

# Growth Stocks Weekly www.gsweekly.com

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YE Apr30 Δ: '96 16.9%; '97 28.1%; '98 36.4%; '99 39.4%; '00 18.0%; '01 -50.5%; '02 18.7%; '03 28.8%; '04 166.7%; '05 28.2%; '06 153.3%; '07 8.8%; '08 -25.2%; '09 -50.3%; '10 162.3%; '11 2.6%

Vol. 16 No. 2

## Portfolio Review Edition

April 30, 2011

<b>Current Model Portfolio</b>							
Last Purchased	Units	Positions	Ticker	Average \$Cost	Market \$Price	Current \$Value	%Gain/ (Loss)
6-26Oct10	3,000,000	AKA Ventures	AKA-TSXv	0.07573	0.200	600,000	164%
21Jan11	500,000	Alange Energy	ALE-TSXv	0.31875	0.290	145,000	-9%
21Jan11	125,000	Alange Energy \$0.50 w ts exp 22Feb16	ALEWT-TSXv	0.00000	0.120	15,000	N/A
15Aug-8Oct09	250,000	Altair Ventures	AVX-TSXv	0.146	0.075	18,750	-49%
12-24Dec08	25,000	Anvil Mining	AVM-TSX	0.785	6.390	159,750	714%
25Feb11	5,455,000	Bell Copper Corporation	BCU-TSXv	0.3643	0.255	1,391,025	-30%
2Oct08	175,000	Bravo Venture Grp	BVG-TSXv	0.316	0.125	21,875	-60%
16-25Feb11	150,000	Canasil Resources	CLZ-TSXv	0.438	0.375	56,250	-14%
15Jun-17Aug10	250,000	Cardero Resource	CDU-TSX	1.178	1.740	435,000	48%
4Jan10	250,000	Catalyst Copper	CCY-TSXv	0.105	0.155	38,750	48%
11Aug10	5,000	Claymore/Alphashares Real Estate ETF	TAO-NYSE	18.680	18.830	94,150	1%
17-25Feb11	100,000	Concordia Resource (ex-Western Uranium)	CCN-TSXv	1.065	0.950	95,000	-11%
13Oct10	100,000	Creso Exploration	CXT-TSXv	1.020	0.425	42,500	-58%
23Nov-3Dec09	250,000	Donner Metals	DON-TSXv	0.175	0.335	83,750	91%
8Feb-22Apr10	500,000	Duncastle Gold	DUN-TSXv	0.077	0.065	32,500	-15%
9Mar11	250,000	Encanto Potash	EPO-TSXv	0.3325	0.280	70,000	-16%
8Dec10	125,000	Encanto Potash \$0.60 w ts exp 30May12	EPO-TSXv	0.000	0.000	0	N/A
01Feb10	100,000	Endeavour Mining Capital	EDV-TSX	1.792	2.390	239,000	33%
17May05	27,500	Entrée Gold Inc.	ETG-TSXv	0.812	2.620	72,050	223%
7-15May09	250,000	Evolving Gold	EVG-TSX	0.388	0.800	200,000	106%
1-10Dec09	250,000	Geovic Mining	GMC-TSXv	0.593	0.550	137,500	-7%
11Apr07	12,500	Geovic Mining \$5.00 Wts exp 27Apr12	GMC.WT.B-TSXv	0.000	0.010	125	N/A
3Aug10	62,500	Gran Colombia Gold	GCM-TSXv	1.600	1.360	85,000	-15%
3Aug10	31,250	Gran Colombia \$2.60 w ts exp 24Aug15	GCM.WT	0.000	0.800	25,000	N/A
17Mar11	250,000	Hathor Exploration	HAT-TSXv	1.7367	2.180	545,000	26%
4Jan06	60,000	Impact Silver Corp	IPT-TSXv	0.433	2.250	135,000	420%
21Jan09	5,000	iShares Cdn Energy Sector Index Fund	XEG-TSX	12.510	21.750	108,750	74%
25Apr11	10,000	Japan Smaller Capitalization Fund	JOF-NYSE	8.010	8.190	81,900	2%
17Jul-7Aug09	109,250	Kobex Minerals	KXM-TSX	0.705	0.900	98,325	28%
10Jun10	625,000	MGC (ex-Meekatharra Gold)	pre-IPO	0.200	0.300	187,500	50%
9-16Jun10	250,000	Mega Precious Metals	MGP-TSXv	0.478	0.450	112,500	-6%
20Nov09	25,000	New Gold Corp	NGD-TSX	2.860	10.630	265,750	272%
13Apr07	17,500	New Gold \$15.00 w ts exp 03Apr12	NGD.WT.B-TSXv	2.343	0.065	1,138	-97%
16Sep09	175,000	Novus Gold	NOV-TSXv	0.155	0.165	28,875	6%
21Nov09	250,000	NYCE Netw orks	pre-IPO	0.495	1.250	312,500	153%
15Mar10	250,000	NYCE Controls	spinout, pre-IPO	0.005	0.250	62,500	4900%
2Mar06	100,000	Orko Silver Corp	OK-TSXv	0.380	2.730	273,000	618%
20May10	850,000	Orsu Minerals	OSU-TSX	0.310	0.230	195,500	-26%
16Apr10	125,000	Orsu Minerals \$0.50 w ts exp 15Apr12	OSU.WT.B	0.000	0.005	625	N/A
4-12Feb10	400,000	Petroamerica Oil Corp	PTA-TSXv	0.586	0.180	72,000	-69%
16Feb10	250,000	Petroamerica Oil \$0.75 w ts exp 08Oct14	PTA.WT-TSXv	0.180	0.090	22,500	-50%
23Jun10	350,000	Petromanas Energy	PMI-TSXv	0.264	0.410	143,500	55%
4Dec09	250,000	Petromanas Energy w ts \$0.45 23Feb15	unlisted	0.000	0.220	55,000	N/A
24-29Mar11	250,000	Prima Colombia Hardw ood	PCT-TSXv	0.252	0.240	60,000	-5%
7Feb11	600,000	Rusoro Mining	RML-TSXv	0.729	0.260	156,000	-64%
17Feb-9Mar09	350,000	Shamaran Petroleum (ex-Bayou Bend)	SNM-TSXv	0.175	0.860	301,000	391%
2May08	40,000	Sky Ridge Resources	SYR.H-TSXv	0.245	0.275	11,000	12%
9May06	20,000	Strateco Resources	RSC-TSXv	1.380	0.600	12,000	-57%
31Oct-11Nov08	350,000	Terra Ventures	TAS-TSXv	0.362	0.425	148,750	17%
19Jul05	10,000	UEX Corporation	UEX-TSX	2.750	0.980	9,800	-64%
25Mar10	350,000	Valeura Energy (ex-PanWestern Energy)	VLE-TSXv	0.399	0.460	161,000	15%
28Apr11	400,000	West African Iron Ore (ex-Westward Expl)	WAI-TSXv	0.4586	0.450	180,000	-2%
25May10	50,000	Western Zagros Resources	WZR-TSXv	0.235	0.410	20,500	74%
		Cash Credit (Debit)				232,279	
		Portfolio Value (NAV)				8,052,167	
		Value @ 30Apr2010				\$7,850,597	
		Year-to-date NAV Growth				2.57%	

