

# Outlook

Research & Recommendations with a Global view

ALLIANCE

DIRECT MANAGEMENT

February 2012

## Economic Trends & Developments

### U.S. Federal Reserve Spurs Markets

When Fed chairman Ben Bernanke announced on January 25th that the Fed intended to keep interest rates at their current low level (Under 1%) until late 2014, markets responded immediately by turning around a losing session and carrying stocks up sharply. Bernanke once again stated that the Fed stands ready to conduct more asset purchases (Quantitative Easing) if inflation remains under its

long-term target and if the economy is not growing quickly enough. Alliance Direct has been anticipating additional Quantitative Easing "QE3" as a move that would no doubt fuel a stock market rally that would benefit the incumbent president in this important election year. We maintain our bullish stance on stock market activity during 2012, with a special focus on virtually the entire range

of commodities in light of the weakness in the U.S. dollar and the strong demand for metals, energy and other commodities by many of the world's emerging economies.



### The January Effect

Unrelated to the Fed's late January message, stock markets responded to positive economic news by rising significantly during the first month of this year. This begs the question; how important is the "January Effect"? First, an explanation of this phenomenon: The January Effect refers to a general increase in stock market levels during the first month of the year. The rally is generally

interpreted as a rebound from lower prices caused by year-end tax-loss selling during December. Then, of course, there is the "January Barometer", a theory that the movement of the S&P 500 during January portends the stock market's primary trend for the year; "If the S&P 500 is up at the end of January compared to the beginning of the month, expect the stock market to rise during the rest

of the year." Unfortunately, few such stock market adages are dependable as precursors of future market direction. Predicting the future regarding stock market behaviour is fraught with risks.

There is one indicator that has been fairly accurate over the years: the performance of the S&P 500 Index during election years. Since 1928. There have been only 3 of the past 21 election years in which the S&P 500 had a negative return. Intuitively, this does make some sense, since incumbent U.S. presidents can obviously try to lift the spirits of the populace by attempting to positively influence stock market performance. Announcing more "Quantitative Easing" in the months ahead would be one logical way for this to occur.



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While the general market performed strongly in the first month of the year, it remains to be seen if this trend will continue through 2012. This being an election year, we are optimistic that markets will perform much better than they did in 2011. Indeed, if decisive action is taken by the Euro countries to edge back from the precipice of a credit crisis and foster economic recovery, we would expect to see a much more bullish global stock market. The general investor mood has improved dramatically in recent months, carrying the S&P 500 steadily higher since early October. The volatility index "VIX" has fallen to its most bullish level since last July as

general market fear and anxiety have given way to optimism. Alliance Direct believes that we are increasingly seeing a return of a sustainable "risk-on" period.

Encouragingly, the world-leading U.S. economy continues to show signs of recovery that could actually begin to accelerate in coming quarters – there has been a steady flow of good news since last September. Also, the Chinese appear to have removed the spectre of runaway inflation and they are now loosening policy in order to spur economic activity. Inflation in India has not been tamed so easily, so the RBI (Reserve

Bank of India) cannot loosen the reins quite yet. Macroeconomic management by the RBI is more difficult than in China, where major changes in interest rates and bank behaviour can be effected on the spur of the moment. Nevertheless, we are cautiously optimistic that the slowdown in the Indian economy will bottom around midyear and that economic growth will ultimately exceed 6% on average for 2012.

We remain decidedly bullish on the outlook for global stock market performance through 2012.

## Is Perth, Australia sitting on a gold mine?

Documents submitted to the West Australian Department of Mines reveal that Chinese Government-controlled HD Mining and Investment has applied for a mineral exploration licence over about 150sqkm of the

City of Perth metropolitan area.

HD Mining and Investment states that historical records indicated there was gold in the eastern regions of the city. The Chinese Government-

controlled company seeks exploration licences for Perth Airport, sections of the Swan River, two national parks and several suburban areas.

West Australian Mining Minister Norman Moore informed the company that its proposal would face intense scrutiny: "Anyone can apply for a mining exploration licence but whether they get it or not is another thing," Mr. Moore told *The West Australian*.

While the chances of these exploration licenses being awarded appear slim, this does serve to illustrate the aggressiveness and determination of gold exploration companies in the current environment of lofty gold prices.



*Will mine headframes soon join the skyline of glistening towers in Perth?*

## Gold & Silver rally off late 2011 correction

Since marking its intraday correction low of \$1,523.90 on December 29th, gold bullion has rallied more than \$200 or over 14% during the month of January. This explosive move (see *3-month chart of Spot Gold with Relative Strength Index "RSI"*) may have taken gold to an overbought level in the very short term before continuing the uptrend towards, and probably through, last year's record high. Alliance Direct would view any temporary softness as an opportune time to buy in anticipation of subs-

tantially higher prices in the months ahead.

