Sand Spring Advisors LLC

2002: A Golden Year?

by,

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Almost exactly a year ago, we wrote an article entitled "Finally Time to Start Accumulating the Golds?" In that article, we focused in on the fundamentals and chart patterns of four stocks: Harmony Gold (HGMCY), Homestake Mining (HM), Anglogold (AU), and TVX Gold (TVX) – all of whom we recommended for purchase. Since that time, and in spite of nay-sayers that gold-oriented investing is a relic of the past, these stocks performed admirably with one exception, TVX, that has languished in a spiral of reverse-splits and ongoing political problems with its Greek mining properties.

	Dec. 20, 2000	Dec. 14, 2001	Change
Harmony	4 3/8	6.93	58.4%
Homestake	4 ¼	8.62	102.8%
Anglogold	14	18.73	33.8%
TVX	2	.41	-79.5%

We stated at the time: "Our 8.3 year cycle in gold is due to bottom sometime in 2001…It might not well come until the latter half of the year, but we'd start nibbling in this space now. With Anglogold at least, one collects a nice dividend while waiting."

The 8.3-year cycle that we were referring to, had been outlined in an even earlier Sand Spring article "Cyclical Commodity Turns," where we pointed to rallies from significant gold lows occurring on average every 8 to 8.5 years. For newer subscribers who may not have noticed this piece among our past articles, let us quote from that article once again:

> This cycle undeniably stretches back as far as 1960 when a speculative attack on the U.S. dollar led the London price of gold to rise from its then official price of $35 to $40 an ounce. The central banks of the U.S., Britain, Belgium, Holland, West Germany, Italy, France, and Switzerland all subsequently were forced to form the "gold pool" to re-peg gold at $35.

Flash forward from then approximately 8 years….
Mar 1968: Because of significant demand pressure, the gold pool was replaced with a two-tier system -- an official price that remained fixed at $35 an ounce, but a market price that soon soared above $100.

8 years 5 months later….
August 1976: gold low at $102.20 led to a 3 ½ year rally into January 1980 of some 832%;

8 years 5 months later….
February 1985: gold low at $284.25 led to a Dec 1987 high some 76% higher;

8 years 1 month later….
March 1993: gold low at $334.70 led to a Feb 1996 high 25% higher.

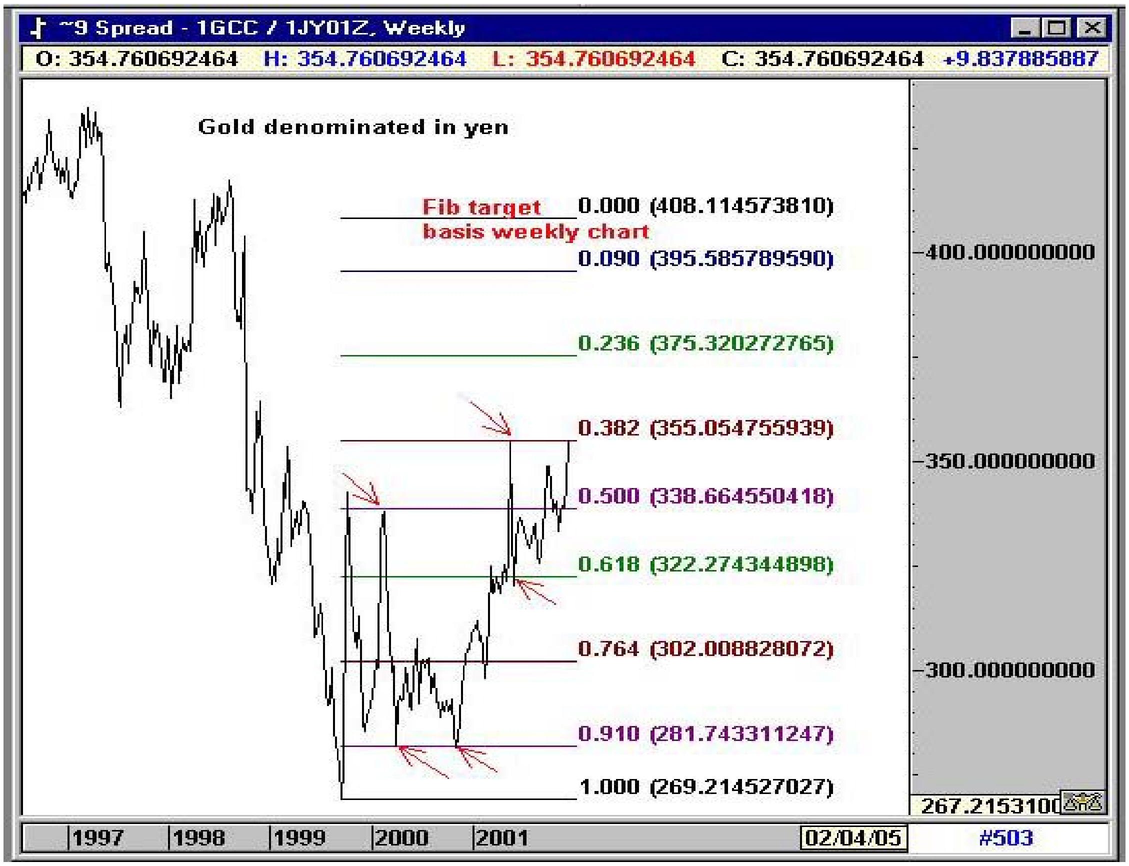
This was the picture that we displayed back in our "Cyclical Commodity Turns" article:

