Basic Points

FASTER, HIGHER, STRONGER

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Don Coxe

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OVERVIEW

The Olympic motto captures the aspirations and drive of poor nations which reform, achieve faster economic growth than the established nations, and rise to global competitiveness.

Economic historians consider the last millennium as being primarily about the Renaissance in European civilization, the discovery of the Americas, and later, of the inventions and investments that together powered the Industrial and Technology Revolutions in Europe and North America. China and India did not adopt the new technologies and lost their standing as global economic leaders to the West.

When future historians write of this century, they will focus on the re-emergence of China and India, as large-scale technology-adopting economies which, in just five or six decades regained the pre-eminent shares of global GDP they had enjoyed for seventeen centuries prior to the Industrial Revolution.

Since 1998, we have advised clients, *"Do not invest in companies that produce what China produces, or will soon be producing. Invest in companies which produce what China needs to buy."*

This month we update that thesis—we review the Super-Cycle, and assess the problems of the Eurozone. Because most commodities are no longer priced primarily by Europe and North America, they are less risky than conventional Wall Street economists understand.

Economies with costly social benefits systems and deteriorating demography age in vitality along with their populations. It is unreasonable to expect that overindebted Europe or the US will again have economic recoveries of Reaganesque or Thatcherite vigor.

Investors need to invest where the demand is—and will be for coming decades. That means economies whose consumption of commodities per unit of GDP is still far higher than ours.

We are modifying our Recommended Asset Mix to reflect the recommendations we made in our Conference Call of June 22nd and our more cautious views now.

Nasdaq's Triple Waterfall Crash began within three months of the Millennium. It was the sign that the Old Order had shot its bolt.

In the West, most economies and benefit systems, were in the middle stages of longer-term decay from aging populations with rising needs for health care and retirement incomes while plunging birth rates ensured that each new generation was smaller than its predecessors.

It was the sign that the Old Order had shot its bolt.

In the emerging economies, the rewards from stronger economic growth flow to those who are working hard and assuming rising levels of economic risk, rather than being drained off by politicians to pay for over-generous and under-funded government employee benefits, plus underfunded government-financed health care programs, and in payments and benefits for the poor.

The Commodity Boom—The First Super-Cycle of this Millennium—was born almost immediately after the Commodity Triple Waterfall Crash ended—shortly after 9/11. Commodities went from bust to boom without the usual lengthy basing period because raw materials pricing mechanisms began an historic shift away from the Industrial World.

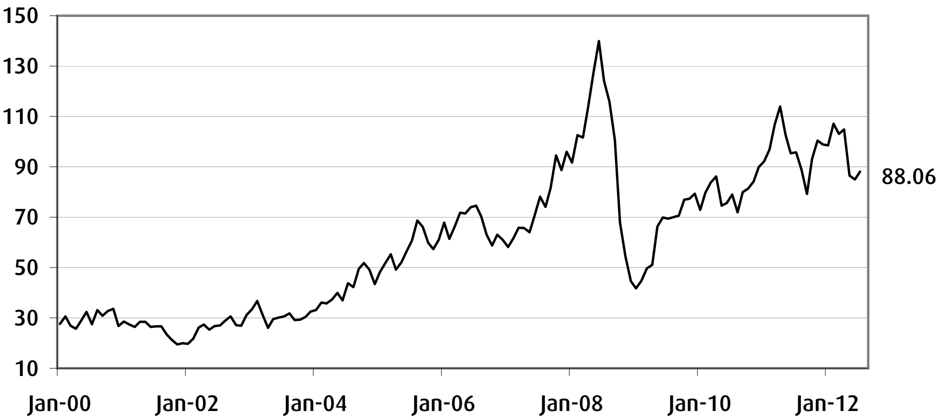
CRB Futures

January 1, 2000 to July 31, 2012

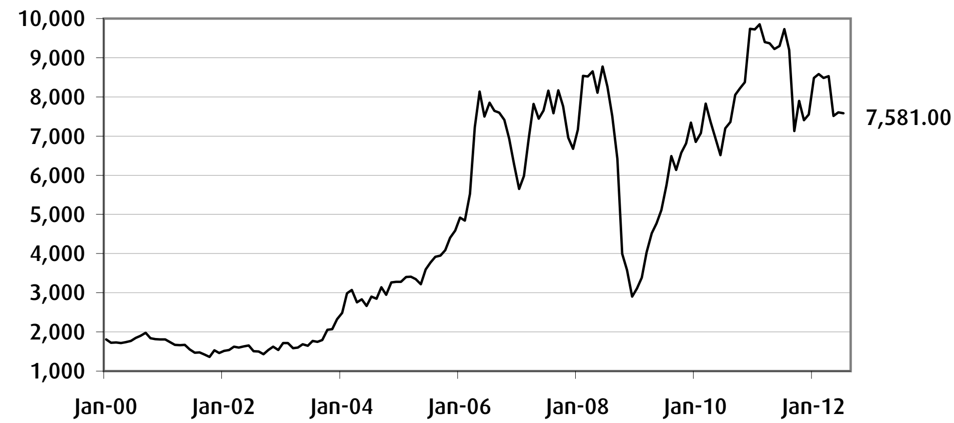
Crude Oil (Brent)

January 1, 2000 to July 31, 2012

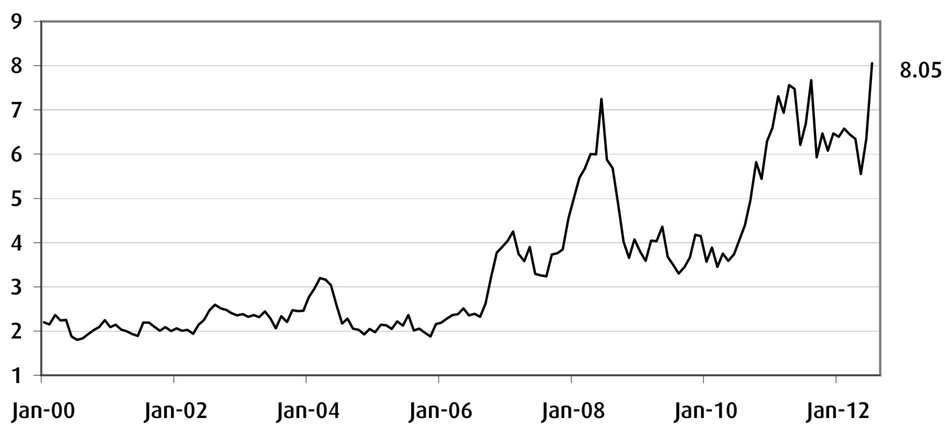
Crude Oil (West Texas)
January 1, 2000 to July 31, 2012



Copper
January 1, 2000 to July 31, 2012



Corn
January 1, 2000 to July 31, 2012



Gold

January 1, 2000 to July 31, 2012

"The takeoff into sustained growth".

At the onset of the millennium:

1. Two decades of remarkable Chinese economic progress under the leadership of Deng Xiaoping had transformed the primitive economy of Mao Zedong and moved it to that sweet spot that economist Walt Rostow, the noted macro-economist, called "The takeoff into sustained growth".

2. India was also—finally—stirring from its fifty years of socialist somnolence. Economic growth activity was finally exceeding "The Hindu Rate of Growth." which barely kept up with population growth. In 1991, the Indian government, which included Manmohan Singh as Finance Minister, began to alter its domestic and foreign policies to reflect the new global strategic realities—with momentous consequences. Under Singh's leadership, India turned from modeling its economy on Marxist theories to capitalist theories.

3. Brazil greeted the millennium with a new mixture of economic vibrancy and political wisdom, determined to end its history since independence as the nation destined forever to be the next global success story. It began its own capitalist-oriented transformation in 1995, with the election of Fernando Henrique Cardoso, a student of the eloquent writings of Mario Vargas Llosa, a classic liberal, and of the policies that had led to the remarkable transformation of Chile. He was succeeded by a prominent leftist, Luiz Inacio Lula da Silva (Lula), who surprised most observers by adopting most of Cardoso's reform agenda.

