Featuring investment coverage of precious metals, base metals and gems

Steve Palmer: Get in Early, Short Gold

Source: Brian Sylvester of *The Gold Report* 12/15/2010



If you're looking for an upward-trending outlook on gold from AlphaNorth Asset Management President and CEO Steve Palmer, it's not coming anytime soon. "If you just look at the supply/demand factors outside all the gold investment demand, it's not a pretty picture," he says. But he's still making money on junior gold equities. The AlphaNorth Partners Fund, about 10% of which is comprised of gold small caps, has averaged returns of 28.4% since it started in 2007. In this Gold Report exclusive, Steve explains his position

on gold and shares some of his favorite gold juniors in the Yukon.

The Gold Report: For our readers, who may not know much about AlphaNorth Asset Management, please give us an overview of your company, its funds and how you manage them.

Steve Palmer: My partner Joey Javier and I founded AlphaNorth in 2007. In December of that year, we launched the AlphaNorth Partners Fund, which is a long-biased, small cap-focused hedge fund. We focus on Canadian securities, primarily. The goal of the fund is to maximize returns over the longer term. I should also comment that it's a diversified fund, so it's not a strictly resource fund. Typically, it's half resource focused and half technology and special situations.

TGR: The fund has averaged annualized returns of about 28.4% since it launched in 2007. Congratulations!

SP: Thank you.

TGR: You're welcome. In another interview, you said you select these companies based on what you call "inefficiencies" in the small-cap space. What constitutes inefficiencies?

SP: In the Canadian micro-cap and small-cap spaces quite often there's a lack of general awareness of company fundamentals, especially if there's no research coverage or institutional ownership. Frequently, there are orphaned companies with some exciting prospects and nobody knows about them. So, we try to identify these early stage situations and get on board at a cheap price before they become widely known.

TGR: How do you find these companies? Is there a certain process you go through? Or, are your decisions influenced by what you hear on Bay Street?

SP: Well, we have quite a large network of friends and people in the investment business who are giving us ideas all the time. We do some of our own screening, as well.

TGR: You started in the investment business back in the mid-1990s as a research associate, and then you became an analyst. I know from some previous interviews that you very much believe in technical analysis of companies. Are we talking discounted cash-flow models or charts? Are we looking for catalysts?

SP: Technical analysis in terms of reading stock price charts to complement our fundamental research. Technical work has been very useful for us in the past, as it helps us time our buy and sell decisions.

TGR: What sort of charts?

SP: I use candlestick charts exclusively. We overlay several other technical indicators on our candlestick charts. These charts were not very common in the mid-1990s but now they're used much more to identify patterns. We have found technical analysis particularly useful in instilling sell discipline; for instance, selling is the trickiest component of investing. A lot of people buy in at the same time, but timing when to sell is the hardest part.

TGR: What are some rules of thumb that you've managed to work out for selling?

SP: One rule of thumb from your fundamental analysis is to have an idea of what a company is worth. When it gets into that range, you're looking for an opportunity to sell. We wait for the charts to confirm it's time. At other times, they help you say, "Well, I think this thing may go further still."

TGR: Both the TSX and TSX Venture Exchange were up last week and are at or near their highest points since the 2008 crash. In such markets, the bases for company valuations often cease to be only fundamentals and regularly get caught in the momentum of the market. How do the charts work when everything is up like that?

SP: The market was up over a few days but it hasn't been particularly volatile lately. It's just been trending up nicely for the last three months. I don't think things are getting too crazy. The S&P 500 Index is trading at 13x forward earnings; this is particularly cheap in the context of a fixed income environment where yields are so low So, I don't think equity valuations are out of whack.

In Canada, the markets are largely resource focused. Our indexes have a much bigger component in resources and the primary driver of those share prices is what the underlying commodity prices are doing. Gold's been hitting new highs and oil has increased to the \$88-range last week, so it shouldn't be surprising that the stocks are following.

TGR: As a percentage of your holdings, how many bought at the private-placement level?

SP: Most of them. I like to buy as private placements because you get the additional leverage of the warrant, and there's no trading cost to get involved. You don't pay commission on the purchase and you can buy it at a discount quite often.

TGR: So, you don't go through a broker?

SP: Sometimes it's directly with the company, but most of the time it's through a broker—or brokers—if it's a big deal.

TGR: You said in a recent interview with SmallCapPower that you're something of a gold bear and you're short COMEX Gold. Please explain the rationale behind that decision.

SP: Well, it's a somewhat contrarian call. Gold is a very crowded trade. Investors are unanimously and wildly bullish on gold and they have this view regardless of the unfolding economic situation. In recent quarters, I think the gold market is being driven entirely by investors and exchange traded funds (ETFs). Many ETFs have entered the market and there is much gold hoarding. If you just look at the supply/demand factors outside of all of the gold-investment demand, it's not a pretty picture. Another thing I don't like about gold is that it's not good for anything other than to wear around your neck. I much prefer buying a commodity that is useful to people, such as oil.

TGR: You have numerous positions in small junior gold companies, nonetheless, many of which are in the AlphaNorth 2010 Flow-Through Limited Partnership Fund. What tax advantages are there for being vested in a fund like that?

SP: Our Flow-Through Fund provides investors a tax write-off of the purchase amount, so that has the effect of lowering the breakeven costs of the investment. It also has the capability to convert earned income into capital gains, which are taxed at half the rate.

TGR: To make this clearer, let's use a round number as an example. If an investor put \$10,000 into your fund, how much of that investment would he or she receive as a tax refund?

