INSTITUTIONAL ADVISORS

December 22, 2006

GOLD EXPLORATION

This updates the study dated September 19, 2006, that concluded that gold's real price was close to bottoming and that the gold sector should be aggressively bought.

Overview: Gold's real price has long been the key to profitability of mining, as well as to investment opportunities often opposite to the direction of the general stock market.

Historically, the CPI in the senior economy has provided the best determination of gold's real price, but the calculation of the U.S. CPI has become suspect.

A better alternative has been our gold/commodities index, which is calculated daily. This is a sound proxy of gold's real price, that also represents purchasing power or mining profitability.

This suffered a significant decline from January until October and this was accompanied by a relentless decline in many gold exploration stocks.

This study concludes that the real price has set a cyclical bottom in anticipation of a lengthy new bull market. Within this, gold stocks should outperform the bullion price as the exploration sector becomes the equivalent of the junior tech stocks in the mid-1990s.

The role of the latter was to fund a great innovation in technology and business. The role of gold's real price and the exploration sector is to meet an extraordinary increase in investment demand for gold that typically follows an era of remarkable credit expansion.

Historical: Another term for gold's real price is money and, typically, during a great boom in tangible and financial assets (think industrial commodities and real estate, as well as stocks and corporate bonds), money loses purchasing power.

The very big asset inflations include the "Roaring Twenties", which ended so dramatically in 1929. Other examples concluded in 1873 and 1825, with the earliest example being the 1720 South Sea Bubble. (Illustrative charts follow.)

In all such examples, gold's real price declined to a significant low as speculators scorned cash and leveraged up on the hot stories about stocks, bonds, commodities, and real estate.

Once the era of asset inflation exhausted itself, typically gold's real price increased for some twenty years.

One explanation is that during the leveraged manias, reckless borrowing and equally reckless lending expands credit to an unsustainable level.

In all cases, once the speculative boom breaks it has been followed by a sudden and pervasive loss of liquidity. Under similar devastating conditions, legions of intellectuals and experimental economists have recommended that some agency apply yet more credit.

Interestingly, since as early as the 1622 example severe liquidity vacuums regularly inspire such impractical visions, but typically Mother Nature finds it more practical to replenish global banking liquidity by increasing the supply of gold.

This is prompted by increasing investment demand, which in all cases has been anticipated by changes in the credit markets. Other than the exhaustion of speculative momentum, key determinants have been a turn to widening of credit spreads as market forces begin to ration the availability of credit for speculation. This happens with or without the defiance or cooperation of policymakers.

While the action in stocks usually commands most of the attention in a financial mania, speculative excesses are also displayed in the credit markets. The above paragraph reviews the spreads between high and low grade credits. Another aspect is the mania to borrow short term and lend out longer term. Popularly called "the carry", this time around ostensibly extremely low deposit rates in Japan were ambitiously used to obtain higher rates elsewhere.

Typically, the height of a mania is accompanied by speculative demand for credit driving short-dated rates up relative to long-dated bonds. Just as typically, the end of speculation is marked by the reversal of the yield curve to steepening.

On this, treasury bill rates decline in yield as long rates increase.

Typically, this has occurred late in the year that the mania climaxed. This was the case in 2000, 1929, and 1873, just to list the most recent.

Also, in each of these, gold's real price turned up and initiated a lengthy bull market for the gold sector. Within this, the exploration sector provided outstanding performance.

Of course, the usual 3 to 5-year business cycle prevailed and the gold sector action was essentially contra-cyclical.

Near-Term: It is important to emphasize gold's real price. During its bear market into 1929, gold stocks underperformed the stock market as earnings declined due to rising costs. For example, Homestake's earnings declined from .73 to .52 per share in 1929 with no change in the nominal price, which was fixed at 20.67 per ounce.

Then on the post-bubble contraction, earnings jumped from .74 to 1.24 in 1932 with no change in gold's nominal price. (This did not change until later in 1933.)

The improvement was due to the increase in gold's price relative to the costs of mining. On this, Homestake's stock soared from 8 ⅛ in late 1929 to 20 ¼ in December, 1932.

