

May 2008 Market Update

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Credit Markets & Inflation

In the middle of March we learned about an unprecedented bailout package of Bear Sterns by the Fed working with JP Morgan. Since that time, we have had a daily dose on the airwaves how the worst of the credit crisis is behind us. However, the reality is the credit markets have not turned a corner, nor are things getting better. I want to go through a new major issue that will be hitting the credit market shores followed by the long term ramification of the actions of the US government: create rampant inflation.

Recent data on the housing market has turned out right ugly. Home prices throughout the country are falling at rates not seen since the 1930's. Rapidly declining home prices are primarily driven by three factors: foreclosures, home over-supply and credit tightening by lenders. All three play together in a vicious cycle driving the problems seen in the global credit markets. Most of the trouble in the housing market has been created by sub-prime borrowers being unable to pay when their adjustable rate mortgages reset. Last summer, sub-prime began defaulting at a rate of around 14%. Now the number of sub-prime loans in default is approximately 40%; almost one of every two outstanding! Highly leveraged mortgage investment pools buying securitized home loan packages have taken horrendous losses. Every foreclosed sub-prime home sold for pennies on the dollar wipe out huge sums of interest payment profits. This has resulted in the face value of the securitized mortgage backed securities to fall precipitously.

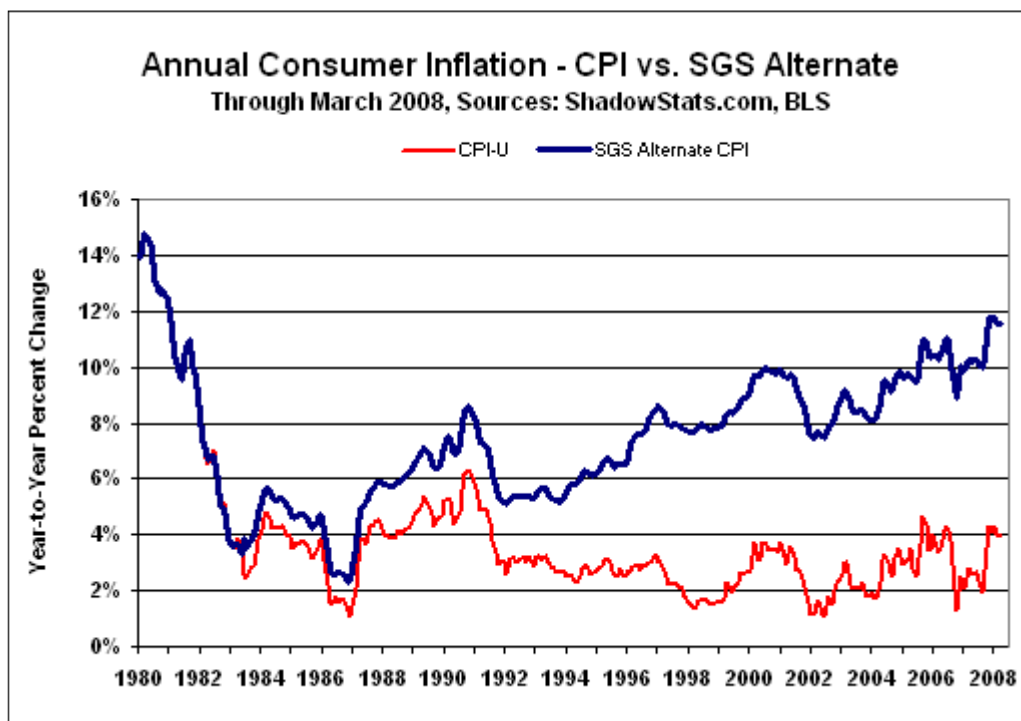
Sub-prime defaults and foreclosures are still working their way through the system. The largest wave may have already hit the markets and technically the worst may be behind us for this class of securities. However, new trouble is brewing in the Alt-A mortgage pool. These are borrowers who have enough troubled loan history to not qualify for prime mortgages but not bad enough to be in the lowest class, sub-prime. Alt-A mortgages are double the number and loan size of sub-prime. Currently Alt-A loans are defaulting at an approximate rate of 14%, strikingly similar to sub-prime. Reports are surfacing that Alt-A and even prime borrowers are handing in their house keys when faced with a negative equity in their homes. Negative equity situations are growing more numerous by the day. Data on California shows that Alt-A loans originated in recent years started with on average 6% home equity. Since Californian home prices are falling faster than 10%, most Alt-A loans in the State originated over the last three years have a loan amount larger than the asset value of their home. Considering the tremendous damage a "small" market like sub-prime has caused financial markets it may only be a minor hiccup compared with what the Alt-A market may do.

Since last summer, the Federal Reserve (Feds) has come out with rate cuts, a new bail out package or some other unprecedented financial alchemy followed by a deluge of propaganda from the markets that the credit crisis is ebbing or

turning the corner. A few months after each new Fed action reality comes back to the markets as it is seen the situation has not improved. What the Feds are trying to do is prevent a deflationary collapse of the financial system. This is what occurred in the 1930's that caused the Great Depression. The biggest financial weapon to fight deflation is with inflation and the Feds are bringing out all of their biggest inflating guns: interest rate cuts and 1 month maturity loans.

Sound monetary policy for any nation is to have interest rates above the rate of inflation. A fundamental building block of solid monetary policy is to accurately report inflation. Back in the early 1980's inflation was raging at a clip of over 14%. The Feds had to raise interest rates dramatically to prevent hyperinflation and to support the US dollar. This era was when 16-18% mortgage interest rates existed. Fed Chairman Paul Volcker was able to finally tame the inflation beast and interest rates fell dramatically, making it possible for the US economy to begin to grow. Late in the 1980's, the US decided that one way to prevent run away inflation expectations from growing was to modify the way inflation is calculated; hedonic adjustments to inflation was born.

There is a website, ShadowStats.com, devoted to showing how the US calculates many different economic statistics. They have preserved the way the US calculated inflation in 1980 and have a comparison to the one used today. Thanks to the "new" hedonic adjustments you can see how large the disparities between the two inflation methods are:



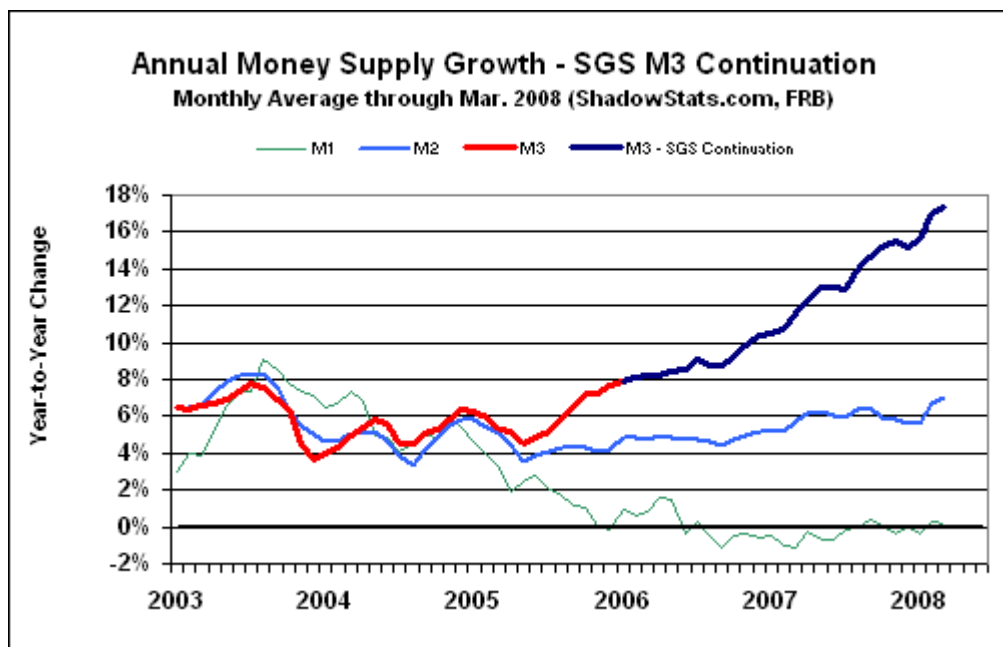
Today the US government is reporting inflation 8% lower than the way it was calculated in 1980. Many skeptics of the US calculated inflation numbers call the

CPI the “Constant Price Index”. We have seen oil go from a low of \$20 per barrel in 2002 to \$120 today, with very little increase in reported inflation despite the rather large component the cost of energy plays in the US. Understating inflation is actually quite inflationary. By the US reporting inflation significantly below the actual inflation rate, it allows the Feds to cut interest rates far lower than where they should be.

