

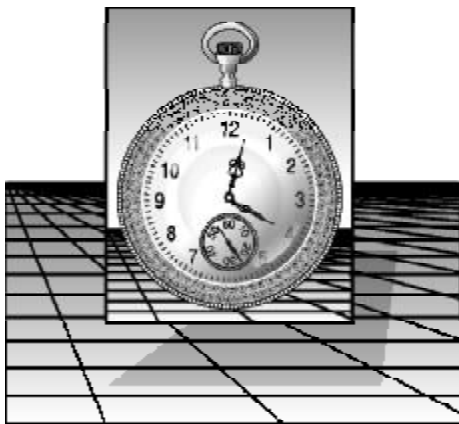
**2007  
Publishing Schedule  
January through April**

**January 3  
January 25**

**February 8  
February 22**

**March 8  
March 22**

**April 5  
April 26**



## SOME THOUGHTS ON 2007

Here is an interesting happenstance. Since last summer, the stock market has been rising, albeit with slight conviction. This would portend a decent economy for 2007 since the stock market is a leading indicator of the economy.

The bond market has also been rising. Normally, when bonds rise and interest rates fall, it is because bond traders anticipate the Fed will lower interest rates in response to a weak economy. Clearly, something is amiss.

The mistake some investors make is to try and couple events too tightly. I have found that it is always better to follow and analyze each market independently based on their respective price action. Regardless of the U.S. economy in 2007, my work points to higher precious metals and energy prices.

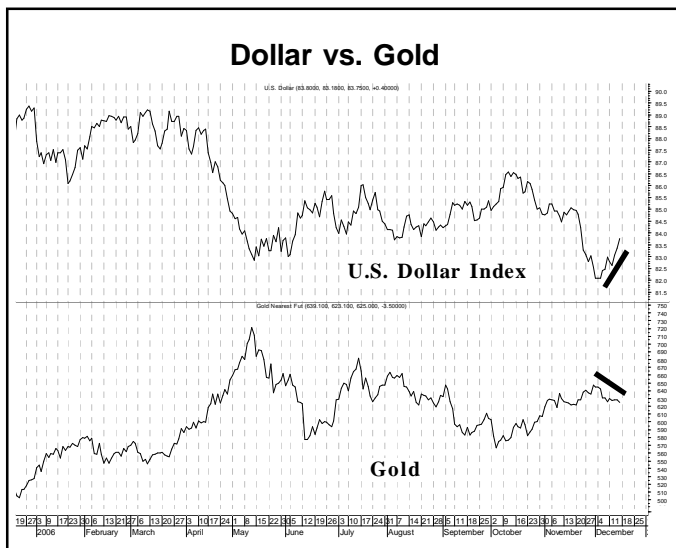
**Here's what is going to move gold higher next year:** Regardless of the economy, the Fed is going to be motivated to pressure the U.S. dollar lower. Mind you, they want a decent and orderly lynching - not a collapse. Therefore, we will see waves of weakness and strength on the way from a current dollar index of about 83.70 to at least 60.00 (if not 40.00) longer term. A lower dollar means higher inflation, and inflation is bullish for gold.

A cheaper dollar is not all bad. It will improve unemployment in the manufacturing sector and can alleviate some of our trade debt burdens. I think the Democrats in their new position of power will be on board with a weaker dollar policy.

The mining industry will continue to consolidate through mergers and acquisitions. Those more efficient operations with cash will ingest their competitors. The M&A activity alone tells us we are only in the second phase of this commodity bull market (the longest phase) and that the best is still ahead of us. It also tells us that investing in junior mining operations that may be acquisition targets is a great speculative strategy. Those that are not acquired will rise with the rest.

**The Fed is in a tough spot.** If they raise rates to fight inflation and defend the dollar, they will accelerate the housing slump. Since so much of the last economic boom was due to over stimulation of the housing sector, an uncontrolled collapse would seriously disrupt the American financial system.

The Fed's 2007 goal will be to keep the White House in Republican control and help them win back the Congress. That means a maximum number of voters employed. If that takes a lower dollar and higher inflation, so be it.



One rule is cast in stone - as the dollar falls, gold rises. As gold rises, it is more attractive to investors, including central banks. Investors love to buy rising prices, and Central banks cannot just liquidate all of their dollars. They can and will, however, hedge their dollar reserves with gold.

There are many other reasons to expect higher gold prices in 2007. John Hussman is a successful gold investor and mutual fund manager. He found that: 1) when the rate of inflation has been higher than six months earlier, 2) Treasury bond yields have been lower than six months earlier, 3) the NAPM Purchasing Manager's Index has been below 50; and, 4) the gold/XAU ratio (Simplicity) has been above 4.0, the XAU has soared 123.63% annualized.

In November, the NAPM reading fell from a previous 51.2 to 49.5. The gold/XAU ratio has been remarkably steady at about 4.30. T-bond yields are lower than six months ago. The close call here is in the November reading for the CPI. It was 201.7 compared with a 201.9 reading six months ago. Thus, officially, the model is not bullish quite yet, being shy a go-ahead from the CPI. We will keep a close eye on this, but the implications are very bullish for gold in 2007.

**What to buy?** We have been warning that because the dollar became so oversold during late November, it would bounce to some degree and that this would pull gold down in the process. Gold should drift to about \$610 basis April gold. I expect to see the mining shares come off a little bit also. The XAU should visit 135.00. Heed the downside buy prices on the buy-and-hold list (see Page 3 of the Tuesday and Thursday updates and Page 6 of the monthly letter).

My shopping list includes **Yamana** (AUY-AMEX-\$12.18), **U.S. Gold Corporation** (UXG-AMEX-\$5.34), and **Everton Resources** (EVR-TSX-C\$1.48). Shoot for some Yamana at \$11.00 or less, U.S. Gold at \$5.00 or better, and Everton at C\$1.30. Note that Everton is in Canadian dollars. The U.S. dollar equivalent to C\$1.30 is about \$1.13 at today's conversion. Incidentally, U.S. Gold was just listed on the AMEX with the symbol UXG.

Energy should have a great year in 2007. A weaker dollar, of course, is bullish for crude (just as it is for gold), but there are additional factors that will drive crude and natural gas higher next year that I will take up in the January letter. I am looking for new energy investments with income, and I will have some new ideas for you next month on these. In the meantime, stay with our recommendations in the last letter.

The stock market has continued to trudge higher since June; but each day when I look at my charts, the picture is bearish. The averages are overbought, underlying indicators are breaking down, negative divergences persist, and the rally since summer is long in the tooth without even a minor correction. I have a guess on the resolution between the bullish economic outlook that this rally is painting and the bearish outlook we are seeing forecast in the bond market - they are both wrong.

John Hussman (mentioned above) recently reported that the S&P is selling at 18 times "fresh record earnings." This is high historically. He goes on to say that investor's attention has been distracted from other value measures. Price/revenue, price/dividend, and price/book ratios are all double their historical norms due to wide and unsustainable profit margins.

The stock market will peak somewhere soon - perhaps in January-February 2007. However, a surprise trigger event could tip the market at any time. Risk levels are very high. I have the same sensation looking over my technical work as I had in December 1999. The technical work looks bearish, and the market looks bullish to the public. That is a bad combination. As a last word, we still do not have a buy signal to report in our best/worst six month program. For now, we will stick with our Rydex short funds.