INSTITUTIONAL ADVISORS

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GOLD

THE CONTRA-CYCLICAL BULL MARKET IS STARTING

"***Bell, book and candle shall not drive me back, when gold and silver becks me to come on.***" **- William Shakespeare**

The action over the past week for gold has been very constructive, but to place this in perspective it is worth reviewing that three aspects of gold have been in a bear market since 2003. These include the important exploration sector (www.goldcolony.com has an index of 50 stocks), gold's price in real terms as measured against commodities and, with their failure in April, senior golds. In April, this letter again reviewed that for a real bull market in gold investment demand should be increasing as the business, stock, as well as credit markets rolled over to the next contraction. Until that melancholy event, any rallies in dollar terms, as key currencies strengthened, had to be considered as "***faux***" bull markets.

Since March, orthodox economic reports indicate that the economy is weakening rather quickly and this should soon bring down the rate of CPI inflation and, thankfully, this will diminish the common goldbugs' ravings about an inflation-driven bull market for the golds or their opposite error, the dismal forecasts about a deflation-driven bear market for golds.

The possibility of a post-boom disinflation, or perhaps outright deflation, is daunting to conventional wisdom about gold. History shows that the real rise in the price of gold following a bubble has prompted some dramatic increases in production and this typically prevailed for some 20+ years. Of course, these have been interrupted by the usual 3-4 year business cycle, such as the one ending now.

It is appropriate then that the three components of the gold market should have been in a contra-cyclical bear against the boom in business, commodities, and credit expansion. The key is to determine that it is ending or, indeed, over.

The last such change followed the tech mania as it blew out in 1Q 2000. With this, it became almost automatic that gold's real price and gold shares would begin a bull market as the bubble collapsed.

The research used was that this occurred in the Fall of 1929 and 1873, which were the two previous bubble collapses. Of interest is that in all three cases, the rise in gold's real price was associated with the reversal in the U.S. yield curve from flattening to steepening.

As the calculation of the CPI is suspect and then only posted monthly, we use our gold/commodities (G/C) index and it has been a worthwhile measure of gold's real price.

The following chart shows the key lows in late 2000. Note that the low for the HUI was set at 36 in November with the low for G/C index Then, as the dollar index (not shown) remained relatively steady and with gold declining, the HUI rallied 60% from 36 to 58 in early 2001. Note also that gold's real price increased from 189 to 222 in April, 2001. No big deal, but during the same interval gold declined from 272 to 266 and, with this, the yield curve was doing the very dramatic steepening typical of the initial liquidity crisis that follows any mania.

Obviously, these two overwhelmed the influence of a steady dollar and a dull market for gold in dollar terms.

The high for the HUI in May, 2002 was 150, which was up 317%. Then, although gold's nominal price was in an uptrend, the G/C index was in a choppy trading range until mid-2003 and the HUI showed some huge swings with no net gain until later in that year when the "***dollar down – gold up***" mantra finally began to drive gold shares up.

The rally in gold and the HUI was without support from the financial side as credit spreads were narrowing and the yield curve was flattening, which, in indicating a business expansion, is usually negative for gold.

Our G/C index reversed from a high of 252 in September, 2003 and that led the high in the HUI by 2 months.

The next chart covers the key items since the bull market high in late 2003 and introduces the Gold Colony index of gold exploration stocks. This is created by Dr. Robert Shields and can be reviewed in his website www.goldcolony.com . This comprises 50 smallish exploration stocks and the gist of this review is that this sector could become an outstanding asset class.

It is worth acknowledging that wonderful bull markets arise from devastating gloom and the turn is not heralded by, for example – ***The Grand March*** from Aida.

The exploration index peaked in late 2003 with the HUI and clearly shows the bear market down to May. This appears to be a major test of the low in 2004.

For gold's real price, the recent low tested the dismal lows set in mid-2004 and the Fall of 2000. In retrospect, the rally out of the 2004 low was of intermediate duration and what we are looking for now is the next cyclical recovery in the three aspects of gold. This would be driven by widening credit spreads, which trend has reversed, and the yield curve reversing to steepening. The latter could be starting and, once it reverses, it usually has a more immediate effect on gold – to the upside.

