A PEEK AT THE WEEK THAT WAS - July 27, 2013

Patient Capital.... Positioned for Profit

It has been an interesting week for gold but quite frankly, we are sick of writing about it and most of our readers are sick of reading about it.

So this week, we'll try to brief and let pictures tell the story better than we ever could. We have a couple of compelling charts that indicate that maybe both the shiny stuff and the companies that mine it, have turned the corner. As always, no promises but a few possible premonitions.

At the risk of beating on Bartender Ben Bernanke (as we have been routinely accused of doing) our chart of the week shows how Club S&P 1700 and Ben's balance sheet have been associating way too close for our comfort level.

And speaking of amateur economists, we have another clip from that classic Antipodean comedic duo, Clarke and Dawe, which pretty much sums it up. Click here to view it. It's subtle, wry and dry Aussie humor. Just what we all need these days.

BAD NEWS FOR GOLD MINERS COULD BE GOOD NEWS FOR GOLD PRICES

Our argument for gold continuing its bull market run has always been premised on a potentially significant disequilbrium between supply and demand.

Around the world, a combination of lower gold and silver prices has resulted in many mining and exploratory companies shelving or scrapping projects. In addition, many of the larger mining companies took on excessive amounts of debt in recent years and are now feeling the pinch. Low interest rates made debt an attractive alternative to raising cash via equity, especially while the shares of those companies had been beaten down.

From the WSJ Online....June 28,

> *In the second quarter, the price of gold posted its largest quarterly decline since the start of modern gold trading. Gold fell 23% in the period to close at $1,223.80 a troy ounce on Friday. Already, the price of gold doesn't cover the overall costs of many gold miners. Plummeting share prices have made financing the shortfall through equity markets hard.*

In the meantime, increasing resource nationalism and environmental concerns have made it more difficult for mining companies to get projects under way. A key example is Barrick Gold Corp's. set back at its huge Chilean Pascua-Lama property, whose budget has already ballooned from $5 billion to $8.5 billion. A Chilean appeals court ordered a freeze on construction until better water pollution infrastructure is created.

And now an indigenous group wants to push the ruling further. From the National Post / Reuters on July 22,,,

> ***Chile indigenous group appeals ruling on Barrick Gold's Pascua-Lama mine***

This is happening all over the world. From the Finanical Times last December:

> ***Nationalism threat to resource prices***

We have already seen it in China, where the world's largest gold producer keeps all of its gold at home. You will see more of this in the years ahead. Precious metals will become harder to extract and in the process become more precious. Add to that the greedy games played by the bullion banks and the consistent global demand from the "weak clenched fists" and you have a commodity whose price, based on pure supply and demand, must ultimately be propelled upward.

ARE GOLD MINERS A BAD BET THEN?

Not necesarily....and as we've said before, they may in fact be a quite decent opportunity. Take a look at the chart below showing the gold miners' performance over the past 10 years. Clearly, it's not for the faint hearted investor, but notice how strongly the miners

bounce back after taking a beating in 2003, 2005 and 2008. And their current beating has been particularly severe. In 2008, as you can see, they copped a similar shellacking to what is being dished out today. And the rebound was colossal. Can we expect that same thing now? Who knows...but history is certainly in their corner.

When all the sellers have sold, that only leaves current holders and and potential buyers. And perhaps the buyers are coming. The chart below shows the price of the three ETFs that best illustrate gold and gold miners. They are GLD, GDX and GDXJ.

These should be familiar ETF names because we've talked about them many times before but if you need to, you can click here, here and here. As you can see, they've all taken a beating over the past year, but the miners much more so than GLD.

Most interesting is that in recent weeks, they have started to turn up, each time making higher lows. As you can also see from the bottom highlight bubble, the volume in trading...the interest...has been increasing as well.

Finally, let's look at relative values. One way to do this is to look at the Price to Book (P/B) ratio. From the Financial Times Lexicon...

> *The price/book (p/b) ratio, sometimes called the market-to-book ratio, links the stock/share price of a company with the book or accounting value of shareholders' equity per share. It reflects how many times book value investors are ready to pay for a share. So if the share price is $10 and shareholders' equity is $5, investors are ready to pay two times the book value.*

If we take a look at the chart below, from Casey Research and Capital IQ, you can look at the relative values of the different sectors comprising the industrial landscape. At the bottom of the list is gold and miners with a ratio of 1:1. In very simplistic terms, if you are paying $10 per share for a gold mining stock, you are getting $10 worth of tangible value.

At the other end of the spectrum, is health care at over 3.5:1. If you are paying that same $10 for a health care stock, you are getting $2.85 worth of tangible value and are paying $7.15 for "market goodwill". This simply tells us that Mr. Market's expectations for health care stocks are far more elevated than they are for gold and mining stocks. Of course, some of our readers may scream "value trap" which is essentially

saying that the stocks of companies are cheap for a valid purpose and are going to get cheaper.

