

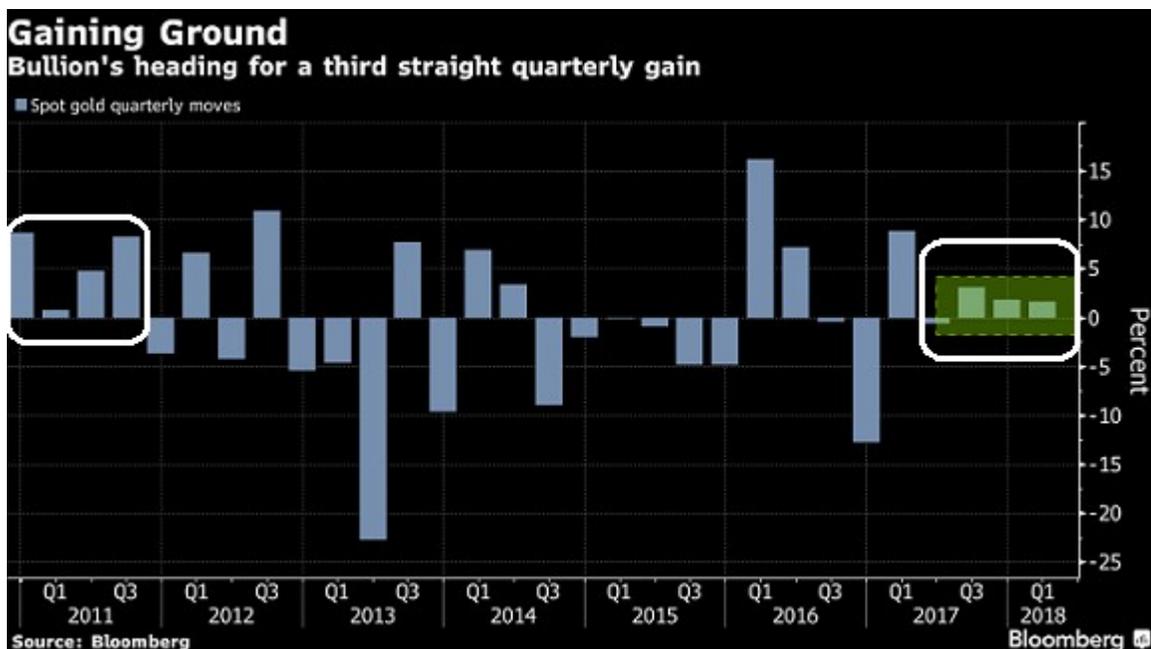
MINING STOCK JOURNAL

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Gold Has Its Best Run Since 2011

It may be hard to believe, and I know it doesn't feel like it to me, but gold has had its best run since 2011, as it finished Q1 2018 with its third straight quarterly gain.



Interestingly, the commodities team at Goldman Sachs, for what its worth, have taken a bullish stance on gold for the first time in more than five years. Part of their rationale is that, according to them, gold appears to have "dislocated" from interest rates, meaning gold is moving higher in spite of rising interest rates. They also cite an uptick in inflation.

I wouldn't expect Wall Street analysts to have all the facts correct. In this case, they are insinuating that the gold and interest rates move inversely. The data going back to the early 1970's, however, show that gold turns in its best performance during Fed interest rate hike cycles.

A study by precious metals researcher, Adam Hamilton, showed that over the last 50 years, on average, gold has its best returns when the Fed interest rate hike cycle is gradual. The theory behind this finding is that, by the time Fed decides to start raising rates, the market perceives that the Fed is well behind in addressing a rising rate of inflation. The current rate-hike cycle features both of those factors. I hope this addresses anyone who might be concerned about the price of gold while the Fed is hiking rates.

I still believe that there is one more drop coming in the price of gold. As I'm sure many of you have noticed, gold is being successfully capped in the \$1350-1360 area. For now, until proven otherwise, I'm sticking with my view that the open interest in gold futures needs to decline by 50-70k contracts before gold can stage a meaningful move toward \$1400.

Currently the open interest as I write this is just under 500k contracts. It's declined about 30k contracts since last week's COT report. Ideally I'd like to see the o/i around 430k. At that point we'll look to put all of our cash to work.



