

Angst and Indices

*From the July 2010 HRA Journal
David Coffin & Eric Coffin, HRA Advisories*

Last year we said we didn't expect the market's summer doldrums to set in. We made no such promise this time. That won't surprise given we have stayed focused on gold plays and haven't been adding new ones lately, but that doesn't mean we expect a significant downturn from here either.

The renewed housing retreat and slowing of employment gains with the waning of government stimuli in the US and Europe is real. However, this has been silting market flow for a full quarter already. It's no longer "news" even if every new stat that displays the obvious is treated like it's a call to Armageddon.

We think the real test of stock market sentiment will be Q2 corporate reporting rather than general economic stats. In particular, traders will be listening to what management is saying about what they are doing, and selling, today and next month. Parked funds will have to look beyond low interest bonds at some point. That capital will support corporate earnings, where it can. We aren't going to second guess those numbers for the broader market. Since little corporate cash has been making its way into new hiring or capital spending, Q2 earnings impairment does not look like a big issue. The follow on is still up in the air, but the present feels like a pause for breath.

This is one of those periods where the slippery and elusive concept of market sentiment does matter. Corporate leaders control more liquid cash than any other segment of the economy. Excuse the politically incorrect terminology but the quickest route to the economy achieving steeper rate of climb is the corporate elite manning up and opening the cheque book.

That extends into the metals space as well. Since their mid February peak levels, **copper** inventories tracked by the LME have declined by over 100 Kt, or about 20%. That drop below 450 Kt has been enough stabilize copper's price near the US \$3 per pound level. Perhaps as importantly is a recent shift towards warehouse changes and their implied supply/demand gauge in copper's price. Old fashioned as it may be, a decline in potential supply still helps to stabilize a commodity's price.

That doesn't mean that the red metal would hold steady in a major market decline. The more inventories fall however, the quicker the copper market would come back after another pummeling. The one thing that would change that is if the Chinese or Indian economy falling apart were the cause of that panic. We don't see that coming and think the BRIC bubble talk is getting very overdone.

In a nutshell we expect copper and base metals generally, to be in the same holding pattern as the rest of the market for a while yet. We do think it is time to be looking more seriously at copper deals again. And we still think that copper should be the focus, and that caution is still the byword for other base metals. Long strikes at Canadian **nickel** operations, for example, have just been resolved. The market is taking that under advisement, and viewing it as a price constraint. **Zinc** is getting a similar treatment since it, like nickel, has a much larger relative excess in warehouse stocks and zinc and lead inventories are still rising.

An up-tick in sentiment would continue to favor “non-warehouse” bulk minerals like iron ore and higher end coal. They are the underpinning of infrastructure builds, unlike nickel and zinc that have a greater focus in the mid-development auto sector. The “build it and they will come” mentality in China favors these bulk minerals, but China is by no means the whole story. That is a good thing since Beijing is clearly serious about reining in real estate developers and speculators at least.

We are keeping an eye on a possible shift, over the mid-term, building in the relative valuations in the metals space. Some of the non-China growth areas, and India in particular, are starting to move more rapidly into that mid-development market. India’s auto sector is now about the same size as Canada’s, and of course on its way to outstripping the number two US auto market in due course. Getting factories, and finance, off the ground can be easier than keeping pace with permitting an infrastructure build.

Though India has broken the bonds of its famed License Raj, its unlikely India or anywhere else in the modern world for that matter, will ever be able to move the forward build of infrastructure at the speed China has. Much more likely will be a build in which infrastructure will be a response to technology, which would favor a greater emphasis on the “auto metals”.

In to this mix should be added a serious flux coming into the **iron ore export** market. India is currently the 3rd major source of **iron ore export**, after Australia and Brazil. India has been the subsector’s swing producer and has been the major source of “spot” sales to China. Earlier this year India began imposing higher export duties on iron ore, while trying to clamp down on illegal (unlicensed) iron ore exports. China has more recently banned the import of low grade iron ore, which impacts about half the 100 million tonnes it has been getting from India, unless of course they export more of the good stuff.

Other considerations aside, China wants to encourage new sources of supply. Chinese companies have been buying up resources in coastal Africa, which can probably be developed relatively quickly. And of course the haggling with and within Australia continues. How all this influences pricing over the long haul is still to be seen. For now it appears most likely that some supply constraint is in the offing for iron ore, which will be good for the assets side of this subsector going forward. Thereafter, some downs and ups seem most likely as the other BRIC’s growth steepens their metals’ use curves.