...this is a competitive success story that sets all-time records according to the three Olympic criteria— *Faster, Higher, Stronger.*

4. The costs of new technology hardware and of transmitting data kept plunging, making it easier for poor nations to move ahead more rapidly than had ever been possible throughout history.
5. The move from subsistence living was accompanied by a rise in per-capita protein consumption. According to published estimates, more than 400 million people have joined the ranks of middle-class persons with high levels of protein in their diets. Anyone watching the Chinese Olympic performers can see the effect of those diets. From the standpoint of human health and well-being, this is a competitive success story that sets all-time records according to the three Olympic criteria—*Faster, Higher, Stronger.* No 20th Century economy grew as fast as China did after 1980. None achieved such high preset goals with consistency. And no underdeveloped economy has ever become so strong in comparison with advanced economies.
6. The millennium marked the advent of the euro, the first postmodern currency. It had no specific backing from any government, taxation system, army, or navy—a meta-currency that was the brainchild of a French socialist. The euro stimulated—for a few years—economic expansion in aging Continental economies with deeply developed protection provisions for a wide range of employment categories from hair dressers to lawyers. It would seem to work well until, in 2008, it rather suddenly stopped working and became a millstone 'round the neck of the global economy.
7. The mining and petroleum industries had gone into survival mode in the 1990s, slashing capital expenditures—particularly for exploration. They were still hunkered down and pessimistic as the millennium dawned. Few non-Chinese investors and even fewer oil and mining company CEOs had any real perception of the transformative impact on the world—and most particularly on commodity prices—of 10% compounded economic growth in the most populous nation on earth.

And then the world turned on the Hinge of History: Nasdaq crashed, 9/11 shocked the west out of its complacency, and the economic revolution that is China emerged…

The First Phase of the Commodity Super-Cycle

The Street was caught off guard when the commodity bust turned into a boom. There were few expert commodity analysts left on either the Sell Side or the Buy Side, and most of them were battle-hardened skeptics. Those who had kept their jobs through the 21-year Triple Waterfall Crash had survived by selling into almost every rally.

It was, the Best and Brightest believed, their *right* to have cheap food, cheap fuel and cheap metals...

As the boom accelerated, prominent economists and strategists challenged both its reality and its durability, noting that the 1970s commodity boom was based on runaway inflation—and *that* obviously wasn't coming back. Indeed, inflation rates were still in long-term decline, and a multi-decade bond rally was continuing—a condition historically fatal for commodities. Birth rates had been collapsing across the industrial world since the stagflationary 1970s, and populations were aging rapidly. Those were powerful, self-sustaining deflationary pressures—so any commodity rallies must necessarily be sucker bait: poor, nasty and short.

In part, the skepticism was demographically-driven: the Street was populated largely with Boomers for whom tech stocks were cool, whereas commodity stocks were their fathers' and grandfathers' speculations. The future of energy was to be Green, which meant the oil industry had no prospect of returning to its former profitability or respectability.

Result: the best and the brightest young graduates of elite colleges sought jobs with Wall Street banks, or tech companies, or with the fast-growing tax-exempt foundations dedicated to reining in resource industries through lobbying, legislation and litigation.

There was another—pervasive—reason. Since the Reagan boom began, and continued, with minor pauses, through the first Bush and the two Clinton administrations, investors and economists gradually became convinced that volatility in inflation, interest rates and GDP would continue to narrow. This was the New Normal. Central bankers had learned to control inflation, and most governments' finances seemed to be improving, as were most corporate and consumer balance sheets. Commodity prices would, apart from brief boomlets, stay cheap, thereby subsidizing governments and consumers with low-cost raw materials discovered and developed decades ago.

As Voltaire wrote three centuries earlier in *Candide*, "This is the best of all possible worlds." It was, the Best and Brightest believed, their *right* to have cheap food, cheap fuel and cheap metals, just as it was their right to ever-more-powerful and portable technology for work and play.

Then came the tech crash and 9/11, and naive optimism melted as rapidly, and durably, as retirement income account balances, whether for individuals or pension funds. For aging Boomers, Nasdaq's implosion was a disaster for their retirement plans. How could they recoup?

Hope suddenly appeared: two big booms at once!

Hope suddenly appeared: two big booms at once!

First came a real estate boom in North America and Mediterranean Europe. The American boom was in the vanguard, based on new mathematically-designed collections of mortgage instruments bundled together to meet institutional investors' requirements. The genius of these designs was their ability to bundle together high-quality, low-quality, and otherwise unacceptable mortgages into one complex product that a well paid rating agency would give a Triple A rating.

So, it seemed, all you needed to do is buy more house—or more houses—than you needed and you'd have enough for your old age.

That boom based on complexity was accompanied, paradoxically, by a new boom in the oldest and most basic products.

By 2008, China was accounting for roughly 40% of the world's base metal consumption, and half of its iron ore. By 2010, it had become the world's second largest consumer of oil. Its stupendous impact on metal demand was—in significant part—because, for the first time since the Industrial Revolution began in Britain, a major, fast-growing economy had almost no scrap on hand from the remains of previous industrial cycles. By 2005, some observers, (including us), maintained that, when the history of the 20th Century was written by unbiased historians, Deng Xiaoping would rank as the greatest of national leaders for kickstarting and modernizing a stagnant economy, primarily by liberating the entrepreneurial spirit of its best business people.

This boom did not appeal to the majority of aging Boomers, because it reeked of the Stagflation era when everything went wrong, and it meant investing in polluting sunset industries. Better to buy real estate with a good view of sunsets.

However, a new class of institutional investors and speculators, mostly Gen X-ers, began buying commodities and commodity stocks. They had seen oil prices double and they were studying the treatises on Peak Oil, which argued that oil could eventually go to $100 a barrel and that meant the Alberta oil sands were the most valuable energy resource this side of Saudi Arabia. They had watched gold prices climb from $250 to $600 and they had no trouble accepting the idea that it could go to $1,000. (It eventually did—just before the Crash.)

Two major economic setbacks caused by supersafe investments.

Just when some of the newly-rich hedge fund managers specializing in commodities and oil, mining and metal stocks were wondering what the next play on the China story could be, the prices of corn, soybeans and wheat entered a major new long-term bull market. Companies that collectively could do the most to solve the world's food shortage—the suppliers of inputs to grain producers—became the next investment growth story.

Well, corn and wheat prices did triple, and shares of such industry leaders as Potash, CF, Monsanto, Agrium and Deere did climb 200% or even 600%.

And then Wall Street became impaled on its own creations, and the worst recession since the Depression hit the developed world.

As banks, Fannie and Freddie and AIG were bailed out, prices of all risk assets—including commodities—plunged. Lehman went bankrupt with control over $65 billion of hedge fund assets, heavily exposed to commodities and commodity stocks. Amid panicky liquidation, crude oil plunged from $140 a barrel to $39, copper from $4.20 to $1.40, corn from 7.66 to $3.23, and wheat from $12.70 to $5.25.

Even the prized new-old store of value was dumped, as gold fell from $995 to $735.

"The Great Commodity Bull Market" was also seemingly over—as had been predicted with growing fervor and frequency for three years by experts who had not predicted the Tech stock crash, or the bank stock crash. The Wall Street darling, Citigroup, born from the corpse of Glass-Steagall, fell from $550 a share (adjusted for the reverse stock split) to $14, at which point it was bailed out.

After trillions in bank bailouts and gigantic payments to the unemployed, North America and Europe crawled out of the abyss. Within two years, a new financial crisis involving Triple A investment products would put the Eurozone economy at risk. This time the bad paper was government bonds.

Two major economic setbacks caused by supersafe investments. Meanwhile, commodities, a supposedly risky asset class, were once again strong performers.

The Case for Commodity Investing

Some voices on the Street tried to lump Commodities with Subprimes— the fraudulent with the factual.