## Review of the last year's buys & sells (Emailed alerts & comments)

May 1, 2010 – April 30, 2011

Company Name	Comments	Date	\$ Chge	Cash
West African Iron Ore (WAI-TSXv)	Bot 250,000 shares @ \$0.45	28-Apr-11	(112,500)	232,279
Japan Smaller Capitalization Fund (JOF-NYSE)	Bot 10,000 shares @ US\$8.38 (C\$8.01)	25-Apr-11	(80,100)	344,779
Corridor Resources (CDH-TSX)	Sold 25,000 shares @ \$4.78 (stop-loss)	11-Apr-11	119,500	424,879
Prima Colombia Hardw ood (PCT-TSXv)	Bot 250,000 shares @ \$0.252 average	24-29-Mar-11	(63,000)	305,379
Gulfport Energy (GPOR-NASDAQ)	Sold 10,000 shares at US\$31.95 (C\$31.44)	23-Mar-11	314,400	368,379
Hathor Energy (HAT-TSXv)	Sold 50,000 shares @ \$2.26 average	21-Mar-11	113,000	53,979
Hathor Energy (HAT-TSXv)	Sold 50,000 shares @ \$2.07 average	18-Mar-11	103,500	(59,021)
Hathor Energy (HAT-TSXv)	Sold 150,000 shares @ \$1.90	18-Mar-11	285,000	(162,521)
Encanto Potash (EPO-TSXv)	Sold 125,000 shares @ \$0.486	18-Mar-11	60,750	(447,521)
Hathor Energy (HAT-TSXv)	Bot 150,000 shares @ \$1.59	17-Mar-11	(238,500)	(508,271)
Hathor Energy (HAT-TSXv)	Bot 50,000 shares @ \$2.133 average	14-Mar-11	(106,650)	(269,771)
Hathor Energy (HAT-TSXv)	Bot 50,000 shares @ \$2.05	14-Mar-11	(102,500)	(163,121)
Encanto Potash (EPO-TSXv)	Bot 125,000 shares @ \$0.355 average	9-Mar-11	(44,375)	(60,621)
Bell Copper (BCU-TSXv)	Exercised w warrants for 1.215 million shares @ \$0.10	23-Feb-10	(121,500)	(16,246)
Encanto Potash (EPO-TSXv)	Stop-loss triggered, sold 125,000 shares @ \$0.5325	17-Feb-11	66,563	105,254
Western Uranium (WUC-TSXv)	Bot 100,000 shares @ \$1.065	17-25-Feb-11	(106,500)	38,691
Canasil Resources (CLZ-TSXv)	Bot 150,000 shares @ \$0.4375 average	16-25-Feb-11	(65,625)	145,191
Corridor Resources (CDH-TSX)	Set stop-loss @ \$4.78 per alert	9-Feb-11		210,816
Encanto Potash (EPO-TSXv)	Set stop-loss @ \$0.54 per alert	8-Feb-11		210,816
Alange Energy (ALE-TSXv)	Bot 250,000 units @ \$0.30, with a 5-yr half-w t ex at \$0.50	13-14-Jan-11	(75,000)	210,816
Rusoro Mining (RML-TSXv)	Bot 250,000 shares @ \$0.3977 average	7-Feb-11	(99,425)	285,816
Alange Energy (ALE-TSXv)	Bot 250,000 shares @ \$0.3375	13-14-Jan-11	(84,375)	385,241
Gold Wheaton Gold (GLW-TSX)	Sold 19,000 shares @ \$5.10 (Takeover by Franco-Nevada)	13-Dec-10	96,900	469,616
Uracan Resources (URC-TSXv)	Sold 200,000 shares @ \$0.26	10-13-Dec-10	52,000	372,716
Encanto Potash (EPO-TSXv)	Bot 125,000 units @ \$0.40 with an 18 mo w t ex at \$0.60	8-Dec-10	(50,000)	320,716
Corridor Resources (CDH-TSX)	Bot 25,000 shares @ \$4.02 average	6-Dec-10	(100,500)	370,716
Encanto Potash (EPO-TSXv)	Sold 125,000 shares @ \$0.462 average	25-26-Nov-10	57,750	471,216
Opti Canada (OPC-TSX)	Sold 250,000 shares @ \$0.694	22-Nov-10	173,500	413,466
Opti Canada (OPC-TSX)	Bot 250,000 shares @ \$0.70	17-Nov-10	(175,000)	239,966
WesternZagros Resources (WZR-TSXv)	Sold 47,500 shares @ \$0.62	8-Nov-10	29,450	414,966
Alange Energy (ALE-TSXv)	Sold 250,000 shares @ \$0.74	28-Oct-10	185,000	385,516
AKA Ventures (AKA-TSXv)	Exercised 1.2 million wts @ \$0.10	26-Oct-10	(120,000)	200,516
Creso Exploration (CXT-TSXv)	Bot 100,000 shares @ \$1.02	13-Oct-10	(102,000)	320,516
AKA Ventures (AKA-TSXv)	Bot 100,000 shares @ \$0.171 average	6-12-Oct-10	(17,100)	422,516
Hathor Energy (HAT-TSXv)	Bot 75,000 shares @ \$1.75	25-31-Aug-10	(131,250)	439,616
Opti Canada (OPC-TSX)	Sold 100,000 shares @ \$1.02 (stop-loss)	19-Aug-10	102,000	570,866
Opti Canada (OPC-TSX)	Bot 100,000 shares @ \$1.059 average	12-16-Aug-10	(105,900)	468,866
Opti Canada (OPC-TSX)	Sold 75,000 shares @ 1.42 (stop-loss)	11-Aug-10	106,500	574,766
Claymore/Alphashares Real Estate ETF (TAO-NYSE)	Bot 5,000 shares @ US\$18.05 (C\$18.68)	11-Aug-10	(93,400)	468,266
Gran Colombia Gold (GCM-TSXv)	Bot 250,000 units @ \$0.40 with a 5 yr 1/2 w t ex @ \$0.65	3-Aug-10	(100,000)	561,666
Hathor Energy (HAT-TSXv)	Sold 75,000 shares @ \$2.086	27-Jul-10	156,450	661,666
Petromanas Energy (PMI-TSXv)	Bot 100,000 units at \$0.30	23-Jun-10	(30,500)	505,216
Cardero Resource Corp (CDU-TSX)	Bot 250,000 shares @ \$1.178	15-Jun-17-Aug-10	(294,500)	535,716
Mega Precious Metals (MGP-TSXv)	Bot 110,000 shares @ \$0.366 average	9-16-Jun-10	(40,260)	830,216
Meekatharra Gold Corp (pre-IPO)	Bot 250,000 shares @ \$0.50	10-Jun-10	(125,000)	870,476
WesternZagros Resources (WZR-TSXv)	Bot 97,500 shares @ \$0.235	25-May-10	(22,913)	995,476
WesternZagros Resources (WZR-TSXv)	Sold 250,000 shares @ \$0.26 (stop-loss)	25-May-10	65,000	1,018,389
Orsu Metals (OSU-TSX)	Bot 250,000 shares at \$0.21	20-May-10	(52,500)	953,389
WesternZagros Resources (WZR-TSXv)	Bot 250,000 shares @ \$0.2767	20-May-10	(69,175)	1,005,889
WesternZagros Resources (WZR-TSXv)	Sold 250,000 shares @ \$0.57 (stop-loss)	6-May-10	142,500	1,075,064
Bankers Petroleum (BNK-TSX)	Sold 25,000 shares @ \$8.11 (stop-loss)	5-May-10	202,750	932,564

*"Deficit spending is simply a scheme for the 'hidden' confiscation of wealth. Gold stands in the way of this insidious process. It stands as a protector of property rights."*

- Alan Greenspan, Chairman, U.S. Federal Reserve (1987-2006), Economist

## ***A look back: What we said during the melt-down crisis ...***

### **On the Resource and Commodity stocks:**

*"Adding up the weight of evidence, this looks to be a good time to search for value amongst the raw materials producers ... on the assumption that this downturn will end, then the commodity story will become more relevant than ever. We have growing doubts that the US economy will regain its characteristic global leadership, so most US stocks today lack the attractive long-term fundamentals of the leading commodity stocks. ... Longer term we have to like the prospects for the Canadian dollar and the energy and commodity plays in Canada. Once there is global economic recovery, the monetary expansion to get out of the crisis MUST be inflationary which ALWAYS benefits hard assets, by definition."*

