

THE MORGAN REPORT

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Quote:

"We believe that such a discussion is critical if one is to have a macro view of where commodity markets are heading. Is this a bubble? Or is there a bona fide Malthusian shortage that is occurring in spite of weakening US economic conditions? We would be inclined to take the latter point of view. It has become quite clear to us that the commodity markets don't need a strong US in order to have wings. We are now more convinced of this than ever before. Recent headlines have only served to highlight the enormous impact China is having on the world." --Eric Sprott, Sprott Asset Management

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Your publisher had the pleasure of meeting Mr. Eric Sprott at the Gold Rush 21 Event held in the Yukon by GATA, the Gold Anti-Trust Action Committee. His thinking is similar to mine in what we will be reporting this month. The U.S. economy is slipping quickly to the downside because it all seems to be coming to a head. Most investors were thinking there was unlimited liquidity to the markets. Now they are wondering if there is much liquidity left. This is because credit spreads have widened sharply since investors are demanding a higher payback for the risk they are taking in the credit markets. Hedge funds are having trouble, there are cancelled debt offerings, Bear Stearns admits to huge losses, and Absolute Capital Group, an Australian hedge fund, has halted withdrawals.

Most of the questions we received focused upon where the U.S. economy was heading and what impact this would have on the prices of the precious metals. Here are two examples, which sum up the concerns of many of our subscribers.

Number 1

What with the Fed printing fiat at a 13% increase each year, we would think inflation and dare we say hyperinflation down the road. But in the last few weeks, we seem to be developing a severe credit crunch that could spell deflation. How do you see these two economic forces play-

ing out over the next year or two? And of course how do you see gold and little sister silver behaving in this environment(s)?

Number 2

The big picture seems to be whether the owners of the Federal Reserve will:

- 1) Save the dollar and sacrifice the U.S. economy or,
- 2) Save the U.S. economy and sacrifice the dollar.

My question is, What are signs that tell us which direction the Federal Reserve will act, and what is our game plan in selling and/or buying silver for trading and core holding accounts?

Many in the mainstream press are speaking about the problems with the Chinese stock market, and it is only a matter of time before this whole house of cards comes tumbling down. The best thinkers, in my opinion, are those who ask the right questions, and the right question is, Who taught the Chinese the modern banking and financial structures? You see, the only way a debt-based monetary system can survive is to continue to expand. Without expanding it will contract, and that contraction is what is normally thought of as deflation. This is what we are just starting to experience now in the United States.



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While so many are focused on the stock markets, whether local or foreign, the equity markets are a sideshow compared to the debt markets. When the mainstream tells us that China has a TRILLION dollars, this is in the debt market. The amount of money in (credit) government bonds, corporate bonds, mortgages, and other debt instruments absolutely dwarfs the equity markets. This is why we write from time to time to keep focused on the U.S. bond markets. This is not to state the stock market is not important, but it is not nearly as important as the credit markets.

For just one of several examples, most know how poorly General Motors is doing. However, most investors do not know that the mainstay of their business was in GMAC—their credit division. In other words, lose money by making cars, but make money by providing loans.

So what is my studied opinion of where we are now and where we are going over the next several months? First, I think that our interview with Bob Hoye in our May issue is what to expect for the next few months. Basically, we are going to see more financial hardship in the U.S. economy, and we expect to see the word “recession” in the mainstream press soon. The Fed has been raising interest rates since 2004 and the dollar has continued to fall—a clear sign that dollar holders want to sell. Raising interest rates usually strengthens a currency.

But credit is contracting, and when credit contracts, those dollars (debt obligations become more difficult to service) become relatively more valuable. I am saying “relatively,” meaning on a very temporary basis. If the Fed increases interest rates again, it might be enough to quell the credit markets and strengthen the dollar for a few months. This would be a tough judgment call on part of the Federal Reserve to keep the U.S. dollar from falling much further at the expense of those who borrowed too much money thinking that their home equity or stock picks would increase their solvency.

This of course would put more pressure on the housing sector and cause further problems in the retail markets that are housing-dependent—furniture, appliances, carpeting, and landscaping, to name a few. So, for the immediate future save the dollar, then later come back and try and save the U.S. economy by perhaps lowering rates.

The big question becomes, Can the Fed re-inflate the U.S. economy? A good analogy is bending a paper clip back and forth, one bend is loosening monetary policy, and the opposite bend is tightening monetary policy. Sooner or later the paper clip will break. I still think the markets are bigger than even the Federal Reserve or the International Banking elite. However, I truly believe that there are enough creditworthy borrowers to allow the Fed to re-

inflate AFTER we go through the new few months of a downturn.

It will not be the U.S. housing market or even a re-birth of the U.S. economy no matter what is written by the mainstream. What does exist is enough of a demand-driven base, primarily from developing Russia, India, China, and Eastern Europe—what I have referred to as RICE in earlier reports. This demand will then fit with what David Bensimon told us in the June report: a huge leg up in the commodity sector. It is also similar to the view that Eric Sprott expressed a few months ago.

I checked with David Bensimon very recently, and he is still looking for gold to move down to 580 by the end of August, en route to 550 in November 2007. This, according to Bensimon, would conclude the overall consolidation since gold hit 730 in May 2006 and launch the next major advance, ultimately reaching 2600 in 2014. We know many of you appreciate the great lengths we took to get our interview with Mr. Bensimon, but most want to know how we see the metals unfolding.