SP: If you're at the highest tax bracket, which is 46% in Ontario, a \$10,000 investment will generate a \$4,600 refund, a little more once you add in some of the other expenses relating to the investment. So, it's closer to 50%.

TGR: Flow-through shares are a government-sponsored program that encourages exploration and development of Canada's natural resources. What are some companies in your Flow-Through Fund?

SP: One that we have a position in is <u>Taku Gold Corp. (TSX.V:TAK; OTCBB:TAKUF)</u>. I mentioned earlier that I'm not very bullish on gold as a commodity; but in several situations, I purchased gold companies. The primary driver of investment return on these companies is not expected to be the gold price, so it doesn't matter if gold is up or down \$200/oz.; it's something specific to the company that will drive the performance. One area that I'm quite excited about is the Yukon. Recently, some significant discoveries have been up there. I have several investments in companies exploring in the Yukon. Taku Gold is one, and I'm quite excited about a private company called Ryan Gold Inc.

TGR: Is that company named after the prospector, Shawn Ryan?

SP: Yes, and that's probably my favorite gold company right now. There's a reverse takeover going on with <u>Valdez Gold Inc. (TSX.V:VAZ)</u>. If everything is approved during the shareholder meeting this month, it should begin trading as Ryan Gold shortly.

TGR: All right, you mentioned there are a few companies you like in the Yukon. Besides Taku and Ryan, what other companies do you have your eye on?

SP: Those are my two favorites in the area. <u>Golden Predator Corp. (TSX:GPD)</u> is another one that has a property up there.

TGR: Let's move away from gold and talk about some other promising companies in that fund. What are some others that you like?

SP: Well, we have a significant investment in <u>Puget Ventures Inc. (TSX.V:PVS)</u> in our flow-through fund. AlphaNorth owns more than 10% of the shares across the funds we manage. The company is in the process of being taken over and re-emerging under the name Global Cobalt Corp., so the stock's been halted for a couple months pending completion of that deal. I expect it will start trading significantly higher than where it last traded sometime in the first quarter of 2011.

TGR: Where are Puget's projects?

SP: It has the Werner Lake Belt Deposit in northwestern Ontario. But the asset that's being merged into it is a Russian asset that is significantly larger. This will become a pure cobalt play, and there aren't many of those around.

TGR: No, it's usually mined as a byproduct in base metals operations. What are some uses of cobalt?

SP: Cobalt is used mostly in steel and batteries. Most lithium batteries use a significant amount of cobalt, as well. Recently, investors have been very excited about the prospects for lithium but cobalt goes hand in hand with that.

TGR: Let's get back to your other fund, the AlphaNorth Partners Fund, where you have had some success with rare earth element (REE) companies. What are you seeing in that sector?

SP: The rare earths sector is quite small. I guess the biggest driver is all the press around China being the largest rare earth producer. The country produces more 90% of the world's REEs, but it has put some restrictions on exporting those materials and the prices of many of REEs have gone up significantly. So, there's a scramble to develop and find rare earth deposits outside of China.

In the summer, we were accumulating some of the rare earth names. We identified the trend fairly early and got in on several situations with which we've done quite well. We've really seen investors pile into that sector over the last two or three months; more recently, it seems a little overheated so we've taken some profits.

TGR: What are some companies that may be still poised for further growth?

SP: Stans Energy Corp. (TSX.V:RUU) would be my favorite rare earth company.

TGR: Why do you like that company?

SP: It has an asset in Kyrgyzstan that was a previous producer. The Russians mined it for about 20 years or something like that. The company has further resources there and prospects for additional resources. The metallurgy is known and the company has the rights to a mill, which can be brought back into production fairly quickly. That's why I like that one.

TGR: Do you have some parting thoughts on the overall mined resources sector?

SP: Well, that whole space is highly dependent on growth in Asia—that's been driving the demand for these commodities. So, the biggest risk would be a slowdown in China. That's why we don't position the fund entirely as a resource play. We buy a lot of names that are less sensitive to Asian growth in non-resource sectors.

TGR: Thanks, Steve. We appreciate your insights.

Steve Palmer and Joey Javier, an investment team since 1998, took three key assets—their excellent track record, their experience and their belief that exploiting inefficiencies in the Canadian small-cap universe would produce superior long-term equity returns to <u>AlphaNorth Asset Management</u>, launching the Toronto-based investment management firm in August 2007. AlphaNorth currently manages the AlphaNorth Partners Fund, a long-biased, small cap-focused hedge fund and the AlphaNorth 2010 Flow-Through LP.

Steve, who is a Chartered Financial Analyst, earned his BA in economics at the University of Western Ontario. After starting in the investment community as a research associate, he moved to a major financial institution in mid-1998 where he met Joey and built his career. As VP of Canadian Equities, he managed assets of approximately \$350 million, including a pooled fund that focused on small-cap companies.

Want to read more exclusive *Gold Report* interviews like this? <u>Sign up</u> for our free e-newsletter, and you'll learn when new articles have been published. To see a list of recent interviews with industry analysts and commentators, visit our <u>Expert Insights</u> page.

DISCLOSURE:

- 1) Brian Sylvester of The Gold Report conducted this interview. He personally and/or his family own shares of the following companies mentioned in this interview: None.
- 2) The following company mentioned in the interview is a sponsor of *The Gold Report* or *The Energy Report*: Puget Ventures.

 3) Steve Palmer: From time to time, Streetwise Reports LLC and its directors, officers, employees or members of their families, as well as persons interviewed for articles on the site, may have a long or short position in securities mentioned and may make purchases and/or sales of those securities in the open market or otherwise.

Site Index Usage Agreement © 2010 Streetwise Reports LLC