

Today's Notes:

1. Yellow and Black (Gold)

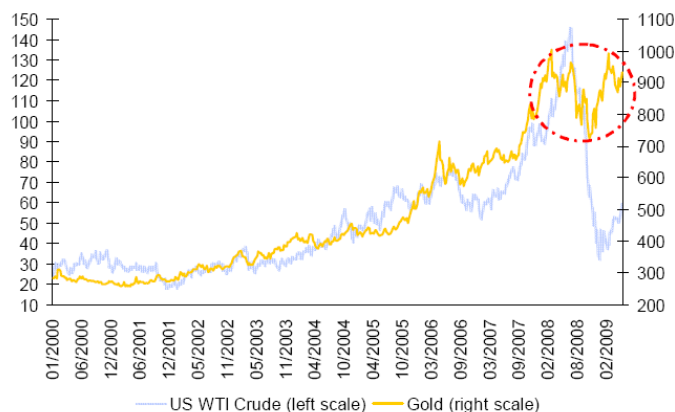
1. YELLOW AND BLACK (GOLD)

I am not a gold bug. Nor do I believe in oil as the ultimate energy source. Neither commodity is essential to our long term survival. But today they serve vastly different and important roles in the global economy. Gold is a global store of value in a world where fiat currencies fluctuate wildly relative to their paper cousins. Oil is now, and will remain for the next few decades, the primary transportation fuel whether it is produced from coal, natural gas, bitumen, jatropha, algae or flows from the ground. As such both commodities are quite different and vastly more important than commodities such as copper or soybeans. They are as different from each other in physical characteristic yet they are related in function. Today gold and oil are central to the functioning of our interrelated global economies. To the extent that we exhaust oil resources its price must increase. Its price increase will obtain whether or not we produce oil from plants, animals or we continue to discover and pump it from the earth. Oils importance to our quality of life (QOL) in the next few decades relates to our dependence on **cheap** energy. Historically oil has been a cheap source of energy. It is becoming more apparent that we will experience peak oil soon. The world's easily recoverable, known oil resource will decline. Couple this with an increased population seeking a higher QOL and oil resources will become valuable, not only for transportation but also for petrochemicals (8% today).

As the price of oil rises it affects every aspect of an economy. Ultimately higher energy prices cause increased price inflation. The headline CPI, for example, is tied so closely to the price of oil that Washington's economists have defined a measure called the Core CPI that eliminates energy price fluctuations, a bit of Economic Black Magic.

Historically gold has been positively correlated to higher energy prices. This is the key relationship even though the flight-to-quality character of gold has recently become evident.

Gold is emancipating itself from oil and other commodities



Sources: Datastream, Erste Group Research

Gold is now, has been for centuries, and will be in the future, a unique commodity useful for storing value once created by discovery and recognized by the market. Gold is a proven medium for wealth maintenance; it is rare, beautiful for adornment, long-lived and perhaps most important gold cannot be created by Central Banks. Central bankers and the IMF love gold; they sell it whenever they need to finance their ongoing ability to print.



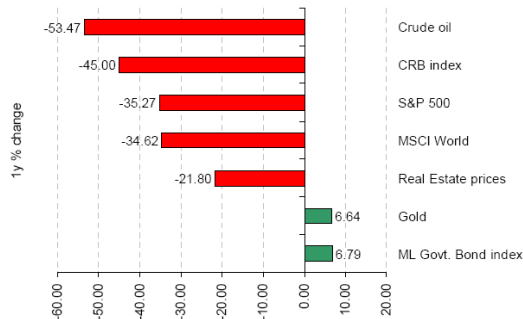
Gold has failed four times to make higher highs. This tells me that in the meantime global economic contraction rules the roost.

Gold's continuing high dollar value is a result of its flight-to-safety character.

In a counter intuitive way gold forms the backbone for central bankers who, though they can create paper currency by fiat, tend to be in the gold market selling gold with stunning regularity¹. If Congress agrees this week, the IMF will soon sell 403.3 tonnes of gold². This is not the IMF's gold but that lent to the IMF by its participants. This will recapitalize the IMF in fiat currency in its attempt to become a more important banking force in the world. Why are China and several Middle East OPEC countries anxious to buy the IMF gold?