1929 TO 1932

STOCK	EARNINGS	DIVIDENDS	GOLD
+ 149%	+ 138%	+ 52%	Unchanged

This was indicative of the industry and, although junior stock quotations are not readily available, the exploration sector soared. There is a reliable report about a young mining broker in Montreal having such a good year in 1933 that one of his larger accounts gave him a new Ford Roadster.

Of course, the driving force was that gold's real price was improving and in 1933 the Roosevelt administration found academic reasons to join the fun and raised the nominal price from 20.67 to 35. (The first page of charts shows that the real price shows a significant increase following every great bubble.)

Canada's premier producer was Dome Mines and, on the full move, the stock soared from 3 in 1929 to 34 ⅞ . Earnings soared from .05 to 2.11 and from 1934 until 1941 the dividend was 2.00, which was a handsome return on the 3-dollar low.

The discovery that led to the Dome mine was made in 1909, and it is now the longest continuously operating gold mine in North America.

Current Conditions: Mark Twain defined a mine as a "***hole in the ground with a liar standing next to it*** ".

Be that as it may, but every mine started as a discovery which, in most cases, was made through prospecting or exploration. The biggest mining companies in the world have been the result.

As Mark Twain quipped, mining promotion has had a colourful history, but this began to change in the early 1980s when the real price of base and precious metals began a lengthy decline.

With accountants facing the daunting prospect of shrinking cash flow, big mining companies reduced their exploration staff. As an example, Placer had one of the great mine-finding teams in history and key members, in being forced out, became successful entrepreneurs in mining exploration. Now big companies are facing the daunting prospect of inadequate reserves.

In the "old" days, a prospector would take a showing to a promoter, who would engage a consulting geologist to write up a report. This would be used to promote the stock and raise some money.

The relentless energy of promoters required a continuous stream of "stories" and, given probability, eventually discoveries were made.

Over the past twenty years or so, highly experienced professionals in exploration have been initiating projects and raising capital.

The result is an unusual combination of a high degree of motivation with a methodical approach to business and exploration. Success so far has made the Toronto stock market the leading exchange for mine finance.

And, as we've recently seen, from the top of the hierarchy from major to intermediate sized mining companies have been acquiring gold reserves through acquisition or merger.

Wrap: The following chart shows the behaviour of gold's deflated price through all six of the great financial bubbles back to the first one in 1720.

Gold's real price declined to a significant low with each great mania and then recovered during the initial contraction. Typically, gold's subsequent recovery has been lengthy, with setbacks occurring within the usual 4 to 5 year business cycle.

The second set of charts (pages 6 and 7) shows the cyclical "buy" based upon the Coppock.

The third chart (page 8) reviews this pattern through the bubble that climaxed in 1Q 2000 and the initial bull market for gold's real price.

With these, it is evident that the gold exploration sector moves more directly with changes in gold's real price rather than with the nominal price. Very few researchers have been using gold's real price so the link from this to market participants remains curious, but it works.

The next step to appreciating the opportunities present in the gold exploration sector is that the real price has been in a steady decline since January, 2006. This has depressed the stocks of some well positioned exploration companies.

As outlined in the last set of charts (page 9), which include technical comments, this appears to be making a cyclical low for our gold/commodities index has been accomplished and conditions in the credit markets are similar to those that typically anticipate a cyclical increase in the investment demand.

This could inspire all aspects of the gold mining industry.

For investors who can handle today's relative illiquidity in the exploration sector, the risk/reward opportunities are outstanding.