We are looking for some more to the downside and first want to see if gold approaches the \$600 level or not. If this takes place, we will put out an e-mail, explaining how we see the market at that time. Basically, we want to maintain our stance that no one is smarter than the market and we should look to keep buying on weakness. Certainly, we want all readers to be prepared to buy in gold and silver if they were to see the lows Mr. Bensimon has forecast, so plan accordingly.

Mining Stock

We outlined the net present value method of analysis last month and did a review as an interim report that gave very specific buy areas on many companies. So we are going to be very brief in this section this month. We like Pitchstone and at the \$3.00 level we think it is a safe buy. What you need to know is **a 3.2 meter core length on the Candle Property averaged 0.31% U₃O₈ including 0.9 meter and 0.4 meter sections that contained 0.76% U₃O₈ and 0.72% U₃O₈, respectively. These are excellent drill results and it is too early to determine that this will become a mine. However, these type of results are well above most junior mining companies.** Additionally, a well-disciplined fund in Europe placed three million with the company at \$3.00 per share. As the uranium market has been hit recently, we are buying back the shares we sold higher on our alert and think this company is one star in a field of so many names it makes one dizzy.

Another company is Endeavour Mining, which we wrote about last month followed by an update just a few days ago. This a company that we think is a good balance of

risk and reward and will see some large capital move into later, as the mining sector becomes the investment fad of the momentum players in 2008.

The balance of this month's report is devoted to my interview with Mr. Rick Rule of Global Resource Investor Ltd. See www.gril.net For over 10 years Global Resource Investments has been a leading natural resource broker guiding clients in and out of investments often overlooked by larger brokerage firms

Rick Rule, the owner of the company, has dedicated his entire life to all aspects of the natural resource industry. His contacts and knowledge of this market are unmatched. At Global he leads a team that features professionals trained in resource related disciplines, such as geology and engineering, who work together to evaluate investment opportunities.

Global Resource Investments' philosophy is to help you make the best investment decisions by providing tailored, strategic and incisive advice. The natural resource industry encompasses the essential raw materials for civilization to exist and run smoothly. Armed with real knowledge, the opportunities for investment returns can be exceptional.

Global Resource toll-free from anywhere in the U.S. 800-477-7853

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The Interview

David Morgan: Rick, you've done plenty of these interviews, and we just basically want to record what you said at the Vancouver show because it fits closely with my philosophy. So, Rick Rule, please just give us your background, how long you've been in the business, what you do, and a little bit about your company.

Rick Rule: I have been involved in the natural resource business since the mid '70s. I currently own something called Global Resource Investments, which I suspect is the largest U.S.-based broker/dealer focusing in a natural resource business, largely because we're one of the only U.S.-based broker dealers focusing on natural resource business. I also own a money management firm, Terra Resource Investment Management, which focuses on money management for high net-worth individuals in the value and resource sectors. And I have a company called Resource Capital Investment Corp., which is formed for capital pool partnerships that are primarily involved in private debt and equity transactions in a natural resource business.

Morgan: Let's say one of my readers was interested in becoming a client of yours. Do you have a minimum requirement that's required to be in one of these capital pools?

Rule: The capital pools are closed. We aren't accepting new capital. In fact, the capital pools have been successful enough that we're busily returning capital. We have more capital employed in that business than we care to employ, thanks to some early luck and a good bull market. In terms of the individual-managed accounts, our minimum is \$100,000. That's where we make the investment decisions. If the client wants to make their own investment decisions and just use our brokerage services and our expert commentary, the minimum's only \$10,000.

Morgan: Very good. What's your track record been, let's say, the last three to five years on your managed accounts?

Rule: The only audited track record that we have is the capital pools, which varies on an annualized basis depending on the pool, from a low of 32 percent to a high 61 percent compounded annually net of fees.

Morgan: Well, I like those returns, Rick. I'll have to compliment you on that.

Rule: Well, I wouldn't want to go so far as to completely confuse a bull market with brains. Although, I will say in my defense that the track record that we enjoyed in '98, '99, 2000, 2001—hardly ebullient times in the business—was also quite good.

Morgan: Very good. Well, I'd like to move on. I heard you speak at the recent gold show in Vancouver, British Columbia, and I thought it was probably one of the best speeches I've heard you give, and I've known you now for several years. I'd just like to basically let you run with that. I thought it was so well done that I said, "You know, my readers have got to know about this," because you talked about the sector, but you particularly focused in on the junior sector and what to look out for. And you narrowed it down very eloquently, so I'd just like to let you loose here and to just go through what you said at that show.

Rule: Well, to paraphrase, I led off by saying that most investors spend too much time focusing on the price of the stock and pay no attention whatsoever with regard to the value, [and price and value] are very different things. And it's very important that before somebody buys the stock, they have some inclination of what the company is worth—not what it could be worth if everything goes according to plan, because things seldom go according to plan. A different way of saying the same thing would be to focus on your downside before you focus on your upside. Figuring out what the market capitalization of a company

is, is pretty easy. That's the current share price times the number of shares outstanding. Add in debt to that or subtract net cash from that to get enterprise value. A much more interesting calculation, and critical for most investors, is to find out what the company is worth. How do you do that? Well, in the first instance, how much cash does the company have? Cash is usually worth cash, except that for our own calculations, we take out the company's burn rate for the next 12 months from cash. So if it's going to cost the company \$1,000,000 to stay alive, and the company has \$10,000,000 cash in the treasury, we suggest that the cash component of the company is worth \$9,000,000.

