ASPERA REVIEW

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2Q 2012 Quarterly Review: EU've Got To Be Kidding Me

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"Only two things are infinite: the universe and human stupidity; and I'm not sure about the former."

often attributed to Albert Einstein

In the last Review, I offered a few solutions that I would implement were I to awaken one morning and find that I had somehow engineered an amnesia-riddled bloodless coup. One suggestion was to reduce and rationalize the excessive amount of regulation that businesses face, and I offered my own industry as an example. In doing so, I took a tender jab at the Securities and Exchange Commission for failing to uncover the Madoff fraud despite being handed incredibly incriminating statistical evidence.

Well, I may owe the SEC an apology. Though they missed Madoff's $50 billion fraud, the SEC has recently uncovered the (alleged) theft of $415,000 by one Gurudeo "Buddy" Persaud. It seems that Buddy was guaranteeing returns of 6 to 18 percent. That was his first mistake. His second mistake was failing to disclose his trading strategy to his clients.

Perhaps he just didn't want to burden his clients with the intricate details of his sophisticated and technical strategy. He may have found it too difficult to explain his view that markets are affected by gravitational forces. Per the SEC's website:

> The SEC alleges that in making trading decisions, Persaud chiefly relied on an Internet service that provided directional market forecasts based on lunar cycles and gravitational pull. Persaud's strategy was premised on the idea that gravitational forces affect mass human behavior, and in turn, the stock market. For example, Persaud believed that when the moon exerts greater gravitational pull on the Earth, people feel dejected and are more inclined to sell securities.

I'm not sure why the greater gravitational pull would lead us to feeling more dejected versus more euphoric. And would we be more likely to focus on our investments and sell when we feel dejected, or more likely to binge drink, watch a documentary marathon focused on historical African famines, or marry a Kardashian? And how does this theory square with those who believe the markets are driven by solar activity or the alignment of the planets? So many questions. The only thing that seems clear is that IF the moon's gravitational pull on the Earth does make us feel more dejected, the moon must be stuck in its orbit…directly above Europe. Speaking of which…

Lucky Number 19?

Prior to the last week of the quarter, European leaders had held 18 summits in the prior two years in order to address their ongoing crisis. These summits must be a blast because they decided to hold a 19th during the last week of June. There is a very clear pattern surrounding these summits:

1. Yields spike in a European country.
2. The European Grand Poobahs hold a summit.
3. They hold a press conference at the end during which they take turns giving each other back rubs and promising that they're united and that they are very serious people with a very serious plan.
4. Equity markets, the Euro, and European periphery debt prices all rally on hopes that the problem is solved.
5. Investors actually read the agreement and realize that the promises made are irrelevant, inexplicably incomplete, and/or impossible to implement.
6. Equity markets, the Euro, and European periphery debt prices all fall.
7. The Grand Poobahs blame the markets and one another for not responding "appropriately".

This latest meeting fits the mold perfectly. More announcements and promises were made after the meeting, and the markets lapped it up. The stage was set for an impressive short-term rally since there was so much concern going into the meeting that the entire Euro experiment could dissolve imminently given recent discord between various leaders. Coming out of the summit, investors were simply relieved that any agreement was cobbled together. They could have just stood together and announced that they had all agreed to go Dutch on a twelve foot Subway Party Sub for lunch and the markets would have rallied. As I write this Review, however, we've already seen all of the gains in the Euro (chart below) and Spanish and Italian bonds given back in just one short week.

Source: Google Finance

Market participants have once again read the details of the latest agreement and have once again found them lacking. It's once again clear that nothing of substance has been solved. No one promised new money for bailouts. No new effort was made to reduce debt. No new substantial austerity measures were set forth. No effort to address the cost, efficiency, and productivity imbalances between Germany and southern Europe was put forth. Instead of focusing on these very real and critical issues, the press all around the world was busy running front page articles debating who came out of the summit as the winner! Half seem to think Merkel won, and half give the prize to France, Spain, and Italy. What a silly debate. Of course, the only winner was the catering firm that has the contract for all of the subsequent summits.