Despite record-low mortgage rates, US house prices have recovered only modestly (except, of course, in recession-proof Washington DC where prices kept climbing). House prices are still declining across most of the eurozone—but ***commodities have revived***, because they are real—and really useful to the dynamic emerging economies.

Proof that commodity pricing power had shifted from the Industrial World to China and the other emerging powers came in 2008-09, when the financial systems of the Industrial nations collapsed, unleashing the worst recession since the Depression.

Some voices on the Street tried to lump Commodities with Subprimes—the fraudulent with the factual. They crashed together, we were told, because they were both bubbles.

1. What Bubble?

China and the other leading Third World economies never fell into recessions. The S&P is more than 100 points lower than it was at the Millennium, whereas numerous Emerging Markets indices, including China and India, are much higher. Commodity-stock-heavy Toronto is 13.8% higher (and the Canadian dollar has appreciated 46%).

The prices of grains, energy and metals plummeted along with stocks in 2008. But this was not a crash driven by massive speculative buildup of raw material supplies, and was a mere pause in the new Commodity Super-Cycle. Most key commodity prices are significantly higher than four years ago and hugely higher than their millennium price levels. The commodity content per unit of GDP in the emerging powerhouses remains high, and remains the primary source of inflation pressures in those economies.

The great commodity stocks emerged from their brief plunge without needing taxpayer support. For example, shares of the world's biggest miner, BHP Billiton, sell for more than nine times their 2002 price, and more than twice their post-Lehman low. Shares of Exxon Mobil, the world's biggest oil company, trade at nearly three times their price of a decade earlier and 44% above their Lehman low. Gold prices are roughly 2.2 times Lehman lows, and the stocks have, in general, risen accordingly.

As for commodities, corn and soybeans are at all-time highs; copper is where it was in June 2008, before Lehman's implosion; silver, feeder cattle, live cattle and lean hogs are far above pre-Crash levels; and Wheat is at September 2008 levels, double its 2010 low.

As great as were the excesses of that era [the 1970s], it was, compared with our time, an Age of Innocence.

The outlier is hydrocarbons. Natgas may not see its Katrina peak of $15.00 for decades, but that is because of the discovery of what may be two centuries' supplies of shale gas in North America.

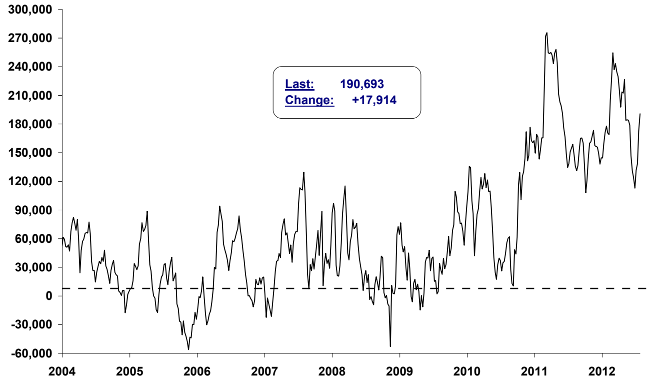
Crude oils—Brent and West Texas—are far below their 2008 peaks. What makes their performance different? Answer: the huge build-up of oil in the commodity funds—particularly the Goldman-Sachs Commodity funds—during the last decade at a time when oil futures were routinely in contangos—where all futures prices are higher than spot prices. As we have written before, those funds were licenses for Goldman to print money at the expense of its hapless clients, because the nature of contangos is that each month the owners roll over their expiring contracts into fewer barrels of higher-priced oil. The Goldman Index had worked beautifully during the long bear market for oil when the index was in backwardation. (To the credit of one branch of Goldman, the head of its private client group did publish a full analysis of the flaw in that fund, explaining why she didn't include it in managed funds for her clients.)

The collapse driven by massive overinvestment in a fatally flawed fund for institutional investors who can't tell a contango from backwardation is actually being cited in some quarters as evidence that the commodity boom ended in 2008. Tell that to jewelers paying $1600 for gold, to Kellogg's paying $8 for corn, or to pipe manufacturers paying $3.40 for copper, or to the millions of gripers about gasoline prices.

Bubbles are inflated by speculators. How much of this "commodity bubble" comes from those levered speculators who trade commodity futures?

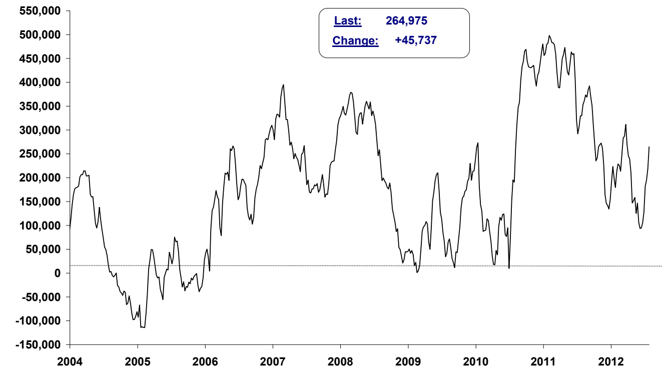
Speculators were major contributors to the 1970s commodities bubble, when margin was more freely available than today. As great as were the excesses of that era, it was, compared with our time, an Age of Innocence. Commodity trading firms were not going bust from buying Greek bonds with clients' funds, or from lying about their financial strength. Eurodollar rates were set mostly by the heavy, open-market trading of Eurodollar futures in London and Chicago. Wall Street firms weren't being bailed out by taxpayers and then paying huge bonuses to their bosses. Politicians weren't pressuring banks to make mortgage loans to poor people with dubious credit ratings. Prospectuses on financial products were tiny by modern standards, but they were intelligible.

Oil – Commitment of Traders: Net Spec Position
(# of contracts)
January 1, 2004 to July 28, 2012



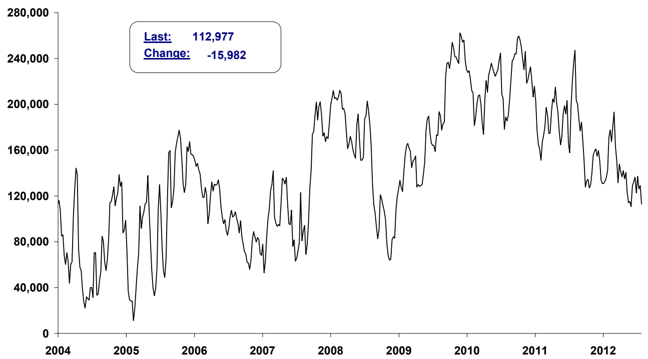
Source: Meridian Macro Research LLC

Corn – Commitment of Traders: Net Spec Position
(# of contracts)
January 1, 2004 to July 28, 2012



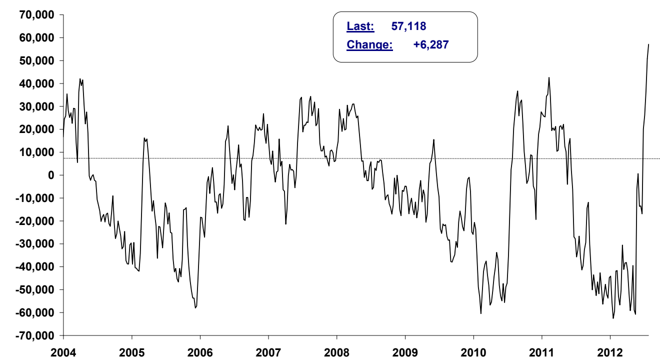
Source: Meridian Macro Research LLC

Gold – Commitment of Traders: Net Spec Position
(# of contracts)
January 1, 2004 to July 28, 2012



