

Growth Stocks Weekly

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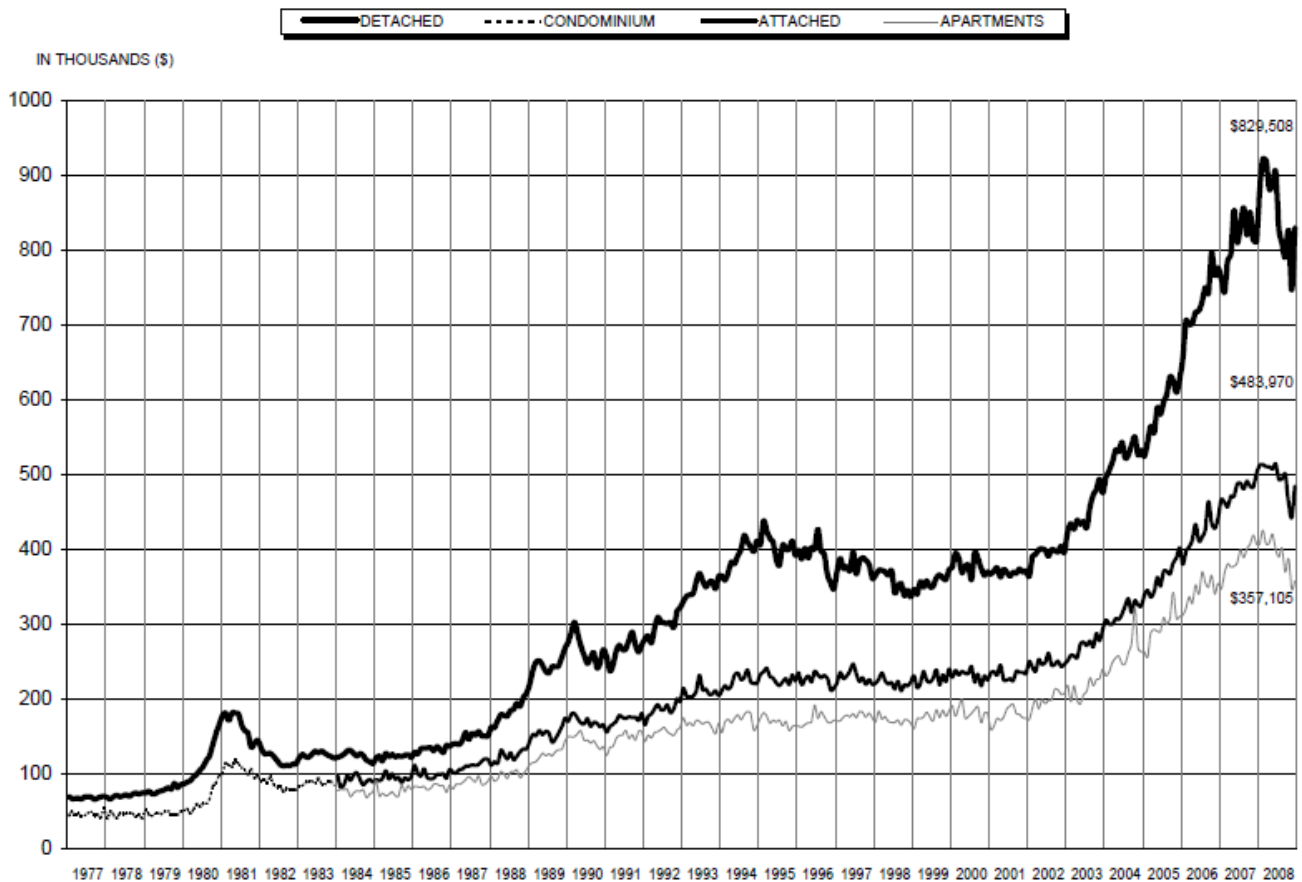
Performance: 1996 116.9%; 1997 28.1%; 1998 36.4%; 1999 39.4%; 2000 180.9%; 2001 -50.5%; 2002 18.7%; 2003 28.8%; 2004 166.7%; 2005 28.2%; 2006 153.3%; 2007 8.8%; 2008 -25.2%

Junior Gold and Natural Resource Sector Report

February 7, 2009

Economic Commentary and Update

Real Estate Board of Greater Vancouver Average Price Graph
January 1977 to December 2008



NOTE: From 1977 - 1984 condominium averages were not separated into attached & apartment.