You can't have a monetary union without a fiscal union. To have a fiscal union, debt would have to be pooled in some manner, which means that the Germans would be on the hook for Greek, Spanish, and Italian debt. Furthermore, national budgetary decisions would have to be sublimated to some Eurocratic parliamentary body. Are the citizens of Germany, France, Spain, Greece, Italy, Portugal, etc. really ready to hand over control of such critical issues to a body of foreigners who speak a different language and have different beliefs, customs, and traditions? There are still no good and easy choices -- only less-bad choices. Even Germany, the strongest European member, will have a huge bill to pay one way or another regardless of how things unfold. They will either pay to bail out the periphery countries or they will pay to recapitalize their central bank and bail out their banking system. The continued can-kicking merely adds to the total tab that will eventually come due.

bEUROcracy

Polls show that Europeans are increasingly questioning the value of the European Union, and more people are realizing that the purported benefits of membership might not be worth the cost. The absurdities of many policies and the inherent conflicts between various member countries are rightly receiving ever more attention. Allow me to offer just a sampling.

The following has been making the rounds recently:

► Pythagoras' theorem	24 words
► Lord's Prayer	66 words
► Archimedes' Principle.	67 words
► 10 Commandments.	179 words
► Gettysburg address.	286 words
► US Declaration of Independence	1,300 words
► US Constitution with all 27 Amendments.	7,818 words
► **EU regulations on the sale of cabbage**	**26,911 words**

Nearly 27,000 words to regulate the sale of cabbage! Who wrote that? Has anybody actually read that? And this is for cabbage. What about the regulation of vegetables that are actually tasty? How many words does that take? Has anybody asked why any regulation of cabbage is needed? These guys claim to want to encourage growth. I'm sure there are hundreds of new cabbage farmers just chomping at the bit to get planting now that they have to abide by a 27,000-word rulebook telling them what they can and can't do. Europe would be much better off if the legion of lawyers, lobbyists, advisers, and writers who helped craft this legislative pile of compost were fired and encouraged to go plant some cabbage.

How about a little more absurdity? France just elected a new socialist President and socialist parliament which have recently begun fulfilling some of their promises. President Hollande campaigned on a renewed focus on growth in Europe. To help spur growth, Hollande and company have lowered the French retirement age from 62 years to 60. Just what the world needs – another two years worth of overweight Frenchmen in undersized Speedos trolling the beaches of the Riviera. To make matters more contentious, Germany recently raised its retirement age from 65 to 67. How excited do you think the Germans will be to work longer in order to help fund those extra seven years of retirement benefits the French will get?

As I'm writing this, the latest French proposal has been issued. France will increase the tax on foreign-owned second homes, labeling the new taxes a "social charge". I'm sure this will do wonders for the French property market. There will also be a "one-off" levy on the highest earners, bringing the top tax rate to 75%. Much of the new taxes will go toward adding 150,000 more government jobs to an already bloated

government payroll. France has its own debt and deficit problem, and the solution is to raise taxes to confiscatory levels on the few remaining wealthy idiots who haven't already moved their assets to the U.K. or Switzerland. You can expect foreign capital to stay away from France. David Cameron, the Prime Minister of Britain put it nicely a few weeks ago when he said, "If the French go ahead with a 75 per cent top rate of tax, we will roll out the red carpet and welcome more French businesses to Britain…" I had thought that Italy would be the next problem child in Europe, but France seems eager for its turn.

Let's turn to another one of my favorite examples of silliness out of Europe. The bailout agreements that have largely been agreed to and are in place require all members to contribute if called upon. Even the members who are in trouble themselves are required to step up and somehow provide money that they don't have at a rate which is lower than their borrowing rate. So, while Italy would have to pay 6% to borrow money from the bond market, they would have to lend money to Spain per the recent deal at a rate probably closer to 3%. Borrow at 6% to lend at 3%?! What could possibly go wrong?!