### **On Gold:**

*"In the 1970s gold rose from \$35 to \$850, a factor of 24 times. The 21-year low set in 2001 was \$255.95 ... multiply that by 24 times and you get a gold price of \$6,200 per ounce ... the Gold/Dow Ratio was about "1" when gold peaked in 1980 meaning the Dow and gold were the same price. To restore that relationship at today's stock prices would mean when the Dow is at 7,500, gold should be at \$7,500/oz. ... the US government currently holds 287 million ounces of gold. If the government were to make each dollar redeemable by the amount of gold it possesses, we'd arrive at ... \$5,467 per ounce. Simple arithmetic, but you get the idea that the move to date has been pretty tame. The point here ... gold is at a historically cheap level when compared to the dollars out there. And when the dollar resumes its downward slide, and the expanding money supply jolts the real economy, and inflation kicks in, gold should start to reflect its intrinsic ability to store wealth."*

### **On China:**

*"Maybe China is ALREADY recovering. It may be a structural depression - but only for the developed countries, particularly the United States. Maybe it's only a recession for China. And maybe it's over." "Developing economies are reporting increases in exports after a catastrophic collapse at the end of the last year. Again, you can measure the collapse easily just by looking at the Baltic Dry Index. It fell by more than 90% last year. From its low, it's doubled - up 100%. But that still leaves it down 80% from a year ago." "Brazil's stock market is up almost 90% from its low. South Korean stocks are up 71%. And Chinese stocks - those listed on the Shanghai exchange - have gained 50%. Apparently, someone thinks the worst is over."*

### **On America:**

*"We doubt that this rebound in many of America's financial sector is the sign of a new, healthy boom. Credit expanded for half a century and the ultimate bubble has caused trillions of dollars worth of errors. Many of those errors have already been corrected, but the economy the bubble built remains unreconstructed. Same mismanaged companies, same mismanaged regulators, same mismanaged banks. Exporting nations had gotten very used to earning net sales from the U.S. of \$2 billion per day. Those earnings provided much of the speculative capital that created misallocations. A lot of that money has all but disappeared. The process of deleveraging will take many years."*

### **On Energy:**

*"Within the energy group, refiners and oil sands are attractive. Most oil analysts despise refiners, and they have to continue to refit their aging refineries. But Americans are driving less, and so refiners should hold up better than other oil sectors if there's one last oil shakeout coming. We also suspect that given their safe-haven location and long term life, we may never be able to buy oil for the future as cheaply as is possible today by buying the oilsands stocks. Peak oil is real, and it is here, now simply masked by the dislocation of massive deleveraging."*

### **On the U.S. dollar:**

*"Despite the already enormous depreciation in the US dollar's value, the currency still has much farther to drop. Recently the U.S. dollar "enjoyed" a counter-rally of epic proportions. This is just de-leveraging, with gold going down for the same reason a lot of stocks were going down, a lot of commodities were going down. There's a lot of leverage in this system, there's a lot of margin calls, a lot of liquidation; a lot of people are having to sell whatever they own to pay off their debts ... there was some perception of safety in the U.S. dollar, but it's the opposite of*

*the leveraging. If you're selling your assets, you're accumulating dollars. It's like there's been this gigantic nuclear explosion in the United States, and everybody is running toward the blast. Pretty soon they're going to figure out they're going in the wrong direction. The U.S. dollar will be the next bubble to burst."*

**On the American Consumer:**

*"The American consumer is basically going to stop consuming and start rebuilding his savings, especially as his home equity, the American consumer's largest source of "equity", evaporates. When you have the economy 70 percent consumption, you can't address those imbalances without a severe recession, and so here we are. As government and the lenders re-impose lending standards and tightening up on credit, and the sky-high real estate prices come crashing back down to earth, baby boomers are facing some severe challenges."*

**On U.S. Real Estate:**

*"Don't expect any major turnaround in prices soon. When the housing crisis began, we provided data that estimated that prices needed to come down about 40% in order to make the average house affordable by the average person. Of course that was before the average person's income came down. If the depression continues, house prices should come down a further 10% to 20%. And don't forget about the second wave of defaults ... some unlucky homeowners could see their mortgage payments as much as double ... and then there's the serious state of the commercial real estate market – only now starting to become evident."*

**On the Canadian Dollar:**

*"With the Canadian economy more stable than the American, savvy Americans a few years ago started putting their money into our resource sector. This had barely gotten going when the July 13, 2008 massacre was orchestrated by Bernanke and Paulson, killing the leveraged long commodities and short the dollar trade. Keep in mind that the Canadian dollar had gone from the low 60 cents to the Greenback to \$1.09 in relatively short order. OK, so now we've had a counter rally. We suspect the resulting deleveraging and forced liquidation certainly took even its instigators by surprise. We are one of the few countries to have not inflated our monetary base by printing more dollars. Plus we have the soundest banking system in the world now. It is ironic that Canada is more fiscally conservative yet the Canadian dollar goes down against the U.S. dollar for most of the last year. The Canadian economy and value system is like the best of America, but avoids most of its pitfalls."*

**On Timing:**

*"Our experience is that when everyone is bearish, it's invariably right to be buying. Being contrarian at the extreme works. The bottom of a stock-market cycle, by definition, has to be the point of maximum bearishness. The news doesn't have to be good for prices to rally; it just has to be less bad than what has already been factored into the market"*

**On the Depression Fear:**

*"A Depression in the old sense of the word is impossible. The world is a different place, and far wealthier than it was 80 years ago. If one describes a depression as the loss of purchasing power of the wage earner (a correct definition), then we have been in one for the past 50 years since wages have not kept up with the cost of living".*

*"Headlines: 'We are heading into the Greatest Depression in history'... as long as this image gets into the press and the media and politicians buy into it, the government has a green light to create as much money as is needed, and they will do whatever it takes. Bernanke has been telling us that for years. Throwing money out of helicopters ... believe him!"*

**Our April 2009 Conclusions:**

*"We believe that the stock market is giving the correct signals, that commodities and tech will lead the next recovery. Yes, China is coming back – they have high savings rates, no debt and are long term players, but the industrial world is still looking bleak... We continue to believe that small-caps are the place to be for 2009-10, as readers of my "Back up the Truck" commentary last year know all too well ... history has shown that if you can weather the volatility (meaning stay out of margin, stay disciplined with mental stop-losses in place, and use money earmarked for aggressive growth, not retirement cash flow) you will out-perform the market. With some good timing thrown in, performance can be wildly profitable. Jumping into the deep-end and buying well considered, traditionally riskier small cap stocks continues to be the smartest bet right now ... Gold stocks may well be superstars again once the dollar finally falls, and people begin to get genuinely worried about inflation's return, and they should outperform bullion to the upside."*

