

Notes From the Rabbit Hole ©



Peter Newell's illustration of Alice surrounded by the characters of Wonderland. (1890)

In Lewis Carroll's *Alice's Adventures in Wonderland*, Alice follows a mysterious white rabbit into a rabbit hole to enter 'Wonderland', an absurd and improbable world inhabited by many strange characters.

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Change

The title of this segment is meant as a demand upon the conventional herd more than a descriptor of anything likely to happen as a result of the Obama presidency or Wall Street having learned its lesson in the wake of a systemic financial meltdown. The title of this segment is meant to implore a few more people to consider the degree to which everything has changed, not since the deflation impulse became readily apparent in October 2008, but since secular forces began to cycle in very early in the decade.

A relatively few people will implement real change in their financial viewpoints, but humans being human, the vast majority will cling to conventional constructs as long as they can. Despite the financial horror that is on full display and its implications for the future, there seems to be no sign that people have left behind the etched in stone precepts of [Jeremy Siegel's](#) *Stocks for the Long Run* and those put forth by the investment king of the great bull market of the previous secular cycle, [Peter Lynch](#) (his best known philosophy "Invest in what you know" is an all-time keeper, however).

The herd will likely focus its attention on the current crop of financial perp walkers like [Bernie Madoff](#), just as it did with that other [bad Bernie](#) (Ebberts) a few years ago. Cartoons are much easier to digest, after all, than doing the work of understanding how the system works, where the real faults can be found, and where the sound investment themes can be found.

The herd will not change because the herd does not change. The herd's perceptions may change, but because the herd is the herd, these new perceptions will ultimately be incorrect. The herd is the counterparty to the winning trade. The herd defers to the experts. The herd sleeps soundly in the comfort of its desire to remain disengaged.

Take the 'dollar to zero!' and the 'you must be 100% cash in a deflation!' herds for example. Two powerful armies led onto a battlefield, each expecting to triumph. But neither of them will win the war. Some experts tell us that the dollar is the contrary play because the euro is as bad fundamentally and over valued to boot. Some experts cite the profound and unmanageable issues particular to the US as the reason the dollar will be destroyed as we 'devalue and inflate our way out of our debts'.

The answer is of course that the dollar, the euro and every other currency are likely to survive as long as the... Beuller? As long as the herd buys the idea that a currency's value is anything more than its government says it is. Their exchange rates flash like red and green lights in the FOREX casino and meanwhile, gold just sits there as it always has, holding monetary value against the lot of them.

But surely the letter writer is a cranky crackpot. Well maybe it takes a crackpot to successfully navigate insanely complex and dysfunctional financial markets. Maybe it takes a small army of crackpots to see the value of a monetary metal and deploy their debt-backed paper money accordingly. Maybe it takes a crackpot to do what my friend [Chris](#) has done, and build something from the ground up, helping thousands find answers to some very complex questions. Maybe it takes a crackpot to summon the nerve to run for President armed with nothing other than an honest message.

NFTRH has now had enough track record to prove that the crackpot stance of being long gold miners and putting more money where my mouth was at HUI 150's was correct. The stance of 'if gold declines, it will do so to a lesser degree than positively correlated stuff and it will fuel the miners' bottom lines' has proven out despite the deflation alarm on code red. The NFTRH speculative portfolio is now more than 15% above baseline where not too long ago it was 27% below.

The Obama administration ran and won on a message of change. I suppose in the context of politics, plenty will indeed change. But I believe politics and sociology spring from economics in many ways, and in that regard real change is definitely not on the agenda. In actuality, Mr. Obama, aided by Mr. Summers and the rest of the Clinton holdovers, are bringing opportunity. But it will take investors who are willing and able to get outside the box to take advantage of it, because the dynamics at play in the ongoing boom/bust drama are not going to change. They are going to intensify, and convention is going to be punished more intensely than it has in the past.

Okay, sermon over. Let's get to the good stuff...

Precious Metals Sector

I thought I would start off with the daily chart of gold as it has made some nice progress in the face of a rising USD right to the target that a subscriber had predicted. I believe this was included in one of the Update emails that went around on Tuesday with several subscribers' thoughts. Nice call Jon!

For those who care about gold's nominal price, the chart is self-explanatory. There is certainly room to run higher and if the dollar indeed proves to have another leg down in its immediate future, gold could threaten the all time highs. But again, I would expect it to under perform many other things, including silver and oil, if hope springs in the face of a would-be devaluing Uncle Buck. This would be very temporary.



Meanwhile, over in gold miner land we have Goldcorp not even in the same zip code as over bought. Many people saw yesterday's 9% HUI rally as a chance to take profits, and that is never a bad thing. A subscriber asked if I had done any profit taking and the answer is no, not yesterday. I did that before the expected correction to 250 and the SMA 50 and so I have a cushion here, being fundamentally engaged and all.

The caveat is that if the USD does what I do not expect and breaks to new highs, while the broad markets tank, the stance will probably be proven wrong because it is likely that the commodity bull trade, led by the gold miners on Friday, rose with the dollar only because of an anticipation of the topping of same.



Following is the chart of a smaller miner that has been in the portfolio since the dark days of October. Everybody knows Northgate's issues: Kemess South gold-copper deposit running out of life, a bad investment in financial securities for which there is no market and some high cost Australian gold mines that have resisted turnaround. That is now

changing with some improvement in performance in the Australian Stawell and Fosterville underground mines, each forecast to produce 100, 000+ oz. per year. The securities 'investments' were never a back breaker and have long since been factored as has been the Kemess South mine life. Also, the company's Young-Davidson gold property in Ontario continues to move through the preliminary economic assessment phase. So, all is looking fine with NXG fundamentally. But I am a technical guy so here is the chart.

