The Sid Klein Comment

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ANOTHER GOLDEN WAVE

WITHIN AN AGE OF GOLD

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Nikkei:	**15,307.61**	(June 8)	14,633
Gold:	**$628.70**	(June 28)	575.30
Silver:	**$11.34**	(June 28)	10.26
Yen:	**. 8780**	(June 28))	87.06

NB: The gold section is a contribution by Donald Dross, as this month's report focuses on the precious metals and how to profit from them. Given the timely consideration of that asset class, the others are summarized in a manner designed to capture what is critical to the intermediate term. At this report's conclusion, my addendum offers stock ideas that are consistent with the themes and outlooks discussed in Donald's piece.

JAPAN:

At the beginning of the year, I felt that 16000 represented resistance, as the market would start to focus on higher interest and tax rates. My view included that the economy would remain strong, with the marketplace's psychology turning to the powerful fundamentals that would be causing these higher rates. These SKC reports led the world in identifying the low for Japanese deflation, and then the need for the Japanese government to turn its attention to combating ***inflation***!

Quantitative easing ended and higher Japanese rates were seen as a matter of course. Then, the Bank of Japan stated that the recent massive draining does not need be taken as a signal that rates will commence rising immediately. This gave some relaxation to a pressure filled situation, as the US Fed was under the gun leading up to its most recent quarter-point-rate hike. Now, however, that Fed hike is out of the way and the long bull market in Japanese rates may now commence. Japanese rates can now move up at ***any*** time.

CONCLUSION:

I have been warning that the US market may react to Japanese rate movements with great sensitivity. Still, seeing the Nikkei as being in a bottoming phase, the June 8 report analyzed that a possible rally toward 16,000 could be followed by a test of the 14,000 level before advancing further. After rallying to about 15,700, the Nikkei may put in a higher low now. This could coincide with a rate hike. This would also be consistent with a successful test of the recent lows in gold. Of course, one shouldn't try to correlate markets.

NEW YORK:

The rate hike is out of the way and the technicals are terrible and deteriorating. The peak at 11,700 is in and one should therefore view this patient as terminal.

Given that the recent low (10,700) was made with put premiums and historical volatility each forecasting and discounting further downside pressure, it is possible that this near term correction conclude above 10,800. This would be consistent with a higher low in precious metals and precious metal stocks but, as described above, one really shouldn't correlate markets.

CONCLUSION:

A break of 10,700 could accelerate to 10,200. For now, a month-and-a-half of summer doldrums appears more likely. According to our strategies, the point is moot.

GOLD:

WHERE DO WE STAND WITH GOLD?

Donald Dross
Associate, SKC

We are at the point in the gold market where we know that the price of gold is irretrievably destined to climb right up the mountain, but we don't know whether there are high hills and deep valleys between us and the mountain. What's the best investment strategy for the treacherous situation we find ourselves in at this moment in time?

I. ASSUMING A SHARP N.Y. EQUITIES DECLINE

First, we begin with the hypothesis that the New York equities market is at the edge of a cliff and can plunge without notice. (This is Sid Klein's hypothesis, so don't blame me!) If this happens, many gold stocks will be sold because investors (a) have profits in those stocks, and (b) need the money to satisfy margin calls on their regular equities portfolio. But some investors, of course, will have gotten out at the top of the equities market and will be looking for a safe haven for their investment assets. So we have a countervailing possibility: that although squeezed investors may be forced to sell their gold stocks, newly cash-rich investors will be buying gold stocks.

But the two countervailing positions are not symmetrical. The gold stocks that squeezed investors sell are not necessarily the same gold stocks that cash-rich investors will be buying.

Assuming that the squeezed investors will sell their gold stocks willy-nilly across the board in order to meet margin calls, their selling will cause all gold stocks to go down. But now the cash-rich investors have entered the game. The stocks they choose to buy will go up (because the cash-rich investors have so much more money than the squeezed investors), while the stocks they ignore will continue to go down.

Let's divide gold stocks into three rough categories: the producers, the sitters, and the explorers. The cash-rich investors will only be interested in the first two categories; they are not psychologically equipped to gamble on the chance that a junior exploration company will hit pay-dirt. So, under our initial hypothesis that the New York equities market will soon plunge, all those junior exploration stocks -- the ones that have done so outstandingly well in the past nine months -- will be clobbered. Hence, if you believe that the equities market is heading for a crash, you may want to consider selling your junior golds and silvers, and maybe buying back later at lower prices.

Next let's look at the producers -- companies such as Newmont Gold, Barrick Gold, AngloGold Ashanti, Goldfields, Coeur d'Alene Silver, and Rio Tinto, among others. These are income-producing stocks. They sell gold out of their inventory. They have compensated for inventory depletion over the years by replenishing inventory with purchases of junior exploration stocks that have hit the mother lode. But this replenishment of inventory does not come free. The producers have to pay up for the successful juniors. That's why I don't own any of these major producers. They are living on the hope of acquiring more inventory at prices below the market value of their stock (if they pay more than market value, then they lose ground automatically). They are certainly not "growth stocks" no matter how much their earnings may increase on a year-to-year basis. They do not create new value (as true industrial growth stocks do); they simply live off the fat of the land.

Nevertheless, when the price of gold rises, the producer stocks will rise also. After all, their income will rise due to the higher price of gold. Their other costs (production, overhead) remain roughly the same. However, if they don't continue acquiring inventory, then we can expect their price-earnings ratio to move slowly downward.