The Feds battling the credit market freeze have now offered to banks and investment banks 28 day maturity loans, which will be rolled over indefinitely into the future. The idea is to inject the markets with cash that cannot be raised by banks selling near worthless mortgage backed securities. I affectionately call the huge loan guarantee program by the Feds as the “cash for trash program”. Essentially the Fed will loan money to any bank cash in exchange for mortgage backed securities, structured investment vehicles or other exotic derivative based instruments at full face value as collateral. The Fed has now become lender of last resort injecting money into the financial system for instruments that cannot be sold. What this action does is place more dollars into circulation without economic benefit.

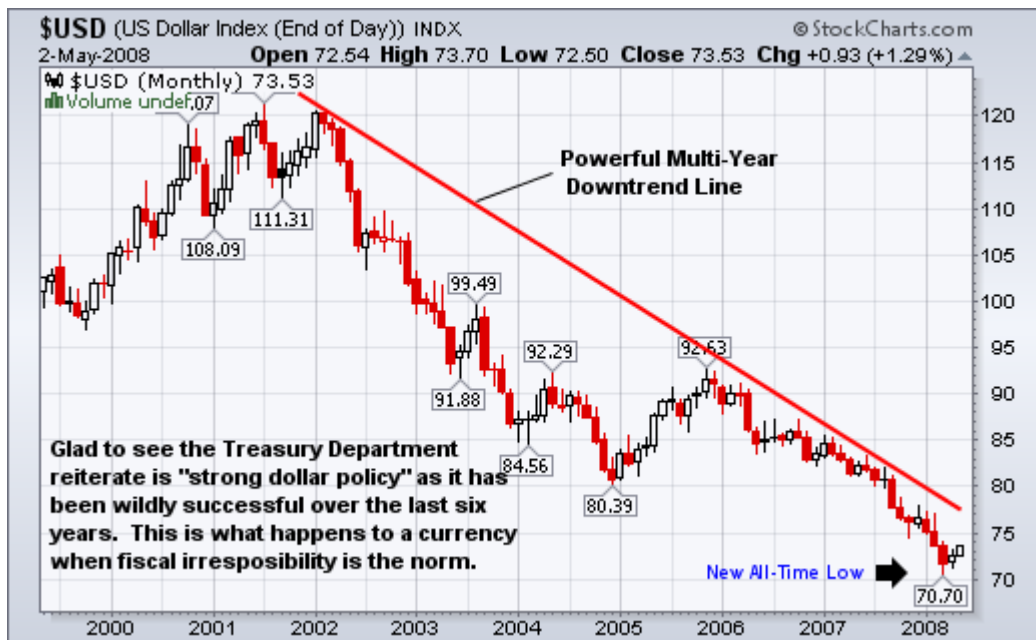
When Ben Bernanke took over the helm at the Federal Reserve he wanted the institution to be more transparent. One of the first major actions prior to taking over was to eliminate reporting M3 money supply. Now that’s transparency! It was argued that calculating M3 was too expensive and no one really used the data. Both arguments are completely without merit. The US spends more in an hour of operations in Iraq than what it would cost to calculate M3. M3 is probably the most important of all the classes of money supply as it is the broadest measure of the Nation’s money supply. The reason I believe M3 was abolished is that it would painfully show how the money supply is rapidly inflating. In general, if real economic growth is 4% then 4% growth in money supply is non-inflationary. The supply of goods and services has increased and hence an increase in money supply in proportion creates balance. Consequently, if money supply increases above the rate of real economic growth the result is inflation. A stagnant environment of goods and services with more money in circulation results in rising prices. An exploding money supply for long periods of time generally result in escalating inflation pressures and eventual economic ruin.

The following chart was generated by ShadowStats.com, which includes M3 data after the Fed discontinued its reporting.



I have seen other websites report similar results and have no reason to question the validity of the values shown. You can immediately see why the Fed discontinued the reporting of M3. The US rate of supply of dollars has accelerated to banana republic levels. My estimate of real economic growth now stands at a rate of -3% per year accounting for realistic inflation levels. Thus, the US is creating money at an annual hyper inflationary rate of around 20%. This represents an increase of about \$2 Trillion new dollars per year without the corresponding increase in goods and services. In other words, \$2 Trillion new dollars are chasing the same number of goods and services. Something has to give either the value of the dollar has to decline and/or an increase in prices must occur. As we have all experienced, prices are surging in just about every area except electronics. The scary thing is there's a long time delay between money creation and when corresponding price inflation is experienced.

One can think of a currency as the shares of stock in a company. The number shares outstanding multiplied by the stock price yields market capitalization or market worth of a company. When a company issues more shares without an equal increase of franchise value the price falls. This is similar for any nation. The US is flooding the world with more shares of our society via the creation of dollars. It is easy to see how from the law of supply and demand, as supply increases prices must come down to spur demand. The two charts below are the US dollar index, calculated primarily as a function of the Euro, Yen and Canadian Dollar.



The steep fall in the dollar is precisely what happens when a country mismanages their finances and prints money with reckless abandon. By and large, Americans have only begun to feel the ramifications of the dollar's enormous decline. The charts of the US dollar index are the general trend of investment returns foreign investors have received over the last six years. It also represents the direction foreign company margins have gone on goods sold to the US. At some point in the future, foreign companies are going to say enough is enough and begin to raise prices on goods sold in the US. When this happens, inflation will significantly begin to accelerate.

Dow, Nasdaq and S&P 500

The purpose of this section is to give readers a look at the broader market charts. Two Dow Jones charts, followed by the Nasdaq and S&P 500 are presented. At the end of the charts is brief commentary about what I have observed from the recent trading action.