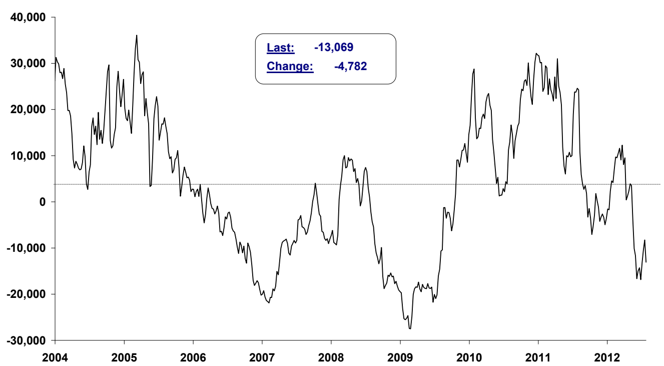
Source: Meridian Macro Research LLC

Wheat – Commitment of Traders: Net Spec Position
(# of contracts)
January 1, 2004 to July 28, 2012



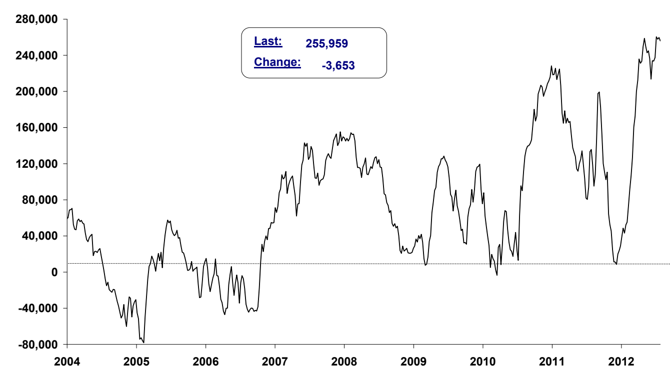
Source: Meridian Macro Research LLC

Copper – Commitment of Traders: Net Spec Position
(# of contracts)
January 1, 2004 to July 28, 2012



Source: Meridian Macro Research LLC

Soybeans – Commitment of Traders: Net Spec Position
(# of contracts)
January 1, 2004 to July 28, 2012



Source: Meridian Macro Research LLC

If today's speculators are responsible for overpricing commodities, thereby inflating a dangerous new bubble, then their total exposures would be gigantic in relation to total open interests on the commodity exchanges.

Hardly.

The US economy is also not growing at a pace that would explain $89 oil or $3.40 copper.

When commodities crashed during previous centuries, prices stayed under pressure until well into the next recovery, because of new production brought on in response to previous boom prices.

Overall Eurozone GDP levels haven't recovered to peak 2008 levels, and, apart from Germany, industrial production is not at levels that would put upward pressure on metal or energy prices. The US economy is also not growing at a pace that would explain $89 oil or $3.40 copper.

This time, the buyers who are the important price-setters did not plunge into recession and their economies continue to grow far faster than those of the Old World.

2. *How Can Commodity Stocks Be Considered Long-Term Investments?*

This is the strongest challenge to our views—because it is based not on fads, fashions or prejudices, but on history. Very long-term commodity price charts show that basic materials haven't been hedges against long-term inflation. For two centuries, commodities as a class have been a cyclical trade, not a long-term investment. As an inflation hedge, then, it makes more sense to buy TIPs.

They should update their charts to show the recent effect of commodity purchases by nations with billions of inhabitants who weren't significant commodity buyers for two centuries.

Had these new commodity buyers experienced the Industrial Revolution at the same time as Europe and North America, China and India would today be the world's dominant economic powers—and the world's remaining supply of oil and base metals would be at crisis levels.

When a nation's wealth grows fast enough to afford to take vast numbers of children out of the workforce to develop their athletic skills, feed them well and give them excellent coaching, then the global athletic power balance is transformed. China won few Olympic medals until its economy was reformed. Now it vies with the USA for medals—and ranks first in consumption of metals.

A notably tough junkyard dog will be worth its weight in gold—at, say, $10,000 an ounce.

The commodity story is essentially a scarcity story. From our perspective, as global living standards improve, the problem will be finding and producing enough raw materials to sustain economic progress. We believe that with two more decades of progress for those billions of people escaping poverty, the kind of police protection that will be needed to protect buildings with copper pipes, or churches with copper roofs will be a daunting cost for municipalities. A notably tough junkyard dog will be worth its weight in gold—at, say, $10,000 an ounce.

3. As Deep Cyclicals, Shouldn't Commodity Stocks Trade at Low Single-Digit Multiples?

This argument is often made when the question of allocating commodity stocks into diversified investment portfolios arises. What are they?

Is an iron ore company with 50 years of reserves entitled to a bigger multiple than its steel-producing customers?

If an oil sands producer has 75 years of reserves, and the typical integrated oil company has roughly one-fifth that duration, how should those distant reserves be calculated?

Gold was priced below $1,000 an ounce as recently as three years ago. Analysts are agreed that nearly all the gold companies now need at least $1250 an ounce to make any money on current production *when the costs of new capex are factored in.* So is it reasonable to value a gold producer's reserves at, say, $1500 an ounce today? A rather minor correction in the gold price could wipe out the company's profits, right?

Our answer to all of the above is that high-quality reserves in the ground in politically-secure regions of the world are becoming more—not less—valuable.

Since the commodity boom began, various skeptics about the sustainability of high oil prices reminded us over and over: "The cure for high commodity prices is high commodity prices." $100 oil will ensure that massive new production will come on stream to drive down prices, or substitutes will be found.

Historically, one of the factors in valuation of mining and oil companies was that there were always potential new deposits that the companies could bring on stream when the next boom arrived.

Given the power of the state-owned Mideast oil companies, and the emerging power of China, the supply of attractive mineral prospects in politically-safe areas that the private sector can acquire is shrinking.

Companies with topnotch managements and splendid reserves have dual scarcity values: there are relatively few such companies and relatively few politically-secure, long-duration, high-quality reserves.

That is why those mining and oil companies that have long-duration proven and probable reserves PLUS a portfolio of attractive prospects deserve a premium in the market.

BHP Billiton and Rio Tinto may have sparked this outburst of Leninizing of the mining industry by their ill-considered agreement...

The reason why some of the majors are willing to consider properties in really risky areas—such as the Democratic Republic of the Congo—is that they cannot find new orebodies or oil deposits in traditional venues. The "peak oil" story is valid as the challenge of reserve replacement for capitalist companies today, because most of the known reserves are now owned by state-controlled companies. That was true a decade ago and will be even more valid in the future now that China is following the Leninist strategy of seeking mineral reserves almost everywhere. Its companies are unconstrained by SEC rules on deals with dictators and dubious middlemen.

The mining industry has that problem—in spades. As we have written[1], they are now faced with Chinese competition for mineral rights almost everywhere they look.

(The gold miners have challenges finding new orebodies in politically-secure regions, but they do not—at least for now—have to fear large-scale competition from China. That nation is the world's largest gold producer, and gold, unlike iron ore or copper is not a necessary input for major Chinese industries.)

BHP Billiton and Rio Tinto may have sparked this outburst of Leninizing of the mining industry by their ill-considered agreement to pool development of their major Pilbara iron ore reserves. This is precisely what Lenin wrote about: "Capitalists everywhere form cartels." Since those two companies and Vale dominate the seaborne iron ore market, China was faced with a situation where its steel mills would—seemingly forever—be forced to bargain with cartels having the reserves China would need.

[1] *Basic Points, All Clear?* March 2012

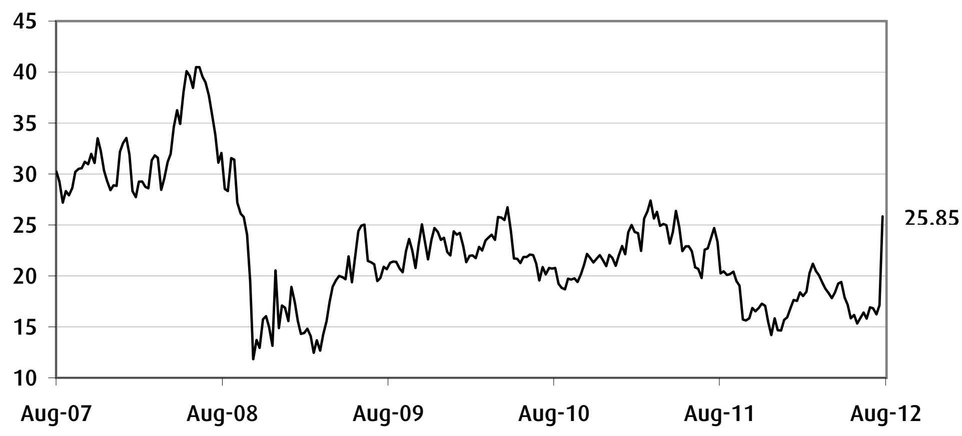
China was able to block that proposed deal. But it alerted Beijing to the longer-term vulnerability of its manufacturers. Taking advantage of the impact on mining and oil companies of the financial crisis, Chinese organizations have moved aggressively across the world, and will be bringing on significant production of iron ore, copper, oil and gas in coming decades.