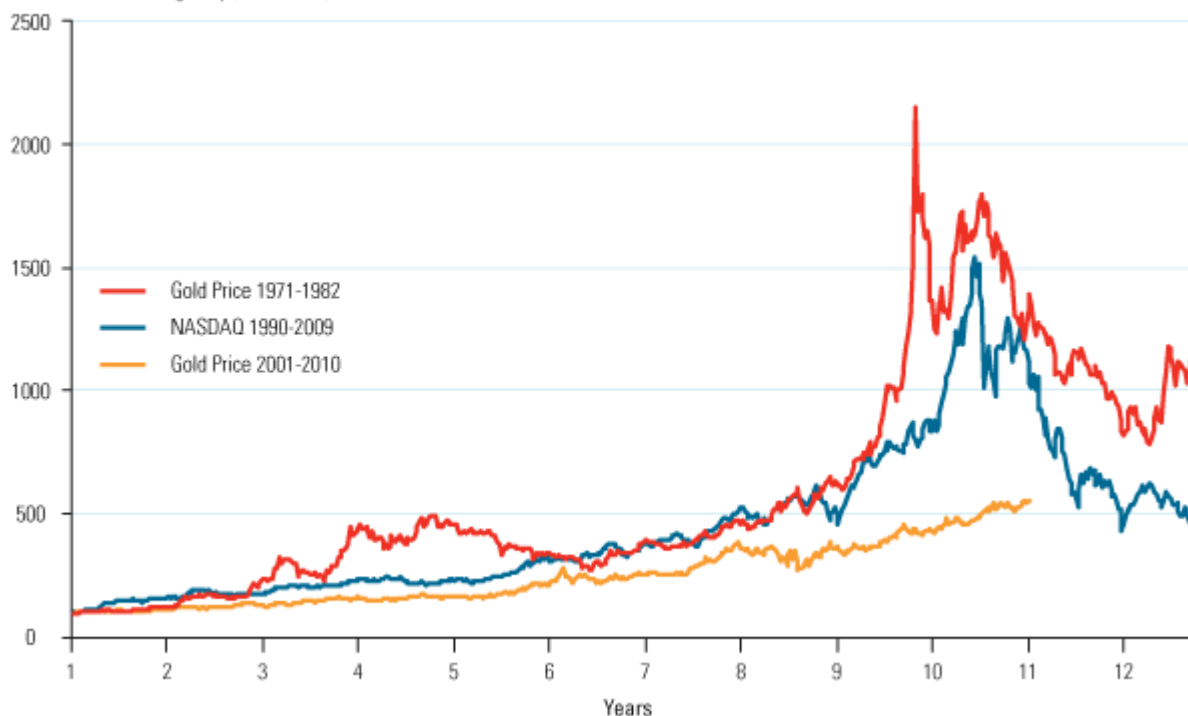
## America's "fatal conceit"

*"As a general rule, the most successful man in life is the man who has the best information"*

- Benjamin Disraeli, British Prime Minister and novelist (1804-1881)

### Compared to Past Bubbles, Gold's Not One

Performance during rally (Set to 100)



Source: DundeeWealth

Comparing the current bull cycle for gold against gold's run from the 1970s and 1980s, you can see that today's run has been slow and steady. It's also missing the sharp spikes typical of a bubble. Another key difference in this gradual move higher is the growing affluence of the developing world where people have traditionally turned to gold as a store of wealth. We are seeing that in unprecedented numbers in countries such as China and India.

First, let's clear the air a bit. Forget all the "bubble" talk about resources and precious metals in particular. The wounds inflicted by the 2008 market crash remain apparent in the occasional hand-wringing media reports covering the booming commodities market. The word "bubble" has lost almost all meaning since 2008, with every bull move now likened to one form of a bubble or another.

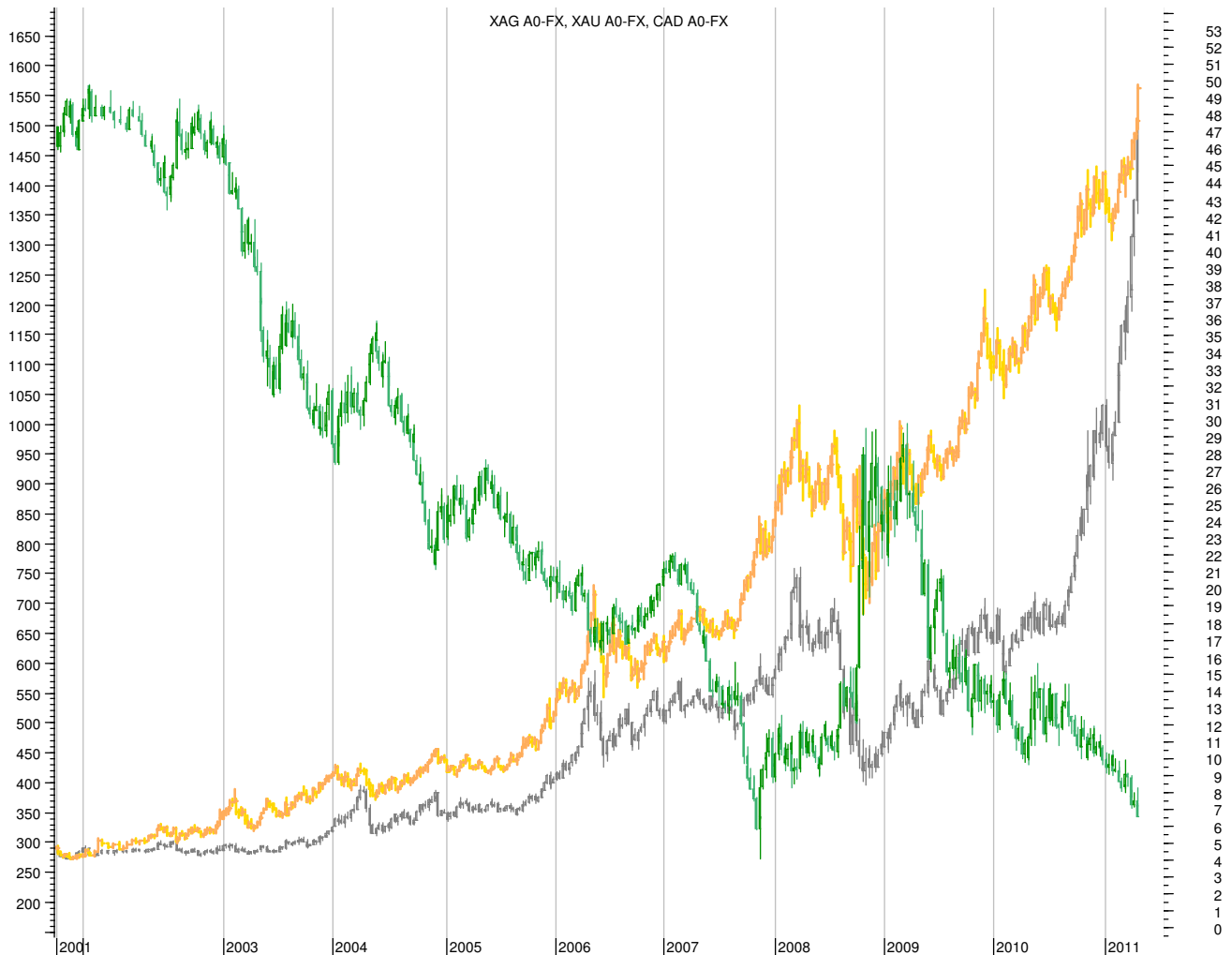
No credible evidence suggests that the precious metals market is in the midst of a mania. It's a bull market, plain and simple. For now, the trend is our friend, as it has been for almost a decade. Of course, a healthy bull market never progresses upward in a straight line. We can expect volatility in gold and especially silver, which will translate to our junior resource sector holdings. The extreme price swings should provide traders with plenty of opportunities to buy shares and take profits.

The main point to consider is how the U.S. Federal Reserve continues to help gold's rise. Record deficits, quantitative easing, and the recent S&P downgrade warning all add fuel to the precious metals' fire. Gold is and will continue to be an attractive store of value as inflation and the government's inability to reverse a growing deficit remain widespread concerns.

This week we heard from Chairman Bernanke about how his "on sound footing" recovery is beginning to falter. The recovery, says he, is now "moderate," requiring the Fed to maintain their historically low interest rates for "an extended period." More unsound money in other words, designed to build a so-called stronger foundation on which to erect that seemingly elusive recovery. Talk about inconsistent economic theory!

The markets were not fooled. As he was busy proclaiming his commitment to a "strong dollar policy," the dollar index hit a brand new, post-2008 recession low. And the price of an ounce of gold soared to \$1,569 ... of course, for our purposes, it's more correct to say that the dollar simply slid to 1/1,569th of an ounce of gold.

