Adrian Day's

Global Analyst

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*Our recommendation from a week ago to buy **Reservoir Capital** would have filled Friday at our limit of C$0.94. We are now adding that to our list of **Current Positions.** Closing at .94 x .96, it remains a buy. We now have only one open order remaining, for **Lara Exploration** (LRA, Toronto), which we are re-evaluating in light of recent price action. In this letter, we'll look at a few of our companies whose stocks have had exceptional moves, up or down, recently, as well as one or two others with significant developments.*

POSITIVE NEWS FOR MANY GOLD COMPANIES

Franco Nevada (FNV, Toronto, 43.96) saw a second-quarter increase in revenue of 112% over last year, and has boosted its expectation for a full-year jump of *at least* 65%. This increase in revenue has come from the higher gold (and other) prices as well as from acquisitions; Gold Wheaton contributed a full quarter, for example.

But these two factors count for only about half of the revenue increase. Significantly, the other half is from existing royalties coming on stream, some of which have been held for a very long time. This is organic growth at no additional cost, and is likely to continue.

Strong growth ahead without added costs

Franco Nevada had (at quarter end) 343 assets, 208 of them mineral assets, of which 39 were producing. It says it has 24 other assets with "reasonable potential" to be producing over the next five years. This would double the company's revenue without additional G&A or other costs.

Just in the remainder of this year, another four royalties are expected to come on stream, including the major royalty on Tasiast. Of course, the company is not sitting still, but continues to seek new royalties; last week it added a significant royalty on part of Rubicon's property at Red Lake.

The company has diversified its royalty base, but it retains the strong political and asset profile. Some 80% of its revenues come from North America while 90% come from precious metals (68% from gold).

The balance sheet remains strong, with $500 million in capital (including a credit line of $175 million). With top management, strong diversified assets, a solid balance sheet, and an exceptional growth profile, France Nevada belongs in every portfolio.

Value will out at Vista

Vista Gold (VGZ, NY, 3.58) has been volatile, but now up one dollar from just a month ago. Things are beginning to come together for Vista. At Mt. Todd, in Australia, recent drill results in an ongoing program to expand the resource continue to be positive. Midas has gone public, valuing Vista's 305 at over $100 million. Initial results (from surface sampling) of its Guadalupe de los Reyes project in an historic mining district in Mexico were positive, indicating continuity of mineralization along strike; the next phase of exploration will include some drilling. At its other Mexican project, Concordia, the company continues to work to break the permitting logjam. And finally, respected analyst and investment banker Dr. Nichole Adshead-Bell has joined the board.

With 18 million ounces in these and a handful of smaller projects around the world, Vista, with a market cap of $250 million, remains undervalued. The company is working now to monetize several of these assets, as it has with Midas. Although it's difficult to value many of the assets, putting a $7 number on the stock might prove conservative. Well financed and with powerful leverage to gold, Vista remains a buy, particularly on any pullback.

Activity across property portfolio

Midland Exploration (MD, Toronto, 1.70-1.78) is firing on all cylinders. Drilling has commenced on its Yterrby rare earths project, a joint venture with the Japanese company JOGMEC. New drill results on its Maritime-Cadillac property (a joint venture with Agnico-Eagle) were mixed; though most of the results were disappointing, one hole hit strong gold intersection (1.7 g/t over 46 metres, including 21 g/t over 1.2 metres). This is in a prolific area, and further drilling is warranted and planned. At another gold property, Laflamme joint venture with North American Palladium, a new gold discovery has been reported; this follows a platinum group and base metals discovery on another part of the property.

All of these are early stage, but all exhibit encouraging results, with partners spending the money.

Well funded, with about $5.5 million (following the exercise of warrants in May), Midland has no debt and no warrants outstanding. It has strong, disciplined management, and we suspect that any major discovery or development would see the shares sharply higher. In the meantime, continue to buy at the low end of its recent range.