And in the current instance, some 8-years later, gold left a nominal low close on April 2, 2001 at $254.20, with two retests of this low on July 6, 2001 and December 10, 2001. Interestingly, at some lower fractal level, the calendar day distance between the first April low this year and the December low happens to measure to a perfect 252 days in length -- or 8.3 months.

Gold equities of course have an uncanny ability to lead the physical bullion. While gold was groping to retest its April lows for much of 2001, gold equities were already among the market's overall best performers for the past calendar year. It's as if the gold equity market has already sized up the unintended impact of the Fed's eleven rate cuts in 2001, and voted that despite all the daily rhetoric in the media about "deflationary forces" in the U.S., that the more likely outcome – in the short term at least – will be an inflationary spurt. Perhaps it is just coincidental but note how nicely the metals rallied this past Friday just as the Congress was working to pass a controversial and potentially inflationary new spending bill to support the economy.

At the same time, and as predicted within Sand Spring missives on several occasions, physical gold denominated in yen terms has already been on a steady march higher. In November 2000, gold in yen stood at 28,145 yen per ounce. Today it stands at 35,083 yen – a 24.6% advance. And yet if you were to only read daily newspapers, you'd think that all that prevails with regard to the Japanese economy was deflation. It's funny how that happens, and also how untrue. As banks continue to sit atop precarious balance sheets in Japan, there is already a strong movement afoot by many savvy Japanese investors to put their money in non-yen denominated gold-oriented investments. We think that trends will only accelerate as 2002 moves forward. After all, examining the multi-year picture below, look how far we potentially have to go.

More immediately, and on a weekly Fibonacci rhythm basis, we see prices reaching 40,800 yen within the next year. $304.50 and 134 USD/JPY would be one potential combo to get there, although there are obviously other possible permutations.



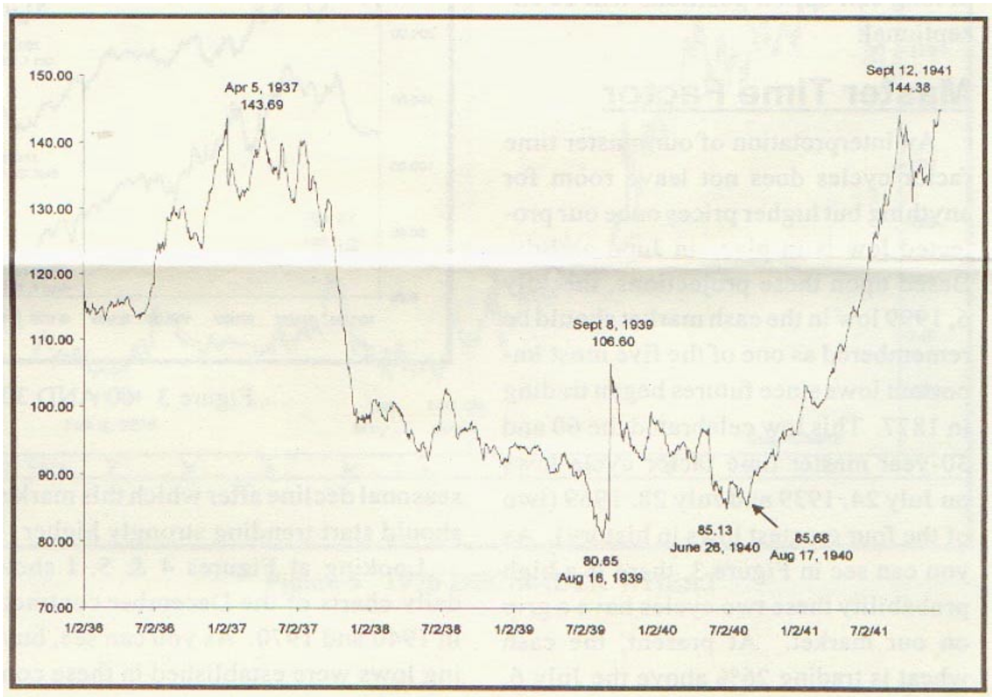
As readers of Sandspring.com know, we continue to believe that this "inflationary spurt" will last into the November 7, 2002 PEI cycle date, beyond which we see an eventual Fed tightening, and debt deflationary forces coming to bear until late December 2004.