And then there's that other increasingly popular anti-dollar investment. Silver moved back up to a hair under that big round number of \$50 an ounce (the 1980 nominal high) and crude (West Texas Intermediate) climbed back above \$113 per barrel. Bernanke tells us that at least these high prices in gas will be a temporary phenomenon.



*This chart shows in graphic detail the performance of gold (left scale) and silver (right scale) versus the US dollar (overlaid without scale, in Canadian dollar terms). What's interesting to note is how quickly silver has made up for lost ground.*

It may be depressingly obvious to the average American that the powers-that-be are not here to fix their problems and cure their ills. They fiddle about with this sector and that, mostly to stimulate in order to get the economic "machine" to correct its course.

Unfortunately, there is no "machine" to fine tune ... no "economy" as such to manage. Not in the sense they are expecting, anyway. The economy is comprised of individuals and their aspirations and desires. Hundreds of millions of decisions and reactions made minute by minute and day by day in order to survive, to hopefully prosper, to make the future better, to take care of one's own.

As Frank Shostak, adjunct scholar of the Mises Institute, puts it, "The GDP framework gives the impression that it is not the activities of individuals that produce goods and services, but something else outside these activities called the 'economy.' However, at no stage does the so-called 'economy' have a life of its own independent of individuals. The so-called economy is a metaphor – it doesn't exist."

Bernanke's Fed is tuning something that can't be tuned, trying to create demand – along with dollars – out of thin air, rather than allowing the market to respond to the wills, desires and follies of its participants. This is their error, one F.A. Hayek so eloquently referred to as "*The Fatal Conceit*."

## ***Is the U.S. at the point of no return?***

Declining confidence in paper money is pushing gold and silver from the shadows to center stage. The US economy is the world's largest, and the federal deficit this year is a record \$1.6 trillion - a number that requires the government to borrow 43 cents out of every dollar it spends. The US government's total debt will mushroom from \$14.2 trillion now to almost \$21 trillion by 2016.

Obama's projected \$1.6 trillion deficit for the current year would be the highest dollar amount ever. It represents 10.8 percent of the total economy, the highest level since 1945 when the deficit was 21.5 percent of GDP and reflected heavy borrowing to fight the Second World War. The US president's 2012 budget projects that the deficits will total \$7.2 trillion over the next 10 years with the shortfalls never coming in below \$607 billion.

Professor Peter Bernholz, from the University of Basel, examined 12 of the 29 hyperinflationary episodes where significant data exists. "Hyperinflations are always caused by public budget deficits which are largely financed by money creation ...the figures demonstrate clearly that deficits amounting to 40 percent or more of expenditures cannot be maintained. They lead to high inflation and hyperinflations."

Government reporting doesn't highlight how big the deficit is relative to expenditures, and thereby misrepresents the true size of the problem. In February President Obama released his 2012 Federal Budget. The report updated the projected 2011 deficit to \$1.645 trillion, based on estimated revenues of \$2.173 trillion and expenditures of \$3.818 trillion. For anyone without a calculator, that puts the deficit at over 43% of expenditures!

Obama then unveiled a \$3.73 trillion budget for 2012 with a projected deficit of \$1.1 trillion – with a lot of savings/cuts and revenue assumptions in the 2012 budget that are considered unreasonably optimistic. The savings and revenue projections may have more to do with the 2012 election than reality – Obama trying to appear fiscally responsible to the voters. Unfortunately it doesn't look like either party can agree to any cuts except to those in someone else's back yard.

Meanwhile the US government is increasingly unable to sell enough of its debt to its own citizens and foreigners to finance the deficit and pay the interest on its existing debt. So on April 18th Standard & Poor's Ratings Service finally lowered its long term outlook for the United States sovereign debt to Negative from Stable. Moody's had issued a warning earlier in 2011 saying that its rating could be downgraded if progress isn't made soon on the (then) \$1.5 trillion US budget deficit.

Are there any countries in the world going to enter into a hyperinflationary episode anytime soon? Tough to say, but we do know that inflationary forces are building, and that it's likely going to get to much higher levels than being experienced today.

As long as such an irreconcilable disconnect between reality and the Federal Reserve's policies remain (do they have much choice?), this experiment in re-writing the rules of economics will continue to see a buildup of imbalances that will someday need to be relieved.

Gold and silver do best in inflationary times, and history proves that the greatest leverage to rising precious metal prices are junior companies involved in the discovery and development of precious metal projects. Further in this issue we take a look at where else one may find relief, but the theme here is definitely one of maintaining our course. The trend remains your friend, and there is not a lot of wriggle room for the Fed at this time.

***“Common sense tells us that a government central bank creating new money out of thin air depreciates the value of each dollar in circulation.”***

-Congressman Ron Paul (Republican Congressman, Presidential candidate)

***“The surge in commodity prices over the past year appears to be largely attributable to a combination of rising global demand and disruptions in global supply. These developments seem unlikely to have persistent effects on consumer inflation or to derail the economic recovery and hence do not, in my view, warrant any substantial shift in the stance of monetary policy.”***

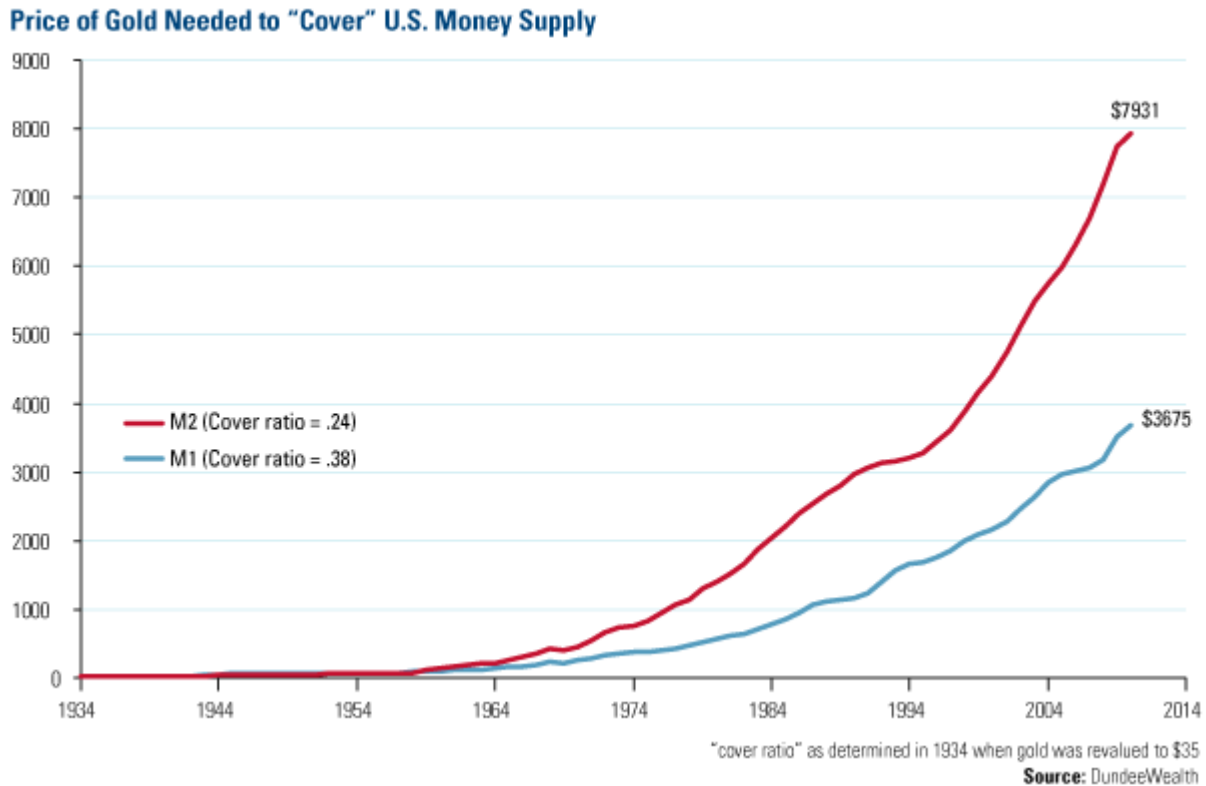
- Janet Yellen (Federal Reserve Vice Chairman, economist, professor)