While not my beat here in the pages of Growth Stocks Weekly, I was warning of the bursting of the housing bubble and the subprime credit crisis for several years to all who would listen, albeit maybe too early for bragging rights. Admittedly a typically stubborn Dutchman, luckily I stuck to my beliefs, thereby successfully side-stepping that particular trap for my own immediate family. Besides, the US experience was allowing me at least some vindication, with the explanation that Canada is typically two years behind US trends. Better too early than too late is also a ready retort.

With few exceptions, most of my in-laws and close friends figured by 2007 that I was simply obsessed and that their wonderful real estate gains here in British Columbia would continue

indefinitely. One close friend actually managed to sell right at the peak, only to succumb to his spousal pressure and proceeded to re-buy at the top, and incur all those costs that often makes real estate such an illiquid and transaction-cost-heavy way to try to get ahead. It's always good to know the facts, and long term, it is a fact that real estate has only just managed to keep up with inflation, on average. Which means prices still have a substantial ways to go down before a long bottoming-out period can follow, to revert back to the price mean. And they'll likely overshoot to the downside, given the overshoot to the upside experience as cheap money encouraged consumption and speculation.

Unfortunately, I was completely wrong about the severity of the current recession, in spite of getting the direction right. As it turns out there was no place to hide, at least not in the short term. The reality is that we are in a much worse recession than I thought it would be two years ago. We will probably be in recession for the full calendar year 2009, with a lengthy multi-year muddle through economy.

We are staying the course however, and have managed to take advantage during the height of the crisis, in the October through December period, by loading up with some of our long term favorites. Many of these are already rebounding, in some cases 100-200-300% from the lows of only a few short months ago. Clearly, you buy when there's blood in the streets and we did our best to point this out to our subscribers.

One guy who very publicly got it right is Peter Schiff, president of Euro Pacific Capital and a frequent commentator on financial news networks such as CNBC and FBN. He has written numerous articles for various trade publications and has been quoted extensively by mass media outlets. He is also the author of the critically acclaimed: "Crash Proof: How to Profit from the Coming Economic Collapse."

There are numerous YouTube videos, articles, and references to Peter Schiff being "right" circulating the globe, with several high-profile talking-heads literally laughing in his face. So much for their credibility now, and hence Peter's much higher profile of late. I passed on several of the better ones to subscribers over the last few months. While Schiff was indeed correct about the US imploding and his early warnings ended up to be spot-on, it is an interesting footnote that many of his clients were not able to avoid 40% to 70%-plus declines in their portfolios. Like us, he had been positioning clients in precious metals, resources and other "real" asset-based stocks outside of the US dollar. Unfortunately, the US dollar has "perversely" strengthened, and commodities have tumbled, as have foreign currencies. Gold stocks lost 50-90%-plus of their values as portfolios around the world were forced to sell everything, in spite of the price gold's outperformance.

But like Peter, we believe this is the big head fake, where the lemmings all follow each other over the cliff, just as they should be running the other way. Unfortunately most investors will again end up in the wrong place as events unfold, the US dollar comes back to reality, and "real assets" actually do become THE place to be.

The following media clips are of interviews just done with Peter Schiff that helps us more fully appreciate a potential scenario we believe is all but inevitable. Peter says it best, and while he may seem rather fixated on his way as being "the only way", it's hard to argue with the facts and logic. You be the judge. If you get the big picture right, you've won the battle for survival. Get it wrong, and it could mean disaster. I know how I'm betting, and you get my daily stuff with that direction in mind.