If such is the case, and for better or worse, don't expect George W. Bush to survive any second run for the Presidency. Despite his current 80+% popularity ratings, Bush is likely to fall pray to this secondary downswing in the economy in 2003-2004. Like his father, it will be "the economy, stupid" that bites him, and re-engenders the desire for new Democratic leadership. Our best guess is that come 2004 we should see something akin to an Ike losing the reigns of government to a new JFK, and we all know what inflation did for the rest of that prior decade: it steadily grew as governmental spending on social programs, highway infrastructure, and the Vietnam war also boomed. From January, 2005 onward we'd expect similar trends.

But all that is far ahead of us. For now we must stay focused on the period of time into November 7, 2002. More specifically for gold, if April 6, 2001 was a low, and 8.3 months later, December 10, 2001 was a successful retest of that low, could 8.3 months from December 10, 2001 be a potential date for a gold high, or at least a high in gold equities? That date falls on August 19, 2002, and it is one day to keep in the back of one's mind as a potential metals top. After all, if the gold equity share market is smart enough to anticipate inflationary pressures building into 2002, it should also be equally early anticipating the diminishment of such forces in advance of the PEI November cycle date.

By the way, the November 7, 2002 cycle date falls just one day after a scheduled November 6, 2001 Fed FOMC meeting. That should be when the current last gasp of consumer spending froth finally takes it on the chin, with some sort of belt-tightening from the Fed.

There is another chart we would like to re-trot out here. It is the 1940 PPF Commodity Index (borrowed from the National Institute of Investment Research).



For all that my eyeballing is capable of, doesn't the date marked by the arrow above, July 7, 1940, carry an uncanny resemblance to the December 10, 2001 shown on the chart below?

We are less sure about a turn higher in other commodity markets, but one Sandpsring.com reader writes to us that in the soybean market, July soybeans futures have not been trading below $4.50 in January of any given year ever since January 1973, and in only one other instance, January 1976, were they below $4.60. Today July soybeans are trading $4.35 and sentiment is almost uniformly bearish.

But if 1973 or 1976 are any guide, look what happened next…..

July 1973 Soybeans from January 1973 onward

July 1976 Soybeans from January 1976 onward

It would appear that overt complacency in January has in these prior instances (red arrow) led to much higher prices by early summer.

Now we are no agricultural market experts, and we note with some humility that past attempts to over-anticipate lows in wheat and corn have not fared well, but could 2002 be the year that the entire ag-sector comes back to life?

The daily March Corn chart below does look “complete” from a Fibonacci rhythm basis.

And we have heard about “dormant rounding bottoms” but this weekly formation in Wheat is getting downright amazing in its length.

So maybe the wind comes further to gold's back due to reversals in agricultural prices, or maybe not. Right now the CRB as a whole is holding just above its 1999 price lows, and if other commodities are to turn higher in 2002, we would not want to see that index fall below 182.67.

Gold Can Go It Alone

But some people forget that even with potential commodity price weakness elsewhere, gold has traditionally fared reasonably well in past periods of equity market stress and "depression." Herbert Hoover once stated "We have gold because we cannot trust governments," and that gold was essential to "prevent governments from confiscating the savings of people by manipulation of inflation and deflation."

Shortly after these words, FDR of course used the gold price as an overt means to try to push up commodity prices during the 1933-34 period. From his bedside each morning, FDR started to jiggle the gold price consistently higher from its established price of $20.67 toward the $35 level it would eventually be re-pegged at.