Finally we come to the group I call the sitters. They have been clever enough to acquire large tracts of land that are potentially rich in precious metals. They raise money from time to time to spend on drilling and assaying. The more gold and silver they discover on their own land, the higher the stock market evaluates their shares. From our point of view as investors, we simply buy these stocks as an asset play. Neither we, nor the company's management, want the company to actually start mining their resources. The whole idea is to sell these resources when the price of the underground assets takes off. You can look upon these sitter stocks as a call on the price of gold. Like a call, they will go up a lot faster than the underlying precious-metal asset. But, even better than a call, they have no expiration date.

The market plunge that we have assumed means that many investors will be looking for a safe haven. In golds and silvers, the safe haven is not the risky exploration group, but rather the producers and the sitters. Assuming the price of gold is trending upwards during the equities decline, the most attractive group for the new cash-rich investors, in my opinion, is the sitter group.

II. ASSUMING A LEVEL-TO-GRADUALLY-RISING N.Y. EQUITIES

Our second hypothetical scenario is a flat to rising New York equities market over the next few months. While all three groups of precious-metal stocks should do quite well, I think the sitters will do best of all because new investors entering the market will perceive that the sitters are greatly undervalued.

III. WHAT IS THE BEST RISK/REWARD GROUP OF PRECIOUS METAL STOCKS?

The “sitter stocks” at this point in time appear clearly to be the most attractive investments among the precious metal stocks from both points of view of risk and reward. This is not because they are generically “sitter stocks,” but rather because of the peculiar circumstance facing us at the present time: that the sitter stocks are ridiculously undervalued. This undervaluation will not last forever; it might not even finish the year. But RIGHT NOW, for a confluence of decades-old reasons, they represent a unique value.

There are three stocks that sit at the pinnacle of the list of sitters. Their undervaluation is so severe that it seems like the stuff dreams are made of. I am referring to (in no particular order) Northern Dynasty Minerals, Seabridge Gold, and Vista Gold. They are all listed on the American Stock Exchange, as NAK, SA, and VGZ, respectively.

Using my own methods of analysis, and doing my own due diligence, I find that each of these stocks is selling at an incredible 5% of its resource value, to a close approximation. You should do your own due diligence. I’m telling you what I have come up with, but reasonable people are certainly entitled to disagree.

Is the stock market right now filled with reasonable people? I don’t think so. It is driven by fads, fears, and fetishes. If the current admixture of investors in stocks remained exactly the same, then I wouldn’t expect NAK, SA, and VGZ either to go up or go down. What I’m counting on is an influx of new investors into the precious mining sector who will be attracted by the rising price of gold and silver. These people are going to do their own homework and their own thinking. It is they who will bid up the price of the undervalued sitters.

ADDENDUM
Sid Klein

The stocks listed three paragraphs above enjoy outrageous potential, according to Donald Dross’ analysis. One would require an in-depth knowledge to pursue investment since there is little historical trading background to analyze. Of course, rather positively, one may note that Seabridge and Northern Dynasty are trading at highs, despite the market’s position (Northern Dynasty also trades on the Toronto Stock Exchange).

Here, I would like to review stocks already recommended and held in the past. Let’s start with Golden Star (GSC in Toronto, GSS on the AMEX). When I had turned bullish on this stock at $1.00 (twice) I wrote that it was purely a technical recommendation and that readers should do their own due silence. That is the case today (I do not cover fundamentals in these reports). Like then, I am forecasting dramatically higher prices for this off-cycle stock. With higher production coming on-stream in 2007, the company’s equity should advance to at least $10.00 and beyond, as gold's price moves to $850…and beyond. An ideal entry is in the $3.00 - $3.10 zone. This is my favourite pick.

Kinross (K in Toronto) is a buy in the $11.00 - $11.50 range. This would align with the anticipated correction in gold, which can re-test recent lows.

Eldorado (ELD in Toronto) looks good in the $5.00 - $5.25 range, based on the same general gold market expectations.

Coeur D'Alene (CDE in New York) looks very attractive in the $4.25 area, after this recent steep sell-off. As silver gets going again, considering the successful absorption of its acquired properties, this stock, like the others, provides meaningful low relative-risk potential.

Vista (VGZ) is covered by Donald above. I would only like to add that a shake-out to $9.50 or so should not bother anyone, since a break over $20.00 will lead to $30.00, and so on. This is expected to follow gold in a leveraged manner.

Cambior (CBJ in Toronto) is a target in the $2.75 - $3.00 area.

Yamana (YRI in Toronto) is a buy in the $10.50 area, plus or minus.

Pan American Silver (PAA in Toronto, PAAS on NASDAQ) is a buy in the $18.00 - $19.50 zone. Like the other stocks listed here, there is potential for a fast 50% move. Moreover, there is dramatic potential beyond $30.00 as silver gets going. Still, one must bear in mind where the best bang for the buck exists. Therefore,…

Silver Wheaton (SLW in Toronto) is a buy in the $9.00 - $10.00 area. As silver moves up, it's only a question of how much one makes.

The bottom line for all these is that there is a short-term correction under way to higher lows in gold and silver, just as SKC had forecast on June 28. The bigger point is that a new intermediate term advance is beginning, a cycle in which gold advances to $850 and over $1000 in 2007. Target prices are much higher than here, with favourites being: GSC, YRI, CDE, ELD, K, PAA, SLW, respectively.

The trick to profit maximization will be in ongoing portfolio rotation. In a portfolio of high performance equities such as these, opportunities abound to creatively switch for profit enhancement. Simply, as stocks run up, become stretched in the short term and are sold, cash can be used for a pull back in a stock that has yet to really move (or for the same stock after a pullback), relative to the metal.

Go for the gold!!!

Sid Klein

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