Drilling ahead at multiple projects

Our other Quebec-based exploration company, **Cartier Resource** (ECR, Toronto, .40--0.42), saw a sharp pop in its stock price, from 32 cents, after sliding throughout most of the year. Cartier is likewise advancing on several fronts. The most encouraging results recently have been from its Cadillac Extension project, where channel samples returned several good samples of gold, silver, and copper, suggesting continuity of mineralization, which will be tested in upcoming drilling. Three other projects, Dollier, Diego, and the Xstrata Option project have seen or will shortly see drilling.

Well funded, with aggressive management, Cartier's $16 million market cap, makes it inexpensive. Again, this company would respond very well to any significant discovery.

<u>Lots of activity on several fronts</u>

Another of our exploration companies, **Miranda Gold** (MAD, Toronto, 0.405--0.42), is similarly advancing on multiple fronts. Pursuing a purer prospect-generator model, Miranda has, in recent weeks, announced the start of follow-up drilling on its Angel Wing project (partner Ramelius); positive assays from drilling at Red Hill (which partner NuLegacy says could be "the margins of a Carlin-type gold deposit); the completion of a drill program at its Red Canyon property (by partner Montezuma); and new drilling at Coal Canyon (also with partner NuLegacy). All these projects are in Nevada.

In Colombia, a second joint-venture agreement has been concluded with Red Eagle. In addition, there is a major joint venture agreement with Agnico-Eagle on the large-scale Esther Dome project in Alaska.

That's a lot of work for a junior—the beauty of the joint-venture model. Well funded with a strong technical team, Miranda, with a market cap of barely $20 million, is inexpensive. Again, tired shareholders have had the opportunity to move on, so any success will be well rewarded in the market, we believe. Meanwhile, *company* risk is very slight. Buy at the current level.

<u>This blue chip continues to deliver</u>

Nestle (NESN, Switzerland, 47.98) continues to demonstrate good results, both in terms of revenue growth and earnings, despite the strong Swiss franc. Its latest quarter showed the largest sales increase since the beginning of 2008, with "organic" growth of 6.5%.

The company also announced it would not be buying back more shares, after repurchasing some $48 billion worth of its shares since 2007. This suggests it may be preparing for a major acquisition, most likely Pfizer's infant-nutrition business. It has also made another acquisition in China, of a confectionary company. Its sales in China are small at present, just Sfr 2.8 billion, but it wants to increase those along with sales in other emerging markets, where it has an overall target of 45% of total sales by 2020, up from the current 38%.

Nestle is good long-term value here, with a yield of almost 3.9%, close to its high; following today's drop in Europe, we'd be buyers.

Don't miss the excellent interview with Nestle's chairman Peter Brabeck-Letmathe in the weekend *Wall Street Journal.* In it, he discusses the major challenges confronting the ability to feed the world, including the diversion of food for fuel programs; opposition to GM food; and the misallocation of water. It's well worth reading.

<u>Continues to grow and pays strong dividend</u>

Gladstone Investment (GAIN, Nasdaq, 6.43) ended the quarter with no debt and $31 million in cash, a strong position for a financial lending company. (See Bulletin #480.) At that time, it promised to be adding new investments, expecting to end the year utilizing some modest leverage. It's on track, with two significant investments. With its yield fully covered by net income, and very marginal leverage, GAIN's yield of 9.33% is outstanding.

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It's shaping up to be an ugly day in the markets tomorrow, following plunges today in Asia and, particularly, in Europe where most markets were down well over 4%. Gold is up over $1,900 again. That means some of the stocks on our list could be trading down and at good levels to buy. In addition to Nestle and Gladstone Investment (above), others on our list to watch for include **Gladstone Capital** (GLAD, Nasdaq, 7.60, 11%); **Altius Minerals** (ALS, Toronto, 10.40); Loews Corp (L, NY, 36.07); and **Pargesa Holding** (PARG, Switzerland, Sfr 60.15). You could see these trade down considerably in what is likely to be a volatile day.