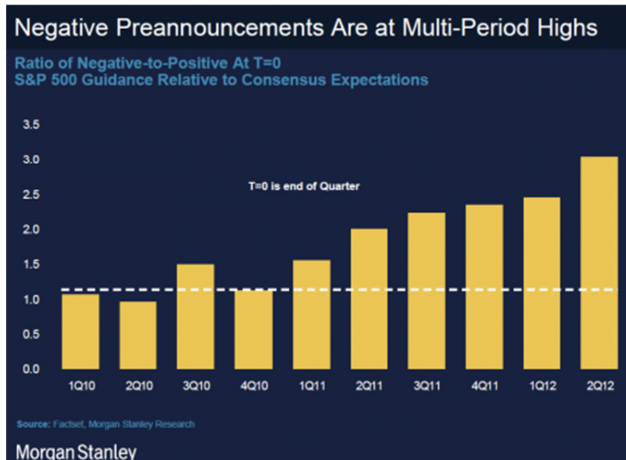
One last absurdity. Most Europeans already get 4-6 weeks of guaranteed annual vacation leave. In a recent ruling, Europe's highest court "ruled that workers who happened to get sick on vacation were legally entitled to take another vacation." According to the court, "The purpose of entitlement to paid annual leave is to enable the worker to rest and enjoy a period of relaxation and leisure. The purpose of entitlement to sick leave is different, since it enables a worker to recover from an illness that has caused him to be unfit for work." I have a strange feeling that more Europeans will be getting sick during their vacations.

Yes, I'm picking on Europe, but that's just because it's still Europe's turn. The focus will continue to shift as this crisis rolls on. China will have its turn, Japan will have a go, and the U.S. will again be on deck. Australia will be making international news, and Argentina is accelerating toward the next in its long-running series of crises. I'm sure I'll be able to demonstrate my broad nondiscriminatory global insensitivities soon.

<u>Q2 = Payback</u>

We all know that Europe is a mess and in a recession. That's finally beyond reasonable argument. The strength of the U.S. economy is open to a bit more debate, though I've made my view clear. Last quarter, when many were singing the praises of U.S. economic strength, I wrote:

> The truth of the matter is that some economic reports did look pretty good, as is the case every single quarter. However, many reports looked much less impressive when the details were parsed, which few expend the effort to do. Furthermore, a number of reports benefited from unusually large seasonal adjustments of a magnitude which called their reliability into question. Also, recall that we just wrapped up one of the warmest winters on record. It's hard to imagine that some level of demand wasn't drawn forward in recent months as construction, hiring, and mall visits weren't impeded by typical winter weather.



Over the past few months, it's become clear even to the bulls that the economy here is far from robust. We've seen weak employment reports, a weakening in both the manufacturing and services sector, and an increase in negative earnings preannouncements. The negative earnings announcements have come from a broad swath of the economy. Clearly, the slowdown in Europe and a strengthening dollar are hurting global U.S.-based firms, but many firms are also pointing to increased uncertainty and weaker demand here in the U.S. Let's not forget that the weather benefit in the first quarter may have resulted in an unusually large headwind in the second quarter.

The earnings picture is likely to remain muddy for a while. The U.S. dollar is benefiting from a flight to safety, especially given the turmoil in Europe. This boosts our purchasing power, but it hurts large firms that have to convert their foreign earnings back to dollars. The slowdown in China that I've been warning about is getting much more press of late as well. China is the marginal buyer of many commodities, and a slowdown there will impact commodity prices and commodity-based countries. Slowing growth in China would reduce demand for global goods, but it would also reduce the input costs for heavy users of many commodities. Hopefully, it will also lead to some terrific investment opportunities for us.

Another key factor that we'll hear more about in the months ahead is the "fiscal cliff". The tax cuts approved by the Bush administration are set to expire at the end of the year, and automatic budget cuts are supposed to kick in at the beginning of 2013. The total impact of these measures is projected to be $600 billion. Let's leave aside a debate about the wisdom of the tax increase and spending cuts (I like the latter but not the former) for now. Should the spending cuts and tax increase go into effect, you can count on a guaranteed recession. Businesses are forward-looking, however, so we should expect them to moderate their hiring and spending plans in the near-term until there is more certainty as to what Washington will do. This uncertainty alone will provide some economic drag in the next couple of quarters. Temporary extensions and half measures, which are the most likely short-term resolution, do not equate to the type of certainty that facilitates long-term investment planning by businesses.