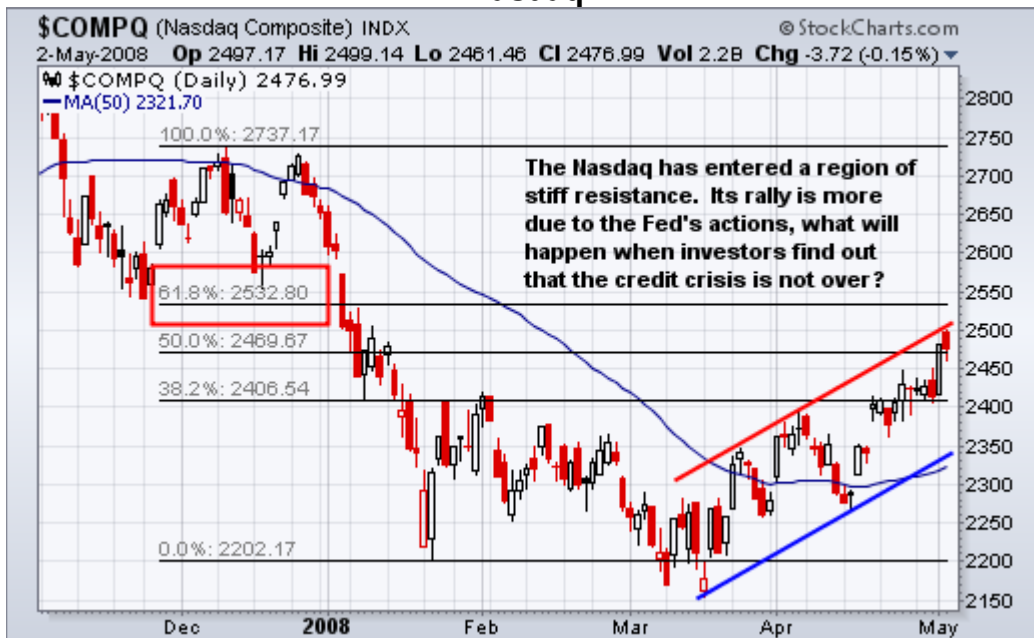
Dow Jones



Dow Jones in Euros



Nasdaq



S&P 500

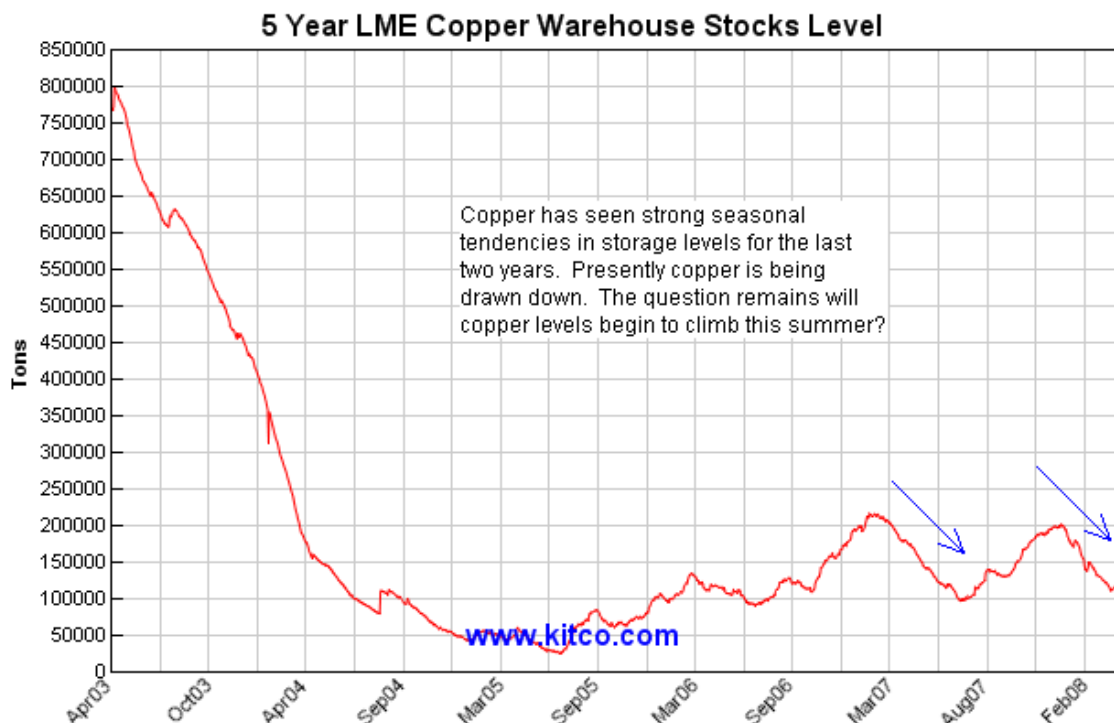


Trade in the broad markets has been heavily influenced by Federal Reserve actions. We have seen them come in with a heavy hand in preventing the Dow from moving too far below the 12,000 level. This appears to be the critical level not to be breached. Post the bailout of Bear Sterns in mid-March there has been a concerted effort to paint the credit crisis as turning the corner. Along with this push to change sentiment, the broad markets have rallied strongly. The credit crisis is getting deeper despite the intervention by the world's central banks to date. The present rally offers a great time to reduce holdings before reality hits.

Base Metal Review

Copper Market

Last time this year I was bearish on copper due to high probability storage draws from the LME would end and metal stockpile would build. This bearishness was born out as yet again the storage levels stabilized and then began to increase. We are looking at nearly the same pattern as last. However, this time around storage levels are considerably lower. The following chart is the 5 year data of LME storage.



I continue to be bullish on copper for the next few months reflecting my sentiment in February that we could see a bull run lasting 3 – 6 months. What may break the seasonal pattern we have witnessed over the last few years are supply side problems. Many are not aware of this but Chile, the South American country located on the Pacific Ocean, is largest producer of copper in the world. The country is blessed with high grade ore. However, Chile is also cursed having a very arid environment. Their source of water is becoming increasingly constrained with the reduction of the size of glaciers and souring relations with neighboring countries. Add to this some of their big copper mines are experiencing labor strikes constraining production. While the water issue isn't an absolute immediate constraint to production it does cast a shadow over Chile's ability maintain its producing capabilities over the long term.

The copper futures price performance chart is below. Copper has found its way to new highs but is finding a tremendous amount of resistance at the \$4 mark.

The price action to me appears that large entities are trying to prevent the metal from blowing through \$4 with the realization \$4.50 would be right around the corner. The strikes in Chile are putting pressure on LME storage levels and providing a firm bid under the metal. Now it looks to me we have a battle of titans with one group (copper users) digging in their heels to prevent further price appreciation. The bulls on the other side are a consortium of speculators and fundamental investors. Copper bulls have to keep a wary eye on LME storage levels this summer to see if the draw down stalls and begins to move up. We may find the copper market be different this time as fundamentals are firmly bullish.



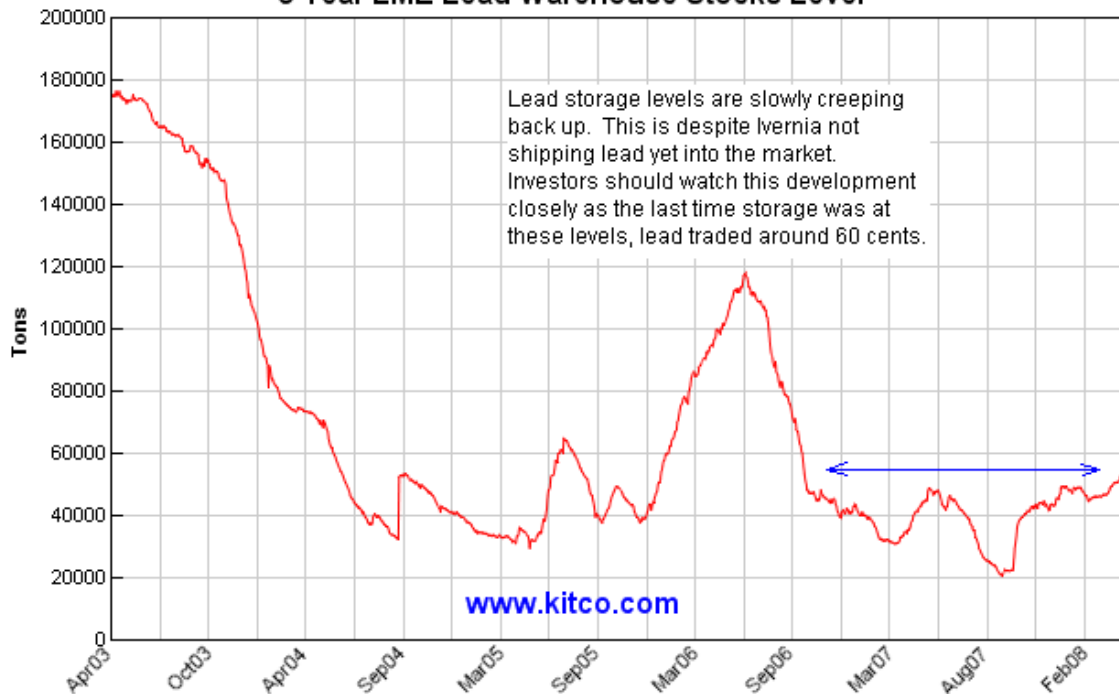
Lead Market

Lead's price has been consolidating for several months and its chart has formed a bullish triangle pattern. Usually these patterns break towards the direction that preceded the formation. I believe this will be one of those times that the chart pattern does not go in its bullish direction. One reason is the price has spent most of its time testing the lower support line. Other reasons for my bearishness are LME storage levels are increasing slightly and a potential large supply side increase may be coming soon. I have mentioned Ivernia, the Australian based company responsible for supplying 3% of the world's lead, has not been able to ship material for over a year. They came out with a press release that they are now rehiring for their flagship Magellan mine. Ivernia says they have no idea when they will get approval to ship lead from a secondary port but the mere fact they are now hiring leads me to believe it will come sooner than later. I believe that if they do get approval, even though shipment of metal would be several months later, that the price of lead could get hammered on the news.