*“There is only one difference between a bad economist and a good one: the bad economist confines himself to the visible effect; the good economist takes into account both the effect that can be seen and those effects that must be foreseen... the bad economist pursues a small present good that will be followed by a great evil to come, while the good economist pursues a great good to come, at the risk of a small present evil.”*

-Frederic Bastiat (Political economist, author, member of the French Assembly, 1801-1850)

*“Yes, we are monetizing debt. You buy bonds and you monetize debt. Right now, a lot of that is going into excess reserves so it is not having an immediate effect on inflation. It will initiate inflationary impulses. It takes time.”*

-Thomas Hoenig (President, Federal Reserve Bank of Kansas City, early March 2011)



One of the things to keep in mind is the effect money supply growth can have on gold. This fascinating chart shows how much gold would need to increase in order to cover the amount of money that has been printed since gold was revalued at \$35 in 1934.

## ***A closer look at the U.S. situation***

So here we are, Standard & Poor's is finally downgrading its outlook for US debt to "negative," from "stable." Of the 17 countries that S&P has rated AAA, the United States is now the only sovereign that carries with it a negative outlook. The complete lack of fiscal discipline currently on display in Washington has potentially dire implications for the US economy.

The problem is that deficits are a lot harder to get rid of than they are to incur. Spending cuts and tax increases are very hard to enact, while spending increases and tax cuts virtually enact themselves. One just needs to recall the \$787 billion US Recovery and Reinvestment Act that was passed in a couple of weeks in 2009, whereas it took Congress three months and a near-shutdown of the government to agree on a mere \$38 billion of 2011 spending cuts.

Traditionally, governments thought they had little alternative but to balance the budget, or risk an economic collapse. The required self-discipline was best demonstrated by Lord Liverpool's British government, which in 1815 inherited the largest public debt that any country has successfully conquered - about 250% of Britain's 1815 gross domestic product (GDP).

Even back then, there were voices advocating a loose monetary policy that would reduce the real value of the debt, satisfying the government's obligations by cheating the bondholders. Liverpool's government took the high road and raised taxes on imported food through the notorious Corn Laws, took the country back onto the gold standard - which involved a price deflation of about 20% -- and cut public spending to the bone.

The short-term result was a huge economic boom, which within a decade produced substantial budget surpluses and reduced the debt's burden to manageable levels. The long-term result was a century of stable prices and prosperity, at the end of which the debt was lower in nominal terms than it had been in 1815, and GDP was about 10 times higher.

The blame for eradicating that admirable attitude towards deficits and debt can be pinned on John Maynard Keynes. His justifications for increasing government spending in depressions and reducing it in booms were used to create deficits, and never surpluses, when Britain in 1945 was faced with a similar but smaller debt problem to that of 1815. It increased public spending rather than decreasing it, and sorted out the debt by creating inflation. Thus it balanced the government's books by robbing bondholders, many whom were literally reduced to poverty.

The current approach by US President Barack Obama and Federal Reserve Chairman Ben Bernanke towards public debt is similar to that of the British leadership after 1945. A huge wave of unproductive spending has been incurred since 2008, most of which has become locked into the "baseline" expenditure for future years - hopelessly preventing the budget from ever approaching balance.

Their strategy for tackling the resulting debt is to create inflation and watch it magically melt away, to become a smaller and smaller percentage of a GDP that is inflating in nominal dollars.

Of course, there are two problems with that approach. One is that there are no longer accommodating bond investors that can be leveraged to absolve the US debt crisis. Instead, much of the debt is held by Asian central banks and the Middle Eastern ultra-wealthy. And it appears they don't appreciate being swindled in this way, and will find some way of protecting themselves.

Compounding the issue is the policy of ultra-low interest rates. They empower the huge public deficits and with the government's attempts to mask the increasing inflation, are very bad for the real economy. They encourage banks to engage either in speculation or to simply buy government bonds and finance them short-term. Neither activity directs money to small businesses, which is historically the leading source of job creation.

Companies also are encouraged to invest in new factories, but mostly outside the US, while cutting domestic labor forces to the bone - since capital is cheap and US labor is relatively expensive.

Those two factors help explain why US GDP growth in this recovery has been so sluggish and high unemployment so persistent. Indeed, long-term unemployment is almost half of total unemployment at present, far above its level in previous post-war recessions - and that's ignoring those who dropped out of the workforce altogether.

Years of ultra-low interest rates are as bad for the nation's social fabric as they are for the economy as a whole, producing a huge pool of unemployables. Gambling is encouraged, and true entrepreneurship and hard work discouraged.

Keep in mind that Lord Liverpool's budgetary austerity was rewarded by a massive economic boom, which was the core of the first Industrial Revolution. The US would likely see similar results if it made that approach its own, instead of avoiding the pain by the very means that created the problems in the first place - misallocation of cheap money and excessive leverage into non-productive assets.

Fortunately, as an investor, there are steps you can take to safeguard yourself against the destructive fiscal and monetary madness. A change or any perceived backtrack in US policy is hopelessly unlikely in the near term, so continue to hold gold and avoid US Treasury bonds. It won't entirely mitigate the economic unpleasantness ahead, but it will help you avoid the sad financial fate of previous generations of savers and bond investors.

For most of the last decade we have beat these “big picture” issues to death, with countless charts, analysis and narrative about the growth of the Asian economies, the coming destruction of the US dollar, the bubble in real estate and consumer debt, the need for precious metals within the secular commodity bull market, Canada’s unique resource sector and currency situation, copper’s coming place for growing our portfolio, etc.

Has the story changed? No! We are staying the course, but will of course maintain a jaundiced eye on the horizon for signs of a sea-change. These trends will often last +20 years. At this time, the forces at work cannot be easily side-tracked, but as any good bull will try its best to do, riders will have to hang on tight to avoid being bucked off too early.

**Top Foreign Holders of U.S. Treasury Securities**

*The share of U.S. public debt held by foreign governments has risen steadily in the last quarter century – up from 13% in 1988 and 25% in 2007 to nearly 50% today. As of January 2011, foreigners held roughly \$4.45 trillion worth of U.S. government debt – which equates to approximately 47% of the \$9.5 trillion worth of federal debt in public hands and 32% of the \$14.1 trillion in total U.S. debt.*

*With \$1.15 trillion worth of U.S. Treasury securities, the central bank of Mainland China was the single-largest overseas holder of U.S. public debt. That was followed by the Bank of Japan (\$885 billion). To see the Top 20 holders, check out the list that follows.*

Rank	Country	U.S. Debt (in billions of USD)
1.	Mainland China	\$1,154.7
2.	Japan	\$885.9
3.	United Kingdom	\$278.4
4.	Oil Exporters (*)	\$215.4
5.	Brazil	\$197.6
6.	Carib. Banking Ctrs (**)	\$166.5
7.	Taiwan	\$157.2
8.	Russia	\$139.3
9.	Hong Kong	\$128.1
10.	Switzerland	\$107.6
11.	Canada	\$86.6
12.	Luxembourg	\$83.0
13.	Germany	\$61.1
14.	Singapore	\$57.8
15.	Thailand	\$56.4
16.	Ireland	\$44.4
17.	India	\$40.6
18.	Mexico	\$34.4
19.	Turkey	\$32.9
20.	Belgium	\$32.1
	<b>Total (all holders):</b>	<b>\$4,453.4</b>

Special Notes: These totals are in billions of USD as of January of this year. The figures were reported by the Department of the Treasury/Federal Reserve Board on March 15.