Time for some big picture commentary. The economy doesn't move in a straight path. There are plenty of wiggles, and those wiggles can be driven by many things: weather, fiscal policy, monetary policy, tax changes, exchange rates, trade conflict, strikes, war, etc. Trying to predict all of the wiggles is a waste of time in my view. It's a guessing game, and the odds are that any of us will guess right roughly half the time, a percentage which would put us well above most "leading" economists. I'm more concerned with big picture issues and trends, and most of the big picture issues that I see fall squarely in the negative camp.

One of the key issues for us to keep in mind is the fact that much of the past growth in economic activity was driven by borrowing. Much of that debt-driven growth artificially inflated GDP and our sense of prosperity. It should be clear now that much of the debt was borrowed for nonproductive purposes and simply stole from future consumption. Today, we're left with this debt hangover. Predicting strong growth going forward makes no sense. We're not going to be able to continue borrowing at past levels, so we won't generate that type of growth. Worse still, we actually have to start repaying some of that debt. So, you'll continue to hear bullish arguments about the economy from CNBC and the Wall Street "experts", and we will see positive wiggles from time to time, but the debt hangover will be with us for some time and will place a limit on how much true wealth can be generated for some time.

<u>Precious Metals Update</u>

"If you don't trust gold, do you trust the logic of taking a pine tree, worth $4,000-$5,000, cutting it up, turning it into pulp, putting some ink on it and then calling it one billion dollars?"

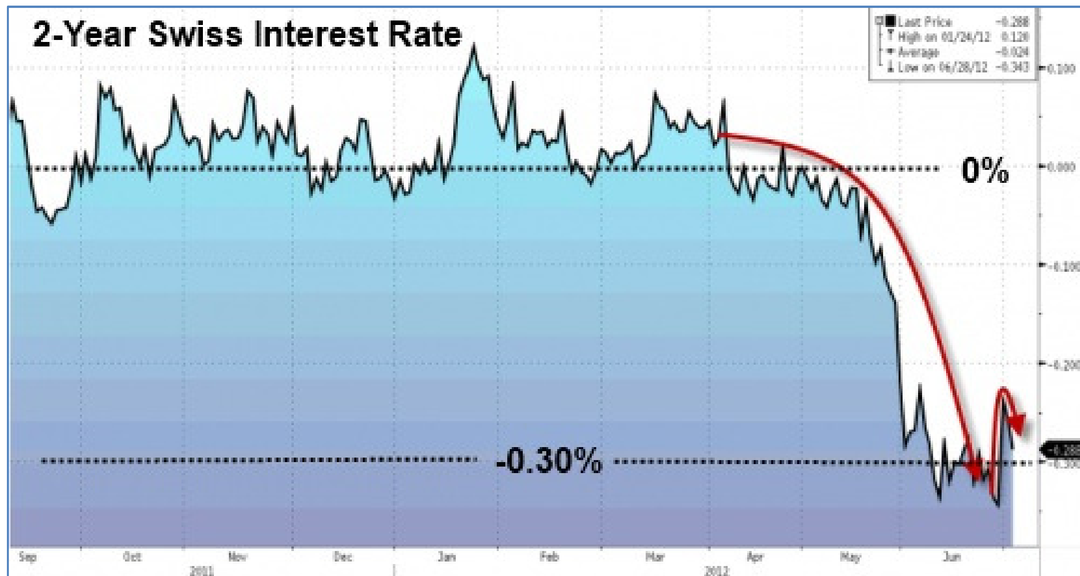
Kenneth J Gerbino

There isn't much new to add this quarter about the precious metals space given the Update written at the end of May. Since then, gold and the miners have edged higher and silver has edged lower. Since prices haven't fallen further (yet), we haven't had the opportunity to further boost our tactical position.

One fairly new phenomenon worthy of comment is the fact that interest rates in some relatively safer countries have actually turned negative. The chart below shows the yield on 2-year Swiss government debt. The yield is MINUS 0.30%. Think about that for a moment. If you buy a security with a negative yield and hold it to maturity, you are guaranteeing yourself a loss. With this security, you are essentially paying the Swiss government a fee for holding your cash for you for a couple of years! We've also seen negative rates in some short-term German and Danish bonds as well.