5 Year Lead Spot



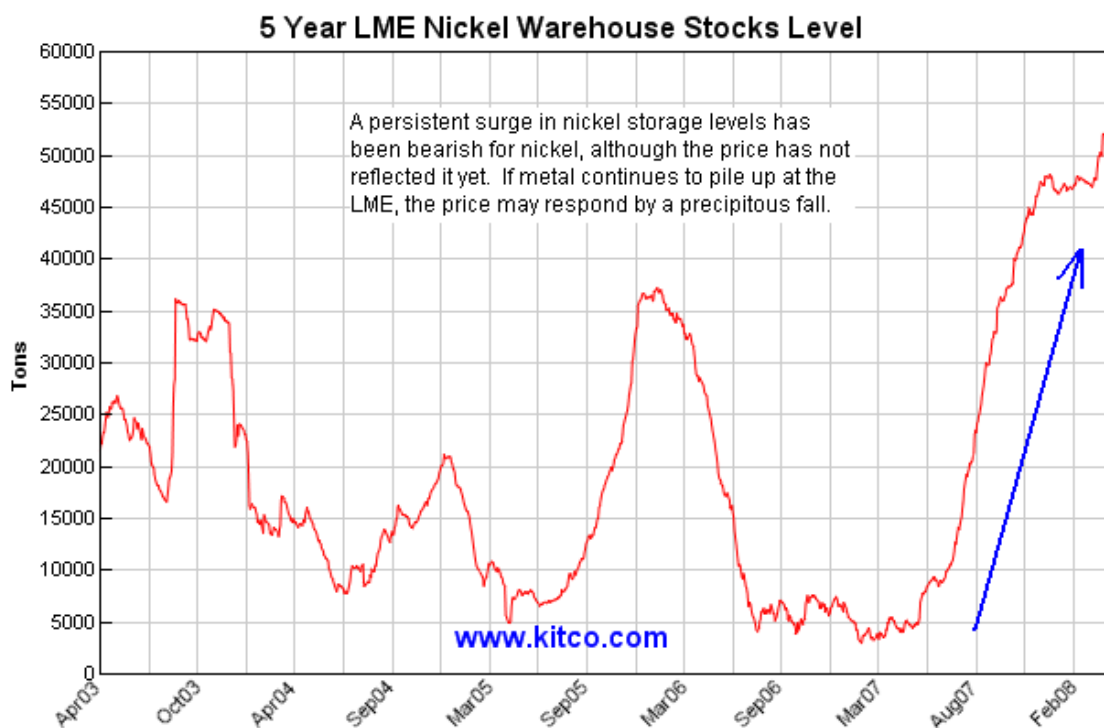
5 Year LME Lead Warehouse Stocks Level

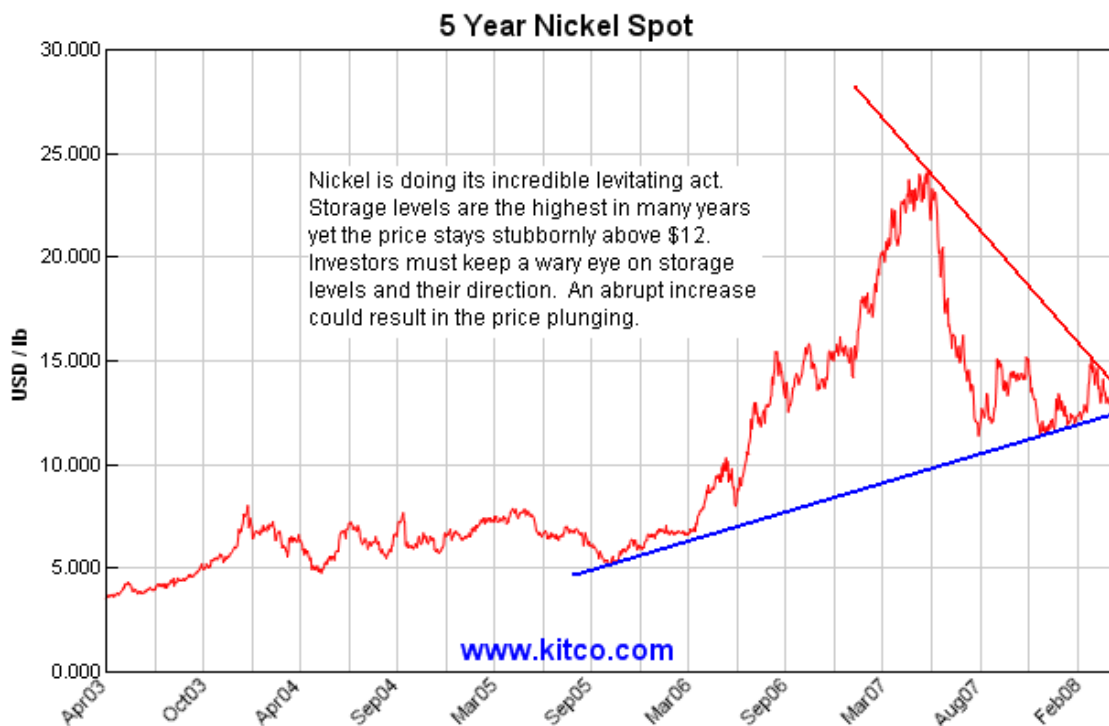


I am now mildly bearish on lead for the short to medium term. The lead market needs LME storage to decline and for Ivornia to be denied shipment of material before the price will catch a firm bid.

Nickel Market

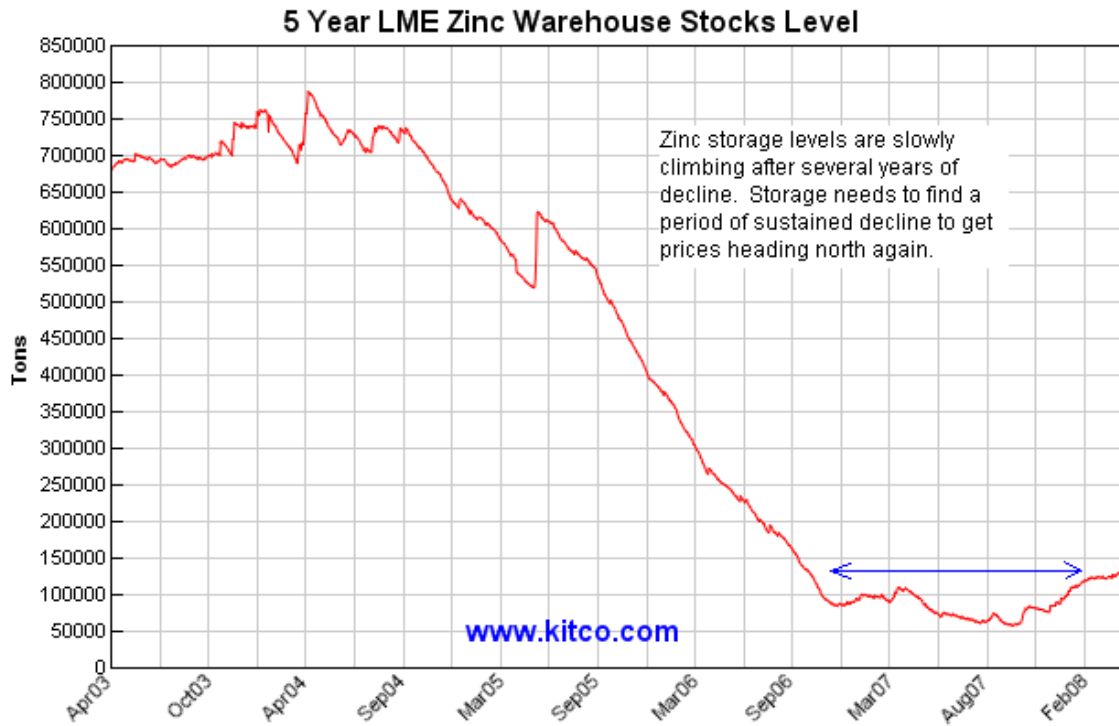
Nickel has been remarkably resilient in the face of multi-year highs in LME physical storage. The market should be experiencing a decline in storage this time of year but recently has increased 10%. I and several others are at a loss to explain why the price of nickel remains historically very high while material continues to find itself building in warehouses. I use LME storage levels religiously as they tend to be a culmination of the vast majority of supply and demand forces into an easily discernible picture. Eventually the divergence between storage and price must correct itself. At the moment, I'm anticipating a fall in price. Until we see a dramatic fall in storage levels like in mid-2006, I remain firmly bearish on the metal.





Zinc Market

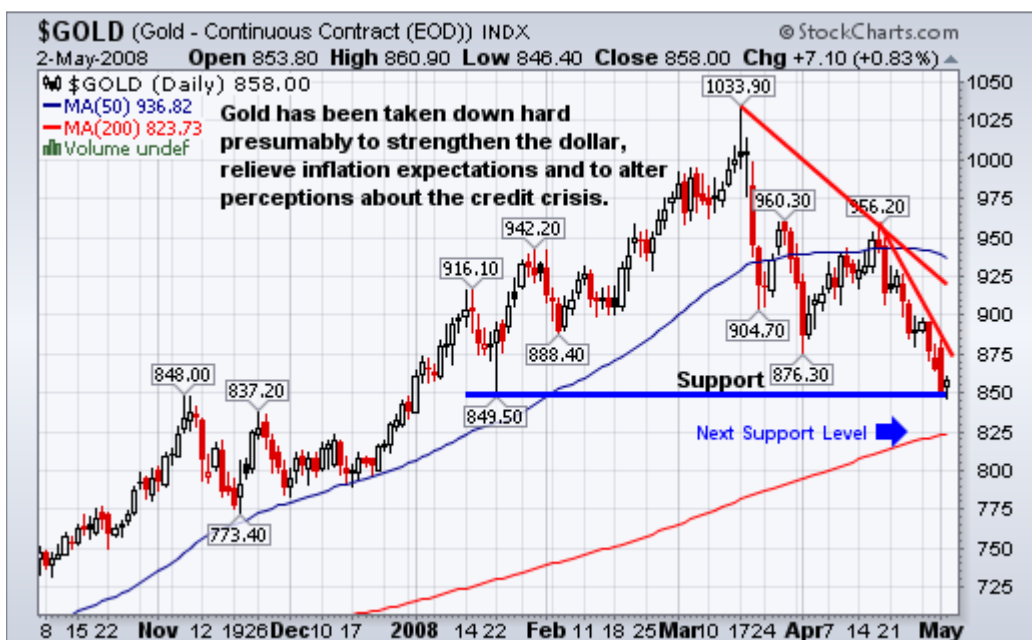
Zinc was a peculiar market last year. Storage levels plummeted while the prices barely budged, which looks like the opposite of what nickel is doing this year. Like lead, zinc is slowly piling up at the LME. It looks as though the market is fairly balanced at the moment. The price chart is flashing a big warning signal for softer prices in the near future. In many commodity markets the direction of equities precedes the direction of the underlying commodity they produce. Junior zinc producer equities have been absolutely slaughtered with many hovering at or making new 52 week lows. I have no firm fundamental supply/demand reasons to be bearish on zinc, but the price chart, slow grinding increase in storage and the plunge of producer equities leads me to believe that the bear has zinc on the menu. For those investing in zinc equities, please be careful to watch out for the price closing below \$0.95. Technically, this will be a very bearish development and will likely lead to further price erosion.



