce of silver produced. Guidance for the 2008 fiscal year (ending March 2008) is for over 3 million ounces Silver, 46 million pounds Lead and 18 million pounds Zinc. Silvercorp is well positioned to take advantage of surging Silver prices and should reward your portfolio handsomely. Website: www.silvercorp.ca
3) Silver Dragon Resources (SDRG.OB): Silver Dragon has been caught in the micro-cap down draft of the last three months. They have come out with two press releases with very promising drill results at their Mexican and China properties. In particular, they found two veins with mineralization extending over 2200 meters in China. The property happens to be close to China’s two largest silver mines. Despite the clearly bullish news, the stock continued to sell down another 20%. I have seen such reactions play time and again throughout the sector as investors flee anything associated with risk. I have a large, underwater position in the company and recently accumulated more. My intention is to add to this position during the year.

Silver Dragon is working hard to convert their Chinese 122b inferred resources to Canadian 43-101 compliance. Approximately 320 million ounces are Chinese 122b inferred. Thus far, about 50 million ounces are 43-101 compliant and much more are expected to be added to this total in 2008. The market pays $3 per ounce in market capitalization. The stock currently receives under $1 per ounce. There are very few opportunities out there where a stock could justify a 10X move and Silver Dragon is one of them. Their rapidly growing resource base along with the possibility of two mines going into production in 2008, offers an exceptional, long term risk to reward ratio. Company Website: www.silverdragonresources.com
4) **Silver Wheaton (SLW.TO, 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 one of the most profitable in the industry. They are guiding 15 million ounces in 2008 increasing to 19 million ounces in 2009. Silver Wheaton commands a tremendous cash flow multiple of over 35. Silver companies get the highest cash flow multiples in the mining industry. Their stock has recently seen a bout of weakness recently despite the surge in silver prices. The reason is that Goldcorp just sold of their 48% interest in Silver Wheaton below market in a single large transaction. It is likely these shares will be in large institutional hands. Website: [www.silverwheaton.com](http://www.silverwheaton.com)
5) **Sterling Mining (SMQ.TO, SRLM.OB):** Sterling owns one of the most prolific silver mines in US history. Located in Idaho, the mine has operated for 100 years producing over 360 million ounces. Sunshine was closed in 2001 due to poor economics caused by low silver prices. For the last few years, the company has been preparing the mine for startup operations. Initial production began in December and Sterling is guiding 2008 production of 2.8 M ounces. Their average grade is about 24 ounces silver per ton with over 10 years of mine life left plus plenty of exploration potential. Sterling’s market cap is only $130 million making it a great candidate for doubling this year. The market hasn’t embraced Sterling yet probably because they don’t have firm multi-year guidance and cash costs are unknown. The stock may begin to catch fire as positive operational results are confirmed. Company Website: [www.sterlingmining.com](http://www.sterlingmining.com)

![SRLM (Sterling Mining Co.) Nasdaq BB](chart)

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Sterling is now ramping up production but its stock is having a tough time moving north. It is doing relatively well since it is a very small cap stock. A close over $3.60 will be very bullish.

6) **UC Resources (UC.V, UCRLF):** UC Resources is a micro-cap silver and gold producer with a market capitalization under $60 million. I calculated at full production they will produce 1.3 million ounces Silver and 14,000 ounces Gold. Silver producers of 1 million ounces typically fetch a market cap of $80 – $100 million. The company does not appear to be focused on bringing their Mexican gold and silver into full production, which is why I recommended the stock in the first place. The drawn out nature of bringing their mine to production would have led me to remove this stock from the recommend list. However, their McFauld’s Lake property has so much upside potential; I continue to hold a large position in the company.