Treasury Secretary Morganthau would write in his diary:

> "Franklin Roosevelt would lie comfortably on his old-fashioned three-quarter mahogany bed…The actual price of gold on any given day made little difference. Our object was simply to keep the trend gradually upward, hoping that other commodity prices would follow…He rather enjoyed the shock his policy gave to the international bankers."

Thus, over a scant two years, the price of gold actually rose 69% in the heart of the depression. Maybe partly as a result, and moving on into 1937, it is worth noting that industrial production actually jumped 60% while wholesale prices climbed 31%, and unemployment temporarily retreated. As gold poured into the U.S. (the only country paying a steady $35 at that time), other countries were forced to devalue their currencies against it (note: a.k.a. Japan today). While the price of gold mounted in foreign currency terms, the actual price of goods and services in most foreign countries fell by substantial amounts. As explained in the fine text by Peter Bernstein, *The Power of Gold,* "The result was that an ounce of gold in the mid-1930's could buy twice as many goods and services as the same ounce could have bought in 1929."

Gold of course also rallied during the periods of equity market stress between 1973-74 and 1979-80, and was highly in demand during the various small panics of the late 1800's -- notably the panic of 1863, and then later, during the Barings Argentinian bond crisis of 1889-1890.

So in short, over very long periods of time, and in both fixed and floating gold price regimes, the message has always been the same: Even if certain deflationary forces exist within economies during periods of market stress, gold tends to go up anyway as a balance against undue government tinkering.

We see no reason that it should be any different this time around.

More Metal Stock Suggestions

In last month's Sand Spring article, we discussed one small Canadian gold miner, High River Gold. There are of course a range of other neglected Canadian and Australian gold mining entities one could pay some attention to.

Cambior (CBJ) for one, is a recently recapitalized company, trading for just .47 cents on the American Stock Exchange. It's biggest stockholder is Japanese gold holding conglomerate Jipangu (who also has a significant investment in High River). Cambior just bought out Golden Star Resources's share of the Gross Rosebel project in the Guyana shield, such that Cambior now owns 100% of this substantive low-cost ($167 per ounce) mine. Cash flow from operations for Cambior is moving higher, while the company's debt load is manageable and scheduled to be reduced over time.

Cambior is still tainted by the failure of a major gold exploration project in Guyana back in 1995 and by cyanide spillage into local streams and rivers of Guyana at its OMAI mine during the same period. Indeed, a class action lawsuit has recently been filed (likely with little merit) concerning this past spillage. Notwithstanding, we think that this company is turning the corner toward profitability, and that the NAV of its assets are not currently reflected in it small $46 million market capitalization.

Cambior - Daily

Also among the micro-cap golds, extremely cheap in terms of market capitalization per ounces of proven and probable reserves, one finds NovaGold (NVGLF) with a number of fine Alaska mining properties, and some 13.2 million ounces of proven and probable reserves. Given a total market capitalization of just $53 million, and even at recently higher equity prices for NVGLF, this means that NovaGold's gold assets in the ground are effectively being valued at just $4 an ounce. Alternatively, one can say that there is half an ounce of gold behind every share of NovaGold outstanding.

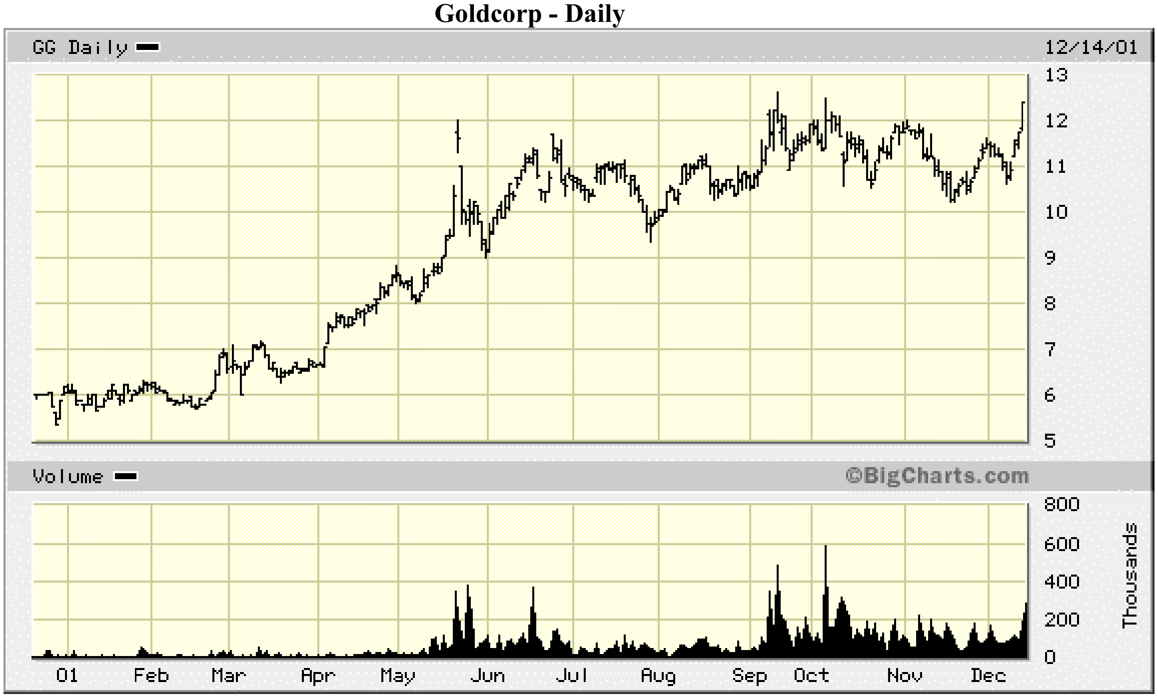
NovaGold Resources – Daily (CDN)