<u>Ron Paul likes Virginia</u>

According to public records, among the top ten holdings of Rep. Ron Paul—all gold and silver stocks—is our very own favorite, Virginia Mines—hold on, Congressman!--as well as some others on our list. Incidentally, Paul is gaining ground in his campaign for Republican presidential nominee. The latest Gallup poll has him #3 (behind Mitt Romney and Mitt Perry), but ahead of Michele Bachmann who just edged him out in the Iowa straw poll.

Despite his standing in the polls, Paul is not treated as a viable candidate by the media. Liberal commentator, the *Daily show's* Jon Stewart had a very funny piece on this.

<u>CNBC doesn't like gold</u>

Some commentators seem to have a vociferous antipathy towards gold. Watch in astonishment as CNBC's Bill Griffiths berates State Street, manager of the gold ETF, for making it *too easy* for ordinary investors to buy gold. Yes, really. It's unintentional comedy, but also tells us that the mainstream media fighting gold so hard, it isn't anywhere near a top.

<u>Buffett likes taxes</u>

Warren Buffet wants to raise taxes on high earners. (Pony up, Warren, if you want; the Treasury won't return your check.) The liberal *New York Times* estimates the plan would raise a $500 billion over 10 years. That's only a very small dent in the context of a $14 trillion plus deficit. Moreover, that generous estimate assumes people would not alter their behaviour in the face of higher government take. Raise taxes on dividends and companies pay out less (it's happened before) while investors shift to tax-free munis.

Let's look at the hard numbers. The top 1% of tax filers paid 38% of all income taxes (twice their proportion of income). The top 5% paid 70% of taxes. If you include all federal taxes, the top 1% paid 28% of taxes, and the top 5% nearly 45%.

Buffett's contention is that the tax rate on the wealthy is lower than on the middle-class. Baloney! *The Wall Street Journal's* excellent Stephen Moore demonstrated this was not so. The effective tax rate (overall rate on total income, not the marginal rate), *including all federal taxes* on the top 1% of earners is 29.5%. For middle-class families (earnings between $34,000 and $50,000) the equivalent rate is 14.3%. (Including only income taxes or looking at marginal rates would skew the comparison even more against higher earners.)

And of course, as Mr. Moore pointed out, many high earnings own companies, which pay corporate tax. Buffet owns a quarter of Berkshire, so his share of Berkshire's tax bill was $750 million.

<u>Would higher taxes solve the deficit?</u>

So the simple truth is that the top earners are already paying far more than their "fair share". But would higher taxes on the wealthy solve the deficit? The government would have to take *all* of the income from *every* household earning $250,000 or more to raise the $1.4 trillion to match the deficit. So increasing taxes on the so-called wealthy is not going to the debt problem.

What about the bottom 48% of earners who pay no income taxes? I'm never going to argue for increasing taxes, but it does seem to me that it's unhealthy for a political economy in which almost half the population are tax recipients, particularly when their votes have equal value to the vote of taxpayers.

<u>Are taxes the answer?</u>

When someone argues for higher taxes, they imply that Washington will spend the money in a better way than individuals; history suggests not. (Wealthy people tend to invest in new companies, make charitable donations, and support the arts.) We also know from history that more government revenue only leads to increased spending. History also tells us that raising rates does not increase revenue (as individual's patterns change to avoid the higher taxes).

There is also the very intriguing argument about higher taxes on the wealthy, not that the wealthy cannot afford it—they have already made their money—but the deleterious effect it has on the creation of new wealth. If you consider the case of Hong Kong, with a very simple tax structure with low rates, the creation of new millionaires happens rapidly. When the government takes over half the marginal dollar of income (including Social Security taxes, state and local and so on), wealth creation occurs much more slowly.

And beyond all these very sound arguments is the basic question: Whose money is it anyway?

<u>Obama has a plan to cut the deficit</u>

Too much spending caused the debt problem, so cutting spending must be solution. And it's the only answer. But not to worry: Obama is on the job. He agrees the deficit must be curtailed and spending cut. His roadmap to cut the deficit includes…wait for it…the establishment of an infrastructure bank to build new roads and railroads; extension of unemployment benefits; continuation of government grants to solar firms that eventually go bankrupt; extension of a cut in payroll tax; new tax credits to companies that hire veterans; and on and on and on. This is meant to cut the deficit?