Precious Metals Market

Gold rallied \$200 from early February to mid-March. The metal hit an all-time high on the Sunday evening when news of the bailout of Bear Sterns came out. Gold has for centuries been a safe haven investment in terms of economic crisis and responded intuitively to the Bear Sterns news. However, three days later gold fell all the way down to \$905 along with collapsing commodity sector prices. The airwaves were abundant with proclamations that the worst of the credit crisis was over and commodities were dead. Barron's that week had a cover story how the bull market for commodities was coming to an end. Interesting that a credit crisis can turn around in a few short days and an eight year bull run in commodities ended virtually over night.

I believe that the Feds were in an absolute panic and purposely sold gold down to calm fears that an economic melt down was at hand. There was absolutely no reason for gold to trade the way it did after the Bear Stern news. Following its initial drubbing, gold rallied strongly only to be met with a second wave of selling pushing the price down \$160 off its highs. Again gold rallied and was threatening to break out in mid-April, two weeks before the Federal Reserve meeting. Gold was then treated with another massive wave of selling to drive the price down off \$180 from its peak. The metal did this as the rest of the commodity sector and in particular, oil rebounded to near all-time highs. Pundits have tried to say that gold has plummeted on the rise of the dollar. Actually, where the dollar is today is about the same place when gold was trading close to \$1000.



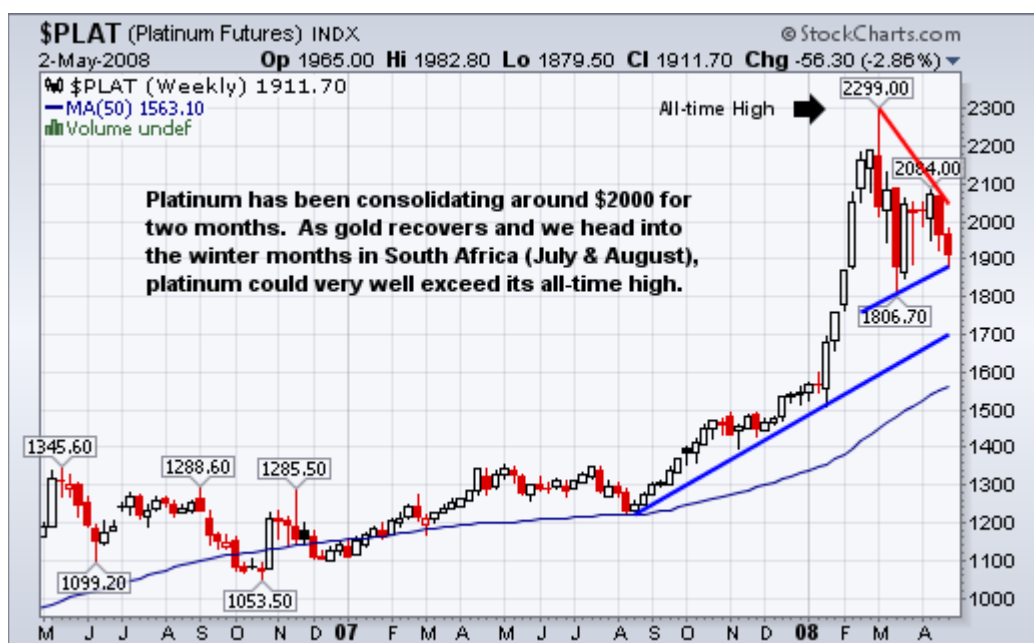
Why gold and its precious metal sisters have been sold down so violently is a bit of a mystery to me. If the Feds were intent on changing inflation perceptions, they would have to go after the price of oil and gasoline, which presently are both

close to all-time highs. What ever the reason, one thing is perfectly clear to me: in times of crisis gold will be sold off violently. Keep this in mind before buying precious metal stocks upon an announcement of equal or greater magnitude to the Bear Sterns bailout.

Platinum has the best fundamentals of any metal I follow. Growing demand for use for catalytic converters in vehicles and flat or declining global production have propelled the metal to new all-time highs. Parabolic moves in price of nearly anything ranging from stocks, bonds to commodities are usually followed by long periods of consolidation. Platinum has been no exception trading around \$2000 for the last two months. The plunge in gold and silver has caused sympathetic moves in platinum but not nearly to the degree.

I believe we could see platinum's price firm this summer. Platinum miners are now coming to the quarterly confessional concerning how the power crisis in South Africa has affected their production. Anglo Platinum, the world's largest producer, said their platinum production fell 24% or 130,000 ounces. This might not seem like much but it is quite significant in a very tight market. Many more producers are going to report their declines in production soon.

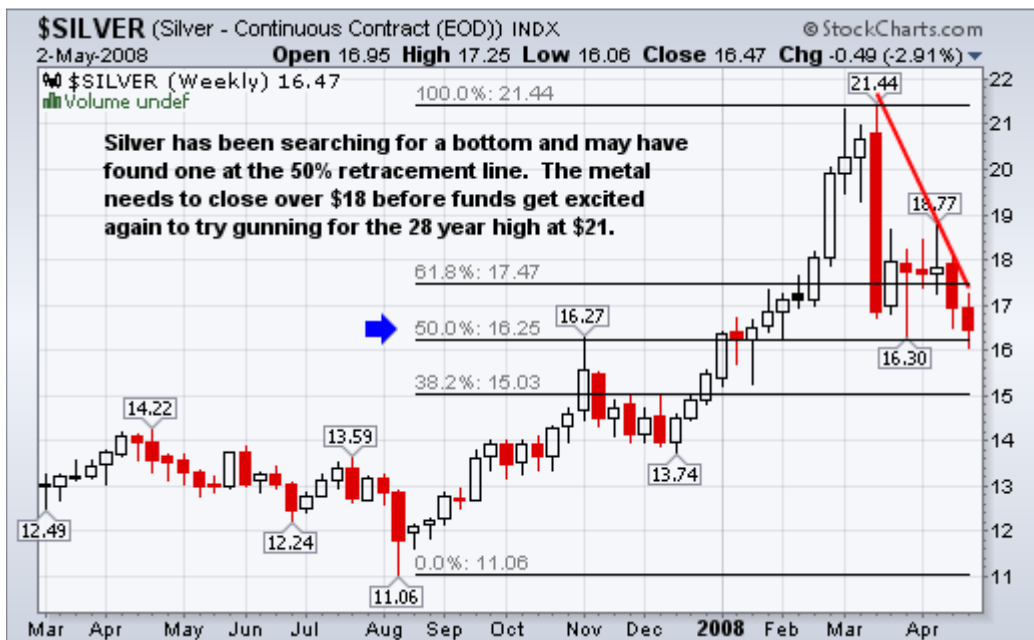
There is also another reason platinum could firm and even explode upwards this summer: the South African winter. The largest electric power consumption occurs there in the months of July and August. South Africa's power grid for several months now has had several periods of intermittent power. I think there is a very real possibility that we will see a reoccurrence of power shut downs at mines similar to January. Platinum is trading on the fact supply has been knocked down in Q1 but has not accounted for any future disruptions. If we get



another two weeks of mine closures, platinum could be trading in excess of \$2500 in a short period of time there after.

Silver exploded up \$5 from early February to mid-March, where it promptly fell with gold. Silver is tied to gold's hip and will generally have accentuated moves in either direction gold is moving. One unusual development has occurred when silver blew through \$20. Investment demand of coins and bars has gone through the roof. Many large bullion vendors had several silver products sold out. I checked out several vendors verifying that various silver sizes were either low or completely gone. This is something we have to monitor closely to see if this is a short term phenomena or the beginnings of a long term chronic problem. What would confirm there is a physical shortage is if the spot silver price exceeds the futures (paper trade) market (known as backwardation). Commodity markets will trade like this when there is a shortage in physical supply.