We've had negative <u>real</u> rates for many years (interest rates below the level of inflation), but this current phenomenon of negative <u>nominal</u> rates is fascinating. It points to the fearful state of (particularly

European) investors as well as the lack of safe investment alternatives. Fortunately, it makes gold look even more attractive on a relative basis. One of the arguments against gold has been that it doesn't pay interest, and that you have to pay to store it. This oft-cited disadvantage of gold disappears in a negative nominal yield world. I keep saying that we're in uncharted territory. These negative yields are just the latest example of the uniqueness of the current crisis and crisis response.



Source: Zero Hedge

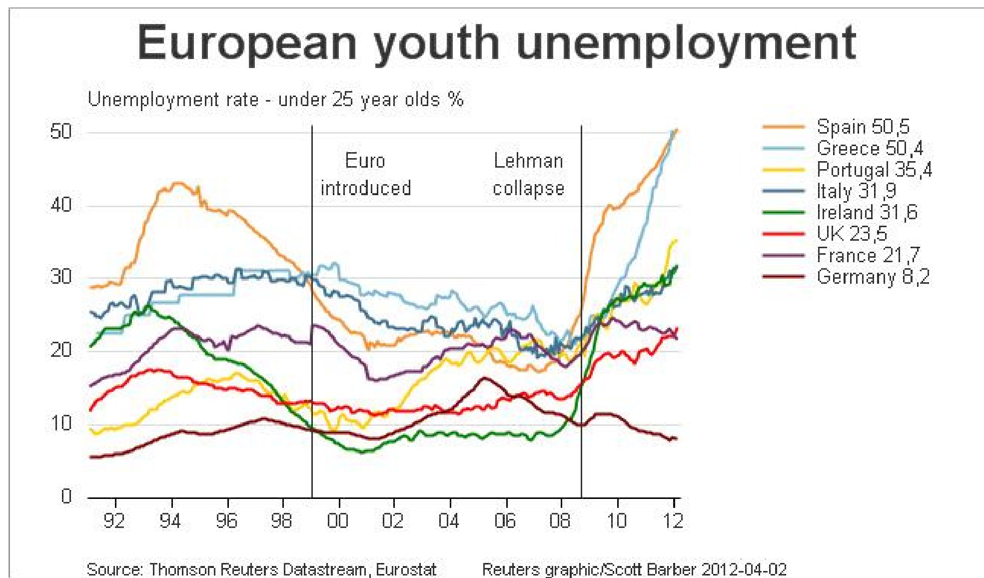
Speaking of crisis response, there are only a few ways to reduce excessive debt:

- Austerity – Cut spending and/or raise taxes so that you can stop borrowing
- Default – Bankruptcy, foreclosure, etc.
- Forgiveness – Your creditor agrees to forgive your debt
- Inflation – Essentially print money to pay back existing debt with a cheaper currency

We've recently seen a big backlash against austerity from the struggling countries in Europe. France, Spain, Greece, and Italy have joined forces against Germany to push for an easing of austerity measures. Instead, they're talking about a renewed focus on growth! When overly-indebted countries start talking to you about growth, you'd better hide your pocketbook. The only way they could finance this growth themselves would be through increased borrowing, and the capital markets clearly aren't going to lend even more money to them at favorable rates. Besides, wasn't it a focus on growth that led to all of the borrowing and spending in the first place? Focusing on growth is wonderful rhetoric, but it's empty.

At the same time, it's understandable that austerity is causing headaches for politicians. They're unfortunately raising taxes in the middle of an economic maelstrom. Unemployment rates are high and rising, particularly for the youth of Europe (see chart below). A bunch of unemployed kids with student loan payments, poor job prospects, and plenty of time on their hands will eventually find things to start throwing. Politicians like to get re-elected. We've seen incumbents get the boot all over Europe. Campaigning against the Euro and austerity is becoming increasingly popular for upstart politicians and political parties, as most recently exemplified by the Syriza Party in Greece.

What about default? We did technically see a modest default in Greece by the government, but the defaulted debt was largely replaced with new debt, so it's hard to count this as a real default. This could and should be a solution for one or more smaller countries, like Greece. A massive default coupled with a return to a national currency (leaving the Euro) and a large devaluation would certainly be painful, but it would clear the decks and set the stage for an eventual return to stability and then growth. It's a little more difficult (though not impossible) to imagine a large default by Spain, Italy, or France, as that could collapse the global monetary system. Central bankers know this and would probably bring out their bazookas before this happened.