Chinese organizations have moved aggressively across the world...

Already, China's aggressive new interest in the oil deposits under what is called the South China Sea has forced global attention on previously obscure reefs, islets and islands called the Spratlys. Geologists estimate there are tens of billion of barrels of oil in those waters, which are also claimed by the Philippines, Vietnam, Malaysia and Brunei. The US has been drawn into this potentially explosive situation, and has warned China about its "provocations."

Last week alone there two new Sinocommodity stories; (1) Sinopec, the Chinese government-owned oil company spent $1.5 billion to buy a 49% stake in Talisman's UK North Sea properties; (2) CNOOC, another Chinese government-controlled company, agreed to buy the Canadian international oil developer Nexen at $27.50 per share (up 60%) — a $19.5 billion transaction.

Nexen (NXY)
August 1, 2007 to July 31, 2012



If the commodity markets are truly a burst bubble à la Nasdaq, then why hasn't somebody, sometime, bid for, say, Cisco at $65—its price six months before its peak at $80? Twelve years later it trades for $15. Intel is at $24, twelve years after it sold for $70; the list goes on and on. Nexen is going for its price of four years ago as the commodity boom was collapsing because of the collapse of the global banks and the collapse of housing prices in the US and Europe—not because oil was to be replaced by windmills and solar panels, as the winning Presidential candidate that year was predicting.

...no sudden discovery that taking a seemingly safe pill may lead to hideous side effects that will enrich a herd of rapacious tort lawyers.

These commodity blue and red chip companies have minimal endogenous financial risk because their balance sheets and income statements are clear and conservative, which means they are far higher quality investments than all but a handful of big American and European banks. Commodity companies' risk is negative commodity price movements—pure market risk.)

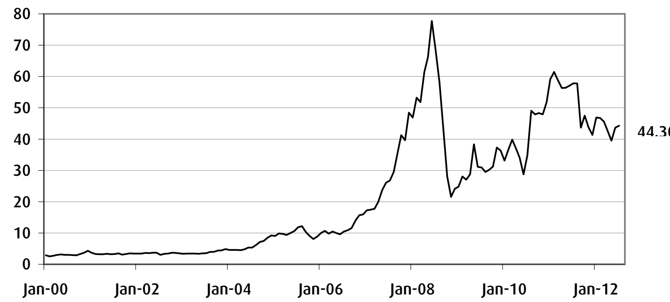
We think quality commodity stocks should be valued similarly to quality pharmaceutical stocks: their proven and probable reserves are the equivalent of drug companies' patents, plus the present risk-adjusted value of their new formulas undergoing the various levels of testing. If so, then high-quality mining and oil companies are *better* long-term investments than pharmaceutical companies, and will continue to give much better returns than drug stocks. Their reserve life indices are vastly longer than the drug companies' patent rights, and they tend to have minimal litigation risks: there will be no sudden discovery that taking a seemingly safe pill may lead to hideous side effects that will enrich a herd of rapacious tort lawyers. Their pricing is not subject to controls by government health care monopolies. And their products serve us at minimal risk.

There is no reason that these advantages for commodity stocks will not continue for decades to come.

Here are six charts to illustrate our case. The six companies would all have been considered as being quality investments in their industries at the time of 9/11.

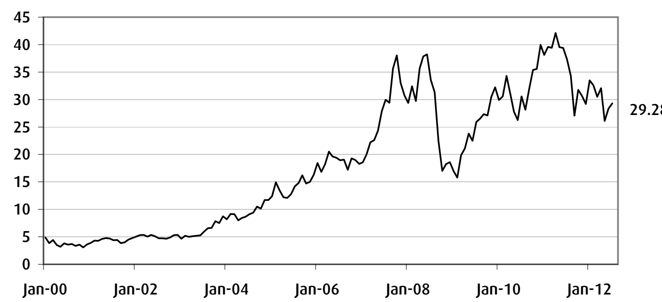
Pfizer (PFE)
January 1, 2000 to July 31, 2012

Potash Corp. (POT)
January 1, 2000 to July 31, 2012



Eli Lilly (LLY)
January 1, 2000 to July 31, 2012

BHP Billiton (BHP)
January 1, 2000 to July 31, 2012



Merck (MRK)
January 1, 2000 to July 31, 2012

Canadian Natural Resource (CNQ)
January 1, 2000 to July 31, 2012

What About Those Sophisticated Arguments Against Oil Derived From History?

The Canadian oil sands companies offer more barrels of oil per share in a politically-secure nation than almost *any* other oil companies. At the moment, because of political risk arising from *American* political bias in the foundations and the White House, those reserves are devalued in the stock market. Should the White House switch tenants to an avowed believer in private enterprise and free trade with Canada, there would be a huge rally in those stocks, and America would once again be treating Canada as a friendly nation, and NATO and NAFTA partner.

When Mr. Obama was running for President, he drew cheers from a crowd when he promised that, in his first day in office he would call "Canada's President" to tell him NAFTA had to be changed to protect American interests.

If Mr. Obama is re-elected, and if, as seems likely, he continues his Keystone boycott, then the oil sands companies will, for at least four years, have to find some much-costlier way to unlock their treasures—which may be even greater than Saudi Arabia's. Already, one tiny company has arranged to ship its output by train to the Gulf Coast—if the tax-exempt environmentalists' lawyers don't gain an injunction to block the import of the oil. When Mr. Obama was running for President, he drew cheers from a crowd when he promised that, in his first day in office he would call "Canada's President" to tell him NAFTA had to be changed to protect American interests.

It is not known how Prime Minister Stephen Harper reacted to this display of ignorance about Canada's Parliamentary government or the threat that little Canada should submit to the new big, tough Yankee boss who wanted to tear up a treaty that had been defining North American relations for 16 years. But we do know how he has reacted to Obama's Keystone boycott: he has vowed to open up Canada's oil to China. He will, we assume, approve the Nexen purchase and will doubtless dedicate his best efforts to more deals and a far closer relationship with China should the American NGOs and the White House continue their embargo—(a prediction made recently by publications such as *Forbes* and *The Wall Street Journal*.)

The Canadian oil sands and discoveries of billions of barrels of oil offshore wouldn't destroy oil prices, but would protect energy security at a price that would encourage energy conservation—a win-win situation.

"Renewable energy will end the age of fossil fuels within a few decades," proclaimed the Green Left, which by 2008 was no longer led by Al Gore, but by Barack Obama. We responded to those claims by noting that the major source of renewable energy has been power dams, and they were now proscribed by the high priests of the secular religious community of Green[Belly]Achers.

The over-arching enthusiasm uniting the Conspicuously Concerned Boomers and Millennials is to block Super-Major new oil projects by any legal or political means whatever.

Confirming our view that Obama's millions of Green jobs were a fantasy was evidence that even the tax-exempt foundations that funded the assaults on fossil fuels could be unreliable allies. A solar project for a southwest desert—one of the most climatologically reasonable solar projects ever proposed—has been tied up in environmental litigation over an endangered species of tortoise. And then there is the continuing saga of the windmills of Nantucket. Their first obstacle was objections by rich, politically-powerful liberals, that it would destroy their ocean views. Amid the embarrassment a new obstacle was found: the registration of the block in the North Atlantic proposed for the wind farm as a national heritage site because, according to affidavits in the litigation, it had long been a sacred burial ground for a native tribe.