What would be price explosive for silver is if the spot price exceeds the futures price by \$0.50 or more. Hedge funds could then buy futures at a discount and later take delivery of the metal to sell into the spot market. The Achilles Heel of the Comex paper traders who have controlled silver for the last 25 years is the ability to deliver the metal. There are 600 million ounces of silver sold short on the futures exchange; there is no known above ground metal stored of that magnitude. My guess is if some buyer or a group of buyers took delivery of 100 million ounces out of Comex ware houses, the price of silver would explode.



Precious Metal Stocks

Precious metal stocks (HUI Index) roared from February to mid-March sending many large and mid-cap gold and silver producer stocks to all-time highs. By and large the HUI has lagged the metals in performance from a historical

perspective. The index has been drug kicking and screaming going up but has fallen harder when the metals have gone down. Part of the reason is gold and silver producers have not been showing strong earnings and cash flow growth as energy costs have put a significant dent in their bottom line.



I should point out that summer months are not kind to the precious metal sector. Often times, the HUI puts in a bottom in early May and then chops violently sideways for the next three months. Late July is a favorite time for Comex paper traders to pound gold and silver down. The strongest period for the sector is between August through January. Will it be different this year? That really depends on how the credit crisis unfolds and how it weighs on the US dollar. Should the US dollar rise throughout the summer, gold and silver will have a tough time. However, the opposite is true if the dollar continues its slide. As I said earlier, platinum may trade on its own fundamentals this summer being weakly influenced by what gold and silver do.

Stock Recommendations

New recommendations will have the Company name highlighted in **blue**. A short highlight description of each stock with a chart is presented. **Red** is used to denote resistance and **blue** is generally used to highlight support. To the right of each Canadian listed stock, is the symbol US investors use for the stock.

We had a fantastic run from January to mid-March. Personally, my portfolio had doubled for the year. Then, following the Bear Sterns bailout by JP Morgan and the Fed, all commodities were trounced. I believe there was a strong connection between the bail out and the hard fall of commodities. Commodities are widely recognized as inflation and dollar hedges. Their soaring has put inflation on the front pages of nearly every newspaper in the US. The US government after taking measures not seen since the 1930's had to act fast to prevent an all out sell off in the broader markets. I believe commodities were sold down in a coordinated effort to make them less appealing as an investment and to change sentiment concerning inflation and the dollar.

Most commodities have rebounded to their highs since March but not gold, silver or platinum. Precious metal stocks have been pulverized in a relentless series of selling. The sector often experiences these gut wrenching moves. Many will be inclined to sell and move on. Actually, in this sector in particular, now is the time to be buying. I expect that we are going to see extreme volatility from now until the November elections. Investors in this sector would benefit from selling one third to half of their positions on strong rallies and buy back those positions after extreme moves down (like we are experiencing today).

You will note that I have more silver producers recommended than gold or platinum. I do not have a stronger affinity for silver than the other metals. The reason there are more silver producers is they are more abundant than gold or platinum miners that meet my criteria. Many gold producers are either too richly priced or have poor production profiles. I prefer to stick to a formula of finding miners who are undervalued relative to their peers with increasing production profiles.

There are many quality base metal companies out there but unfortunately the market is not willing to bid them up. Base metal equities have had a strong correlation to the movements in the Dow. When the Dow goes down, base metal stocks fall hard. Precious metal stocks, on the other hand, have been weakly correlated to the Dow. I have seen base metal junior stocks continue to get slaughtered with many half their price today than last November. Base metal stocks thrive when there are strong, sustained upward movements in the prices of the particular metal they produce. We do not have this type of environment today with the exception of copper. I will be more than happy to jump back into base metals should we begin to see prices firm and after they finally break away from the Dow's influence.

Gold Producers

1) **GBS Gold International (GBS.TO, GBSFF)**: GBS is an off the radar gold miner with operations in Australia. The company expects 2008 production of 130,000 ounces at cash cost of \$645/ounce. Unlike most miners, GBS is actually including in their forecast a stronger Australian dollar and higher fuel costs. Going forward the cash cost is expected to decline as production ramps up at their new Tom's Gully mine. Ordinarily, a high cost producer such as GBS would not be something I would recommend. What is compelling is their low valuation against peers making it possible for the stock to double and still be under valued. Don't expect eye popping gains from GBS until investors find the love with small cap gold producers. However, with GBS the downside is quite limited and the stock should be a good performer. Website: www.gbsgold.ca



2) **Golden Star Resources (GSC.TO, GSS)**: Golden Star's new management is working through residual issues with their Biox plant. Q1, 2008 won't be a stellar quarter for the company but it's the future prospects that make the case for investment. The company had to do repair work to their Biox tanks in Q1 and presently mining transitional ore containing gold oxide and sulfide ores. Q4, 2007 their recovery was 57% for their Biox plant. The company believes they will achieve 70% for transitional ore going up to 80% for pure sulfide ores. Ore becomes more sulfide rich the deeper they go. At today's gold prices, each 10% improvement in recoveries equates to \$5 million per quarter gross earnings. Golden Star's second mine, Wassa, is profitable processing low grade (1.1 g/ton) ore. They are building a road to be completed this summer where they will truck in and blend high grade (4.4 g/ton) ore. Increased recoveries out of the Biox plant with blended high grade ore at Wassa are going to substantially increase their gold production throughout the year. Website: www.gsr.com



3) **Kinross Gold Corp (K.TO, KGC):** Kinross gold production is growing the most of the major producers. Gold production for 2008 and 2009 is projected to be 2 million and 2.5 million ounces, respectively. This rapid production growth begins this summer when two large mines start operations. In their latest presentation, Kinross shows Q1, 2008 production around 370,000 ounces increasing to 630,000 ounces in Q4. Achieving this aggressive growth profile should result in the stock being handsomely rewarded. For those wanting some leverage to Kinross, I would recommend investing in their B series warrants. Website: www.kinross.com



4) **Semafo (SMF.TO, SEMFF)**: Semafo did something in Q1, 2008 that they have not done in years: beat production guidance. They performed their first gold pour at their new Mana mine and are ramping up production. Guidance for 2008 is producing 165k – 185k ounces gold. Semafo’s market cap is \$270 million, which is approximately half of its peer group. I should point out that Semafo does have a small residual hedge at \$375/ounce from an old loan, which will weigh on earning results as gold rises. This company could be a tasty morsel for three the larger West African producers: Golden Star, Red Back Mining or Randgold. Website: www.semafo.com.



5) **Yamana Gold (YRI.TO, AUJ)**: Yamana had a rather disappointing earnings report for Q4, 2007 with lower than expected earnings and cash flow. One thing that has been absolutely fantastic about the Company is they are one of the very few who deliver on production guidance. Now Yamana has to begin to deliver producing financial results. They are projecting 1.3 million ounces gold production for 2008, a 30% increase over 2007. At present gold and copper prices, Yamana’s 2008 cash flow will be over \$850 million. Their peer group currently fetches a price to cash flow (P/CF) multiple of 25 indicating a year from now Yamana’s share price could be over \$30. Yamana offers the investor excellent share growth potential with the security of a large, diversified mining portfolio. For those with IRA’s, I highly recommend Yamana’s C series warrants for adding leverage to your portfolio. Website: www.yamana.com.



Platinum Miners

1) **Eastern Platinum (ELR.TO, ELRFF)**: Eastern Platinum has been a long time favorite way of mine to be exposed to the platinum sector. The stock is highly liquid and trades in the Western Hemisphere, unlike the vast majority of platinum producers. The company is slowly growing its production rate with several new projects in development. Management is sitting on a war chest of over \$200 million in the bank and has been spending it wisely. Last year they funded process equipment to treat tailings adding 5,000 ounces annual platinum production at a cash cost of \$150/ounce. The type of ore they mine is high in chrome for which Eastern is penalized up to \$250 per ounce to process. Management invested in a chrome recovery plant, now operational; to lower the chrome levels to remove the penalty. They now have on order enough diesel power generators to power all of their operations even if their South African power is shut off.

Eastern had guided that 2008 production would be 185,000 PGM ounces and has since lowered it to 155,000. Much of the lost production was due to a six month delay in obtaining permitting for their Crocette section of their mine. Last month they did get their permit and are now actively preparing the mine for production. I calculate for the Q1, 2008 earnings to be reported in a few weeks that they will have record revenue, earnings and cash flow. This should happen despite the fact they lost 6,000 PGM ounces due to power interruptions.

Website: www.eastplats.com



Silver Producers

1) **Aurcana (AUN.V, AUNFF):** Aurcana is a small cap lead, silver, zinc and copper producer located in Mexico. They brought their La Negra mine to full production last summer at 1000 tpd. Average annual production should be close to 1.2 M ounces Silver, 5.4 M pounds Lead, 10.8 M pounds Zinc and 2.3 M pounds Copper. Aurcana's interest in the mine is 80%. This one operating mine justifies a stock price double of what it is today.