For those who prefer actual producing properties instead of more speculative exploration companies, there is of course Meridian Gold (MDG), a producer and exploration company with very low sub-$100 per ounce all-in gold production costs at their El Pinon mine in Chile. The company is debt-free, with net free cash flow, and is also unhedged against the gold price. Although the market has already given Meridian a fairly high market capitalization in terms of its proven and probable reserves, one has to admire this company's track record of profitability and success to date.

Meridian Gold - Daily

A similar type company to Meridian (profitable, but also relatively fully valued in terms of market cap per proven and probable reserves) is Goldcorp (GG). Goldcorp is all North American- based, with its primary Red Lake mine in Canada, and has been a solid out-performing gold stock for multiple years.

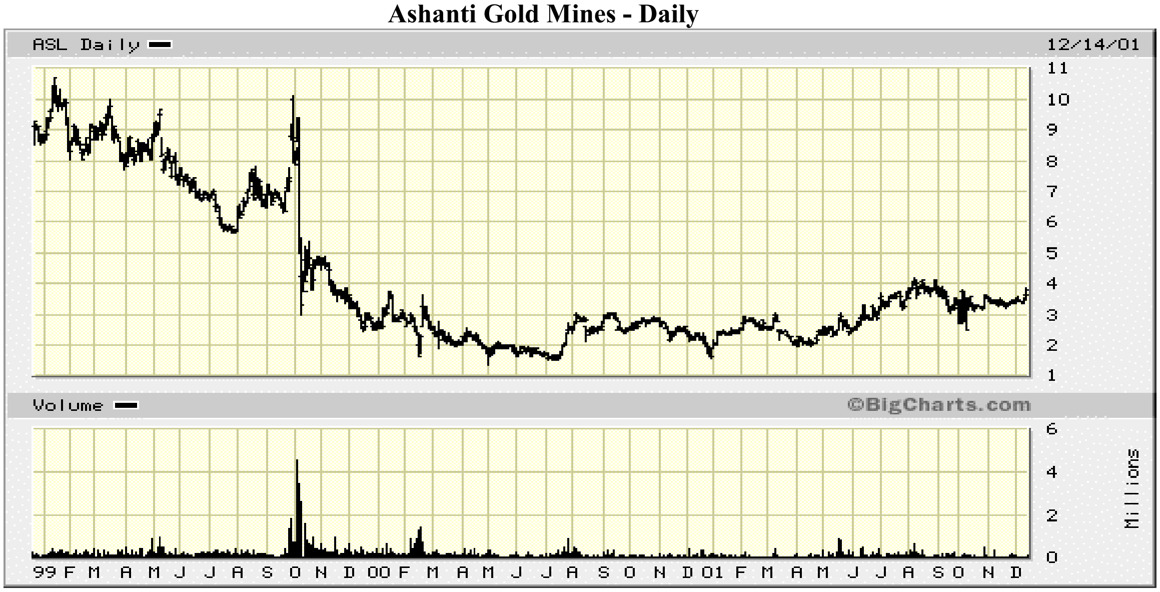
Goldcorp - Daily



We point all this out not to necessarily recommend any one gold stock over another, but more to highlight that the universe of gold stock investing stretches far beyond the typical large-producer names of Newmont, American Barrick, Anglogold, and Goldfields that most people aggregate towards. Indeed, in our opinion, the recent Newmont bid for Franco-Nevada is pretty sweet mostly for Franco-Nevada shareholders. Newmont basically is paying $1.79 billion for a $65 million per year royalty stream, or 28x the flow, representing only a 3.6% return on investment – not exactly a princely expected return.