The first thing to figure out is what the company's properties are worth, not what they could be worth if the company gets lucky with the drill bit. But rather, what they could be sold for now. And then you add back any other "redundant assets" and delete out any liabilities. It doesn't mean that you need to look at companies that are selling at discounts to liquidation value currently. What it does mean is that you need to look at the value to quantify your downside if the exploration potential that you're buying the stock for doesn't work out.

The second thing, and many people would put it first, really is the people involved. I put it second, because I like to find ways to not have to look further, And there are a couple of really critical things about the people. The most important thing is that they have to have been successful in an endeavor that is very, very, very closely related to the endeavor that they're involved in now. An example would be that if the person running the company is a mining engineer whose past successes, if any, involved operating mines in Proterozoic rock in the eastern Canadian cratons, or operating a gold mine in a greenstone belt. And that person is now running a company exploring for copper/gold porphyries in the high Andes, the intellectual disciplines involved in the activity that made this person a success are very different than the disciplines involved in the company that the person is trying to be successful in now.

I like situations where the people are proven successes in an endeavor that is very, very, very similar to the one that they're trying to make me money on now. One of the things that I like to point out to speculative audiences is the principle of the bell curve, or Portent's Law. Most people know of it as the 80/20 rule: the supposition, that 20 percent of a population will generate 80 percent of the utility. And that's been proven across a wide variety of social science disciplines. There are two important things to know about Portent's Law from a speculator's point of view. In the first instance, the bell curve has two lips, a backward lip and a forward lip. That means that while 20 percent of a population generates 80 percent of the utility, a different 20 percent of the population generates 20

percent of the disutility, or to cite a more common phrase, the aggravation. What that means from a speculator's point of view is that you try and focus your efforts on identifying the good 20 and avoiding the bad 20.

A much more useful piece of information is that in large population bases, say the mining industry, you can run the 20 percent through the performance dispersal curve again and the population base is conformably aligned. What that means in mathematical terms is that 20 percent of the 20 generate 80 percent of the 80, or 4 percent of a population base generates better than 50 percent of the return. The importance of that for a speculator is that rather than trying to analyze the 4,000 companies that report to be in the mineral exploration business, if one can confine one's efforts to companies that are headed by people who are proven to be in that 4 percent range, it's a far more efficient use of your time and effort. People object to that, because they say, "Well, you'll miss the up and comer. You will miss the person who is achieving his or her first success." That is true, but it is statistically unimportant. You will enjoy better returns for yourself if you focus your efforts on studying people who have been serially successful in the past. And that's probably the most important speculative precept I know in the junior mining business.

The third thing that we ask people to look at is cash in and cash out, and this is really critical. This is the capital-intensive business and companies that have no cash, have no capital, have no business. The fact is that these companies generate no cash. Usually, if they're successful, they're successful because they develop a deposit that can be sold. And in that case, the amount of cash that the company has relative to the amount of cash that has to be spent to achieve the company's objectives is an absolutely critical thing for speculators to look at.

I'm belaboring this point, but it's important: A company that intends to spend \$10,000,000 to advance the company's projects to a point that it will justify the speculator's expectation has to be able to demonstrate that they have that \$10,000,000 to spend. And most people overlook this. Particularly in bull markets, they focus on what would happen to the share price if the company ultimately were successful with regard to their exploration plans, without any sort of attention to how likely a positive outcome is, or whether or not the company has the cash resources to answer the unanswered question. I ask speculators to focus on the company's business plan on the one hand, and create their own business plan with regard to the speculation on the other. Many times, when interviewing a company, I have asked them for their exploration theory regarding a certain property, and asked them how they intended to exploit the theory, or in a different sense, asked them how they attempted to prove

their thesis, and found out that they really had no plan. Having no plan is the same thing as planning to fail. The idea that somebody is going to raise \$5,000,000 or \$6,000,000 and spend it with no concise plan, with no sort of critical path plan, really is obscene from a capital allocation viewpoint. But it is more common than not in the junior exploration sector. At the same time that the company has to have a plan, the speculator has to have a plan, too.

I never buy a junior exploration stock without a specific set of goals with regard to that stock. And if the reason to own the stock goes away, in my portfolio, in every case, the stock goes away. I don't care if I'm up 50 percent or down 30 percent; when the reason to own the stock goes away, the stock goes away. It's important for speculators to recognize that adding value in exploration involves answering unanswered questions. So you need to say to the company that you're considering, "What is it that you hope to accomplish with this work program? How do you see this benefiting the company? What do you see this beneficiation ultimately being worth? What are the probabilities that this method will be a success? What will cause you to know that this course of exploration is a failure, and if this thesis is a failure, what is your fallback? Where do you go from here?" That will give you some sort of sense of your own plan for owning a stock. It has been my experience in 30 years of doing this that answering most unanswered questions takes at least two field seasons. So from my own point of view, I always plan to hold an exploration stock for a minimum of 18 months. And my internal risk-adjusted rate-of-return targets are that I have to believe that the company can generate a double or better within 18 months, and I also have to believe that the property is profound enough that there is a possibility over time of this speculation generating 1,000 percent returns, or 10 to 1.