Aurcana is bringing a second mine, Rosario, into production. The mine is fully equipped and just needs to be refurbished to go into producing metal. Using the historical production of the mine, I calculate annual production of 1.2 M ounces silver, 8 M pounds Zinc, 9 M pounds Lead and 5,000 ounces Gold. Rosario is expected to start H2 2008. Considering the solid economics with two producing mines late this year, the share price could conceivably be four times higher than today. Company Website: www.aurcana.com



2) **Coeur D' Alene (CDM.TO, CDE):** The trading action in Coeur has been simply unbelievable. Even \$21 silver could not get the stock much over \$5. I warned in February that investors should buy for the long haul because the stock is being played by short funds. What I did not realize is the extent of the short pressure the stock has. The most recent short interest report showed that Coeur had the second highest short increase last month for the entire NYSE. At present, there are 60 million shares short. Coeur released about a month ago they had to idle a mine for six weeks to upgrade the electrical system costing them a paltry 180,000 ounces of silver and 4000 ounces of gold. This did not justify the stock being cut nearly in half.

Coeur has guided 2008 production of 16 million ounces of silver production with the increase coming from their new Bolivian mine. They have another large silver mine, Palmarejo, expected to start in H1 2009, raising annual production to well over 20 million ounces in 2009. Fundamentally, Coeur has very bright future prospects but until they can blow away the street with a few earnings reports the trading funds will continue to play. Company Website: www.coeur.com.



3) **First Majestic (FR.TO, FRMSF):** First Majestic is my top pick of silver producers. First Majestic 2008 production is expected to be over 6 million ounces of silver with cash cost of \$6/oz. Their production numbers are up over 200% from 2006, yet the stock is roughly at the same price. I use as one of my valuation tools for stocks comparing companies with similar production. Hecla (NYSE -HL) has a flat production profile of 6 million ounces per year for the next several years. Their market cap is \$1.5 billion. First Majestic's current market cap is under \$300 million. Hecla has lower cash costs to produce an ounce of silver, but First Majestic has roughly one fifth the market cap. One of the primary reasons First Majestic has not been recognized by the market is due to its lack of self promotion. They have no presentation on their website and don't actively attend mining conferences. Their brilliant execution to plan should begin to get noticed by investors. I highly recommend purchasing their newly minted A series warrants. Strike price is C\$7.00 with expiry in March 2010. They have recently traded around C\$0.90, which means you can get exposure to the stock for about a quarter the cost. What Company Website: www.firstmajestic.com.



4) **Silvercorp Metals (SVM.TO, SVMFF):** Silvercorp is a highly profitable blue chip Silver, Lead and Zinc miner. All of their operations are in China where they are mining some extremely high ore grades. Using Lead and Zinc byproducts against costs, Silvercorp cash costs are now -\$13.60 per ounce of silver produced. Guidance for the 2008 fiscal year (ending March 2008) is for over 3 million ounces Silver, 46 million pounds Lead and 18 million pounds Zinc. Silvercorp is well positioned to take advantage of surging Silver prices and should reward your portfolio handsomely. Website: www.silvercorp.ca



5) **Pan American Silver (PAAS):** Pan American can be considered a large, blue chip primary silver on par with Silver Wheaton. They have producing mines in Bolivia and Peru, which are known to have political flare ups on occasion. Pan American is guiding 19 million ounces silver production at a cash cost after byproduct credits of \$4.31. Their byproducts are 50,000 ounces gold, 43,000 tons zinc, 17,000 tons lead and 5,400 tons copper. Production is to grow in 2009 to 25 million ounces. The stock has taken a beating with its sister silver producers but has weathered the storm significantly better. Website: www.panamericansilver.com



6) **Silver Dragon Resources (SDRG.OB):** Silver Dragon has been caught in the micro-cap meltdown with its stock getting absolutely annihilated. The market environment isn't the sole cause of the stock's plunge. As the stock was falling, they retracted a press release concerning exploration results in Mexico due to some errors. The market basically ignored their Chinese property press release concerning 2 km of new mineralization. Recently the CEO resigned under pressure from investors. He has since added to his large stock share position in the company, giving the market a shot in the arm of much needed confidence. The share price has fallen to a level that is going to make it difficult to raise funds for exploration. To my great disappointment, they have not advanced their Mexican property to production so Silver Dragon remains an exploration company starved for funds to continue drilling. I probably would have removed Silver Dragon from my list months ago but their properties in China and Mexico have tremendous promise. There is a good possibility that Silver Dragon can merge with or form joint ventures with other companies with enough cash to explore the properties and/or bring their Mexican operation into production. I'm going to hold my heavily underwater position a few more months to see if they can advance their business. Website: www.silverdragonresources.com



7) **Silver Wheaton (SLW.TO, SLW):** Silver Wheaton is a blue chip silver stock. It has wide institutional ownership with excellent leverage to the price of silver. The stock is richly priced but still is an attractive investment vehicle if you are bullish on silver. The combination of high silver prices and increased production has made Silver Wheaton one of the most profitable in the industry. They are guiding 15 million ounces in 2008 increasing to 19 million ounces in 2009. Silver Wheaton commands a tremendous cash flow multiple of over 30. Silver companies get the highest cash flow multiples in the mining industry. Website: www.silverwheaton.com



8) **Sterling Mining (SMQ.TO, SRLM.OB)**: Sterling owns one of the most prolific silver mines in US history. Located in Idaho, the mine has operated for 100 years producing over 360 million ounces. Sunshine was closed in 2001 due to poor economics caused by low silver prices. For the last few years, the company has been preparing the mine for startup operations. Initial production began in December and Sterling is guiding 2008 production of 2.8 M ounces. Their average grade is about 24 ounces silver per ton with over 10 years of mine life left plus plenty of exploration potential. Sterling's market cap is only \$65 million. The market hasn't embraced Sterling yet probably because they don't have firm multi-year guidance and cash costs are unknown. The stock may begin to catch fire as positive operational results are confirmed. Company Website: www.sterlingmining.com



9) **UC Resources (UC.V, UCRLF)**: UC Resources is a micro-cap silver and gold miner with a market capitalization under \$26 million. The company changed leadership to someone who appears to have a pulse. The new CEO Voisin is actively buying shares on the open market. One of the big strikes against UC was they kept promising to begin producing gold and silver at their Mexican property and never doing anything about it. This has now changed as Voisin said in a recent video presentation they are expecting production to commence Q4 this year. I calculated at full production they will produce 1.3 million ounces Silver and 14,000 ounces Gold. Silver producers of this size typically fetch a market cap of \$60 – \$80 million. Using current silver and gold prices, their annual revenue is more than their present day market cap.

The potential to send the stock into the stratosphere is their McFauld's Lake property. Noront Resources hit tremendous mineralization of high grade Copper,

Nickel, Platinum and Palladium in the area. Subsequent to their first discovery, Noront's stock exploded from C\$0.30 to over C\$7.50 within three months. UC has several "Noront like" drill targets on their nearby properties. Weather is impeding active drilling but they intend to get crews on the ground in June. UC should have completed their first drill program by the end of August. A real wild card for the stock is several other companies will be actively drilling in the area this summer. If any of these operators hit Noront like mineralization, UC's stock price could surge higher in sympathy. UC is highly speculative and can be likened to that of a lottery ticket with far better odds. Company Website: www.ucresources.net



Base Metal Stocks

The stocks in this section produce Copper, Lead, Nickel and Zinc.

1) **Quadra Mining (QUA.TO, QADM.F)**: Quadra is a highly profitable copper-gold miner. Their flagship mine is expected to produce 130 million pounds copper and 100,000 ounces of gold in 2008. They may have to increase guidance since they produced 42 million pounds of copper in Q1. They have a second mine located in Arizona due to come online later this year. Expected annual output is 75 million pounds copper at a cash cost of \$1.00. Copper has been firm hovering around \$4 and Quadra will be reporting record quarterly results fairly soon. Being primarily a base metal miner be mindful that if the Dow should plunge, Quadra may get hit disproportionately. Investors with IRA's should seriously consider buying Quadra's warrants on the TSX. Company Website: www.quadramining.com



Stock Deletions

I decided to put in this section because at times, stock selections do not go the way you'd like. The majority of the information I obtain is from public sources and found via the internet. One of the most basic assumptions is that guidance and performance of management will be within reason. In general, nearly all mining companies miss guidance. It takes time to see what companies miss a little or to see those that miss a lot. There are cases where management teams continually miss guidance. Those stocks are to be avoided until proven otherwise.