How about forgiveness? Forgiveness may be a core religious tenet and the topic of thousands of quotes and Dr. Phil episodes, but I can't imagine bondholders will ever be in a forgiving mood when it comes to mature developed countries. Such forgiveness is typically reserved for small developing world countries that have undergone some type of turmoil, such as a civil war exacerbated by the sale of arms by the very same developed countries which lent them the money to buy the guns and ammo in the first place.

As always, that leaves us with inflation (currency debasement) as the most likely path forward in the quarters and years ahead. It's simply the easiest and most politically palatable solution. The cost is largely hidden, and it's spread throughout society (though unfortunately mostly borne by the poor). It is always easy to run your printing presses in order to monetize government debts and deficits. Of course, it isn't a wise solution, and it's bound to cause untold blowback in the future. Still, it's an easy short-term political "solution", and we all know that our politicians can't see past their next fundraiser.

With all of that as a background, you shouldn't have been surprised by recent central bank action. In recent days, the Bank of England, the Federal Reserve, the Chinese government, and the European Central Bank have all made it clear that, when pressed, they will continue to ease. Our Fed extended its Operation Twist program, China reduced some key interest rates, the BOE boosted the amount of its quantitative easing (QE), and the ECB lowered two key interest rates. Let's not leave out the central banks of Australia, the Czech Republic, Kazakhstan, Vietnam and Israel, which all cut rates in June, or the Swiss who were still busy buying Euros in order to keep the Franc from appreciating. The magnitude of the recent eases by the larger central banks may have underwhelmed some, but the key point is that easing remains the order of the day. We should expect this to remain standard operating procedure going forward, with an increasing use of nonconventional monetary tools with each new crisis and with the magnitude of each policy response tied directly to the magnitude of each flare up.

Monetary debasement and financial repression remain the key policymaking tools. In addition, the massive global debt bubble continues to fester, banks continue to operate with insufficient capital, counterparty risk is still very real, and trade tensions are building. We're now learning that one of the world's key interest rates (LIBOR), on which hundreds of trillions of dollars worth of derivatives and loans are based, has been manipulated by member banks for years. Our long-term thesis for owning the precious metals remains firmly intact.

Performance

It was an ugly quarter across the board for most asset classes. Were it not for the big end-of-quarter rally on the last trading day of the quarter, the results would have been even worse.

Index/Market	2Q12	YTD	1-Yr
S&P 500	-3.29%	8.31%	3.14%
DJIA	-2.51%	5.42%	3.75%
Nasdaq	-5.06%	12.66%	5.82%
Vanguard Total Stock Market (VTI)	-3.54%	8.40%	1.90%
Vanguard International Stock Index (VGTSX)	-7.46%	3.60%	-17.20%
Europe - Euro STOXX 50 Price EUR	-13.58%	-6.86%	-24.25%
China - Shanghai SE A Shares	-1.67%	1.15%	-19.46%
India - BSE India Sensex 30 Index	0.15%	12.78%	-7.51%
Emerging Markets (VWO)	-8.14%	4.50%	-17.87%
iShares Aggregate Bond (AGG)	1.32%	0.95%	4.34%
Dow Jones Commodity Index (DJP)	-5.06%	-4.88%	-14.93%
Gold (SPDR Gold Trust - GLD)	-4.27%	2.11%	6.29%
Silver (iShares Silver Trust - SLV)	-15.07%	-1.08%	-21.25%
Gold Miners (HUI Gold BUGS Index)	-9.54%	-14.23%	-17.98%
Oil (Cushing WTI spot)	-20.76%	-13.95%	-10.77%
U.S. Dollar (UUP)	2.56%	0.00%	5.89%

The “winners” in the quarter were the U.S. bond market and the dollar. The dollar benefitted from a flight to safety thanks to the continued trouble in Europe, while bonds moved higher on the back of a slowing economy. The big losers were European stocks, silver, and oil.

Year-to-date, the biggest losers have been oil, European stocks and the gold miners. Over the last year, the only modest winners have been tech stocks, gold, U.S. bonds, and the U.S. dollar. Everything else looks pretty ugly.