The over-arching enthusiasm uniting the Conspicuously Concerned Boomers and Millennials is to block Super-Major new oil projects by any legal or political means whatever. The real motivation is not—as alleged in lawsuits or pipeline boycotts—local environmental impact, but the effects large-scale hydrocarbon development—such as the oil sands, offshore USA, or shale gas and oil—would have of (1) removing American dependence on oil produced by "unfriendly nations," and (2) keeping energy prices at reasonable levels, thereby (3) convincing voters that fossil fuels can continue for decades as the basis of how America travels, heats, cools, and manufactures. As a senior Obama official once declared, what the USA needed was $9 or $10 gasoline prices to force Americans to switch from oil.

For many years the enviro-Left has promoted its goal of getting America "off oil" by insisting that Green energy development is needed NOW! because the world is running out of fossil fuels. The most publicly convinced believers in Peak Oil in recent years have become those most eager to see new oil production controlled—or banned outright.

Thus, the new horror story for the enviroleft: since Mr. Obama was awarded the Nobel Peace Prize (for somewhat gauzy and indistinct reasons), the US oil and gas industry has discovered enough shale gas to meet US needs for more than a century. Moreover, in the course of drilling for gas, the industry is finding vast new reserves of shale oil: North Dakota is now out-producing Alaska and the best (or worst, depending on your bias) is yet to come. Already there are forecasts that the US could become energy self-sufficient—and even a net exporter—within a decade from shale oil and gas and production from major new offshore oil fields.

The supposedly pragmatic Germans have invested more than $100 billion in solar power ...That solar enthusiasm would be understandable in the over-indebted land of *O Sole Mio*, but not in the cash-rich land of Gotterdammerung.

The EPA's man in Texas who bragged how he "crucified" frackers was forced by Republican fury to resign, but he has turned up with a job with a foundation, and can now wage his secular holy war by other means, on other people's tax-free money.

The President astonishingly claims credit for the hundreds of thousands of jobs being created through oil and gas exploration (while still maintaining that he is well along in creating millions of Green jobs). His claim is as amusing as if George Bush had bragged about how he'd been largely responsible for all the jobs created in Hollywood during his Administration.

The tremendous expansion of US oil and gas exploration is largely in privately-owned lands—not in the millions of acres of federal property, where permitting is—how shall we say it?—restrained.

Fracking is banned outright in some American states. It is opposed bitterly in Europe, where it is seen by elites as the worst US infamy since genetically-modified seeds or George Bush. The supposedly pragmatic Germans have invested more than $100 billion in solar power development for a nation not previously known for its sunniness. That solar enthusiasm would be understandable in the over-indebted land of *O Sole Mio*, but not in the cash-rich land of *Götterdämmerung*. It recalls the Saudi project to make the desert bloom like a rose by slicing off Antarctic icebergs and towing them north. The backers were defeated by the warm waters of the Red Sea and the sun in Sunni headquarters.

Conclusion:

> Despite the politicians and the tax-exempt jet-setters, the oil and gas industry will develop the fossil fuels the world needs, using its own financial resources. That is what private enterprise companies do.
>
> Governments will continue to create new Solyndras; that is what governments do.

THE INVESTMENT ENVIRONMENT

1. The Eurozone Keeps its Millstone Status

The euro is the biggest Trans-European delusion since the Holy Roman Empire.

When the history of our time is written, its authors will note that, for the third time in a century, Continental Europe has become a curse to the rest of the world. True, the eurozone's continuing drag on financial markets and the global economy cannot be compared to the horrors of two world wars. However, investors and businesspeople are fed up with the endless meetings, agreements, disagreements, promises and broken promises, defaults and faulty public sector financial data.

The euro is the biggest Trans-European delusion since the Holy Roman Empire. It took a long time—and some long wars—for the HRE to finally exit the stage, and today's leaders seem equally eager to prolong this pretension. The only time they are willing to let the supposedly abandoned nationalisms assert themselves is on the soccer pitch; it was therefore amusing to see that the leaders could be so publicly passionate about their national identities. Greece performed brilliantly in the semi-finals and Spain ended up winning it all. All the Germans took home was the bill.

World Wars I and II came primarily because German elites assumed they could conquer France in a few weeks as they had done in 1870, while French elites assumed they could smash the Bosch or that their defenses would hold until the Germans tired of the exercise.

The current eurocrisis developed because euroelites thought their monetary creation was better than gold—and most certainly was better than either the dollar or the pound. They also assumed there was safety in numbers—numbers of nations in the euro that is, not the numbers fudged by applicants to show that all was well until it was too late to unwind the union without embarrassing the entire political class.

The irony is that Germany started both world wars, for which it was hated, but redeemed itself during the decades of shared reconstruction and economic advance. Germans have been paying a disproportionate share of the eurozone costs and assuming a disproportionate share of the risks as the euroliabilities soar. For these sacrifices, Germans find they are now even more resented—or hated—by the PIIGS populations than decades ago when they were atoning for Hitler. Some bad deeds go unpunished; in the eurozone, it would seem, few good deeds do.

The elites who foisted their Great Big Idea on their peoples were able to communicate with each other freely in German, Spanish, English and

French, but most members of the workforces of the nations did not find job-changing as easy as it was, say, for an unemployed person in Detroit to take a job in Texas. [The US was the model assumed for the eurozone—one central bank and a common labor market.]

"The European Stability Mechanism," ... is eurospeak for a lender that allows deadbeats to get even more hopelessly indebted in the same of stability.

The economies thrown together in the common currency had widely varying levels of competitiveness and the common currency's forex strength punished most of the economies globally as the years wore on. The high savings rate countries subsidized the high-living countries through the common banking system—which meant that when the global financial crisis hit, it spread through the financial systems like a plague.

We remain of the view that no new promises, no new paper money creation, no new bailouts, and no new debts will resolve the basic problem—that only a few eurozone members have soundly functioning, globally competitive economies. That these nations should continue to subsidize their dysfunctional co-believers in Europeanism would be OK if it were not inflicting such damage on so many millions of unemployed young people, let alone the global capital markets and the global economy.

During the last two years, the rest of the world has watched with growing impatience as leaders strutted and fretted their hour upon the stage and then, in many cases, were heard no more, because their own voters, in an overdue spasm of good sense, rejected them.

There is an Orwellian aspect to the emerging nomenclature of the emerging institutions in this process of illusions and delusions. The latest bailout banking entity is called "The European Stability Mechanism," which is eurospeak for a lender that allows deadbeats to get even more hopelessly indebted in the same of stability.

Each time the leaders announce a solution, the financial markets, like so many Pavlovian dogs, rush to the feeding trough. Within days, reality sets in, PIIGS bonds and prices of European bank shares sink, and stock markets across the globe fall.

John Milton concluded his reflection on his disability in the sonnet *On His Blindness*: "They also serve who only stand and wait."

The markets lack Miltonian piety and asceticism.

They also see what the seemingly blind politicians claim they don't see.

The euroelites should have declared *La Commedia è finita* and rung down the curtain two trillion euros or so ago.

2. Liboralism: the Big, Bad Bonused Bailout Banks' (B5) Latest Affront to Capitalist Morality

Then came the story of the lies of Libor, thereby raising questions of the fairness of rates on almost everything for almost everybody...

Why have we been expressing disdain for the B5 since 2006?