Characteristically more volatile, silver similarly zoomed upwards during January, from its intraday correction low of \$26.15 on December 29th to \$33.90, a >29% increase in one month! As with gold, this explosive move is a bit overdone technically and so we would not be surprised to see some temporary weakness in the near term.

Continued Quantitative Easing "money printing" in one form or another provides a major underpinning to global commodity prices, especially precious metals in light of their undeniable relationship to fiat currencies the world over. Alliance Direct continues to recommend gold producer shares for above average capital gain potential during 2012 and beyond.

In the senior gold producer category, we continue to favour shares

of Barrick Gold (ABX: NYSE & TSX) which we recommended in March, 2010 at US\$37.30. Barrick shares have subsequently been as high as \$55.77 before decline during the correction in the second half of 2011. Currently trading at the \$49.00 level, we advise purchases for exceptional gain potential in the year ahead. Barrick is the world's largest gold producer, with 26 operating mines and 9 projects located on 5 continents. It is also among the lower cost produ-

cers in the industry. With enormous reserves of ~140,000,000 ounces of gold, plus an additional 76,000,000 ounces in the Measured & Indicated resources categories, Barrick's share price trades at a significant discount to the value of its gold resources (not to mention its global resources of copper that exceed 15 billion pounds). The Company has super-efficient operations, some \$3 billion in cash on hand, and has increased its quarterly dividend by more than 170%

over the past 5 years.

In addition to Barrick's obvious potential, we also favour the following junior company that has a World Class deposit clearly destined for production:

**Exeter Resource Corporation "XRA"** on the AMEX @\$3.80 – Exeter owns a very large gold/copper deposit in Argentina containing NI 43-101 compliant reserves of 19.3 million ounces of gold and 4.6 billion pounds of copper. The Company recently released a very robust Feasibility Study on this major project and Alliance Direct believes that XRA offers very attractive potential that could be realized through a takeover by one of the gold industry majors.

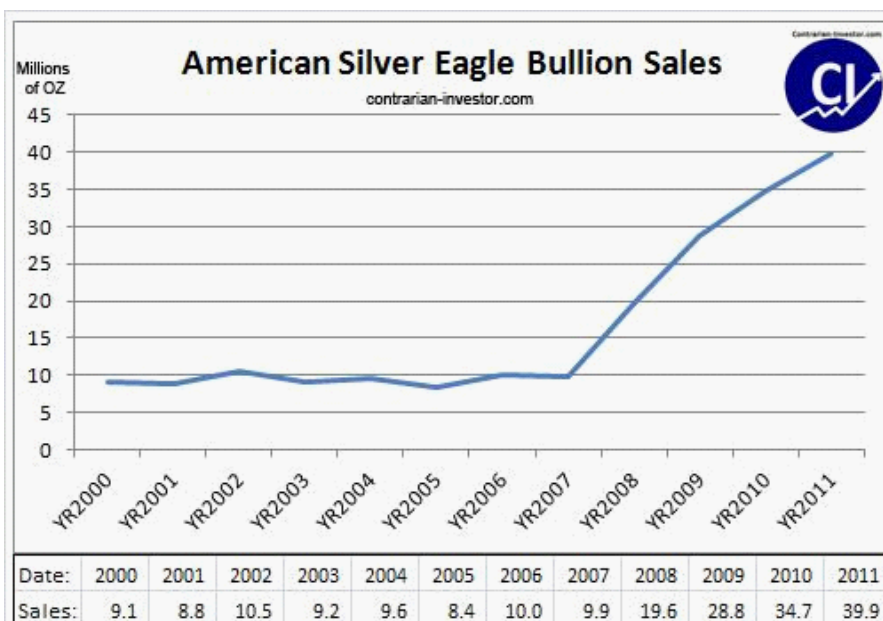
We view the shares as being dramatically undervalued in comparison to its peers, given this large mineral resource. Technically, the shares have recently broken out and we believe they are in the early stage of a substantial move higher.



## Silver price strong on solid fundamentals

Demand for physical silver has been very strong over the past year, with frequent shortages and delays in delivery of physical metal to various investors and dealers. New mine production of silver has been rising, but not fast enough to meet global demand for physical silver. Global inventory remains in short supply and the melting of scrap can obviously not satisfy rising demand forever.