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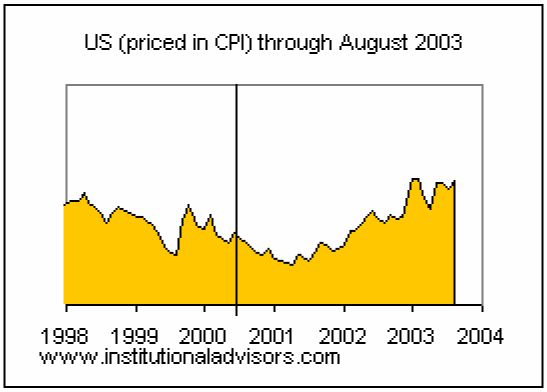
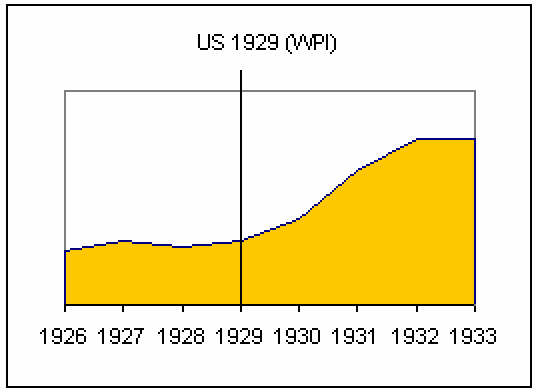
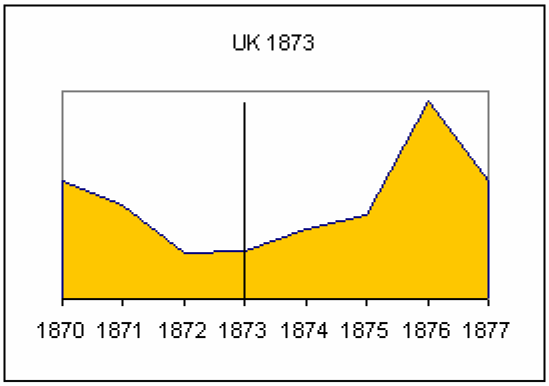
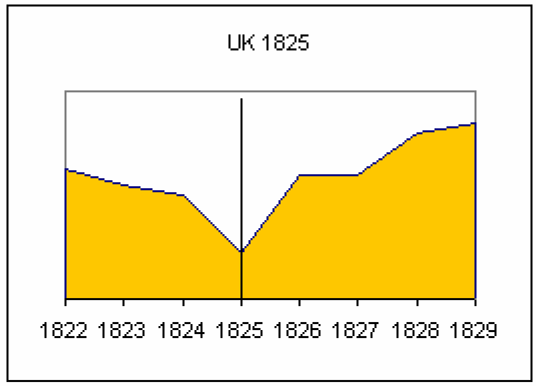
Deflated Gold Prices and Financial Bubbles

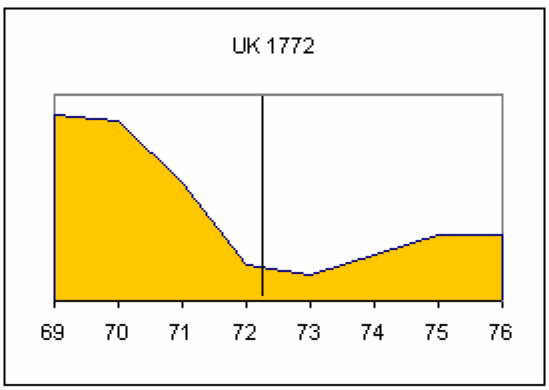
The charts below record the behaviour of gold's real price through all six of the great financial bubbles in history. Data are in senior currency terms.