Morgan: Let me stop you there, Rick, if I might. On the doubling over the 18-month timeframe, I have suggested at times that when we get a double in a speculation that conservative investors take their money out and let the rest ride, commonly known as a free trade in the options market or the futures market. Do you advocate that at times?

Rule: I absolutely do. I refer to that as the point of no concern. You have your capital back. If you've done a private placement, you have the warrant. That's a fantastic way to go. The exceptions to that would be where the answer to the unanswered question is so good that it causes you to redefine the underlying value in the securities. An example that you would be very familiar with would be the initial three drill holes on the Pitarrilla discovery by Silver Standard or the first drill hole at Aurelian. The results were so good that it allowed me to

reappraise my potential downside, which caused me to be less afraid of chasing the upside. But in most circumstances, speculators are very well advised to take their capital off the table. And I mean all their capital. By that I mean if you have \$100,000 invested in the position and you sell stock valued at \$100,000, you sell a little more so that you can pay the tax on the money that you took out. I like my clients to have the position absolutely free on an after-tax basis when possible.

Morgan: Very good. When you look at the people being probably the primary asset, if I can call it that, on the speculative situations, do you have a database? How do you determine past successes just outside of your experience? Is there anything a normal investor could do to determine whether someone's got sufficient experience or sufficient success in the past to basically look at that situation a little harder or conduct a little more due diligence?

Rule: There are a lot of databases available. Probably the easiest and most interactive for your subscribers would be the stock watch database, which is very, very, very interactive and for me, not being a computer genius, fairly intuitive. I'm sure for people that have better data processing skills there are other databases that work. But one of the important things to do, in fact, is let the David Morgans of the world do some of that work for you. The newsletter writers, and I don't mean the ones that came into the business last year, but the ones who have been in the business 10 years, have almost universally learned that a track record is an extremely important determining factor. What is important from the speculator's point of view is that you take the suggestion from a newsletter writer or a broker, and you do your own due diligence.

And the best way to do that is a telephone interview with people involved. Many retail speculators are afraid to pick up the phone and call the company, thinking that the company's executives are too busy to talk to them. In truth, for the good guys, nothing could be further from the truth. These are people who are so focused on what they do that they're incapable of talking about things like baseball or movies; they love to talk about what it is that they're doing for a living, and they welcome incoming calls from investors. Those, by the way, who are too busy to talk to their shareholders are telling the investors something equally valuable, if somewhat disappointing, which is that they don't regard their shareholders as partners, but rather as victims. But I would say get on the phone with the company's principle actors and say, "What is it that you propose to do for a living? Okay. You're exploring for copper/gold porphyries in Peru, Ecuador, and Chile. How much experience do you have? How much success have you had exploring for copper/gold porphyries and tertiary volcanics in the cordillera previously? I mean, is this

something that you've made money for people at before?" If the answer's no, you have to be extremely cautious. That doesn't mean there aren't people, like Roman Shklanka, who haven't been successful with different deposit types in different parts of the world. But it's a question very, very, very worth asking.

Morgan: I'm going to switch topics slightly on you. Here, what we've done from the outset is advocated basically a three-tier approach to the market in resources. And that is when you start with the real metal base as a foundation investment. And we're talking about gold and silver coins or bullion, fully paid for, non-leveraged, that you can basically go touch. In other words, it's allocated to you and you only. The next step up is cash rich, unhedged, large cap or mid-cap mining companies. (Goldcorp is a perfect example. We had Goldcorp very early on and we had Silver Standard very early on, as well as Pan-American.) Then, we speculate in the junior sector, and we've had very good success. Like anyone, we've had a few that have blown up on us.

But I like your comment on that approach. In other words, right now, we still like Silver Standard. We certainly cannot promise a 4,000 percent return to anybody who's subscribing to our service now, because the days of Silver Standard being 65 cents in U.S. terms when the Canadian dollar was 65 cents to the U.S. dollar are gone, and they're not coming back. However, for a conservative portfolio, we think that stock still represents some upside going forward. What is your basic style, Rick, if I can ask? And I know it varies depending on your clients, but you personally, do you venture into nothing but speculations? Do you have a balance, do you have a 50-50 approach? What's your approach?

Rule: As you suggest, in terms of my relationship with the public, that will depend on my perception of the customer's needs and the customer's prejudices. I personally own some bullion, and I own it for two reasons. Some of the bullion I own, I own in effect as insurance. I own it in the certain hope that, when I'm 85 or 90 or however old I am when I become reflective, I look back and say that owning it was a waste of time and money. That would be my hope, because I own it as catastrophe insurance and I hope we don't see a catastrophe. I also have a bullion component in my portfolio, because I hold relatively large amounts of cash. And I regard bullion as a form, in fact, a superior form of cash.

Many of my customers don't have the same patience that I do and don't like to hold as much cash as I do. I found that cash is good for the nerves. I hold in my own account and client accounts large cap stocks and mid-cap stocks, which I benchmark against others based on things like recycle ratio—that is, the cash margin from exiting

production and the company's efficiency in converting that margin into new reserves and resources. And on a discounted net present value basis, you know, that sort of thing is very important for me. Or where a company has developing projects that I think are misunderstood by the market. An example would've been in the early '80s, Freeport McMoRan's copper and gold Ertsberg-Grasberg complex. And as you point out, Silver Standard is merging deposits at San Luis and Pitarrilla. And coming down into the juniors, I think the common misperception that people have is that the juniors themselves represent efficient leverage to the commodity price. That's almost never the case. The juniors are almost always exploring for something.