UC just announced they are sending drilling crews to McFauld’s to start exploration. They told the market drilling will be focused on “Noront” like signatures. Noront (NOT.V) just came out with more magnificent drill results with very high grade Nickel, Palladium, and Platinum. Noront before they announced
their first results at McFaulds traded at C$0.30 and in three months reached a peak over C$7.50. Should UC get their Mexican property to full production, the stock is worth C$1.00. However, if they were to find Noront levels of mineralization on their neighboring property we can probably expect a similar reaction to their share price. UC is highly speculative and can be likened to that of a lottery ticket with better odds. Company Website: www.ucresources.net
Multi-Metal Producers

The stocks in this section produce several metals such as Copper, Gold, Lead, Silver and Zinc.

1) **Aurcana (AUN.V, AUNFF):** Aurcana is a small cap lead, silver, zinc and copper producer located in Mexico. They brought their La Negra mine to full production last summer at 1000 tpd. Average annual production should be close to 1.2 M ounces Silver, 5.4 M pounds Lead, 10.8 M pounds Zinc and 2.3 M pounds Copper. Aurcana’s interest in the mine is 80%. This one operating mine justifies a stock price double of what it is today.

Aurcana is bringing a second mine, Rosario, into production. The mine is fully equipped and just needs to be refurbished to go into producing metal. Using the historical production of the mine, I calculate annual production of 1.2 M ounces silver, 8 M pounds Zinc, 9 M pounds Lead and 5,000 ounces Gold. Rosario is expected to start H2 2008. Considering the solid economics with two producing mines late this year, the share price could conceivably be four times higher than today. Company Website: www.aurcana.com

2) **Impact Silver (IPT.V, ISLVF):** Impact Silver is a small cap Silver, Zinc and Lead producer located in Mexico. Unlike many silver miners in their industry, Impact actually earns money. Impact’s added bonus is producing Lead and Zinc. They intend on bringing two small mines into production in 2008. The added production will greatly enhance their value. Whether or not the market recognizes this remains to be seen. Company Website: www.impactsilver.com
Impact is one of the few examples of a micro-cap stock holding its own.
Base Metal Stocks

The stocks in this section produce Copper, Lead, Nickel and Zinc.

1) **Acadian Mining (ADA.TO, ADGLF):** Acadian is a Zinc and Lead producer with about 500,000 ounces of gold resources. They recently guided 2008 production of 34 million pounds zinc and 17 million pounds lead. They are discussing splitting the gold side off from the company, which would be a good idea since gold companies get much higher valuation multiples. Company Website: www.acadiangold.ca

![Acadian Mining Chart](chart.png)

Acadian was cut in half in under three months. Base metal miners are tied to the broader market squared. A close over C$0.80 would be a very bullish development.

2) **Blue Note (BN.V, BMNFF):** The company has refurbished an old mine they bought from Breakwater Resources. Blue Note’s recent presentation guides 2008 production of 120 million pounds zinc and 51 million pounds lead. One of the knock’s against the company is analysts thought they could not get their lead and zinc recoveries to economic levels. They presently are getting over 95% and 85% recoveries for lead and zinc, respectively, which are excellent. Earnings and cash flow will be huge relative to the capitalization of the company. The stock has been killed along with Blue Note’s peers without any fundamental justification. Company Website: www.bluenotemining.ca
3) Liberty Mines (LBE.V, LBEFF): Liberty is a small cap nickel and cobalt miner. They are increasing current production by developing three mines. Their Redstone mine is in production and they are increasing production. A second mine, McWatters, is expected to be at full production mid-2008 at a rate of 1200 TPD. Liberty also has some high grade cobalt properties they want to bring to production. Cobalt trades over $35/pound with supply being constrained worldwide. Liberty is vague about their guidance but should be highly profitable in 2008 assuming they meet their guidance. Company Website: www.libertymines.com
4) **Quadra Mining (QUA.TO, QADMF):** I have held off recommending Quadra for sometime waiting for copper’s fundamentals to change. Quadra is a highly profitable copper-gold miner. Their flagship mine in Nevada, USA is expected to produce 130 million pounds copper and 100,000 ounces of gold in 2008. They have a second mine located in Arizona due to come online later this year. Expected annual output is 75 million pounds copper at a cash cost of $1.00. Copper looks set to surge in coming months and Quadra is well positioned to take advantage of it for investors. Being primarily a base metal miner be mindful that if the Dow should plunge in coming months, Quadra may get hit disproportionately. Investors with IRA’s should seriously consider buying Quadra’s warrants on the TSX. Company Website: [www.quadramining.com](http://www.quadramining.com)