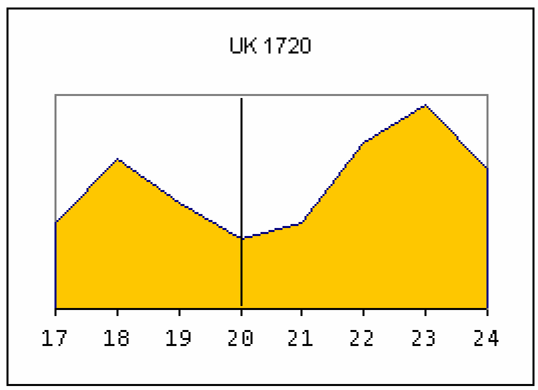






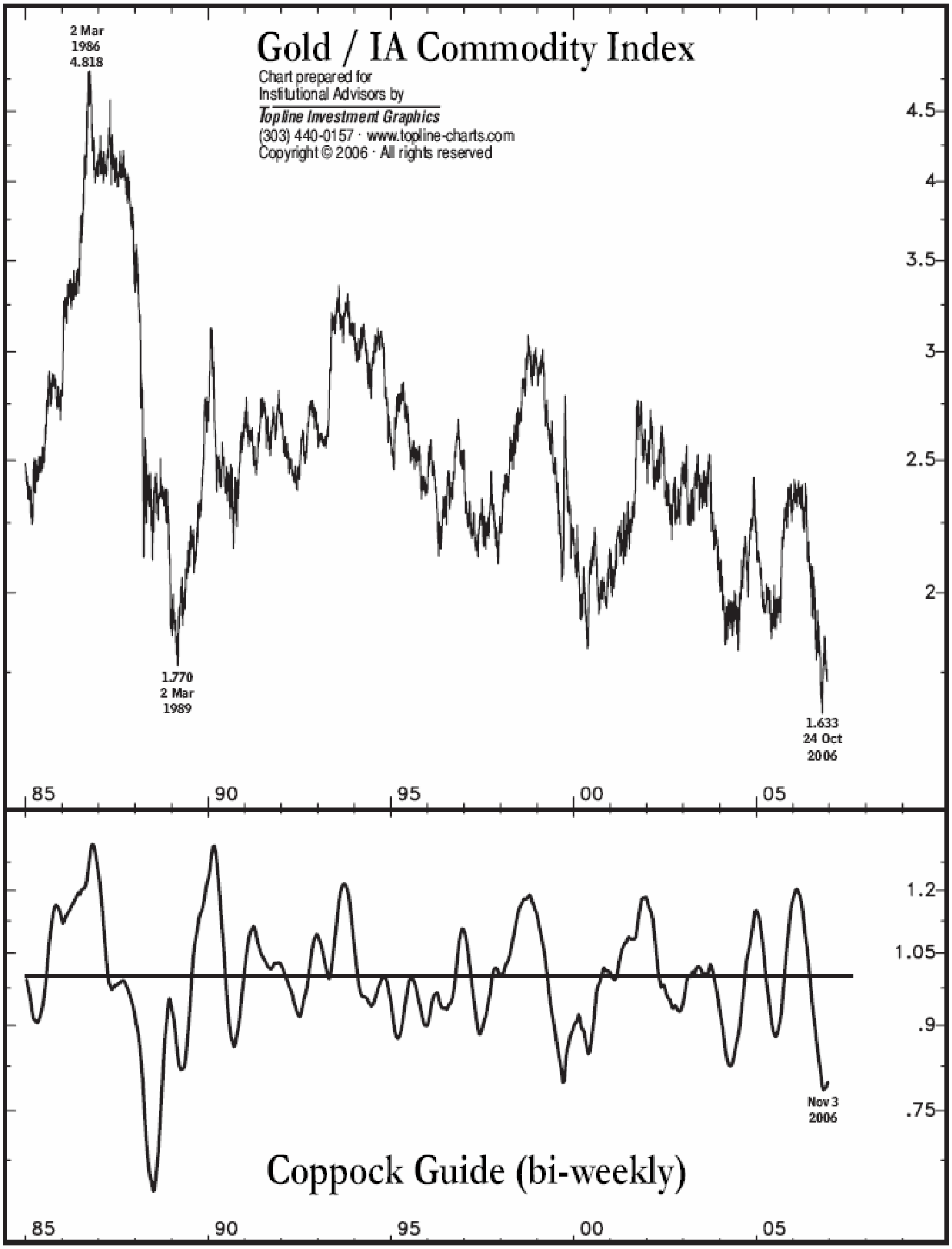






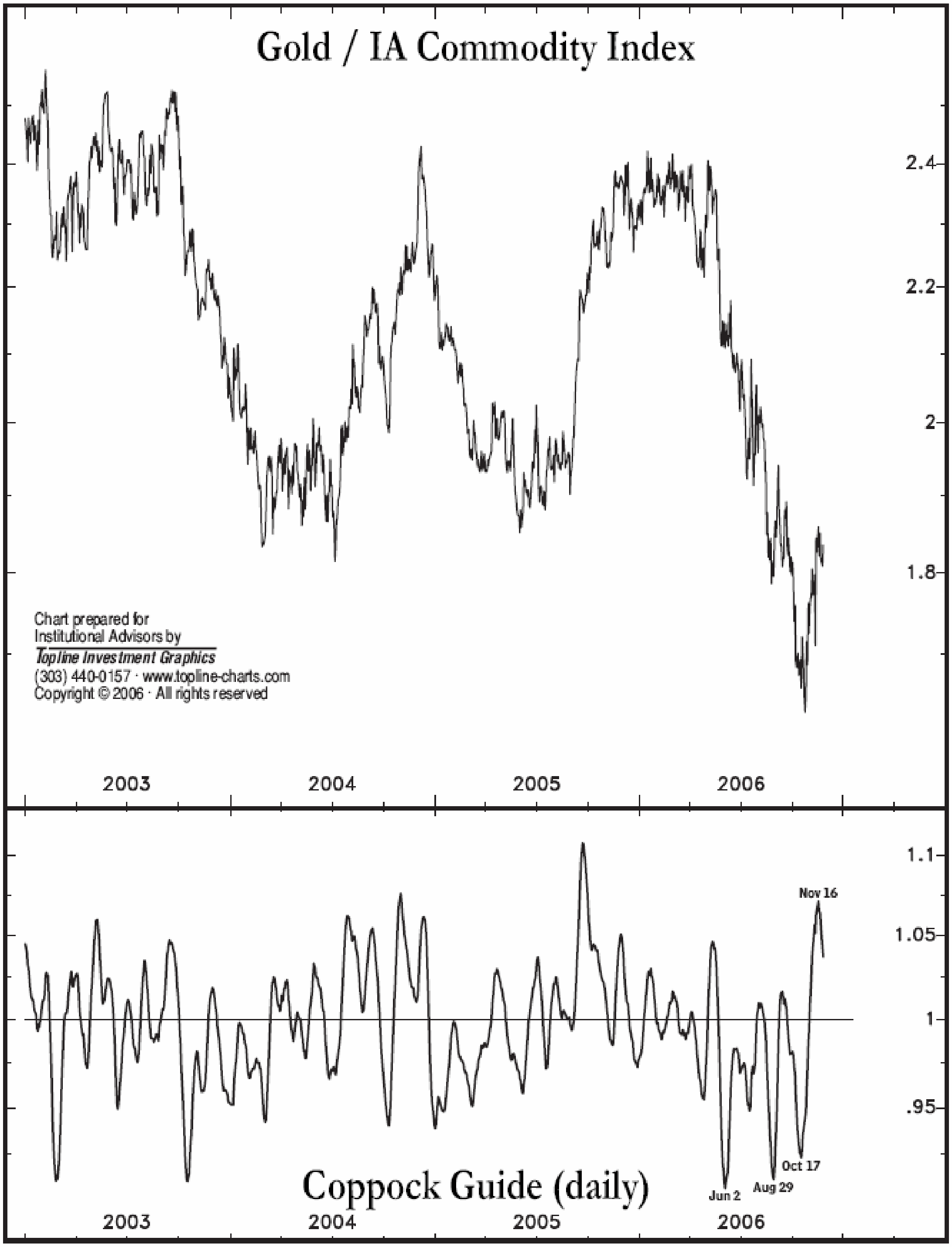
- **Analysis of gold's real price has avoided the problems deriving from a sole focus upon the nominal price and dollar depreciation. Since late 2003, mining costs have been rising relative to gold's price. Earnings adversity seems close to ending.**
- **Analyzing gold's real price and its consistent behaviour during the remarkable financial volatility of our times has been an important adjunct to orthodox determinations about the character and timing of the Indian Monsoon, gossip in the Middle East "Souks" and the schemes of central bankers, as well as estimates of jewelry consumption, which typically increases during a bubble and slumps with the consequent contraction.**