And the idea that, if the price of silver were to advance from \$12 to \$20 or \$25, it should have an impact on the value of a company that's exploring for silver rather than having some silver, is a bit silly. If the price of something that I have none of goes up, it shouldn't impact me. It may impact the market's perception in the short term of the affairs of the issuer. But people who are involved in exploration speculation need to understand that mostly these companies are small research and development businesses. They're knowledge-based, not asset-based businesses. And in a real sense, they don't exhibit very much by way of leverage to the commodity, but are much more focused on successful efforts and exploration. And I find value—at least I find opportunity—on occasion, across all three spectrums. The beauty of the speculative sector as far as I'm concerned is that the transmission of information is very inefficient, and the market's ability to process the information and draw conclusions is very inefficient. And so I have found the most inefficient and volatile place to be in the speculative sector. Hence, it's a place where my own knowledge and my own ability to process information, and the ability that I have to add value with my own staff of geologists and engineers, relative to fairly unsophisticated competition, give me large competitive advantages.

Morgan: I know from the times we've spoken in the past that you basically like to get in early and you usually get out a lot earlier than most. In other words, you've got a goal set when you buy a company. If it achieves that, unless it's extraordinary, like Aurelian like you mentioned. And you're pretty happy taking a nice big slice out of the middle, so to speak. First of all, is that accurate, and secondly, where do you think we are in this market overall in the resource market?

Rule: I am normally early out and I am often early on. I was particularly early on in that I was an extremely aggressive speculator, as you were in the '98, '99, 2000, 2001 timeframe—where things were very cheap and it was fairly lonely. I'm early out because I'm not much of a dreamer. I have a risk-adjusted net present value model

where I try and figure out what a property is worth rather than the journalist sense of how high the market can take it. And I am very content to take 100 percent of my estimation of a property's value, which is almost always more conservative than the market's estimation of the value in a bull market. The consensus in a bull market almost always becomes like a sort of a herd mentality.

With regard to the second part of your question, which is where we are in the context of a precious metals market, while we have enjoyed lovely, spectacular gains thus far, I suspect that the precious metals market has further to rise, simply because I expect that the U.S. dollar has further to fall. That's a fairly common theme, I think, among your interviewees. Where I would differ with most of your interviewees is, while they consistently pan the U.S. dollar, I would suggest that the U.S. dollar is in fact the worst currency in the world except all the others. And I suspect that as you see the U.S. dollar continue to fall, what will, I think, surprise most observers is that other currencies will have to fall as those countries seek to maintain their market share in the U.S. market, which is over 30 percent of the world's GDP. And I think that you will see competitive devaluations amongst virtually all the currencies, with the possible exception of the Russian ruble. And I also think what you will see (and I emphasize that this is "think" because I'm more of an exploration analyst than an economic analyst), is a precious metals rise against all currencies, which is what you saw in '79, '80, and '81. And I think that'll be a sign that we're into a seriously real precious metals bull market.

Morgan: Well stated. I tend to agree with that view. I mean, most markets go from undervalued to fair-valued to overvalued. And I've stated that the metals markets will get overvalued. And there are many ways to analyze that, but one of the simplest ways is just to take M1, divide it by the amount of gold the Treasury says the United States owns, and on a cash basis, come out with a theoretical price of gold. And I did that a few years ago; it amounted to \$2,500 an ounce. Now, that's suggesting that gold could get to that level. If we did that same exercise in 1980, it was interesting, because the theoretical price of gold was only \$400 an ounce. And Rick, you and I both know that gold went to double that—it was over \$850.00 on an intra-day peak.

So in my view, we have a long way to go. But regardless of that, we're investors. We like the resource area and we'd like to get your views on other sectors of the market. Last time we spoke about doing this interview, we were talking about water, we were talking about oil and gas, and we were talking about even maybe some of the agricultural commodities. I'd like your overall perspective now on the general resource sector and what you like now, what you don't like, what you think might be overvalued,

and your comment looking forward three to five years as to where you think some of these other sectors have to go.

Rule: I think the silliest overvaluations occur in the uranium junior sector. I was extremely aggressive, recommending the uranium stocks in the period 1998 to 2002, when they were astonishingly cheap and had to go higher. The situation is different now. That doesn't mean that the commodity price can't go higher, but it doesn't have to go higher. When uranium was selling for \$8 a pound, it cost the industry \$20 a pound to make it. So the industry on aggregate was losing \$12 a pound and paradoxically trying to make that up on volume. Two things could happen. Either the uranium price could go up or there wouldn't be any more electricity from uranium. Clearly, the uranium price had to go up.

Now, it cost the industry, they estimate, something like \$26 a pound to make the stuff, and they sell it for \$140. This is one of the fattest operating margins that's ever occurred in a commodity. So the price clearly doesn't have to go up, although it can. Much more problematic, however, is the fact that you have 550 junior exploration companies purporting to explore for uranium. I would suspect that there were 30 or 40 management teams that survived a 20-year bear market in uranium. So the probability that your junior is run by a competent exploration team is arrived at by dividing 30 or 40, that is the number of teams, by 550, the number of companies. Dividing 40 by 550 does not yield you a very comforting number in the context of having your company run by a competent management team. So people who like to speculate in the uranium juniors need to understand that, as a whole, they're playing a game of passing burning matches. Doesn't mean that individual issues can't work, it means statistically the math is not in your favor.