There is no alchemy that turns any other material into gold cheaper than the costs of discovery - a wide margin. So while oil is a wasting asset, critical to our lifestyle, gold is precious and indestructible and has a 5,000 year history of storing value through thick and thin economies. It seems to me that gold is something you might want to own.

Gold vs. other asset classes since our most recent Gold Report (June 2008)



Source: Datastream

Gold is a wonderful “store of value asset.”

This chart demonstrates its “flight-to-safety” character as well between June 2008 and June 30 2009.

1. We all remember Dr. Bernanke's oft-quoted, infamous 2002 printing press speech? How's that working out?

² Title XIII, Section 66 is titled, Approval to Sell a Limited Amount of the Fund's Gold is considered this week. The IMF has been waiting for since the G20 meeting in April. This gold was acquired after the second amendment to the Fund's Articles of Agreement in April 1978

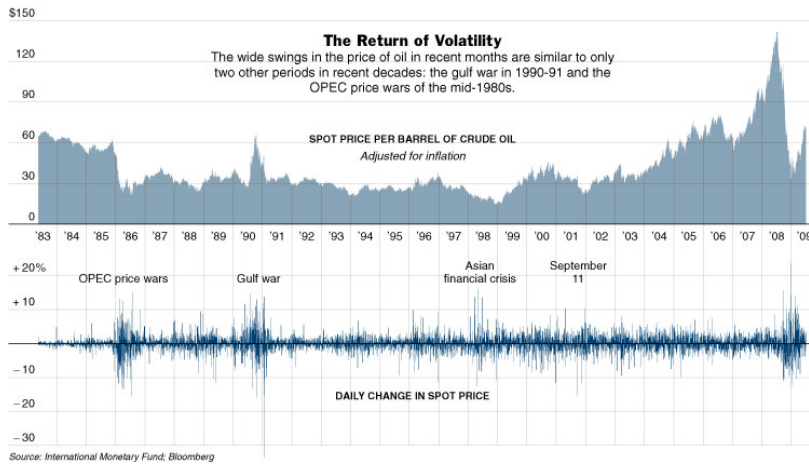
As oil's volatility increases due to its own rarity, market speculation and its wasting nature, it harms the economy. As oil prices increase, eventually due to peak oil, economic transactions become more expensive (economies decline). This reduces the quality of our lives. The current plight of the airline industry is a relevant example. In the longer term oil's relevance to human kind is not about global warming, carbon gases or peak production, it is about maintaining, if not increasing, the quality of our lifestyle.



We cannot change energy modalities instantaneously. Energy Secretary Stephen Chu recently said that within 30 years only 15% of our energy needs will be supplied by alternative sources. What will fill the gap? The answer is that such an energy source has not yet been discovered and scaled to economic levels. Cap and trade of CO₂ will increase electricity rates by at least 30% which will slow our economic progress while perhaps eroding some of the diseconomies of wind and solar powered electricity. It is notable that the bridge to the future in our domestic natural gas and oil resources is being ignored. Our view is that once this massive global debt load is painfully worked down the price of oil will rise to the \$75 target that OPEC seeks and far beyond. When this happens its commodity cousin gold will also work its way much higher. The question is, when. Owning oil's commodity cousin as a hedge will be a necessity, both in kind and with paper claims.

The Discovery Investing philosophy is simple and can be very powerful. The advantage of Discovery Investing is that it is painfully obvious. The catalyst is embedded; it is the realization of the potential discovery. When I look around the financing landscape today I see gold and silver discovery and near-term production opportunities in much demand with most other metals ignored.

This week I shall travel to Kenora, Ontario to visit the Houston Lake Mine gold deposit and assess team's progress. You may remember that I visited this resource last year. They are much further along in their discovery process and rapidly approaching the early Mature Discovery stage. Yesterday I also spoke with management of the Fire River Gold company. Their North Fork Mine is ready to produce within one year and it is wedged in elephant territory between Donlin Creek and Fort Know in Alaska. I will be building my ten point grids on both these opportunities after my visits.



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a financial advisor. In his role as advisor he has been awarded 75,000 options from Polymet which strike at C\$2.76. We cannot attest to nor certify the correctness of any information in this note. Please consult your financial advisor and perform your own due diligence before considering any companies mentioned in this informational bulletin.