A continued near term focus on the largest of metal markets makes sense to us. In the medium term a shift from China’s infrastructure planning as a demand driver could morph into a more chaotic consumer-focused demand from India, Russia and Indonesia. That and the innovations that will come with this will determine when to emphasize zinc, nickel and smaller metals.

Still at our forefront now is how **gold** fits into this picture. The yellow metal has moved into its own holding pattern, around the US \$1200 per oz level. If the recent down shift continued below the \$1180 point we would have expected that to be a ceiling for a while. Gold and the US\$ both rose when sovereign debt caused the Euro to nosedive. That has quieted down, for now, but the shift in portfolio planning towards holding some gold as insurance should continue to support the metal’s price.

We still consider the other precious metals good bets and perhaps very good ones while buyers in India and China decide what the new pricing norm. Prosperity will then again be the main driver for all noble metals.

Global Economics and the “Baton Toss”

*From the July 2010 HRA Journal
David Coffin & Eric Coffin, HRA Advisories*

Recent conferencing in Toronto was another waypoint in the transit of global authority. The G8 (G7+Russia) economics discussion group began broadening a decade ago with creation of a forum of economic ministries. The western banking crisis pushed that larger forum to heads of government level. The long planned G8 gabfest in a wealthy enclave of Ontario's cottage country had a city centre G20 (G19+EU) gathering appended to it. Even protest groups who claimed allegiance with emerging economies a decade ago knew G8 was but a preamble and focused on the quickly organized G20 fete.

Oddly enough the G8 doesn't get quite the same listen now that most of its members admit to being broke. The G20 has become the main potentates' club less than 2 years after its heads of governments first met to deal with the Western credit crunch. Does this matter?

Hopefully it does. The rise of Europe half a millennia ago has reshaped the world. Our bias as ethnic Europeans living on the Pacific Rim notwithstanding, we think that has been mostly to the good. The reinstating of scientific method it produced in Europe has expanded our understanding of being, on a global basis. Now seems as good a time as any to move from that to being smarter.

That would include popping the myth that cultural differences generate state level conflict. Its actually sameness that does that. Wanting the same resources and the same abilities to form them into comforting goods causes most conflict. Its true that much violence happens in the name of cultural nuance, and some would be insulted by the notion that mere goods underpin antagonism. However, even saints have to eat and the infighting tends to lighten up when there is plenty of real estate to go around.

G20 expands the cultural context surrounding economic discussion to most of the planet. This hopefully will mean eliminating culture as an excuse for economic differences. It eschews the unwieldiness of the UN system, which of course leaves some feeling left out. It is a government based forum, which leaves others feeling left out. And without question the gathering has a large measure of photo-op that could be handled by photo-shop these days. Even in Canada's none too competitive telecom market a basket full of cell phones wouldn't have cost a billion bucks.

However, realistically these forums work when they provide the fulcrum for changes actually levered by other means — they work if they can provide politicians with *good* photo-ops.

What really matters with this particular gathering was that it has recognized the major geo-economic shift we are in. This is confirmed by hand wringing from the cadre who have shaped and shaded the G8. The nut of these cadres' concern is that the new boys and girls don't understand how to presage the outcome, which could ruin the photo-op. However, the “new guys” priorities are after all new, at least in this millennium.

Two of these new guys are the largest and among the oldest of functioning human cultures. China and India are the poster cultures for modern shifts away from stagnant multi-tiered class systems by, respectively, revolution and evolution. They know quite a bit about how cadres function. And everyone has lots of experience with empire.

Its entirely possible that what seemed like intransigence to the old cadres was diplomatic politeness. The new guys are all pretty much solvent. So they don't have the same focus on fixing the financial system G8 had. Ensuring fixes don't trash the investments they have made or want to make is. A role reversal of sorts is playing out after all.

The Toronto meet made plain who are the debtors and who are the creditors. "He who pays the piper calls the tune" is understood by everyone. That message is going to get repeated, and it isn't just capital cities that should heed it.

So far there has been no real accounting for the underpinnings of the Credit Crunch. The Crunch was preceded by much touting of the system that caused it, and was followed by ample monetary support from the creditor nations who didn't cause it. Too big to fail was taken to heart, and wallet. Too big to fault wasn't.