This could run for 2 to 3 years and, within this, there could be some exploration success that could rally the sector even during periods when gold may be correcting or otherwise showing dull action.

EXPLORATION SECTOR

The next step of this study is to review the exploration side of the gold market, which offers opportunity possibly beyond what one would expect from a typical cyclical recovery in gold's price relative to commodities and most asset classes.

Since the launch of the first cyclical bull market in gold stocks in 4Q 2000, there has been considerable activity by mining companies to expand gold producing assets through acquisition rather than fieldwork. Yes, there have been some discoveries but, in the meantime, it has been a top-down process with the very big ones, such as Newmont merging with Franco Nevada, right down to takeovers of companies with only one mine.

Compared to acquisitions, there has been relatively little spent on "grass-roots" exploration.

A review of only one company as an example can explain the diminished exploration efforts and results. For decades until the early 1980s, Placer Dome (it was then known as "Placer"), enjoyed the reputation of having one of the great mine-finding teams and an outstanding startup team.

In the early 1970s, the company set up a forward planning committee that recommended an aggressive expansion in gold over the hitherto exposure to base metals. The timing and field results returned Placer to the ranks of important gold producers.

The play in gold into 1Q 1980 was remarkable, as was the subsequent plunge in both precious and base metal prices.

By that point, some of the old top management had retired and the new guys showed an alarming (at the time) dedication to short-term results. As cash flows diminished, the bean counters laid off the exploration geologists.

That essentially ended the unique and ongoing culture it takes to find mines and start them up. Occasionally since then, strong rallies in gold's nominal price prompted Placer to suddenly acquire mine capacity, such as in South Africa, in order to be "in the play". The Cortez joint venture discovery has been an exception.

This one story generally reflects the policies of some of the major companies and the big opportunity pending is that the game of acquiring ounces of proven reserves is maturing just as gold is set to start another post-bubble cyclical bull market in real terms.

On this one, it will become paramount to make many significant gold discoveries. Again, in turning to generalities, the exploration talent and ambition is not found solely in the big companies but in many small exploration companies.

Every era of financial bubbles is eventually followed by a severe credit contraction. Since the advent of modern financial markets by around 1700, there have been five examples prior to the blowout in 1Q2000.

Mother Nature needs to fill the post-bubble credit vacuum and, typically, gold's real price has increased significantly and this resulted in equivalently increased production and exploration success. This, in turn, adds real liquidity to the global banking system.

Also typically, the post-bubble rise in gold ran for 20+ years and, in a number of examples, a great gold rush occurred with gold's highest real price at the end of the secular credit contraction. The discoveries in the 1840s and late 1890s are the best known gold rushes – "California" and the "Klondike". With varying degrees of intensity and success, the record is complete back to the 1690's depression bottom, which recorded the "Oro Preto" mania in Brazil.

It should be stressed that, at this stage, most exploration stocks have small capitalizations and considerable risk. Those who have some experience can act independently and do some diligence on the stocks listed in the Gold Colony index. From time to time, new stocks may be added to the list and old names, for various reasons, may be dropped from the list.

Institutional Advisors considers the index only as a proxy for the exploration sector and will make no recommendation to buy any of the stocks in the index. There are gold fund managers who have shown outstanding abilities in this sector and individual readers who wish to be positioned in the pending play should review the well known funds managed in Canada and the U.S.

Institutions that would like to learn more about this opportunity can contact us directly.