Aspera Performance

With the precious metals sector still under pressure, we didn’t escape the quarter unscathed. I expect continued volatility in this sector to result in highly variable short-term returns. This has been the case for years, and there’s no reason to expect it to change. Nevertheless, we are due for a couple quarters of solid numbers driven by a bounce in the miners.

As always, our non-bond yield positions need to be viewed in the proper context. Think of these as perpetual bonds. Their prices will fluctuate with the stock market, but these are not owned for their appreciation potential. They are owned for the attractive yield they are providing us. This yield does not change for us based on whether the security rises or falls in price. The yield will change for us based on the operations of the company over time. I do not intend to sell these securities if they rise 20% (and a number have risen much more than that since we’ve owned them), and I certainly don’t intend to sell if they fall in price by 20%. Why am I repeating all of this again? A portion of our reported return is driven by the price changes of these securities. I do not care when their appreciation boosts our returns in a given quarter, and I do not care when their price depreciation hurts our returns in a given quarter. Neither should you. Our only concern with these securities is their ability to maintain and grow their dividends and distributions over time. [If you need further clarification, please review the “What And Why” piece I wrote on yield at the beginning of this year.]

Existing Position Updates

Extorre Gold Mines (XG)

Extorre has provided an incredible ride in its short life. XG was spun out of one of our other holdings, Exeter Resources, in March of 2010 in order to better focus on the development of its Cerro Moro Project in Argentina. The stock initially traded at $2.00 per share. It ran up to $14 in July of last year before falling as low as $2.15 last quarter. We sold half of our position north of $12 at the end of June last year.

When discussing that sale in last year's Q2 Review, I wrote, "I suspect they'll be attracting an increasing amount of attention in time with a strong possibility of eventually being purchased by a larger competitor." In the May Update on precious metals, I commented that, "With new mines becoming more challenging to find, I suspect we'll see a pick-up in merger and acquisition activity as the larger firms accelerate their purchases of the smaller players with attractive properties but limited access to capital." It didn't take long. On June 18th, Yamana (another one of our holdings) announced that they were buying XG for a little over $4.00 per share. All in all, this has been a very good name for us. It's also representative of the tremendous volatility that comes with the junior miners.

Sara Lee (SLE)

You may have noticed that Sara Lee is no longer in our portfolio even though we didn't sell our position. Sara Lee effected its split into two separate companies at the end of the quarter. In return for our Sara Lee shares, we were given an equal number of shares in the new international coffee and tea business (D.E MASTER BLENDERS 1753) as well as shares (one-fifth as many shares as we held in SLE) in the newly named Hillshire Brands (HSH), which will focus on "food products and foodservice operations."

In addition, the company paid the $3.00 per share dividend that they promised last year. SLE was a solid and safe performer for us, and I expect the separate companies to perform well. There is already speculation swirling that HSH will be acquired at some point, and I would be surprised if this didn't happen eventually. Each of the two new companies would make good acquisition targets.

Nokia (NOK)

Let's keep this new section balanced with an update on one of our poorest performers. Nokia had been a dog well before we dipped our toe in it, and it hasn't stopped barking since. The company reported disappointing results in April and another (needed) restructuring in June. We have never been blind to the risks in this name and have always viewed this small position as a call option with no set expiration date. As with any call option, there is the potential for big upside as well as the potential for a total loss (which is why it's a small position).

In the meantime, the company continues to struggle with the same risks they faced when we dipped our toe in. Overhead is still too big, products aren't flying off of the shelves, and increased competition is pressuring margins. All the while their pile of cash is continuing to dwindle, prompting debt downgrades. I continue to hear very good things about the Lumia line of phones, but as I said when we bought the position, "…even if the technology is wonderful, it doesn't mean that customers will buy it." Despite the risks and headwinds faced by the company, we'll hold on to our small call option.

Trading Activity – Closed or Reduced Positions

It was a quiet quarter of trading.