On the other end of the spectrum, I think water is extremely undervalued. And it's very boring. People don't care about it. They never do, in fact, until they don't have any. That doesn't mean that all water investments will work out. You need, as an example, to speculate in water in a place where it's scarce. I'm in British Columbia right now and the challenge that they're having is making water go away. So owning water in a place where there's too much water is of no particular benefit. The second thing is, of course, that you need to be involved in a market that (a) has a scarcity, and (b) can pay for it. Owning lots of water resources in Ethiopia or Tibet is of no particular benefit, because nobody can pay for the water. But jurisdictions like Arizona, Nevada, Texas, California, southwestern Australia, Spain . . . excellent, excellent, excellent speculations. I would suspect in California, Arizona, Nevada, the southwest U.S., that the price of water can and will go up 1,000 percent. And people who own water rights in those jurisdictions will make really, truly fabulous

amounts of money. I'm attracted, I think, across the board to the energy sector. I mean, energy's had a spectacular run, but it's had a spectacular run from a base that, in inflation-adjusted terms, is extremely low. And that's happening simultaneously with two-thirds of the world's population coming to the point where they increase their own energy footprint. It was pointed out to me, but I haven't independently confirmed this. The Chinese per capita consumption of hydrocarbon energy is 3 percent of U.S. per capita consumption of hydrocarbon energy. It is unlikely, well, probably physically impossible, for Chinese per capita consumption to approach the U.S. consumption rate. But I have been informed, and again I haven't independently confirmed, that if Chinese per capita energy consumption approached South Korea's consumption, the demand for energy on a worldwide basis would double. That's a fairly interesting statistic.

Closer to home, I am very attracted to the micro cap Canadian natural gas stocks, which have been absolutely pummeled, because of (a) a decline in gas prices, and (b) the stripping of the tax status from the trusts, which leads people to believe that these little companies will never be sold, so there's no exit strategy. I suspect that the Canadian micro cap natural gas sector represents a intensely attractive 2, 3, 4-year scenario. I think it'll be a very boring sector for the next 18 months, but at my age, I've come to welcome boring. I think that's high praise indeed in a volatile sector. And I like the international exploration sector an awful lot on the energy business. I'm less negative, I guess, on the outlook for base metals than some of my precious metals contemporaries. The difficulty is that when I benchmark a lot of the base metal stocks against the best producers in the sector, I have a difficult time buying these juniors, because some of the other companies in the sectors are so good that I tend to allocate money to existing names in my portfolio, rather than being able to add any new names. The people who run base metals companies have been through both a bear market and 20 years of a volatile market, and have become much more efficient allocators of capital than their cousins in the precious metals business.

So I find almost uniformly that the management teams involved in the legitimate base metals explorers and producers are of much higher quality than their counterparts in the gold sector. And hence, I can afford to be far more selective with regard to management teams. As for soft commodities, I think we have a five- or six-year bull market ahead of us, maybe more, as per-capita meat consumption increases. And as an example, per-capita grain consumption goes up disproportionately because of the inefficiency or relative inefficiency of getting nutrition from animal-based proteins rather than soft goods like grains. You see a tremendous stealth bear market in fertilizers, which I suspect continues both because of the

advance in their raw costs, natural gas in the case of nitrogen, but also in terms of pot ash, phosphate, the whole range of things. And the fact is that we, despite very rich people's preference for organic food, will increasingly need to rely on the so-called "green revolution" technology, which really requires artificial nutrients to sustain the population base that we have in the world, and particularly to sustain this population base to the level that they would like to become accustomed to. So I see an ongoing bull market in agricultural producers and agricultural service companies, like irrigation companies and fertilizer companies.

Morgan: I'd like to explore the oil sector with you a bit further. What is your position on peak oil?

Rule: I think peak oil is an economic exercise. We are a long way from physical peak oil constraints. At \$200 oil, as an example, I would suspect that we are 200 years or 250 years away from peak oil. At \$200 crude, that assumes constant 2007 dollars. If they devalue the dollar enough, \$200, \$250 crude doesn't do much. But at \$200 crude, 2007 dollars, a couple of things happen. Markets work and the utility to consumers represented by \$200 crude is much less than the utility represented to consumers by \$60 or \$70 crude. At the same time, that makes a whole bunch of exploration and processing technologies feasible. So I really think that you have an economic tradeoff when you talk about peak oil. And that exists in the natural gas side, too.

I'm reminded by some geologist-friends of mine that the sort of base eccentric, or shale gas plays, that are so popular in the United States, typified as an example by the Barnett Shale play, which is now the biggest single gas field in the state of Texas, aren't anything that's extended to the rest of the world. And some of the largest known accumulations of gas-rich shales in the world are in the Persian Gulf, in Saudi Arabia. The Saudis haven't gotten around to exploiting those gas-rich shales because they haven't had to. That is the sort of thing that would respond very well to price incentives. I read a really interesting thing in the oil and gas journal four or five months ago that said that in its history, there have only been 175 pure exploration wells drilled in Saudi Arabia because nobody's had to drill pure exploration wells. So I would suggest that peak oil is a function largely of price in the near term rather than physical constraints.