1. Large-scale abandonment of the prudent global bank rules structure created by Paul Volcker in 1988? *check*
2. Guilty for pressuring Congress to repeal Glass-Steagall? *check*
3. Hiring mathematics and physics PhDs to design ever-more complex financial instruments that investors could not understand? *check*
4. Loading their balance sheets with these toxic new products in the trillions? *check*
5. Following Enron's innovation in creating Special Purpose Entities off bank balance sheet so as to disguise the extent of their leverage? *check*
6. Managing their banks in a gigantic new game of risk: "Heads" the banks' bosses and—maybe—the stockholders would win; "Tails" the taxpayers would lose... big time? *check*
7. Conspiring with politicians to expand Fannie and Freddie participation in mortgages of steadily-decreasing quality? *check*
8. Causing a global financial crisis and crash, which cost taxpayers worldwide trillions and plunged the industrial world into the deepest recession since the Depression? *check*
9. After taxpayer bailouts, spending vast sums in lobbying to defeat government attempts to prevent them from reining in their Bourbonesque bonuses and possibly unleashing a new disaster? *check*

At this point, we thought they'd exhausted the list of sins against capitalist principles. It was as if they had collectively dedicated themselves to prove one of Milton Friedman's more acute analyses: "The problem with socialism is socialism; the problem with capitalism is capitalists." He warned that a great economic system is at risk from strangulation from two directions: Socialist governments and immoral businessmen who abuse their powers and privileges.

Then came the story of the lies of Libor, thereby raising questions of the fairness of rates on almost everything for almost everybody—or so the lawyers will doubtless allege in the lawsuits to come.

Why should we allow these people to continue to defame capitalism? If they have so little shame, why should we believers in capitalism have to be tarred with their brush? Marxism is now widely said to be staging a comeback in respectability primarily because the Crash and Recession proved that capitalism has failed.

Marxism is now widely said to be staging a comeback in respectability primarily because the Crash and Recession proved that capitalism has failed.

This was the only basic interest rate guideline under private sector control, and the bankers abused that trust.

Even some long-time defenders of the big banks are now breaking ranks and calling on governments to break them up.

The latest convert, Sandy Weill, who put Citigroup together as THE global megabank, announced last week that he'd changed his mind. He now believes the big banks are not capable of being managed properly and should be broken up. He was joined in this *mea culpa* by his former partner, John Reed.

Paul Volcker has been right all along. Naturally, the Wall Street elites continue to sneer that he's too old and out of touch.

However, the tide is turning away from those mega-institutions.

Fortunately, there are lots of banks left which still carry on the traditional businesses of banking based on traditional morality.

Capitalism will, we hope, survive this latest—and greatest—assault against it, made by some of its own most prominent figures. The "Occupy Wall Street" crowd were onto something, but they ruined their cause by attacking *all* capitalists.

When the stock market began rallying from its Bankerly Slough of Despond in 2008, we asserted that, until the bank stocks started to outperform the market, the rally was suspect. We had been using this indicator for nearly four decades. In this era of badly-behaved bankers backing Ben Bernanke in his role as crisis hero, leading them to the Age of Zero, we are no longer sure that the Big Bank Index (KBW US Bank Index, BKX) is relevant. We have chosen to rely on the KRX (KBW US Regional Bank Index, which includes a long list of local banks, most of which, we presume, are led by the kind of people we would trust.

3. The Arab Spring and the Mideast

Al Qaeda followers equipped with weaponry from the Libyan campaign stormed into peaceful Mali, occupying its historic capital Timbuktu...

We first wrote of the Arab Spring[2] last year when nearly everyone was enthusiastic about it.

We shared in the hope (if not the belief) that these would be truly liberalizing and relatively peaceful revolutions, but we reminded readers that the French and Russian revolutions were also hailed abroad for having overthrown tired, illiberal, disreputable regimes. Each of those proved to be disastrous for both their own populations and their neighbors.

The Iranian Islamic Revolution wasn't so widely hailed—even at the beginning—except by such routinely deluded observers as Jimmy Carter, and it is still too soon to be sure just how catastrophic it will be for its own citizens and the world.

It is also too early to draw firm conclusions about the Tunisian, Egyptian, Libyan or Yemeni revolutions—let alone the ongoing civil war in Syria. The Egyptian revolution led to the Muslim Brotherhood's control of Congress and the Presidency, despite its oft-repeated promises not to offer candidates in either election. It maintains promises to observe liberal democratic principles, including religious freedom, while balancing power with the army—and will continue Egypt's treaty with Israel, even though these promises conflict with its own constitution. As Reagan would say, "Trust, but verify."

Libya's future still seems hopeful, but there is already a horrible tragedy unfolding to its south. Al Qaeda followers equipped with weaponry from the Libyan campaign stormed into peaceful Mali, occupying its historic capital Timbuktu, amid widespread slaughters. Anyone with an appreciation for Timbuktu's historic status as guardian of the texts and artwork from Islam's glory years and the sanctuary for Muslim scholars facing persecution under the Caliphate has to feel horror that these barbarians are desecrating sacred treasures and texts accumulated over centuries. This may well be a humanist disaster that will be compared with the sackings of Rome and the Turks' destruction of the Parthenon. That tragedy overshadows the likely longer-run strategic aspect of this coup—a seemingly permanent base for Al Qaeda-type warriors, in control of a nation which has accumulated, for its virtues, respect and connections across the world and within international agencies.

[2] *Basic Points, Slouching Towards Stagflation?*, March 2011

As for Syria, the outlook currently ranges from grim to horrendous. That the Alawite Shias, a small minority, have managed, with reluctant Christian support, to rule over a huge Sunni majority for so long is testimony to their shrewdness, ruthlessness and ability to play regional and international politics successfully.

These critics clearly aren't sophisticated enough to know that diplomacy has long been defined as "Lying in State."

Few will mourn the departure of the brutal Assads, even though they were beneficiaries of praise from many Europeans and from such leading Americans as Hillary Clinton. (She described Mr. Assad as "a reformer" some months after the troubles began, for which she has been ridiculed by some Republicans. These critics clearly aren't sophisticated enough to know that diplomacy has long been defined as "Lying in State.")

Recent reports from Syria claim that Assad was the recipient of dozens of truckloads of weapons of mass destruction prior to the invasion of Baghdad... the WMDs Bush never found. All reports agree he has a fearsome collection of *materiel* that could make the horrors of this civil war look modest in comparison.

Syrian implosion will be a blow to Iran and to Hezbollah, but they will regroup. Whether Syria in its current geographic configuration can be governed at all is another question for another time. Al Qaeda is seeking to re-establish itself among the Sunni majority before the Assads fall.

The brutal civil war could end suddenly if the Assads flee. As long as it rages, Israel's Northern border is secure in the event Israel attacks Iran.

The Iranians continue to stretch out a meaningless "dialogue" on weaponizing. They have successfully launched a potent rocket. The partial embargo on Iranian oil is a mere nuisance to a regime that has an estimated $120 billion in cash on hand.

Israel believes Iran is close to achieving 90% purity for uranium fuel—which could have only one purpose—a bomb. It is long past the 20% enrichment level (reactor fuels) and recently passed the 30% level—medical radioisotopes.

Mr. Romney's visit to Israel will have doubtless reinforced Mr. Netanyahu's view that Israel has—numerically at least—even more supporters among conservative American Christians than among American Jews. That is something that will give him confidence. However, his coalition recently collapsed, over the rights of the ultra-Orthodox who have long backed his party.

...the Mediterranean is returning to its historic role as the focal point of Continental European civilization— for better or worse.

Will Israel attack Iran? It is a real possibility. If so, Israel's friends may hope Netanyahu keeps it secret from Washington. The White House would seem to have become a sieve where security is concerned. (We watched the respected Democratic Senator Dianne Feinstein, Chair of the Senate Intelligence Committee, making her accusations about the appalling seriousness of the leaks, specifically citing the White House.)

As we wrote in January, the Mediterranean is returning to its historic role as the focal point of Continental European civilization—for better or worse.

4. The Drought—And The Stock Market

The Midwest drought is a Page One story. But when you turn to the stock market pages, you might be surprised to see the big agricultural companies' shares seem to be attracting little attention. Don't commodity stocks soar when a commodity price soars?

That has always been the case with these stocks, which we have been favoring much of the time since 2006. This should be a time when owners of shares of the great farm machinery, seed, fertilizer and farm technology companies are all smiles.