The debtor nations are going to have to get that accounting started in earnest soon. Sound market practice was put aside to aid actors who still hold down jobs with 8 or 9 figure incomes. They continue to be regulated by the people who were dumb enough to equate those big incomes with brilliance. This didn't have to be a talking point to be the 800 kilo gorilla at the table. Trust hasn't been rebuilt. The debtors need it — service is their main industry and customer satisfaction will determine who gets the repeat business.

"G summitry" grew out of recognition in the '70s that coordinated regulation by the US and Europe could smooth trade in a market system. Japan was included because its economic size. Canada got a seat to balance one Italy got for the sake of EU peace. Russia was added as a post Cold War olive branch. The G8 is a trans Atlantic rich boys club, plus Japan that recreated its economy to sell into the Atlantic basin.

G8 took kudos for the long post Cold War economic expansion. That growth was mostly a lot of spy vs. spy clamps being removed from client economies, which we suppose does qualify as G7+ tinkering. Overturning the anti-empire rhetoric of the Cold War didn't have to be part of the deal, but that history didn't go away either. The G8 ought to put that reality on the table before G20 fully takes over.

Expanding to G20 world in the late '90s recognized a global economy was forming, but it took the Asian monetary crisis to focus this. The push to include growth economies was from North America since the Euro zone then thought its new currency was a panacea. Not so much it seems.

Conferencing is no panacea either. But the EU experiment, which is at its root a conferencing forum, has shown it can have salve old wounds for the sake of avoiding new ones. Those who bemoan the EU as a political forum pretending to be about economics ignore the reality that politics is mostly about how cash flows. Governments ignoring politics is an idea we like on paper, but also dread — when politics no longer dictates, government usually does.

No small part of China's amazing growth story has been a changed strategy by the crowds who weren't run down in Tiananmen Square — voting with their wallets rather than their lives while those in power worried about the politics. Twenty years later they are wealthy enough to have an audience across the street in the Great Hall of the People. By various means the same thing is happening in the other emerging economies. And as part of that process the denizens of those economies have been talking to, and working with, each other. This is why we hope the G20 will matter.

The balance of this century will be about how the growth economies that have expanded the G8 into the G20 progress. The Credit Crunch has effectively sped up the commerce, and hence congress, between these growth economies. For the moment there is a degree of solidarity amongst the new group. That is left over from the old Third World concept which, not ironically, was coined by Mao as a means of creating a large enough group to force the wealthy worlds' clubs to listen to them. Most of that Third World grouping now sits outside the G20 gathering places. The more things change....

Realistically there does need to be a cap on the number of voices at the table or none of them will actually get heard (see Climate Conference in Copenhagen for a reference). For the immediate future the debtor/creditor distinctions will play a big role in defining how the new grouping operates. The official G20 meeting for 2010 will be held in Seoul this November. Since the shift from government stimuli to private commerce will either be working or failing by then, the elbowing in Seoul could say a lot about whether this new grouping can function.

The last vestige of the Cold War is a two hour drive north of Seoul, and it would make sense to shift the meetings to that ironically named DeMilitarized Zone. It would remind everyone why politicians sitting down to talk about the economy makes any sense at all. If the G20 is to be important it will be because it helps prevent the creation of more Korean type DMZs. And it might prevent them amongst the new guys in the grouping. That's why the new guys wanting G20 to turn into a good photo-op is important. Everyone say "cheese please".



The HRA – *Journal*, *HRA-Dispatch* and *HRA- Special Delivery* are independent publications produced and distributed by Stockwork Consulting Ltd, which is committed to providing timely and factual analysis of junior mining, resource, and other venture capital companies. Companies are chosen on the basis of a speculative potential for significant upside gains resulting from asset-base expansion. These are generally high-risk securities, and opinions contained herein are time and market sensitive. No statement or expression of opinion, or any other matter herein, directly or indirectly, is an offer, solicitation or recommendation to buy or sell any securities mentioned. While we believe all sources of information to be factual and reliable we in no way represent or guarantee the accuracy thereof, nor of the statements made herein. We do not receive or request compensation in any form in order to feature companies in these publications. We may, or may not, own securities and/or options to acquire securities of the companies mentioned herein. This document is protected by the copyright laws of Canada and the U.S. and may not be reproduced in any form for other than for personal use without the prior written consent of the publisher. This document may be quoted, in context, provided proper credit is given.

©2010 Stockwork Consulting Ltd. All Rights Reserved.

Published by Stockwork Consulting Ltd.
Box 85909, Phoenix AZ , 85071 Toll Free 1-877-528-3958
hra@publishers-mgmt.com <http://www.hraadvisory.com>