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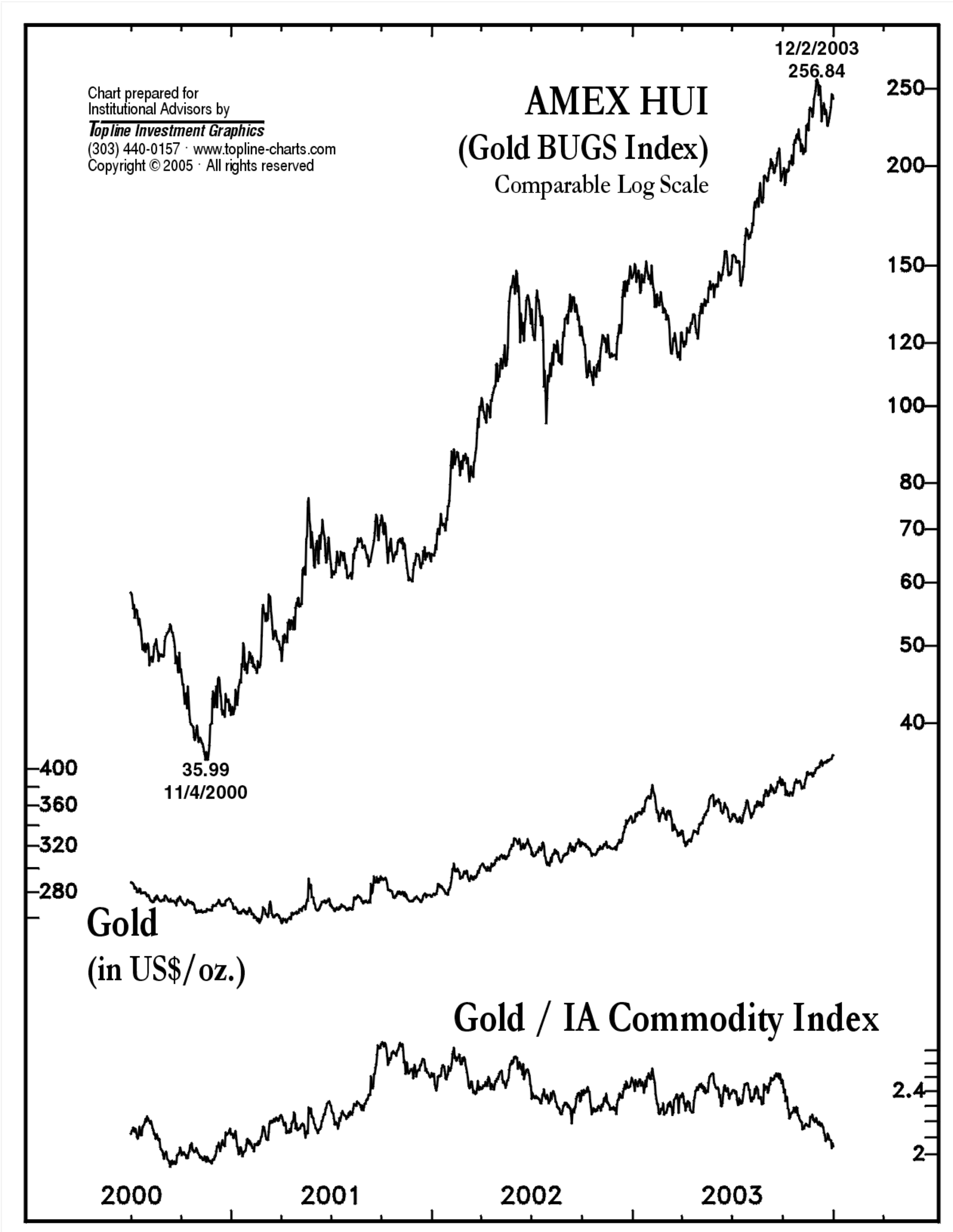
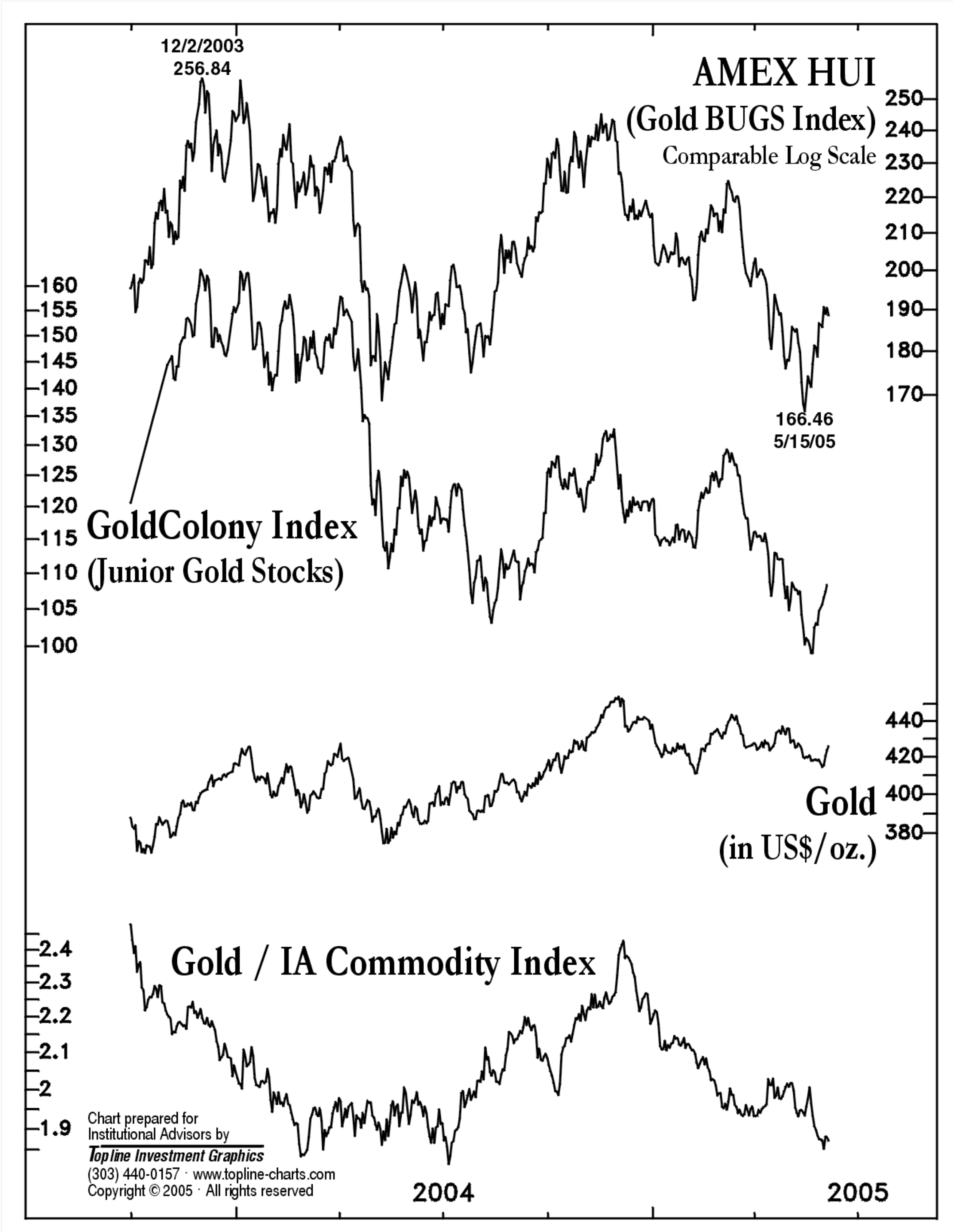
First Cyclical Bull Market For Golds Following The 2000 Bubble



- Note that the HUI rallied 60% from November, 2000 until early 2001.
- This was with the rally in gold relative to commodities.
- During the interval, the dollar was steady as gold's nominal price was dull.

First Cyclical Bear Market For Golds In Their Secular Post-Bubble Bull Market



- Financial conditions are changing in a manner that, in the past, has signaled an increase in investment demand for gold.
- The real price will likely have more influence upon share prices than the nominal price.
- It is possible that some discoveries could rally the exploration sector while gold is correcting the uptrend.