Until the drought hit, agricultural companies' shares were good performers, because their profits were so reliably strong, driven by those 400 million extra people on high-protein diets. They have powerful competitive positions because they've been helping farmers increase their production and profits for many years, back to the era when corn sold for $1.50 a bushel, and soybeans for $5.25. They tend to be scandal-free—and are absolutely necessary components in the global campaign to end hunger..

The thoughtful Jeremy Grantham speaks of the Dystopia that may come from sustained food shortages, noting that the past five years have meant food crises "for several of the poorest countries." He notes that such crises are politically destabilizing and points out that Egypt is trying to feed 84 million people from roughly the same amount of arable land as fed three million when Napoleon arrived. Crop failures abroad mean misery for Egypt—and for many other nations.

The Midwest drought follows on the brutal winter in the key grain-growing regions of Eastern Europe. The effect on grain prices has, of course, been dramatic.

That record grain prices haven't meant record stock prices for agricultural companies is because the Street says farmers won't have either the money or inclination to buy seeds and fertilizer, let alone a new tractor.

What is scaring the statisticians at the global food agencies most right now is the Indian monsoon...

We disagree.

The overwhelming majority of Midwest corn and soybean farmers carry crop insurance, whose cost is 60% subsidized by Washington. The benefits: up to roughly 85% of what the farmer would have earned by selling his crop at the price in September, based on the average yield per acre achieved in recent years. Since corn prices are up by more than 25% from April levels, a farmer experiencing a total loss stands to receive from the insurer what he expected to earn when he planted his crop (less proceeds of forward sales). The drought has been so devastating that corn for delivery *next September* is quoted at $6.86 a bushel. The corn carryover, (measured as stocks to use), will be one of the lowest ever. Already there are demands that the ethanol mandate be eased so that livestock farmers won't be driven out of business by record prices for corn and soybeans.

But the Midwest drought may not be the worst crop failure story this year.

What is scaring the statisticians at the global food agencies most right now is the Indian monsoon: it is, to date, so disappointing that it has contributed to record-level power outages. Roughly 700 million people were without power one day this week. But if the monsoon continues to disappoint, the cost of food for almost everyone on earth will climb dramatically--and it would take at least two years of bumper crops in all the world's major grain regions to refill the granaries.

RECOMMENDED ASSET ALLOCATION

Recommended Asset Allocation
Capital Markets Investments
US Pension Funds

	Allocations May 2012	Allocations June 22	Allocations July 31
US Equities	23	22	21
Foreign Equities:			
European Equities	1	1	1
Japanese and Korean Equities	3	2	1
Canadian and Australian Equities	4	3	3
Emerging Markets	5	4	4
Commodities and Commodity Equities (ex-Gold & Gold Stocks)	6	6	6
Gold & Gold Stocks	6	6	6
Income Generating Assets			
Dividend Stocks	15	15	15
Bonds:			
US Bonds	11	11	11
Canadian Bonds	4	4	4
International Bonds	2	2	2
Inflation Hedged Bonds	10	10	10
Quality High-Yield Bonds	2	2	1
Cash	8	13	15

Bond Durations

	Years May 2012	Change	Allocations July 31, 2012
US	5.25	unch	5.25
Canada	5.25	unch	5.25
International	4.00	unch	4.00
Inflation-Hedged Bonds	7.25	unch	7.25

Global Exposure to Commodity Equities

	Years May 2012	Change	Allocations July 31, 2012
Agriculture	32 %	unch	32 %
Precious Metals	29 %	–1	28 %
Energy	26 %	+2	28 %
Base Metals & Steel	13 %	–1	12 %

We recommend these sector weightings to all clients for commodity exposure—whether in pure commodity stock portfolios or as the commodity component of equity and balanced funds.

RECOMMENDED ASSET ALLOCATION

Recommended Asset Allocation
Capital Markets Investments
Canadian Pension Funds

	Allocations May 2012	Allocations June 22	Allocations July 31
Equities:			
Canadian Equities	18	18	16
US Equities	7	5	5
European Equities	2	1	1
Japanese, Korean & Australian Equities	2	1	1
Emerging Markets	5	4	4
Commodities and Commodity Equities (ex-Gold & Gold Stocks)	6	6	6
Gold & Gold Stocks	6	6	6
Income Generating Assets			
Dividend Stocks	15	15	15
Bonds:			
Canadian Bonds			
Market Index-Related	17	17	15
Real-Return Bonds	10	10	12
International Bonds	3	3	3
Quality High-Yield Bonds	2	2	1
Cash	7	12	15

Canadian investors should hedge their exposure to the US Dollar.

Bond Durations

	Years May 2012	Change	Allocations July 31, 2012
US (Hedged)	5.25	unch	5.25
Canada			
– Market Index-related	5.25	unch	5.25
– Real Return Bonds	7.25	unch	7.25
International	4.00	unch	4.00

Global Exposure to Commodity Equities

	Years May 2012	Change	Allocations July 31, 2012
Agriculture	32 %	unch	32 %
Precious Metals	29 %	–1	28 %
Energy	26 %	+2	28 %
Base Metals & Steel	13 %	–1	12 %

We recommend these sector weightings to all clients for commodity exposure—whether in pure commodity stock portfolios or as the commodity component of equity and balanced funds.

INVESTMENT RECOMMENDATIONS

1. Increase your cash exposure to 15%. The euro's death throes could take a long time. The elites may try to drag down as many innocent victims as possible to deflect attention from themselves.

2. The dollar's surge is bad news for US exporters, but even worse news for equity investors. It is the key component of the "risk-off" trade that drives investors into Treasurys with barely-observable yields out of almost anything else. As an indicator, it is more reliable than Libor. Avoid committing new cash into the US stock market as long as Treasury yields are going down and the dollar is going up.

3. The US economy is slowing toward stall speed. But it looks lustrous compared to Europe. Remain underweight Europe and maintain exposure to high-quality US stocks, particularly commodity stocks, and technology stocks with demonstrably unique products.

4. Canada continues to be the Northern Star that is barely visible amid the atmospheric pollution from US deficit politics and the widening crises in Europe. It is a good financial market to find quality investments in a reliable currency.

5. Gold has once again become a "risk-on" asset, which means it tends to fall when the stock market falls, and to rise when the market rises. This is paradoxical and illogical. Gold is a "Bad News Bull's " commodity. This schizophrenic period of gold and gold stock valuation is unsustainable. At this time last year, gold was inversely correlated to the value of the euro. For months it has been positively correlated. Bizarre! We remain of the view that what might be the only way for the eurozone to assemble enough firepower to give credibility to the markets is for governments which have gold to use it to back very long-term convertible bonds.

6. Libor-rigging, the latest—and biggest—story of bad behavior among the big banks in London reinforces the wisdom of avoiding investment in financial institutions whose public standing continues to deteriorate. Investing in companies with traditions of incompetence has not historically been successful. Investing in companies with traditions of incompetence and deception has historically been even less successful. In the US, that argues for investing in the regional Main Street banks, which collectively continue

to outperform the biggies. In Canada, some of the big banks have been downgraded because of fears of a bursting real estate bubble, but those institutions and their brethren have reputations for being—in comparison with the Wall Street banks—stolid and solid. As for the European banks, they are collectively undercapitalized and way overloaded with eurozone sovereign bonds.

7. The Commodity Super-Cycle will last for at least a decade more. Investors should be patient, and await an all-clear for the euro crisis before committing new money to a sector with a bright long-term investment future.

8. Remain overweight the agricultural stocks within commodity equity portfolios. We continue to believe this is the commodity sector with the best risk/reward characteristics.

9. That the Canadian oil sands companies' shares have become the most conspicuous victims of American political risk fears is a grotesque, unseemly development. Mr. Obama remains favored for re-election, because most Americans like him a lot more than they like the buttoned-down Romney. That should mean that Keystone is dead. But if the Republicans keep their control of the House and their strong representation in the Senate, they could certainly force his hand during the inevitable Budget bargaining. Maintain strong exposure to those companies that give you more barrels of oil per share than almost any others in the stock market. If Mr. Romney pulls off an upset, load up on those stocks that will suddenly be rejoicing about free markets.

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