5) **Strategic Resource (SRZ.TO):** Strategic Resource Corporation has a mine located in Tennessee in the USA. They just declared production and anticipates producing at an annual rate of 125 million lbs Zinc by mid-2008. Strategic is developing recovery circuits to capture two valuable semi-conductor materials: Gallium and Germanium. They should be operating the zinc production profitably but the real profit kicker is when Gallium and Germanium begin to ship out of their mine. Company Website: [www.sra-corporation.com](http://www.sra-corporation.com)
Strategic fell strongly in sympathy to the Dow and has rebounded strongly. Technically, the stock looks ready to rally. This will be confirmed with a close over $3.50.
Stock Deletions

I decided to put in this section because at times, stock selections do not go the way you’d like. The majority of the information I obtain is from public sources and found via the internet. One of the most basic assumptions is that guidance and performance of management will be within reason. In general, nearly all mining companies miss guidance. It takes time to see what companies miss a little or to see those that miss a lot. There are cases where management teams continually miss guidance. Those stocks are to be avoided until proven otherwise.

Stocks removed from recommendation lists:

1. **Goldfields (GFI):** Gold has risen several hundred dollars and GFI is still at roughly the same place it was. There is now great uncertainty surrounding large South African gold and platinum producers due to the electric power shortages. One thing very bearish for a stock is uncertainty and it can cast a dark cloud over prices for as long as it persists. Goldfields should continue to generate solid earnings and cash flow but loss of gold production and persistent worries over powering their mines should restrain share growth for sometime.

2. **Jaguar Mining (JAG.TO, JAGNF):** We have had a tremendous run with Jaguar and why I am moving it off my recommendation list. For some reason, there are select few juniors such as Eldorado (Amex – EGO) and Red Back Mining (RBI.TO) where the market shoots their market cap to such heights that it will take a considerable period of time before they can grow again. Jaguar is one of these stocks. The market has almost given it a market cap of seasoned producers without the production numbers to justify it. Jaguar will continue to do well with a rising price of gold but it is unlikely the stock can double from its present value.

3. **First Nickel (FNI.V, FNKLF):** The market is in no mood to bid up very small cap base metal producers. With nickel’s price facing head winds, First Nickel is going to need a major move in base metals along with positive broad market fundamentals to move up strongly.
**Final Thoughts**

I named the start “Unknown Quantities” to reflect the uncertainty of the unfolding credit crisis. A range of opinions from denial to catastrophe exist to describe what is going on in the capital markets. We have seen the market upset caused from fear and $140 billion in write downs thus far. How markets may react to write downs 10 fold higher than today, can’t be projected as bullish. Now is a time to be defensive and open to take measures in one’s portfolio to what was unthinkable only a year ago.

Happy Trading,
Toby

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**Disclosure:** The author has not been paid to write this article, nor received any other incentive to do so. The author holds positions in many of the companies mentioned in this report and will benefit from their increase in stock prices.

**Disclaimer:** The author’s objective in writing this article is to promote potential investor interest in these stocks 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.
Appendix I

Buying Physical Gold & Silver

I have led many into the precious metals market. Most begin severely gun shy at first but then begin to realize that gold isn't some bizarre investment that most mainstream advisors proclaim. We are currently witnessing a credit market meltdown that has no other parallel since the 1930’s. I have found no one who clearly knows where the present crisis leads but, there is now the possibility of the entire credit market going into complete disarray. The reason is the shaky financial instruments in question are many times larger than the world’s GDP. This section is to allow you the means to protect yourself from financial collapse. I have done this in the spirit of hope for the best but prepare for the worst.