Oil Exporters (\*) include Ecuador, Venezuela, Indonesia, Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates (UAE), Algeria, Gabon, Libya and Nigeria. Caribbean Banking Centers (\*\*) include the Bahamas, Cayman Islands, Netherlands Antilles, and Panama.

Sources: U.S. Treasury Department, Money Morning staff research

## *The American Dream becomes a nightmare*

Deutsche Bank expects Q1 2011 to show another 14% year-over-year house price drop to bring the total average price drop since 2006 to 41.7% across America. Some markets in California, Florida and Las Vegas will have 90% or more of their loans in negative equity position. Fitch is predicting that home prices will fall another 10 percent in 2011. The agency’s negative outlook is due to the continuing foreclosure crisis, ongoing high unemployment, and the overwhelming supply of homes on the market and relatively paltry demand for them.

The supply of available homes is the number one hurdle to a recovery in the housing market. According to CoreLogic, there are more than 6 million unsold homes (including visible and shadow inventory). There simply is not adequate demand to absorb these homes, and basic economics tells us that home prices must fall as a result. Until the US starts putting people back to work in large numbers, this situation will not change.

Since the debt crisis started in earnest we’ve seen the greatest transfer of wealth in the history of the world. Taxpayers have literally had their money confiscated, with absolutely no recourse, to bailout the very bankers, unions, automakers, mortgage companies and insurance companies that are the perpetrators of the debacle.

This was not "unfettered capitalism" at work as the media and liberals would like you to believe. The more appropriate term is crony capitalism.

This sort of capitalism is based on profits not from the voluntary exchange of two individuals without interference, but from cultivated contacts between multinational corporations and the government ...between the Federal Reserve and the large US financial institutions ...and between powerful labor unions and a government that represents not their constituents, but special interests.

Russian-born American philosopher Ayn Rand's apocalyptic 1957 mystery novel, *Atlas Shrugged*, is a source of inspiration for millions of people. Company CEOs require their executives to read it, and the modern Tea Party movement in the US often echoes the tome's key themes of individualism, capitalism and minimal government. The best seller book gallantly attempts to tear away the thin capitalism veneer to reveal what really is happening today in America: socialism.

The book explores a dystopian US where leading innovators, ranging from industrialists to artists, refuse to be exploited by society. The protagonist, Dagny Taggart, sees society collapse around her as the government increasingly asserts control over all industry, while society's most productive citizens, led by the mysterious John Galt, progressively disappear.

Galt describes the strike as "stopping the motor of the world" by withdrawing the "minds" that drive society's growth and productivity. In their efforts, these people "of the mind" hope to demonstrate that a world in which the individual is not free to create is doomed, that civilization cannot exist where people are slaves to society and government, and that the destruction of the profit motive leads to the collapse of society.

In the subsequent movie adaptation completed in July 2010 ([released April 15, 2011](#)), the great manufacturers, builders and financiers one by one inexplicably disappear. In the last scene, we realize they've moved to locations where their great efforts will be rewarded, without having to bow to the government altar or have others leech off the sweat of their labors.

Is the disappearance of the United States' great manufacturers and companies (along with many productive wealthy individuals) anything more than the consequences of years of increasing government interference in every aspect of production and the citizen's lives?

The movie ends as a cliffhanger with a question: What happens when the builders of wealth, the ones who in the United States are currently fed upon by nearly 50% of the population, reject the proposition that others are more entitled to the fruits of their labor?

As it turns out, Ayn Rand seems to have been pretty accurate with her predictions of what today would look like if the US continued its sponsorship and creation of the parasitic class. Today the movie paints an even bleaker, yet sadly accurate picture of the results of 80 years of the failed policies of socialism. The story is set in a nightmarish future where Europe has fallen into starving ruin, and the US economy is being crippled by maniacal bureaucrats and crooked businessmen.

Some fans of the book are certainly noticing parallels with reality: when the recent recession hit, *Atlas Shrugged* sales spiked to 500,000 in the US - remarkable for a book first published in 1957. With limited screenings and unorthodox distribution, it's not known how the film will fare with general audiences.

Political junkies, Bay Street lawyers and Calgary's oil industrialists would be expected to fill theatres for the film's screening in Canada -- but they will have to wait. Filmmakers are hoping the picture will be considered at the Cannes Film Festival, and rules require the entry to not be shown outside of the country of origin.

## ***Europe takes a back seat to revolution***

The revolutions across the south of the Mediterranean have taken investors' minds off the problems in Europe, and in response the euro has climbed from US\$1.30 to \$1.48, reflecting mainly the US dollar's unofficial, ongoing devaluation, disguised as a "strong dollar" policy. Europe's issues are far from resolved, but other more immediate issues have taken the world stage.

American troops have once again been committed to a war, this time one in Libya that is not called a war, with no real agreement among the partners as to its goals, and without firsthand knowledge of the aims and capabilities of the rebels who created the crisis. Already there are reports that Al Qaeda elements are prominent in some of the rebel groups.

As Thomas Friedman wisely noted, "There are two kinds of states in the Middle East: real countries with long histories in their territory and strong nation identities (Egypt, Tunisia, Morocco, Iran); and those that might be called 'tribes with flags' or more artificial states with boundaries drawn in sharp straight lines by pens of colonial powers that have trapped inside their borders myriad tribes and sects who...have never fully melded into a unified family of citizens. They are Libya, Iraq, Jordan, Saudi Arabia, Syria, Bahrain, Yemen, Kuwait, Qatar, and the United Arab Emirates."

The Americans are now allocating already overstretched resources to a conflict without any reasonable chance of accomplishing something decisive. There is also the real prospect that it would need to commit boots on the ground to stabilize Libya if and when Gaddafi is gone.

Libya is a significant producer of light crude, and so the military activity and rebellion have had a definite impact on oil prices and on perceptions of risk in the global economy. The revolutions in Tunisia and Egypt are also major human and historical events, but are likely to have little investment impact for us.

However, if Saudi Arabia's regime were threatened, the effect on global stock prices would be significant. A 70s-style oil shock remains a remote contingency, but it is far less remote than it was four months ago.

What makes the Saudi situation tenuous are the escalating riots and tumults in neighboring Bahrain and Yemen, where the local Shia population is resentful of the distribution of power and wealth amongst the ruling Sunnis. And the Saudis continue to deal with the ongoing propaganda efforts from Iran to foment unrest.

Worthy of note is that Yemen has long harbored, unwillingly, Arab terrorists, and recent reports state that top officials in the government and army are now defecting to the rebels. Before we can rejoice in yet another triumph of the human spirit, we may well hedge ourselves and prepare for new waves of well-financed and well-trained jihadists across the West – for history shows that popular revolutions open up opportunities for the organized.

Most of the known jihadists who have sacrificed themselves in Afghanistan, Pakistan, America and Israel, and in other parts of the world, have been Sunni. Al Qaeda is Sunni.

Some of Al Qaeda-driven jihadism has been aimed at Shias. The religious war between Sunnis and Shias has been more or less continuous for 18 centuries. Jihadists can create mayhem because they are terrorists, and not uniformed soldiers. While Saudi security forces have been very effective at neutralizing the threat, even a few jihadist employees stationed at oil installations could have a significant impact on Saudi oil output.

As in Libya and Egypt, the ultimate victors of these popular uprisings seeking political freedom could be rigid Islamists with a tendency toward terrorism, and the suppression of women, Christians, and Western sensibilities.

According to Coxe Advisors, a Chicago-based investment advisory firm and publishers of Basic Points, investors should assume that the Arab revolutions have only begun and the potential for the kind of shocks, setbacks and disappointments that could translate into impact on the global economy has only begun. History is full of examples of what revolutions accomplish, and it's not what you'd expect ...

Liberals (Girondistes and their allies) began the French Revolution. The extremists (Jacobins) guillotined or expelled them and took over.