The chart above is a 1-yr daily of the Comex gold "continuous contract." It approximates the current front-month contract (June gold). You can see that \$1310 has been solid support since the beginning of 2018 after serving as "resistance from October 2017 thru the end of 2017. Gold closed just below its 50 dma on Thursday. I would not be surprised to see a drop in price to somewhere between \$1310 and the 200 dma (\$1295, red line). In fact, if that's what it takes to clean out the hedge fund long position, I'd welcome it.

That said, gold has been acting well, especially on days when the Dow/SPX are tanking hard. This is despite the negative sentiment that has permeated the precious metals sector and despite the blatant price-capping by the Comex banks.

I want to address briefly the issue of the bank silver short on the Comex. The "swap dealer segment" was net long a record 20k silver contracts as of a week ago Tuesday (cut-off date for the COT report). However, the producer/merchant/user category was net short a hefty 27k contracts. Netted out, the commercial/bank COT category is still net short silver. While the producer segment positioning contains legitimate hedging positions by producers and users of silver (jewelers, manufacturers, etc), the bullion banks also throw a hefty portion of their silver short position into this category. As such, in my opinion, the silver COT structure is not quite as bullish as some analysts are presenting. At this point, I believe gold will lead both metals higher when the next big move begins. Once that move is underway, I'm highly confident silver contract short-covering by the hedge funds send silver soaring.

Most of the juniors have been quiet. Because of the overall relative indifference to the mining stocks right now, good exploration news is ignored by the market and negative news is punished relentlessly. That said, the HUI/GDX/GDXJ have been in a subtle uptrend:



The graph above is a 1-yr daily of GDXJ. It's been in an uptrend since early December 2017. The HUI and GDX began to form an uptrend in mid-March. This is a positive indicator as long as the trends continue. It seems that even on days when gold gets bombed on the Comex, the mining stocks have been holding relatively firm.

Company Updates

Pure Gold - (LRTNF, PGM.V - US\$0.49) - On Tuesday this week, Pure Gold released metallurgical test results which will be incorporated into the Feasibility Study for the Madsen Project. For those of you who were wondering, "metallurgy" is the science and art of separating metals and metallic minerals from their ores by mechanical and chemical processes. Understanding how to efficiently and cost-effectively separate gold and silver, etc from the ore is critical to determining whether, and at what price, a precious metals mining project can succeed.

The metallurgical testing conducted by PGM focused on three areas of the Madsen deposit. The high-grade gold recoveries averaged 95% and ranged from 90-99%. The results will be used to optimize and fine tune the economics of the Project. The Feasibility Study is expected to be released in Q4 this year.

I believe PGM is undervalued relative to the risks of never achieving production status plus relative to the high quality of its grade vs other near-production and producing small-cap mining stocks. If you are looking for a higher quality junior this is one to own. If you already own it, adding to your position on sell-offs will be rewarded. Because of its high-grade ore, PGM's earnings and stock price should move more than peer stocks when the price of gold rises. AngloGold Ashanti owns 11.4% and Goldcorp owns 7.2%.

US Gold Corp - (USAU - US\$1.50) - USAU bounced sharply from the last week's sell-off. It appears that the sell-off was driven both by retail selling based on another newsletter's stop-loss recommendation at \$2 plus "pile-on" short-selling. I discussed the technical-based selling by retail holders in the update I sent out last week.

On Tuesday I received a call from Schwab that the brokerage firm was paying a 47% rate of interest on USAU stock loans. Easy to borrow shares are loaned out to short-seller's at the margin rate plus a negligible fee. Hard to borrow stocks cost more to borrow. Shares that are potentially involved in a short-squeeze incur exorbitant rates of interest. The fact that Schwab

is offering to pay 47% (annualized rate of interest) to accounts willing to lend USAU shares tells me that short-sellers piled onto the down-side momentum in USAU last week and now the shares are extremely hard to borrow. We could see a short-squeeze in the shares sometime soon.

Dave Mathewson disclosed in an SEC filing (Form 4) that he purchased 10,000 shares of USAU last Wednesday (March 28th) at \$1.27 in the open market. Recall that Dave receives 75% of his salary in shares. I can't think of any better affirmation of the potential prospects for an exploration mining company than the chief geologist buying shares with after-tax cash from his bank account. Also recall that a group led by the largest shareholder, Luke Norman, purchased a \$5 million preferred issue that was converted into shares at \$2/share.

