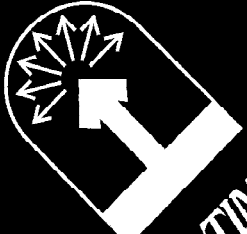


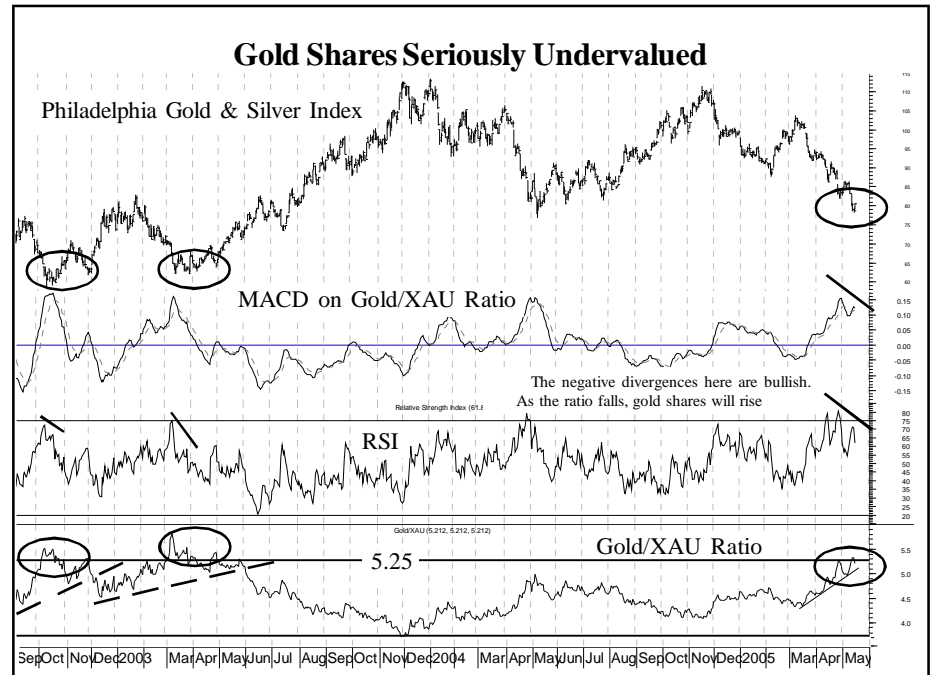
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## Hang On To Your Gold Shares



The next issue will be published June 2.

### • What To Buy?

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I did not anticipate that the gold stocks would get hit so hard here. The dollar has been able to surmount the 85.50 level that gave it so much trouble on the up side, but I don't think the odds are great that it will be able to get through 87.00. We will see. I will have more for you on line next week with a special report on gold. If you want a copy mailed, let me know.

Gold bullion has drifted lower on this dollar strength, but it has yet to touch the \$415 level basis December futures that I have been looking for. Likely, it will.

The surprise is how weak the mining stocks have been with respect to the dollar's strength – and, more importantly, to the price of gold bullion. As you might expect, there

is a relationship between the price of gold and the price of the mining shares. In this, there is the wonderful leverage that we get in buying mining shares rather than gold itself.

If a mine is producing gold at \$300/ounce and gold is selling for \$300/ounce, they break even. However, if gold moves to \$350/ounce, that \$50 will go to their bottomline profit.

Another reason for a link between the price of gold and the price of mining shares is the value of their reserves. Obviously, the value of a company's gold in the ground and processed gold in inventory will be greater at higher prices of gold bullion. Thus, in theory at least, the higher the price of gold, the more valuable the mining shares.

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In reality, the exact price of a mine's shares will vary in some ratio to the price of gold. There are all sorts of other factors to consider, like the skill of management, hedging operations, etc. On an individual stock basis, the ratio of the share price to the price of bullion will vary from company to company.

We can smooth this out by following the ratio between a group of shares like the XAU and the price of gold. Normally, the ratio of the price of an ounce of gold to the price of the XAU will cycle between 4.0 and 5.0. However, sometimes the ratio will run to extremes and provide us with juicy buying opportunities.

There are times that the mining shares represented by the XAU will be so expensive the ratio will fall to 3.50. That is a definite sell signal, the likes of which we haven't seen for some time. At other times, the shares will be sold off far enough that the ratio will zoom to 5.25 or higher. When that happens, the shares are undervalued and it is buying time.

The ratio is not an exact timing device (which you can see on the chart), but you would have made big money buying while the ratio was 5.25 or higher in the past. Buying while the ratio is over 5.25 will have you buying into weakness, but the weakness can continue for a while. You need to be prepared for that.

There is a way to refine this and produce an element of timing. One is to consider the next downside crossing from MACD on the ratio as the "buy" signal. (As the ratio falls, mining stocks will rise.) Another is to trade off the RSI as applied to the ratio. Just as good as any of these is to simply plot a trend line under the lows and consider a break of the trend line the "buy" signal.

All of these timing efforts will put you in the position of buying strength. If you act quickly enough, you will be able to snag some good buys down here.

### What to buy?

Once the trend reverses, all the gold stocks will rise to some extent, but the best buys will be those that have fallen the least in comparison to the XAU. I like **Yamana** (AUY-AMEX-\$2.88) and **Western Silver** (WTZ-AMEX-\$7.86) in the juniors.

Crude oil hit my downside objective of \$51.00 basis December on May 15, and it looks like it is setting the stage for its next rally. That rally will take crude oil to new highs, and our energy stocks will follow suit. There is simply no credible bearish news on oil.

Forget about a depression, or even a recession, in China. Their growth may level off some, but it is screaming. The first quarter of 2005 showed a 9.5% growth rate. We're talking about a huge economy getting bigger by leaps and bounds. As Jimmy Rodgers so aptly said recently, "Ultimately, China will be the largest consumer of everything." Think about that.

When you think about it, the energy problem is not so much about crude oil as what you make out of crude oil. Liquid fuels like gasoline, jet fuel, and heating oil, etc., are what it is all about. It is about the growing demand for electricity. With their 1.3 billion souls, China is just beginning to electrify.

Then consider Venezuela, our fourth largest supplier of crude oil. Consider Hugo Chavez and how we have worked overtime to make him an enemy. Fidel Castro is his mentor, and Castro will teach him well. I imagine Chavez is working on some deals with

China, and we may see less and less Venezuelan crude in the future. Perhaps we will have to invade and save their people from tyranny?

The crude oil supply outlook is tenuous for the U.S., and for the rest of the world as well. We may well look back at the summer of 2005 as the good old days when at least fuel was available at a price.

Crude is going higher, coal is going higher, and natural gas is going higher. Those that think otherwise are simply dreaming of days past, and they are at risk of being left out in the cold. The recent correction in energy prices and stocks is clearly a second chance to buy energy shares.

*Baytex looks especially good here at C\$13.00, but any of those on our buy-and-hold list can be bought at the listed downside buy price or less.*

Our original **Valero** recommendation was premature, but buying at around \$60.00 looks good. The merger with Premcor was not looked at kindly on Wall Street, and they pushed the shares down - but I like the merger. I think they can afford the deal, the price is not as bad as some analysts make it out to be, and this will make Valero THE major oil refiner - and one of the few that can process sour crude.

Hang on to your gold shares and hang on to your energy stocks. This is not the time to be selling. The next leg in the oil market will take prices to \$63 and then to \$76. Gold's next move will be to \$500, and then you can think about selling. Don't lose sight of the **Pimco Commodity Real Return Strategy Fund** (PCRBX-\$14.99). It is falling off, and the B shares are coming close to our buy price of \$14.50. I recommend that you buy some there.