Liberals began the Russian Revolution. The extremists (Bolsheviks) slaughtered them and took over.

Liberals began the Cuban Revolution against Battista. The extremists (Communists) killed or imprisoned them and took over.

Liberals began the rebellion against the Shah of Iran, cheered on by, among others, Jimmy Carter. The extremists killed or imprisoned them and took over; thereafter, they have had the time to torture their opponents before hanging them - by the thousands.

If the Arab revolution story turns from triumph to tragedy, much of the investor optimism that fueled strong equity markets outside Japan could fade fast.

Meanwhile, the very poor fiscal and economic situation in Europe is still simmering away. The resignation of Portugal's Socrates upon rejection of his austerity budget may well make the situation worse. The ECB and IMF are setting the terms for a rescue that is likely to reach €80-billion and would impose harsher austerity on one of Europe's weakest economies.

Greece's situation is still deteriorating rapidly, and Spain's cajas' finances continue to erode, further weakening banks inside and outside Spain.

Italy faces the return of its historic political merry-go-round if Berlusconi's record run ends. A laughing stock in many quarters, he was at least able to sustain for a record time the illusion that Italy was governable. Once the laughter stops, the tears will begin ...and the euro will go back on the critical list, and into the headlines.

The best havens continue to be denominated in Swiss francs and Canadian dollars. Precious metals have already been strong for a decade before western North Africa awoke to revolution, but the so-called "poor man's gold" - silver - has been under fire since events started escalating. As the risks across such a great swathe of the world turn from modest to serious, precious metals' basic values may become even more urgently in demand.

## *Hedging with diversity*

Agricultural stocks remain the commodities group with the best balance of risk and reward among all the possible outcomes of the current crises in the Mediterranean region and the Arabian Peninsula. Even without the possible effects of global cooling (yes, it's cooling we worry about), food and fuel inflation already troubles most of the world.

Triple-digit oil prices are back, with oil production pricing more chaotic and spreads widening between sweet and sour crudes, and day-to-day political risks. The US has been insulated from the worst of the price increases, largely due to its imports of Canadian oil sands products. The liberal rhetoric and efforts to block US imports of "dirty Canadian oil" have become remarkably silent. The oil sands companies continue to offer a long life alternative for investors in North American energy portfolios.

Brazil and Colombia have been fast-tracking access and development, using western technology, of their oil and gas and metals resources. The US government's Export-Import Bank is heavily invested in low-cost lending to Brazilian companies developing the deepest offshore oilfields in the Hemisphere. It is only a matter of time before Obama proclaims a cease-fire and issues licenses for big new deepwater drilling projects off US shores. It's hard to justify American taxpayers guaranteeing loans to develop Brazilian oil at much deeper depths than in the Gulf.

Memories of Three Mile Island and Chernobyl have been remarkably durable, but they were finally fading when Japan's Fukushima imploded. Other than our exposure to undervalued and special situation takeout candidates like our Hathor Exploration, we will avoid uranium stocks in general.

Base metals stand to benefit near-term from the rebuilding of Japan, the continuing urban migration taking place in the world's largest populated countries, and the increasing difficulty in finding sizable new deposits to replace depleting mines.

We do expect scrap to compete with virgin metal as the recovery continues, and some weakening in economic prospects from emerging economies as they deal with food and fuel inflation. A country like China will benefit by allowing their currency to appreciate modestly, thereby exporting some inflation and increasing their purchasing power to buy up technology and resources and make investments in weaker economies and foreign companies.

Stagflation of 1970s' proportions may be a remote possibility but that doesn't mean that meaningful damage won't be inflicted on bond portfolios, particularly those denominated in currencies of excessively over-indebted countries. Long term bonds are susceptible to severe declines as artificially low interest rates revert back to the mean.

Inflation is increasingly being discussed these days. Consumers are beginning to feel the effects of rising costs on their pocket books. As inflation strikes, investors need to position themselves to prevent against loss of wealth and buying power. In the past many investments have been used as inflationary hedges, including various commodities, real estate and stocks. Stocks do tend to gain against rising prices, but they can be volatile. Real-

estate can appreciate, but the current trend in the US is escalating living costs while a huge overhang of inventory keeps real estate price appreciation at bay.

Commodities can be a viable source of inflation protection because as the economy grows, so does the cost of inputs. But not all commodities are created equal when it comes to inflation protection. The classic choices include silver and gold, however, taking data from the recent economic cycle, some economists are beginning to note that in this cycle, copper may be a better hedge.

Copper as a hedge against inflation is cheaper, and according to many analysts, it will have more upside over the next few years. The bullish prediction for copper's price over the near-term is basic ...supply is predicted to lag demand. The International Copper Study Group has said that the growth in copper demand in the world is likely to exceed global output within this year.

Over the near-term, copper demand will be supported by growth in the emerging markets, and even the rebuilding of Japan. There will be a lag in time before adequate, new copper supply comes online. It is quite obvious that miners are positioning themselves to benefit from copper's expected rally. Even the world's largest gold miner Barrick Gold has joined the copper market, through its purchase of Equinox Minerals. Barrick was not shy in admitting that it was interested in the company for its copper assets, and that it had no intention in becoming a diversified miner: it was interested in copper, and copper alone.

Our largest two portfolio positions are all about copper, where we will benefit from a growing resource, deeply undervalued assets, and exposure to a buoyant copper-price environment.

**Fed Sends Gold Sky High; Dollar Lower**



Source: Bloomberg

*The Fed's announcement that it will continue its quantitative easing through June 2011, while keeping interest rates low was the driving factor weighing on the dollar. This is in contrast to the rest of the world where central banks have begun to increase interest rates in an effort to curtail inflation. In addition, the significant budget deficit facing the U.S. will most likely continue to keep the dollar depressed while supporting the price of gold.*

Gold has been, and will continue to be, an excellent hedge against inflation; however, its performance comes with a few caveats. Gold performs best under certain situations. Gold is a great hedge when instability such as war and political crisis rock the markets. Gold also tends to perform the best in the later stage of an expansionary cycle. Copper, in contrast, performs best in the early expansionary cycle, where we are at today, although a good argument can be made that we are benefiting from several concurrent cycles that will have their own life.

Gold is susceptible to unpredictable bubbles, whereas copper's tie to economic growth is so predictable, that the metal is nicknamed "Dr. Copper." Copper can predict the health of the economy. When copper prices rise, it is seen as a prediction that the economy is about to grow; when copper drops, often a decline in the stock market follows.

An example of Dr. Copper's reliability was seen last June, during round one of the Euro Crisis. Copper prices collapsed and bottomed in June. The same dip did not hit the stock market until a month later. So while investors

seek ways to protect themselves against inflation, copper is an important commodity to consider. Copper has already shown its strong correlation with inflation during this recent rally, posting impressive gains whenever market sentiment has turned its focus to inflationary pressures.

## *Postscript*

The S&P credit agency sent shockwaves through the global financial system last week when it issued a warning on US debt and changed its outlook on the US sovereign credit rating from “stable” to “negative.” This sent markets lower and the prices of commodities such as oil rocketing back above \$110 per barrel and both gold and silver to new highs.

It should be noted that the S&P announcement was just a warning, not a lowering of the US debt rating, which was affirmed at AAA (the highest level possible). The fears quickly subsided and US markets hit fresh three-year highs. Essentially there’s only a one-third chance of a downgrade.

The warning validates what we already know: The US needs a plan to address its debt and budget issues ...and fast. Due to the fact that future fiscal austerity measures will likely act as a drag on the economy, we also think this potentially opens the door for a third round of quantitative easing (QE3) heading into next year, so we’ll have to keep an eye on Bernanke and the Federal Reserve’s next move.

These factors will continue to produce downward pressure on the US dollar and upward pressure on commodity prices. This is why we emphatically believe the bull cycle for gold and commodities still has a long way to run.

Good luck, and good trading.



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