Being a staunch bottom feeder, I cannot recommend this stock in over bought conditions such as now. If I did not hold it, I would however be looking for a pullback to one of the green support lines. If I just had to have it, I would try to buy a test of the breakout just above 1.00. If I were to exercise patience and a true bottom feeder attitude however, I would try to buy just under 1.00. Upside targets are noted and they are just targets. Everybody's goal in a trade or investment is different. These are simply prices at which NXG should encounter some resistance.



Finally, let's take a look at silver. I realize that NFTRH has given silver a short leash compared to gold and that is because they are two different animals, with gold by far being the better asset in my opinion, for troubled times.

If policy makers are successful in their efforts to stop the bleeding and get a little optimism stirred up, the silver-gold ratio will lead the charge (and it still looks like it is in a bottoming to bullish stance). Nominal silver, below, has broken some lateral resistance, which, if held, targets the SMA 200 area in the 13's up to perhaps 14. I would not be surprised to see an eventual blast upward to a 70+ strenuously over bought RSI to form a nice symmetry with the September declines. Factoring strongly here is the silver bulls' renowned ability to get the juices flowing.

In the bigger picture however I am not at all sure silver does not have new lows in its future when hope runs out.



Commodities

(Energy)

The chart of WTI crude oil still sports what looks like a very nice bottoming pattern. Like silver, this would be for a trade only for anyone but long term value investors. That is because hope if and when it returns, is likely to only stay for a limited engagement. The inverted head & shoulders remains in the 'potential' category until the neck line is surmounted. Then the mid 60's come into view for the target.



Natural gas remains in a terrible downtrend and for the sake of my UNG position, it should attempt to find support as noted below. Both oil and gas have dropped to levels where, in the big picture, one can start at least thinking about applying the word value again, after a very long layoff.



(Base Metals)

The dynamics that apply to the energies and silver, also apply to the strictly industrial metals. In other words, a trade only. Traders who are not prepared to be nimble or those who tend to fall in love with investment themes might think long and hard before entering positions. Copper was a bubble because China was a bubble. Ditto nickel. Speaking of nickel, I want to show a chart of IRC (ROY), our main base metal play. This is a royalty company that does no actual mining of its own. See the company's pdf presentation **Designed For the Times, Q1 2009** located here: <http://tinyurl.com/d887so> if you have any interest. ROY, while a solid company with a solid business model (and future growing gold royalties) is at this time an over sold part of the hope trade and nothing more. The base metals have been destroyed but will bounce if everything else does in the face of a declining USD.

This is another fairly self-explanatory chart. A bottoming process is still in force with parameters and targets.



(Uranium)

Many of the stocks in the sector, including our FRG, maintain viable bottoming patterns. If the bull trade is a go, the U's should burst higher. Many of these stocks are currently in bullish flag or consolidation patterns from the initial burst off the bottom. The added bonuses for FRG is its gold concentration and cash position.

Stock Market

With the performance of this mess post-panic, it is fitting to put it last among the asset classes. We have reviewed the parameters and the SPX remains very capable of testing or falling through the November lows. Global markets are a mixed bag, with some European markets at or below the lows and some, like the Hong Kong market looking relatively constructive. But relative to what? Relative to utter basket cases is what.



Wrap Up

We are in the age of 'aggregator' banks and infinite money creation. Well, it is finite because it will end when the people demand sound policy. Wait, check that. Different movie. LIBOR, TED, M2, MZM... do you remember when I used to seriously have to evaluate these things during the deflationary panic? Policy on steroids remains the play.

In my view, the pecking order is precious metals, commodities and then, select stocks and sectors for a trade only. Even the gold stocks will hit turbulence at whatever time panic 2 and the next leg down in human spirits arrives. The following chart is one vehicle I plan to use as any would-be stock rally matures, maybe in conjunction with a drop to the noted support. Thanks to new subscriber Larry for this heads up that made a nice profit last week. This thing moves like a wild man however. It's not for the queasy.



Portfolio Notes *(Portfolio notes edited for NFTRH sample editions)*

The capital preservation portfolio had a bit of profit taking and capital redistribution (increased XXX and XXX positions) and currently resides at 73% cash and safest equivalents. Gold stocks XX, XXX and XXX (sold out and re-bought on pull back) remain onboard, while XXX and XXX presented profits that were realized. XXX and uranium, gold, copper exploration guy XXX are still held along with a few precious metals exploration stocks headed up by XXX. Finally, there are the XXX April '09 \$10 calls and the sensible XXXXX.

Over in speculation, everything mentioned above (including XXX and XXX along with XXX) is held except for the XXX calls and XXXXX. XXX was added back as a base metal (copper w/ gold exploration) play to go with XXX. Gold explorer XXX was bought back on downside (albeit limited) to head up the little guys along with XXX. Canadian Royalty Trust XXX (thank you Ron) was added to the existing XXX for would-be upside and monthly dividend. Current cash level is 18%.

Final Note

Things are going our way lately, especially with the precious metals. If we learned nothing else in 2008, it was to remain vigilant. So, that is the final note today; remain on guard. Don't get too high or too low and maybe just maybe we can enjoy the financial markets for a while, whether they are bullish or bearish.

Have a great remainder of your weekend!

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