Morgan: I'd like to explore the Agricultural sector a little further. As somewhat primarily an equity guy, what is your thinking as far as how to participate in the Agricultural cycle? I agree with you, by the way. I think food and water, the two most boring things that we need, are very good investments at this point in time. How would you

suggest an investor participate in this cycle without having to go into the futures market?

Rule: An investor who would like to outperform his peers would do well to look to the London exchange and if they're really aggressive, to exchanges like Kuala Lumpur and Australia, where agricultural listings are fairly common. Most American investors would prefer to pretend to work. And for them, they're going to have to look to agricultural proxies. They'll have to look to indirect plays because there aren't too many publicly listed agricultural producers in North America. But people who want to play soft commodities and are sophisticated enough to pay you for investment advice should be sophisticated enough to explore the agricultural listings, particularly in English language jurisdictions, like London and Australia, where agricultural listings are fairly prevalent. And increasingly, they, being retail investors, will need to begin to familiarize themselves with secondary exchanges (like Kuala Lumpur), which have lots of opportunities in agriculture. You know, I see those as being really good markets for the next 10 years.

Morgan: Excellent. There was one comment you made in your speech and it was that new people, some of your older clients, write in and say, "Rick, I want a portfolio review." Go ahead and give us your take on this portfolio review and what the typical speculator says to you . . .

Rule: Oh, that's a really good question. You know, we have acquired clients by saying, "We have a no-obligation portfolio review. You send in your portfolio and we'll give you a no-obligation buy-sell-hold review." And so people will send in these laundry lists of 50 or 60 stocks. And they say, "Well, Rick, what do you think of Aardvark Resources," or whatever the first one is. I say, "Well, before I tell you what I think of it, what do you think of it?" The person will answer, "Well, Rick, I never think of it." And I ask, "Why do you own it?" "Oh, well, I subscribe to XYZ newsletter and they recommended it." "Do you still subscribe?" "No." "What do you know about the company?" "Nothing." "If you don't know anything about it, why do you own it?" "Well, I own it because I can't sell it," they say. "Why can't you sell it?" "Well, I paid \$5 for it, and it sells for \$0.50 now. And if I sold it, I'd lose \$4.50." At which point I have to say, "Dear sir, I'm sorry, but it isn't that you will lose \$4.50. You have lost \$4.50. Your choice is whether the \$0.50 that you have invested in this stock is best invested in this stock or some other stock. That's what you have to decide."

The sad truth is that a stock doesn't care what price you paid for it. And the market doesn't care, and neither does your broker. No one cares what price you paid for something; only you care. And you have to comb your portfolios, ruthlessly deciding not what you hoped

something might be worth, not pursuing some vainglorious wish to break even, but rather simply, what is the best use of the capital that you have to employ. It's very, very hard for people. People say, "I'm going to wait until the stock gets back to what I paid for it." "Well, why would the stock ever get back to what you paid for it, particularly if you know nothing about the stock?"

Warren Buffett talks long and hard about this from an investment point of view, but it's useful for speculators. Mr. Buffett proposes two tests, which are extremely difficult, but I think very, very instructive. The first is, "Don't buy a stock unless you would be delighted to see it fall 30 percent in price the week after you bought it, so that you could double your position at lower prices." In other words, don't buy a stock that you wouldn't love to see go down so you could buy more. And don't buy a stock where if you had the ability to, you wouldn't buy the whole company at the price per share that you're buying the piece that you're buying. Now, those are really very hard tests. And I think they're very instructive for most people. In fact, one of the things that I say to a customer who won't sell their \$0.50 share that used to cost them \$5 is, "Well, if you like it that much, you bought \$10,000 worth at \$5. Why don't we buy another \$10,000 worth at \$0.50?" And it's odd how many people are (a) unwilling to sell what they've bought, but (b) also unwilling to buy more at that price. A flaw in human nature, I suspect.

Morgan: Definitely. You stated also in your speech that you know ahead of time that you've got an expectation for a given company. And then you watch carefully from there. A lot of people, as you say, blindly fly at these stocks because the symbol matches the letters of their name. Or there's a stock that matches their astrological sign or on and on. Of course, part of my job is to do a great deal of due diligence and say, "This is what we've found so far. Here's what we do like, and here's what we don't like about it." But there's no perfect situation in this business that I've ever found. And then we encourage, especially in our disclosure, people to take that knowledge, which we worked hard to obtain, and go out from there and make an investment decision. Could you review how you enter a position and what your strategies are once you take it?

Rule: Sure. In the first instance, the target size that the company is exploring for, from my point of view, has to be profound. When you are in the exploration business, the expectation is failure. The probability is that exploration efforts will be unsuccessful, which means that a long holding period will, in all probability, result in loss. So if I'm facing the probability of a loss, I have to have the expectation of an inordinate return if I'm successful. From my point of view, if the company's target isn't profound enough to generate a tenfold return for me if I'm

successful, then I have no interest in the speculation. In the nearer term, I realize that by contributing capital to a company, I am enabling them to answer some unanswered question in the context of exploring the property that they're on. And what I want is the probability of a double if the answer to the unanswered question is positive.

Morgan: Let's explore the top-tier companies. Let's look more at the investment side. We like to buy companies that are solid. Let's take Pan-American as an example. I mean, we can write options on that stock when we think the market may be flat and generate some income. Or what I like to do, actually, is take some of that money that we're getting, free cash flow, if we're smart or lucky enough, and recycle it in the junior sector. We're big advocates of solid investments, and then we spice up the portfolio with these speculative issues. What's your philosophy on these larger cap stocks that basically I would consider to be buy and hold for the most part?