YPF S.A. (YPF)

We didn't end up owning YPF for very long. I discussed the purchase last quarter, and while I highlighted the many risks facing the company, I believed the odds favored some type of negotiated solution with the Argentinian government. Whenever we're talking about politicians, however, there is the strong likelihood

that short-term political decisions will outweigh long-term economic decisions. Instead of taking a position which would actually encourage the future development of the country's energy sector, the Kirchner government instead opted for a short-term boost to their poll numbers. In April, the government decided to nationalize the company. Since that time, the government has enacted a number of additional misguided economic measures. Argentina never seems to learn. They've endured repeated crises in the past, and they're in the early innings of their next one. We sold our YPF position at a loss early in the quarter. Loss or gain, whenever our thesis for owning a security changes in a sufficiently negative fashion, we part ways.

I do want to note, however, that I don't view the YPF purchase as an error. This is an important point and is not intended to sound like an excuse. I often say that if I'm "wrong" up to 40% of the time, we will do well over time. Clearly, YPF falls in that 40%, but I still feel very comfortable with the analysis underlying the purchase. In every situation, there is a probability distribution of possible outcomes -- some good, some neutral, and some bad. My job is to try and recognize the many various outcomes and apply a weighting and return potential to each. The weighted average of the combined outcomes is our expected return. In the case of YPF, there was a possible outcome of a 100% loss if the company was essentially stolen by the government. That was factored into the analysis, as were other negative possible outcomes, including the one that actually played out. Of course, there were a number of possible positive outcomes as well. One of those was for YPF to be acquired by another company (at a premium) which was on better terms with the Argentinian government. According to many accounts, a large Chinese oil company was very close to making an offer for YPF at a price 40-50% above our purchase price. There is often a fine line between being "right" and "wrong" when it comes to stock picking.

Trading Activity – New or Increased Positions

Newmont Mining (NEM)

We added Newmont to a number of accounts in early May. Newmont is one of the largest precious metals mining firms in the world, with producing mines and development prospects on a number of continents. The stock has been hit with the rest of the sector, and conflict surrounding one of their large development projects in Peru hasn't helped. Despite this, the company has a well-diversified global portfolio and is sporting a dividend yield near 3%. NEM has a terrific policy of linking their dividend payout to the price of gold. While we don't own as many individual precious metal names in our more conservative accounts, NEM is one of the exceptions.

Market Vectors Junior Gold Miners ETF (GDXJ)

As the miners fell further through May, we added to our GDXJ position in the middle of the month at around $18 per share. While the price could always fall further in the near-term, this level strikes me as a steal.

Portfolio Positioning and Outlook

Given how little trading we did last quarter, our portfolio position hasn't changed. Our portfolios continue to look like a barbell. On one end, we have our precious metals positions with a few other value stocks sprinkled in. Our expectation is that this will provide appreciation over time and help preserve the purchasing power of our portfolios. On the other end of the barbell, we have our cash and yield positions. This includes TIPs, short-term high-quality bonds, and a basket of limited partnership and equity positions providing a nice and (relatively) safe yield.

I remain very comfortable with this positioning. Most of our precious metals exposure is core for us and will likely be owned for some time still as the global crisis continues to unfold. The yield positions we've built are generating nice income for us as they were bought well. We have a good deal of cash (and cash substitutes) available if the wheels really come off. I intend to keep this dry powder handy. [If necessary, please review the "What And Why" piece on cash.] As you know, I'm not about to get lured into any short-term market rally or enthusiasm given the risks that I see ahead and the general lack of compelling valuation.

Nevertheless, prior to the recent sharp rally on the heels of the latest Euro summit, I was finding some opportunities that were beginning to look interesting. As usual, these include some out-of-favor firms, countries, and sectors that have been under serious pressure but are looking interesting on a long-term basis. Don't be surprised if we add some new names on further weakness. Given my overarching concerns about the market, we'll continue our go-slow approach of dipping a toe in with new names as opposed to buying large positions initially.

It's been a little while since I've reminded everyone that we remain in a low-return world. That doesn't mean that we won't see a good deal of volatility. We will have periods of good performance and periods of weaker performance, but we should not be expecting large returns in a world that provides zero or a negative yield on safe securities. Our primary goal remains to come out the other side of this long crisis in good shape and able to take advantage of the compelling values which will likely accompany the beginning of the next great bull market. That day will come. Eventually, the moon will stop exerting such an abnormally strong gravitational pull on our planet.

Have a great quarter!

Best,

Ken Bell, CFA, CFP
President
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