Stocks removed from recommendation lists:

1. Dundee Precious Metals (DPM.TO, DPMLF): Dundee has a unique business model in the gold producer world. They have an operating gold/copper mine and also generate income by investing in other precious metal company stocks. The reasons for removing them are they invest in small mining companies and their gold/copper operation is marginally profitable. As I said before, micro-cap miners are getting killed in the present investment climate. Dundee primarily invests in these companies and their investment portfolio is going nowhere, hurting their bottom line.
2. IAMGold (IMG.TO, IAG): IAMGold just after I recommended it was hit with news that their promising project in French Guiana that their mining permit was denied. Then, Ecuador decided to come out with a Mining Mandate that brutalized the share prices of companies with projects in the country. IAMGold will have flat production growth and has too many dark clouds (uncertainty) hovering over it at the moment. These two factors will likely prevent IAG to have much upside for the foreseeable future.
3. Impact Silver (IPT.V, ISLVF): Impact Silver has really gone nowhere since I recommended it. Stagnant production growth is not what the market will pay for particularly in the current climate. I see the stock not doing much of anything until silver is in the \$20 range again.
4. Randgold Resources (GOLD): Randgold has yielded an awesome return of 260% since I first recommended it over two years ago. The stock is priced to perfection but unfortunately 2008 performance should be a drag on the stock. Attributed gold production was 444,000 in 2007 but in 2008, Randgold is guiding 400,000, or a reduction of over 10%. Certainly the rapidly rising gold price will make up for the lost production but it means we will not see the growth justifying explosive stock gains.

Final Thoughts

The US government and financial media are in full court press mode to convince investors around the world that the credit crisis has turned the corner. These are the same entities that just a little over a year ago downplayed the sub-prime issue, which has turned out to be a quarter trillion dollar problem. We found out Friday that the Federal Reserve just increased their lending program by 50%. Does this sound like an issue that has turned the corner to you? We now see trouble brewing in the Alt-A mortgage arena with investors screaming at the Federal Reserve to bail out student loans. In my opinion, we are in the early innings of credit market turmoil.

As investors in commodities, we must be careful to not over leverage ourselves going forward. Volatility will be the norm until the November election as desperate measures will be taken to cover up the depth of the credit crunch and to sooth inflation expectations. Part of the desperate measures will be to dissuade investors from putting money into commodities by inducing sharp sell offs. Please be careful.

Happy Trading,
Toby

Disclosure:

The author has not been paid to write this article, nor received any other incentive to do so. The author holds positions in many of the companies mentioned in this report and will benefit from their increase in stock prices.

Disclaimer:

The author's objective in writing this article is to promote potential investor interest in these stocks to the point where they are encouraged to conduct their own research. Neither the information, nor the opinions expressed should be construed as a solicitation to buy or sell these stocks. Investors are recommended to obtain the advice of a qualified investment advisor before entering into any positions.

Appendix I

Buying Physical Gold & Silver

I have lead many into the precious metals market. Most begin severely gun shy at first but then begin to realize that gold isn't some bizarre investment that most mainstream advisors proclaim. We are currently witnessing a credit market meltdown that has no other parallel since the 1930's. I have found no one who clearly knows where the present crisis leads but, there is now the possibility of the entire credit market going into complete disarray. The reason is the shaky financial instruments in question are many times larger than the world's GDP. This section is to allow you the means to protect yourself from financial collapse. I have done this in the spirit of hope for the best but prepare for the worst.

There are many ways to own exposure to the precious metals sector. The most popular is to buy gold stocks or to buy shares in exchange traded funds (ETF's). If a financial melt down were to occur, neither gold stocks nor an ETF may offer you protection. The reason is both investment vehicles are held by third parties. How do you know how safe your investments are when your stock broker or those who are custodians of the ETF go bankrupt? If you do get 100% of your investment back, how many months or years might it be before you can get at the funds? This is where owning physical metal offers the best form of financial protection. The first objection you always hear is about storage. I will tell you storage is no problem. One million dollars worth of gold or platinum can fit in a standard \$30/year safety deposit box at your bank. Pretty cheap considering the value of wealth you are storing. Silver, on the other hand, is a completely different story.

How does one go about buying gold? I prefer to go to online vendors to get the best prices. The two I have had good luck with are American Precious Metals and Bullion Direct. Their websites are:

American Precious Metals: <http://www.apmex.com/>

Bullion Direct: <http://www.bulliondirect.com>

I have no financial relationship with either of them except as a satisfied customer.

Gold can be purchased via bullion bars or coins. The advantage of buying bullion bars is the amount of premium over the spot price is lower than with coins. One issue with bullion bars is there has to be some proof that they are genuine containing the gold they say they do. Many gold bars come with some form of official certification. I would recommend buying only those bars that are certified.

Coins traditionally are anywhere \$20 - \$50 higher than gold's spot price. Most coins are 1 Troy ounce (31.1 grams) with some coin series in half, quarter and one tenth sizes. The smaller the size the higher the premium associated with the price. There is one 1 ounce coin that has very little premium over spot: the South

African Kruggerand. Kruggerands are about the cheapest way to own gold. They are fairly ugly coins but beauty isn't much of a concern in times of crisis. Coins do enjoy a slight edge over bullion in that there is less question they are genuine gold containing instruments. While Kruggerands offer the cheapest way to own gold, I would recommend buying gold denominated in your own currency such as Maple Leafs for Canadians and Eagle for Americans, though having any gold in a time of crisis will give you some protection.

Appendix II

Recommended Investment Books

The following books are some of the best texts I have found and have helped me to identify stocks and understand technical analysis. I have no financial ties to Amazon.com or any of the Authors.

1. **How to make money in Stocks** by Bill O'Neil
http://www.amazon.com/How-Make-Money-Stocks-Winning/dp/0071373616/ref=pd_bbs_sr_1/104-1116007-6138357?ie=UTF8&s=books&qid=1178390763&sr=8-1
2. **Japanese Candlestick Charting Techniques** by Steve Nisson
http://www.amazon.com/Japanese-Candlestick-Charting-Techniques-Second/dp/0735201811/ref=pd_bbs_sr_1/104-1116007-6138357?ie=UTF8&s=books&qid=1178391278&sr=1-1
3. **The Visual Investor: How to spot market trends**, by John Murphy
http://www.amazon.com/Visual-Investor-Spot-Market-Trends/dp/0471144479/ref=pd_bbs_sr_1/104-1116007-6138357?ie=UTF8&s=books&qid=1178391374&sr=1-1
4. **Technical Analysis from A to Z**, by Steven Achelis
http://www.amazon.com/Technical-Analysis-2nd-Steven-Achelis/dp/0071363483/ref=sr_1_1/105-2238205-6313213?ie=UTF8&s=books&qid=1192396454&sr=1-1
5. **Technical Analysis of Stock Trends, Ninth Edition** by Edwards & McGee
http://www.amazon.com/Technical-Analysis-Stock-Trends-Ninth/dp/0814408648/ref=pd_bbs_1/104-1116007-6138357?ie=UTF8&s=books&qid=1178391495&sr=1-1

Appendix III

Investing in Mining Stocks

I have been investing in the sector for nearly four years and experience has allowed me to learn many things. Wall Street absolutely abhors commodities. Many of you have over the years heard how China was slowing down and a big commodity crash was around the corner. The commodity bull has been raging for six years and yet the same old prognostications of its demise continue. One major point I want to get across: Wall Street will go out of its way to find an excuse to sell off commodity stocks. Many commodities take a long time to go up but find those gains disappear in a few short days.

What I wanted to do is put together a Table giving you the means to identify good mining stocks on your own. The Table is arranged from best to worst conditions for mining stock appreciation. In general, I avoid stocks that will not be producing 1 year or more. There is a famous chart that shows the appreciation of a stock from first discovery to full production. Mining stocks really don't start appreciating until they are within a year of production then begin to appreciate as cash flow and earnings are generated. Once the miner has hit a plateau in production, its stock is usually dictated by the price of the metal it produces. Many of my stock picks meet the criteria in the high yellow or green areas of the Table. There are exceptions but the guidance in the Table is a fairly consistent rule of thumb.

Table 2: Mining Stock Price Influences

Metal Price	Company's Production	1 Year Stock Potential
Going Up	Rapidly Increasing	> 100% ++
Flat/Trending Up	"	50%
Flat/Trending Down	"	20%
Going Down	"	Break Even
Going Up	Flat/Increasing	30%
Flat/Trending Up	"	20%
Flat/Trending Down	"	Break Even
Going Down	"	- 10%
Going Up	Flat/Decreasing	10%
Flat/Trending Up	"	Break Even
Flat/Trending Down	"	-10%
Going Down	"	-30%
Going Up	Decreasing	Break Even
Flat/Trending Up	"	-10%
Flat/Trending Down	"	-20%