Peter Schiff: Stimulus Bill Will Lead to "Unmitigated Disaster"

<http://finance.yahoo.com/tech-ticker/article/169781/Peter-Schiff-Stimulus-Bill-Will-Lead-to-%22Unmitigated-Disaster%22?tickers=^dji,^qspc,QQQQ,SPY,DIA,TLT,UDN>

Peter Schiff: Why I'm Right and My Critics Are All Wrong

Let's look at a reasonable set of facts (mostly courtesy of John Mauldin's "Frontline Thoughts"), in no particular order, to help us focus our minds on the issues:

1. Consumers are going to save more and spend less. It is likely that US consumers are going to push the savings rate back up to 6% (or more). Total US net worth decreased by \$7.1 trillion through the third quarter of 2008, from housing and stock market losses. The trend suggests that could easily be up another \$6-7 trillion by the end of this quarter. Greg Weldon speculates that it could easily be \$15 trillion by the end of the cycle. That is a massive amount of wealth destruction. And while the absolute numbers are not as large in the rest of the world, the relative magnitudes are. This is a truly global recession. Economists say that anything below 2.5% in world growth is a global recession. We are down to 0.5% and falling.
2. The stimulus package is simply a pork-laden, misguided piece of legislation. The nonpartisan Congressional Budget Office released a report that says "CBO estimates that this Senate legislation would raise output and lower unemployment for several years. In the longer run, the legislation would result in a slight decrease in gross domestic product (GDP)". There is way too much spending on items that have very little current effect on the economy.
3. We are somewhat more hopeful about the Federal Reserve and Treasury programs, although all they really do is buy time for financial corporations to heal themselves. Volker did it in the early 80's by allowing banks to carry debt from Latin American countries that was in default at full loan value. Otherwise every major bank in America would have been bankrupt. Much of the process will be wasteful and unproductive. But if US taxpayer money is involved, shareholders should be wiped out first. Bank investors should not be in a special protected class.
4. It will take until at least 2011 for the housing market in the US (and bubbles elsewhere, as in England and Spain, etc.) to stabilize. It will take several years for the creation of a new credit system to rationally replace the old "shadow banking system." The downgrades by Moody's last week of 2,446 different classes of Residential Mortgage Backed Securities will be a real blow. "Moody's warned in a report last week that loss assumptions would be increased for RMBS and that downgrades could be expected. Moody's is projecting that Alt-A deals originated in the second half of 2007 will experience 25.5% losses of original balance, compared to 23.9% of 1H07 deals, 22.1% for H206 deals and 17.1% for 1H06 deals. The rating agency in May expected average losses for 2006 and 2007 vintage deals to reach 11.2% and 14.7%, respectively." These losses are just going to keep coming. Commercial mortgage paper will soon be written down as well. Banks will likely need at least \$1.5 trillion in private investment and government funding.
5. The US government will run multi-trillion-dollar deficits for several years. Likely the current stimulus package will not be deemed sufficient by the third quarter, and the compelling need politicians will feel to do more will be almost uncontrollable. Interestingly, the increase in federal spending is going to be accompanied by a substantial decrease in state and local spending, as almost all non-federal entities must balance their budgets, and tax receipts are way down. If consumers are spending 5% less, it stands to reason sales taxes are down by 5%. Property taxes will be down, as will the state portion of income taxes. Increasing taxes will bring about local voter rebellion, so spending cuts will be the order of the day. As an example, state employees in California have every other Friday off, which cuts their pay by 10%. Expect more such cuts everywhere and on everything.
6. State, county, and municipal pension plans are woefully underfunded, by trillions of dollars. Within a few years governments are going to have to figure out how to deal with major shortfalls in funding, as many municipal pension plans will be technically bankrupt. Accompanying the increase in federal spending will be a real decrease in federal tax receipts, which will make the deficits worse.