One needs only to look at the following chart of the popular American Silver Eagle bullion sales to see that skyrocketing demand since 2007 is unprecedented. The single-month 29% rise in silver prices since December 29, 2011 has certainly quieted some of the silver bears, though we can probably expect to see a short-term correction before the long-term upward trend resumes. Alliance Direct cautions against silver's extreme volatility; we will leave short-



term trading and forecasting of silver and silver futures to the rank speculators. We do advise participation in the longer term silver bull market via purchases of ETFs and individual silver miner shares.

# Tungsten: Destined to make big news

Global supplies of the lesser-known metal tungsten are tight and getting tighter. Prices have risen to historic highs and supply shortages are expected to persist in the foreseeable future. Alliance Direct anticipates continued price strength and believes that the very small number of publicly listed tungsten producers outside of China will garner increasing investor attention in the months ahead as critical shortages are highlighted in global commodity news.

Tungsten (also called wolfram) is unique for its combination of unusual properties that include:

- Extreme hardness (second only to diamond)
- Heat resistance (Highest melting point of all metals)
- Coefficient of thermal expansion is the lowest of all metals
- High thermal and electrical conductivity



To illustrate the importance of tungsten in our everyday lives, we believe it is worthwhile to enumerate some of tungsten's many indispensable uses. Its unique set of properties fulfills many critical requirements across a host of industrial applications, allowing high productivity levels in industries on which the world's economic well-being depend. Wide-ranging uses include High Speed Tools, Lighting Technology, Electronics,

Power Engineering, Coating and Joining Technology, the Automotive and Aerospace Industries, Medical Technology, and the generation of High Temperatures as well as uses in Sports and Jewellery. Its special properties make tungsten indispensable in such familiar products as light bulbs, fluorescent tubes, "energy savers", HID lamps, heat sinks, cell phones, television sets, magnetrons for microwave ovens and other electrical consumer products. It is used for wall drilling, tile cutting, circular knives, and for the small balls of the ballpoint pen. All advanced chips rely on tungsten contacts.

## Supply/Demand

Approximately 85% of the world's primary tungsten production derives from China. As the world's leading emerging economy, China has steadily lowered its export quotas for tungsten in recent years in order to: (1) Conserve its resources for future domestic needs, (2) Attract foreign tungsten-consuming businesses to build plants in China and thus provide value-added benefits to the Chinese economy.

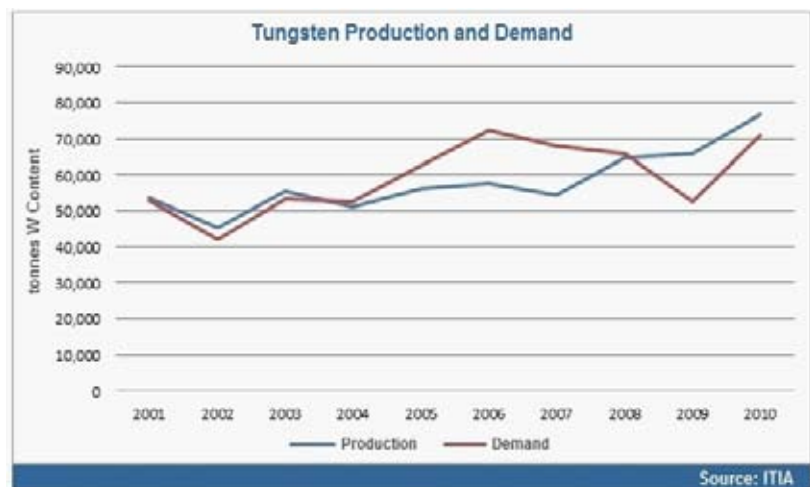
This manoeuvre is similar to that carried out by China concerning Rare Earth Elements "REEs" over the past few years, a move that propelled REE

prices into the stratosphere.

While there are tungsten deposits in such countries as Peru, Portugal, Russia, Thailand, Austria, Bolivia, Canada, Australia, South Korea and the U.S. as well as in various African countries, most tungsten mines in the West closed down about 20 years ago as a result of Chinese tungsten flooding the market and driving prices down to uneconomic levels.

Many such deposits are now the object of feasibility studies and plans for re-opening operations. Alliance Direct believes that most reactivation plans will not be completed for 3-4 years, meaning that those few that are in production should benefit greatly during a 3-year period of tight supplies and rising prices.

The following chart shows that demand is rising much faster than production and, with exports from China declining steadily, industry participants agree that acute shortages will persist for the next several years. Prices have more than doubled to record highs over the past couple of years and, end users and traders are scrambling for supply.



## Summary

Alliance Direct anticipates a strong performance in the shares of publicly traded tungsten producers over the next 2-3 years.