Later this week he will unveil his plan to "rebuild the American economy", including "strengthening small businesses". I wonder if that will mean repealing ObamaCare, cutting back on regulation, and lowering tax rates? Probably not. Dollars to doughnuts, it's a new government program to *spend* money. His plan includes "helping Americans get back to work". Ditto. Then there's more infrastructure spending, subsidies for worker retraining, and new tax incentives to spur hiring. But not to worry—all these new government programs will "reduce our deficit" according to this math wizard.

If the U.S. were a family

Those "debt ceiling" discussions were like a husband and wife agreeing their credit card limit should be increased, while arguing over whether she should cut back her shopping or he should work more.

Let's look at that American family. We have difficulty grasping huge numbers, so lob off eight zeroes from the numbers and put government finances in the context of a family.

Family annual income $21,700
Money the family spent $38,200
New debt on the credit card -$16,500
Outstanding balance on the credit card - $142,710

Not good, so the family agrees it needs to cut back on spending:
Total cuts $385

There is clearly a way to go yet. And yet, as we know, the financial situation is actually far worse than even those numbers. The family has promised to send their child to university and mother-in-law will need to go to a nursing home in a year or too. The so-called fiscal gap—the net present value of all future expenses minus all future projected revenue—amounts to a stunning $211 trillion, according to economic Laurence Kotlikoff (as per *Business Week.)*

Academics very common sense

Well, come the hurricane and out are trotted the Keynesians to proclaim it will help the economy. My local Washington radio had a segment, "Why Irene will be good for the economy". The entire economy will benefit, said (I won't say "argued") one economist breathlessly, as there will be "quite a boom" in the construction industry and those dollars will spread.

Following this, there was a delicious satirical report that Keynesian Paul Krugman had said Hurricane Irene was not bad enough to help the economy, would have been better had it been more damaging, but he had to put out an angry denial.

But these tired—are they not yet discredited?—arguments pale in comparison with Nobel Prize winner Krugman's assertion that a rumour of an alien invasion of Earth would be good for the economy. No, I kid you not. When I heard about this, I thought that *this* was the satire. But no, he's serious, but you can laugh out loud at nonsense.

One of the simplest yet key principals of free market economics, that these academics and government planners can't seem to grasp, is this notion of seen and unseen consequences, first expounded by 19th century economist Frederich Bastiat. We have mentioned his superb essay on the "broken window fallacy" before. It is well worth reading. When I first read it, as a child, I had one of those "ah ha" moments. More here. If you have not read Bastiat, you owe it to yourself.

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Vern Jacobs, RIP Well-known tax advisor, specializing in offshore taxes, Vern Jacobs, has passed away, after a short illness. Vern was well known and highly regarded, not only for his in-depth knowledge, but for his ethics. He was hard-working, ever loyal, and willing to give of his time. I had the privilege of working for him, one of my first jobs in this country, as managing editor of his *Tax Angles* newsletter. He was the best editor to work with: willing to listen to suggestions, with no ego or pretense. He will be missed.

Also passed away recently, **John Hospers**, the first Libertarian Presidential nominee back in 1972, was 94. A professor of philosophy at University of Southern California, he spoke at a rally we organized on Abaco, in the Bahamas, for the Abaco Independence Movement, where he was popular for his straightforward explanation of free markets.

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Prolific author Mark Skousen's latest, *The Maxims of Wall Street*, is a compilation of adages and advice from both old timers and today's investors, well known and less so. Nearly 300 pages, it's published in a special limited edition in leather and gold lettering, each copy is numbered and signed by the author. What a great gift! Available only from Eagle Publishing, 800-211-7661, $29.95 including shipping.

Colorado subscribers: don't forget our private seminar, Saturday 17th September, in Denver….And good news on the one-day ASI seminar, in **Dallas October 15th**: popular and highly-regarded analyst Dr. Steve Sjuggerud has been added to the program, a rare opportunity to hear him in person. For details, read here.