6. The main driver in the economic world now is deflation, in turn set in motion through what started the rot - forced deleveraging. We had a brief whiff of inflation last year, but that was primarily commodity-driven, and that force is now spent. Commodities are likely to rise in price again, but this will at first be a reflection of the depreciation in the US dollar. The rapid shut downs of mines and capital expenditures will ensure future production and supply shortfalls. The Fed currently has the room to print money to monetize the federal deficit, and indications are that Bernanke will do it with a vengeance. He will do everything in his power to keep the US economy from catching "Japanese Disease," that is, descending into a deflationary spiral. We fully expect them to try to "move out the yield curve" and set longer rates at some lower number as well.

For an economy to grow over time, you need some combination of increasing population, productivity increases, and credit creation. A large part of our credit creation model (which was deeply flawed, even though for awhile it seemingly worked well) has been destroyed here in the developed world, and we will simply have to build a new one. We are likely going to see the creation of a massive new private credit market that will compete with banks, if the governments don't make the mistake of trying to nationalize the process. You can see this developing here and there, but it is going to take time. The Fed is stepping in now and buying mortgages, credit card debt, student loans, etc., which is useful in the interim, but they need to make sure they do it at rates that will attract private capital and capital formation. We do not want to turn the Fed or Treasury into a national mortgage bank subject to political whim. That would be worse than what we have now. As an example, the government is now nearly the only source for student loans, as they set prices that do not allow private companies to compete. We must not do that with mortgages.

A New Era

For those businesses dependent on the US consumer, their world is going to be smaller for a long time. We are in a period where the economy is going through what economists call rationalization. We are going to have to reduce the number of retail stores, coffee shops, automobile plants, fast food restaurants, car dealerships, etc., until we get to a level that makes rational sense for the size of the economy. We just built too much stuff, launched too many stores, and created too much capacity for almost everything.