Rule: Well, in the first instances eluded to, I love writing covered calls. I almost never buy options, because most options, if held to maturity, expire worthless. But the idea of allowing the market to pay me to do something that I would otherwise do for free is something I love. If I have a price that I am willing to buy Pan-American for, and somebody is willing to pay me a buck for the right to make me do in the future something that I would willingly do for free, I *really* like that trade. I'm not the kind of guy who buys options, because statistically, if held to maturity, almost all of them expire worthless. But selling options is something I like extremely much if I have a sense about the underlying value of the security.

In the context of buying and holding these things, from my point of view, I always look at mining businesses in the way that you're taught to look at oil and gas businesses, which is, first of all, what is the enterprise value of the company relative to my assessment of the risk-adjusted net present value? Look at the cash flow that could be obtained from the company's existing deposits with their existing assets to capital, looking forward at whatever discount rate you deem to be appropriate. By the way, for inflation-adjusted things like silver, I use the U.S. 30-year treasury rate, which is what Buffett suggests. And I try and look at the expected value of the company's cash flows on an ongoing basis and find out how much I'm paying for that cash flow. Is it a reasonable speculation? You overlay on top of that the thing that we alluded to earlier in the interview, which is the recycle ratio. If a company like Pan-American is producing 20,000,000 ounces of silver, and their net margin is \$5 an ounce, that would suggest \$100,000,000 in cash flow.

And if you look back historically and see what it costs them to add an ounce of silver reserve, if that \$100,000,000 in cash that they are going to generate from producing

20,000,000 ounces of silver has historically yielded more than 20,000,000 ounces of replacement production, that means that the company has a positive recycle ratio. It's companies that are selling at reasonable price net asset value ratios that have positive recycle ratios, particularly when you adjust them against their peers. These are the types of things where we tend to concentrate our portfolios. In other words, we look at performance of the company relative to its peer group.

Morgan: Very good. Well, Rick, we very much appreciate your time. Is there anything that you want to mention here that I haven't asked you about?

Rule: No. I think it's been pretty thorough. One of the things that consistently disturbs me for investors is that they take a look at an interview like this, and they look at the stuff that they're supposed to do. And they don't do it, and then they wonder why their results are sub par. I would caution investors that sometimes in periods like these where they've had three, four, five years of very good performance, they equate their performance in a bull market with brains, which is not the same thing. The more risk you take in your portfolio, the more work you have to do. Your subscribers are going to be one step ahead of the average because they have at least paid you to do the work rather than trusting to luck. But this is a business that very definitely rewards effort. There are hundreds of thousands of participants and probably 90 percent of them don't do any work whatsoever. So it is a business where you can best your peers, but you have to do the work to best your peers. And that's what I would urge people to do.

Morgan: Well, very good. And that is it. Again, I thank you.

Personal Notes:

We have a silver company and possibly another Rare Earth Element company coming your way soon. We just need to finish up some more due diligence on the REE company and are waiting for what we think will be a better entry level on this silver company. We just initiated our subscriber email service and it seems to be manageable so far, remember to listen to our posting at the website, in most cases the responses will be in audio format. Again, every email is read, but not every one can be answered due to time and also some restrictions.

Until next month, wishing you health above wealth and wisdom beyond knowledge,

David Morgan

ASSET ALLOCATION

This section we reserve for our paid subscribers ONLY! We have an in depth PDF file named "How to use the Morgan Report" which you will be able to view on the website as a member.

Top Tier: This section is for serious money where an investor can place up to ten percent of their Precious Metals Equity money in each company. Please spread out in this sector.

Top Gold Companies: We list 2-3 Top Gold/Resource companies these are usually good for long term 3-5 year horizons for serious investors.

Top Silver Companies: We list 2-3 Top Silver companies these are usually good for long term 3-5 year horizons for serious investors

Speculations: In this section (Table Below) only place money you can afford to lose. We will use a trailing stop of 15 percent from the time we feature a speculation in the list below. If a featured company falls to a level of 15 percent below the date the company was featured, we will issue a sell.

* **The Results below are as of December 1, 2007.** Past performance is no guarantee of future results. The "snapshot" in time is that only! The prices of the stocks below vary on a daily basis and at times in substantial percentages. Investing is NOT for everyone, if this would be your only newsletter subscription or your first subscription to a newsletter ever, we recommend you DO NOT begin with us. We rather be of service to those that are "seasoned" with a mature attitude toward the financial markets and their own decisions and responsibilities.

Company	Symbol CAD (US)	Initial Date	Initial Price	Profit (Loss)	Comments
Uranium Jr.	Subscribers Only	3/02/06	\$	+105%	
Jr. Silver Producer #1	Subscribers Only	8/04/06	\$	+100%	
Drilling Company	Subscribers Only	1/02/07	\$	+190%	
Silver Explorer #1	Subscribers Only	3/03/07	\$	+60%	
Copper Explorer	Subscribers Only	3/03/07	\$	+85%	
Mining Capital Co.	Subscribers Only	7/02/07	\$	+4%	
Silver Jr. Going to Production	Subscribers Only	9/30/07	\$	+74%	
Silver Explorer #2	Subscribers Only	9/30/07	\$	+10%	
Jr. Silver Producer #2	Subscribers Only	12/01/07	\$	NA	

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