GOLD'S REAL PRICE



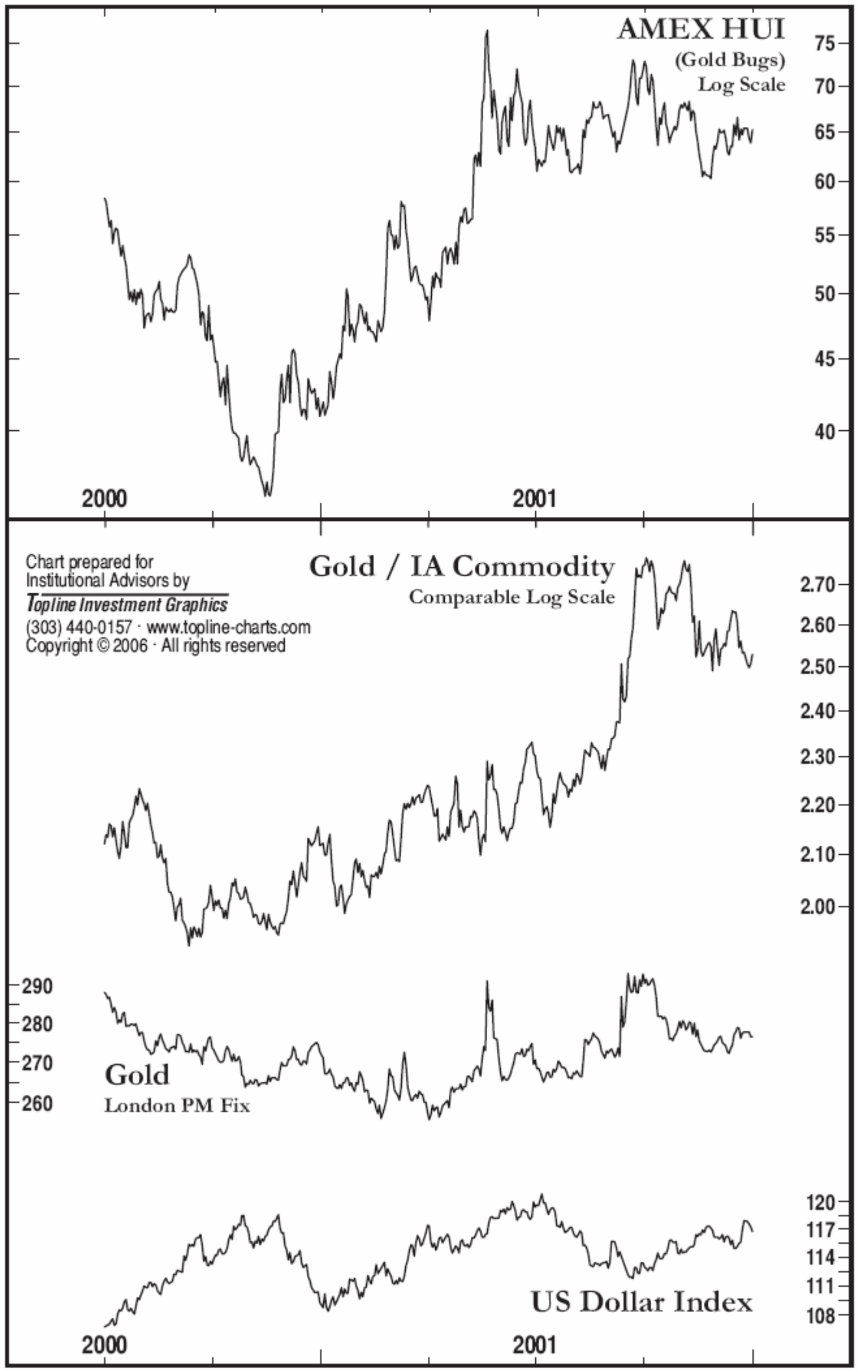
- Note the cyclical low in 2000 as that bubble was blowing out.
- Something similar is being logged.
- The Coppock is designed to determine cyclical lows.