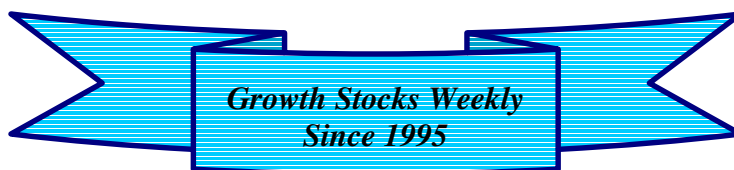
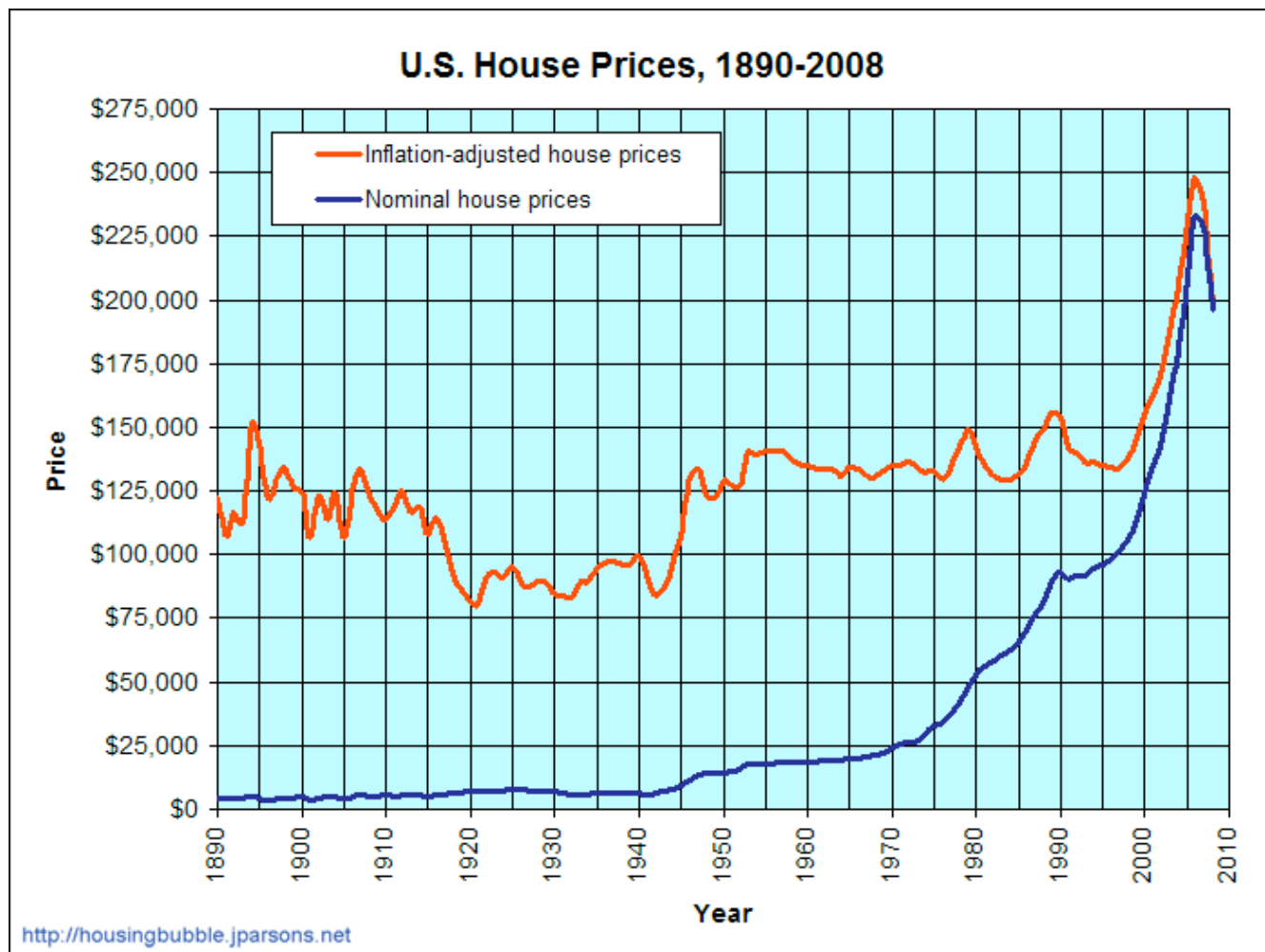
The idea for the businessperson today is to still be standing when we get through this, as we will. That is what free market economies do. The day will come when we get back to 3-4% GDP growth. But it will be a rational growth based in real fundamentals, one that will last a long time. So hope is not a business strategy. You need to be planning for a lengthy recession and a slow recovery.

And if your business is one that helps producers cut costs? Or improve production? Then this is your time to shine. It is not clear what the stimulus plan will be, but look at it to see if there is something you can do to get in the flow of that money. There are opportunities out there.

We were in a similar period of malaise in the late 1970s. Everyone wondered where the new jobs would come from. In hindsight the correct answer was, and still is, "I don't know, but they will." As it turned out, we saw the creation of whole new industries, which the government had little to do with. It is still the right answer. The market is far better at designing our future than any government. What new industries will we see next decade? Biotech? Energy? A new wireless telecom build-out? Something out of left field? The correct stance is to be cautiously optimistic and work hard and creatively for your own family's economic needs and benefit.

We are seeing some amazing private equity deals and new ventures. Deal flow continues to be excellent, albeit that finding the money to fund them is tough right now. Still, the lure of big gains does still find a way of matching money to a deserving project - but it's slower and more due diligence is done, for sure. It is really a great time if you have capital, as you can pick among some very nice opportunities.

Postscript: US Home prices adjusted for inflation were plotted as a roller coaster the graph of which is here: <http://www.speculativebubble.com/videos/real-estate-roller-coaster.php>



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