When it comes to the precious metals miners, given what is happening in the world, we would beg to differ.

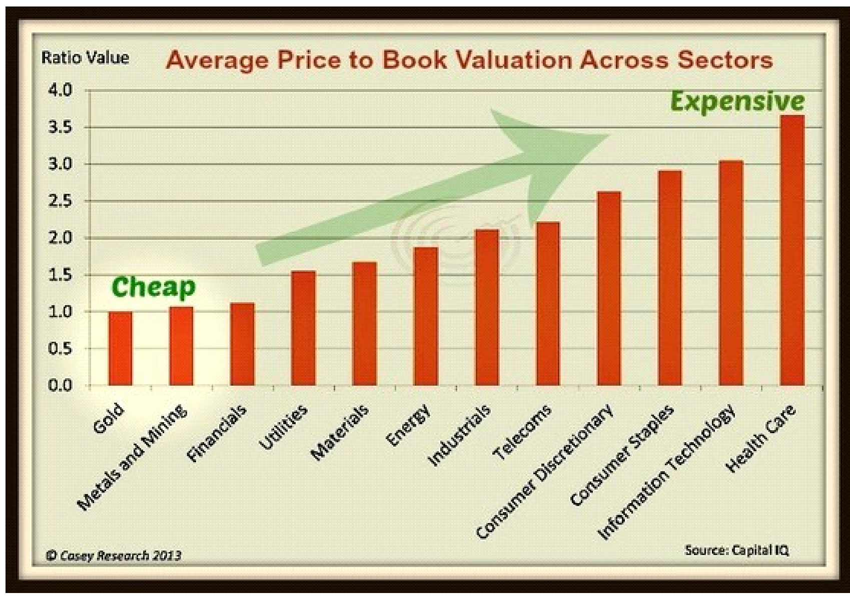


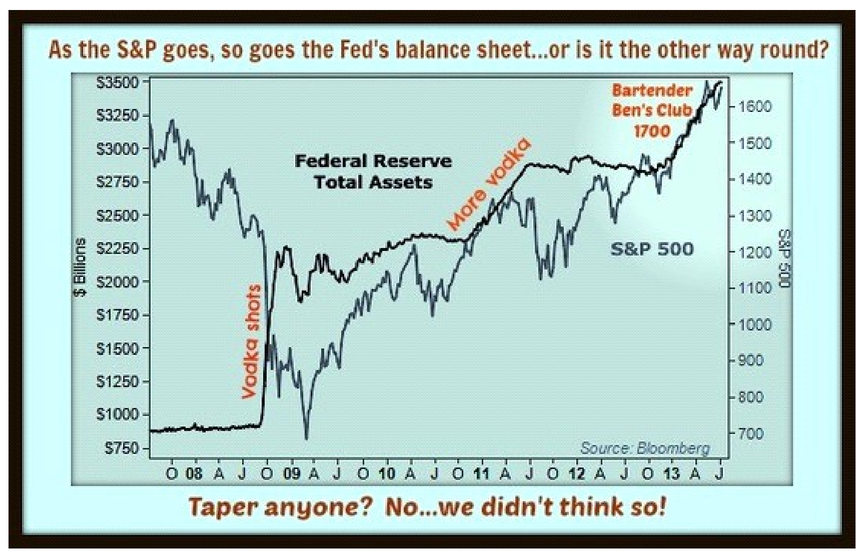
CHART OF THE WEEK - BARTENDER BEN'S WEALTH EFFECT IS GETTING EXPENSIVE

The chart below tracks the growth of the Federal Reserve's balance sheet against the performance of the S&P. This is Bartender Ben's "wealth effect" in action. Print it and they will come. Until they don't.

As you can see from the top right hand corner, the market dropped precipitously in May on the mildest of hints that Ben may put less vodka in the punch bowl.

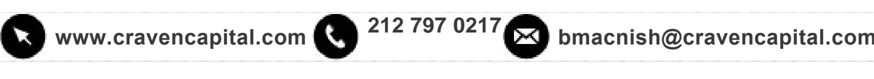
Imagine what might happen if he actually threatened to take the punch bowl away altogether. Don't worry, he'll never do that. But it may get knocked over in the rush to the exits at some point.

Next week, we'll take a look at a couple of charts that might signal that some of the smarter partygoers have already eased out the unmarked exits, while the moms and pops are piling in the front door of Mr. Market's fabulous Club S&P 1700.



Til next week...

"Ignorance is the curse of God. Knowledge is the wing wherewith we fly to Heaven."
William Shakespeare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