DAILY COPPOCK



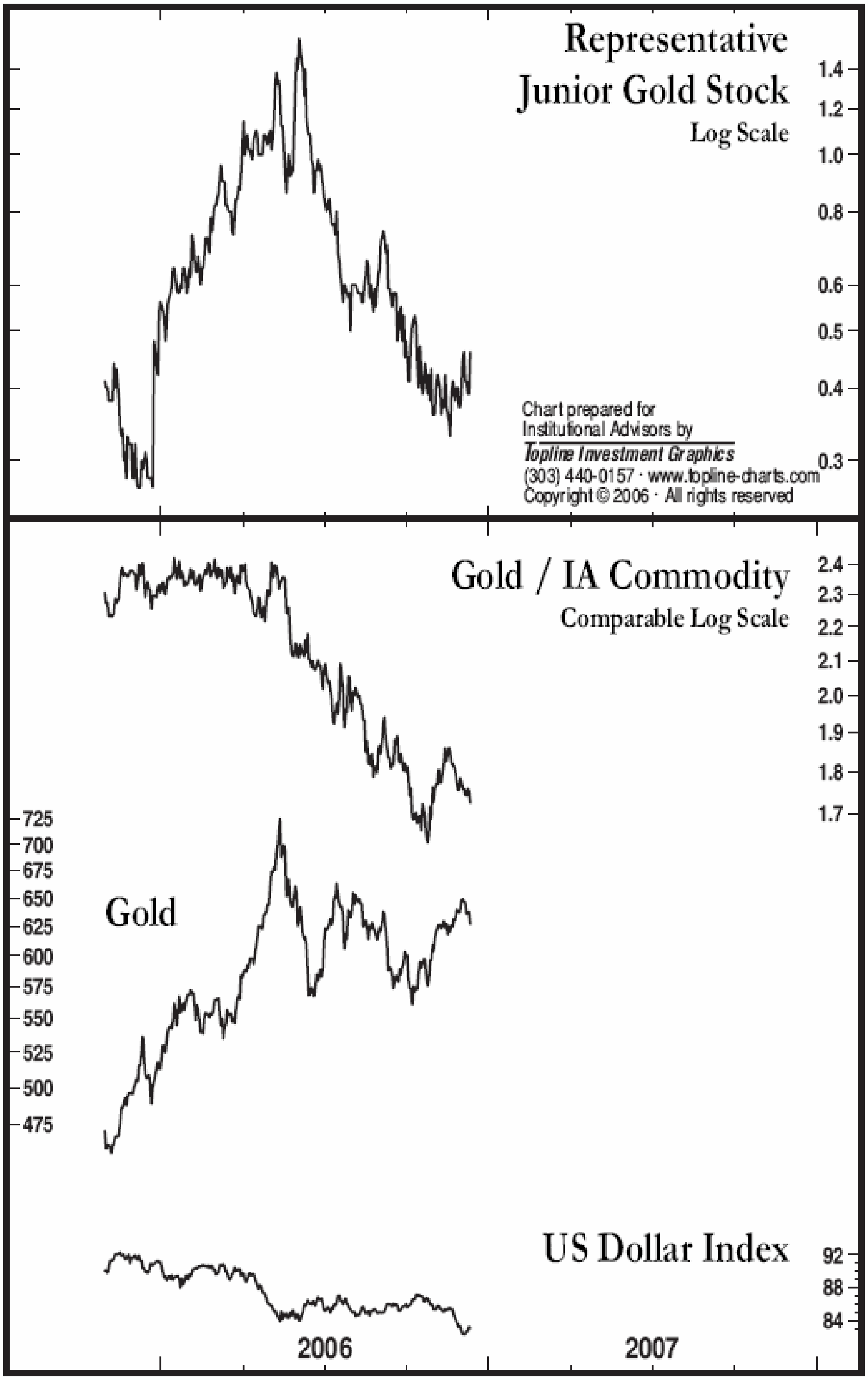
- **Note the constructive testing of the low on the Coppock.**

GOLD STOCKS AND THE REAL PRICE - 2000



- In the Fall of 2000, the HUI turned up with our gold/commodities index (G/C).
- Gold's nominal price didn't turn up until May, 2001.
- By that "breakout" the HUI was up 60%.
- Note how the G/C index rose as the dollar was strengthening. At times then, the real price is more important than the course of the dollar and the nominal price.

GOLD EXPLORATION SECTOR INTO 2007



- As in 2001, gold's real price is expected to take all sectors of the gold market up.
- The exploration sector is poised for a huge bull market.