



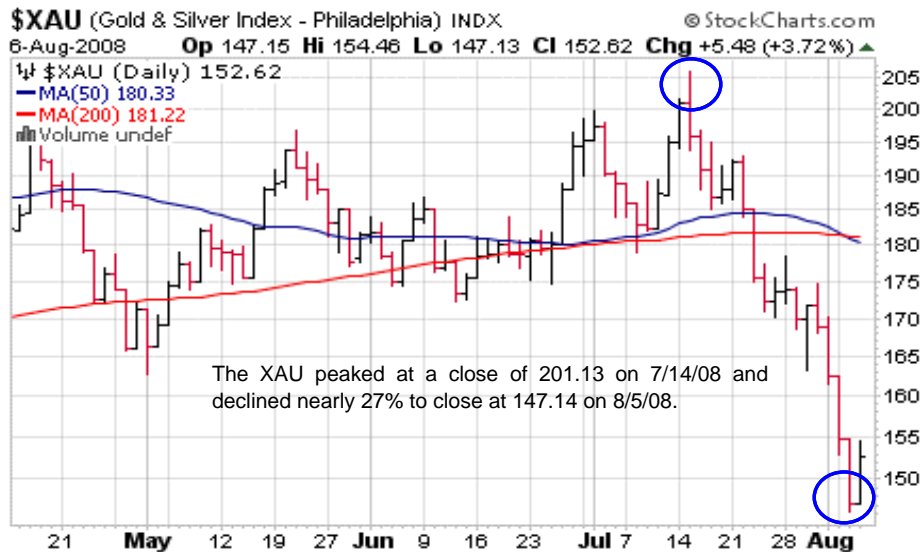
## OUTLOOK

"Rally in Precious Metals Ahead"

8/6/2008

The recent plunge in precious metals stocks has brought them down to values that we consider attractive. Since mid-July, the XAU index of gold and silver stocks declined from 201.13 on July 14th to 147.14 on August 5th, nearly a 27% correction in 3 weeks. There is no doubt that this has been a falling knife for speculators trying to time the bottom.

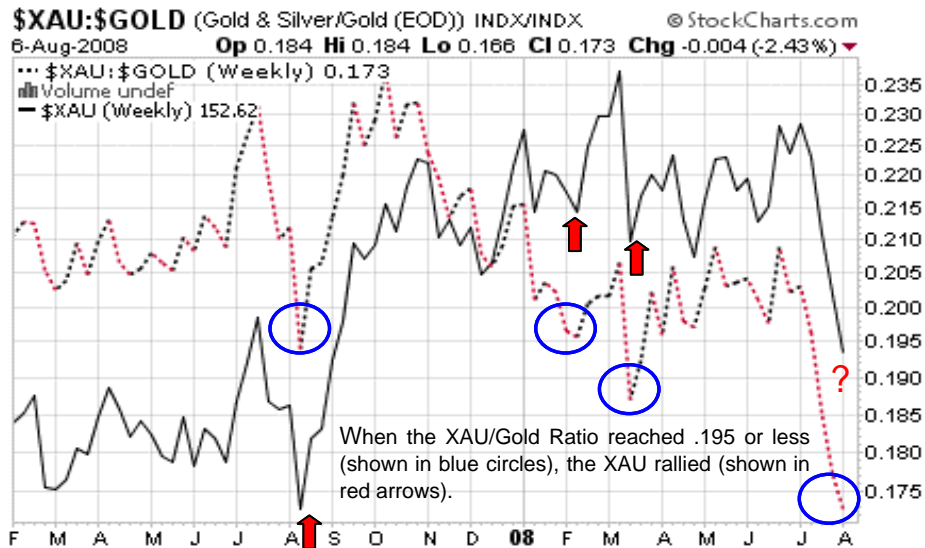
**Graph 1**



Although it is overlooked, we believe Bush's announcement on July 14th to lift the executive ban on offshore drilling was the catalyst to the sell-off in commodities. Of course, Congress would first have to approve lifting the ban and the benefits of offshore drilling would probably not be realized for several years to come. However, the psychological impact on the market triggered a steep sell-off in crude oil which brought down the entire commodity complex, including precious metals.

So are we close to the bottom yet? Based on the ratio of XAU/Gold, precious metals stocks appear significantly undervalued relative to gold. Typically, the XAU has rallied off its bottom when the ratio has reached .195 or lower. Currently, the ratio is less than .175 as shown in Graph 2. For the ratio to revert to its 50 day moving average of .196, we would expect to see the XAU outperform Gold in a rally and decline less than Gold in a sell-off.

Graph 2



In addition, inflation expectations have plunged as shown by the ratio of TIP/IEF in Graph 3. The ratio of TIP/IEF shows the relationship between the TIP, an ETF of inflation-protected treasury bonds, and IEF, an ETF of 7-10 year treasury bonds. A rising ratio indicates increasing inflation expectations whereas a declining ratio indicates falling inflation expectations. Since early 2007, the ratio has ranged from 1.195 on the low end to 1.23 on the high end. Currently, the ratio is 1.198. So what does this mean for precious metals stocks? As buyers of precious metals stocks, we want to buy when inflation expectations are low and beginning to rise. As shown by Graph 3, the XAU index typically rallied when inflation expectations (TIP/IEF ratio) were low and rising.