There are many ways to own exposure to the precious metals sector. The most popular is to buy gold stocks or to buy shares in exchange traded funds (ETF’s). If a financial melt down were to occur, neither gold stocks nor an ETF may offer you protection. The reason is both investment vehicles are held by third parties. How do you know how safe your investments are when your stock broker or those who are custodians of the ETF go bankrupt? If you do get 100% of your investment back, how many months or years might it be before you can get at the funds? This is where owning physical metal offers the best form of financial protection. The first objection you always hear is about storage. I will tell you storage is no problem. One million dollars worth of gold or platinum can fit in a standard $30/year safety deposit box at your bank. Pretty cheap considering the value of wealth you are storing. Silver, on the other hand, is a completely different story.

How does one go about buying gold? I prefer to go to online vendors to get the best prices. The two I have had good luck with are American Precious Metals and Bullion Direct. Their websites are:

American Precious Metals: http://www.apmex.com/
Bullion Direct: http://www.bulliondirect.com

I have no financial relationship with either of them except as a satisfied customer.

Gold can be purchased via bullion bars or coins. The advantage of buying bullion bars is the amount of premium over the spot price is lower than with coins. One issue with bullion bars is there has to be some proof that they are genuine containing the gold they say they do. Many gold bars come with some form of official certification. I would recommend buying only those bars that are certified.

Coins traditionally are anywhere $20 - $50 higher than gold’s spot price. Most coins are 1 Troy ounce (31.1 grams) with some coin series in half, quarter and one tenth sizes. The smaller the size the higher the premium associated with the price. There is one 1 ounce coin that has very little premium over spot: the South
African Kruggerand. Kruggerands are about the cheapest way to own gold. They are fairly ugly coins but beauty isn’t much of a concern in times of crisis. Coins do enjoy a slight edge over bullion in that there is less question they are genuine gold containing instruments. While Kruggerands offer the cheapest way to own gold, I would recommend buying gold denominated in your own currency such as Maple Leafs for Canadians and Eagle for Americans, though having any gold in a time of crisis will give you some protection.
Appendix II

Recommended Investment Books

The following books are some of the best texts I have found and have helped me to identify stocks and understand technical analysis. I have no financial ties to Amazon.com or any of the Authors.

1. **How to make money in Stocks** by Bill O'Neil

2. **Japanese Candlestick Charting Techniques** by Steve Nisson

3. **The Visual Investor: How to spot market trends**, by John Murphy

4. **Technical Analysis from A to Z**, by Steven Achelis

Appendix III

Investing in Mining Stocks

I have been investing in the sector for nearly four years and experience has allowed me to learn many things. Wall Street absolutely abhors commodities. Many of you have over the years heard how China was slowing down and a big commodity crash was around the corner. The commodity bull has been raging for six years and yet the same old prognostications of its demise continue. One major point I want to get across: Wall Street will go out of its way to find an excuse to sell off commodity stocks. Many commodities take a long time to go up but find those gains disappear in a few short days.

What I wanted to do is put together a Table giving you the means to identify good mining stocks on your own. The Table is arranged from best to worst conditions for mining stock appreciation. In general, I avoid stocks that will not be producing 1 year or more. There is a famous chart that shows the appreciation of a stock from first discovery to full production. Mining stocks really don't start appreciating until they are within a year of production then begin to appreciate as cash flow and earnings are generated. Once the miner has hit a plateau in production, its stock is usually dictated by the price of the metal it produces. Many of my stock picks meet the criteria in the high yellow or green areas of the Table. There are exceptions but the guidance in the Table is a fairly consistent rule of thumb.

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<th>1 Year Stock Potential</th>
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