Another strategy might be to try to pick the next gold miner to become a takeover target. Along this line of thinking, and given the scramble for Normandy by both Newmont and Anglogold, can Ashanti Gold Mines be far behind on the acquisition timetable? Ashanti has annual production of 1.6 million ounces (making them a producer of some significant size) with major holders in the Ghana Government, Lonmin, and the bullion banks (Goldman Sachs, etc.) each with an interest to sell. Ashanti's debt must also be refinanced by the first quarter of 2003. Trading at $3.78, Ashanti has a market capitalization of just $19 per ounce of proven and probable reserves. This is also far lower than the $55-$100 per ounce of proven and probable reserves that the majors sport as typical market caps, making any acquisition of it accretive to a larger player. Maybe a takeout at $6-$7 would make sense here given all the other gold takeover activity of late.

Ashanti Gold Mines - Daily



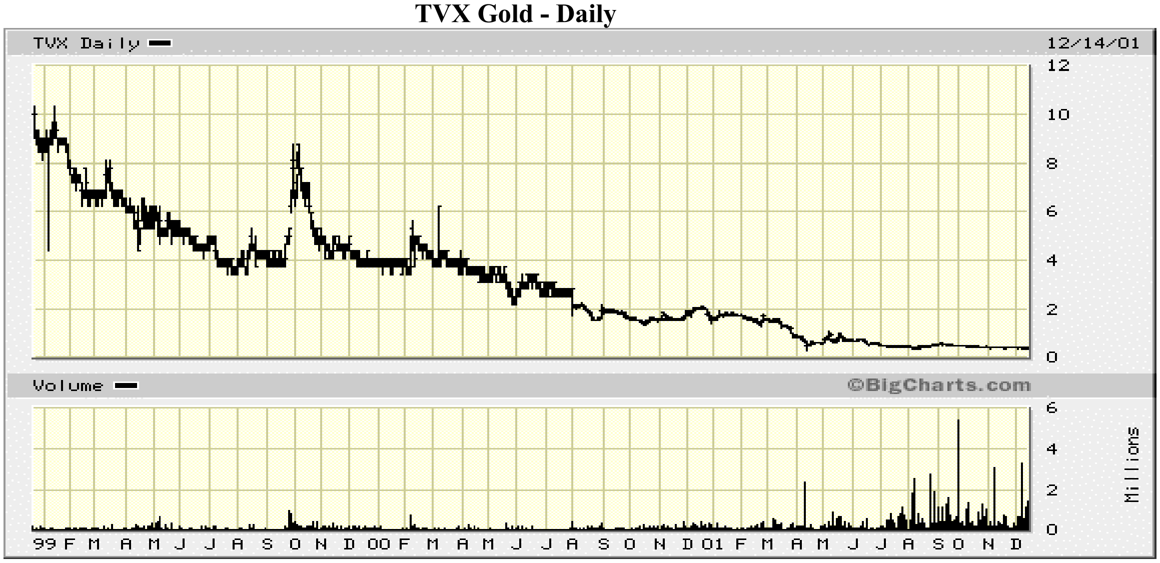
Among other stocks in this space that we previously recommended, Homestake is soon set to become part of ABX, while we still favor Anglogold for a $25.43 target.

Meanwhile in Harmony, is that a reverse head and shoulders formation we spy? If so, the minimum objective would call for the distance of the head (6.125-4.75 = 1.375) to be added to the neckline for a $7.5 target. We're almost there.

Harmony Gold - Daily

Lastly, what about that dog called TVX? New management was finally installed at the company courtesy of the hedge fund management group Poloma Partners, and one would hope that this group is sufficiently incentivized via stock options etc. to try to extract the imbedded value of this company in some way or another. If the Greek government eventually denies TVX's permit, there is a good legal case that TVX could get back the $200 million it has spent on the project to date. And if the Greeks allow the project to go forward, TVX should be able to find itself a merger partner. Is that a win-win type situation? Probably, but in an era when other gold miners increasingly seem to have their act together, TVX has sorely tired our patience. We're currently considering whether to take TVX as year-end tax loss sale, and put the money back to work elsewhere within the sector.

TVX Gold - Daily



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