My point here is that the drop in USAU's share price last week was completely unsupported by any conceivable fundamental news or developments. There will not be any meaningful news flow from the Company until the results from the drill program begin to flow. Hopefully, if the spring thaw cooperates, the drills will start turning in late May, which means news will start flowing in mid to late July, depending on the turn-around time by the assay lab used.

Since the shares dropped below \$2 in mid-February, we have bought stock in the fund from \$1.99 all the way down to \$1.24. USAU is, by far, the largest stock position in our fund and we have room to add more on any weakness in the stock.

Precipitate Gold - (PREIF, PRG.V - US\$.05) - GoldQuest (the Romero Project just to the north of PRG's Juan de Herrera Project in the Dominican Republic) announced last week that the local court in its district issued an injunction against GoldQuest's activities on the Romero Project. It appears that this is a technical issue (more on GoldQuest below) that will not affect Precipitate. I used the news as an opportunity to get an update from PRG CEO, Jeff Wilson.

Jeff spoke with GoldQuest's CEO, Bill Fisher, about the matter. It appears as if the issue is specific to GQ and the Romero Project the Project's "footprint." In going from an "exploration company" to an "exploitation company," specific "exploitation" licenses need to be obtained. Apparently the court is not satisfied that GQ had all of the appropriate licenses in place before it transitioned from a exploration to exploitation. GQ is seeking clarification on which certificates and licenses need to be obtained in order to address the matter. PRG has all exploration licenses and permits, including drill permits.

Currently PRG is fully-permitted to drill 120 holes. It also has about \$1.5 million in cash and a very low cash-burn rate. Having said that, Jeff is inclined to move conservatively until further clarity on the GQ situation is received. The Dominican Republic has always been mining-friendly, as it hosts one of the largest gold mines in the world (Barrick/Goldcorp Pueblo Viejo mine).

Jeff is working on formulating the next steps to take to advance the project. He wants to see the judge's ruling on Romero before ear-marking drill funding commitments. The court should be issuing a ruling on Romero in the next week or two.

Here's my assessment of PRG at this point. We still own about a 1.5% capital allocation in the fund. We have not sold any shares. I think Jeff operates very conservatively (maybe too conservatively) and an investment in this stock will require a lot patience. However, I also believe, given what's already been discovered and declared on the Romero Project (1.1

million probable + 2.2 million indicated gold ozs + copper, zinc and silver), that Juan de Herrera has significant upside potential.

Along with other larger shareholders, I encouraged Jeff to at least commence with some type of targeted drill program this summer in order to get some positive news flow. I believe that the stock could easily double, from 5 cents to 10 cents (US\$) if the Company produces a handful of drill holes on identified follow-up targets that show positive results. In February, GoldQuest stock was trading at 36 cents (US\$) - a US\$91 million market cap. PRG's current market cap is \$3.75 million. If it were to produce positive drill results, the stock should easily reprice to at least double the current market cap - i.e. it should be an easy double from 5 cents. Accordingly, we will likely add shares to our position at some point in the next few weeks.

Treasury Metals - (TSRMF, TML.TO - US\$0.42) - In late March TML released the results of its infill drilling program conducted on the Main Zone of the Goliath deposit. The results will be used to raise the grade and size of the resource in the next resource report, which is expected to be released during Q2 2018. The Company also announced that it will begin "step-out" drilling along the Main Zone this month.

For 2018, the Company has laid out plans for 12,000 meters of in-fill drilling (upgrade the quality of the resource) and 15k meters of expansion drilling. It is working on the crucial environmental permitting as well as engaging in expanded community relations with First Nation. TML has targeted Q3 this year for releasing a Pre-Feasibility Study.

TML is a solid core holding in any junior mining portfolio. While there's still the risk present that the Project might not ever be converted into a mine, the Project has been substantially de-risked. The current market cap using fully diluted shares is US\$60mm. TML currently is projecting a mine that will produce 100k ozs./yr. Current 100k/oz year mining stocks trade anywhere from US\$150-300mm, in general. In this context, buying into TML at a US\$60mm market cap represents a good risk/return, expected value investment.

We own a slightly higher than average weighting in our fund. I will say I expect that the Company will have to raise money sometime this year. That might be a good opportunity to start a position or add to an existing position.

GoldQuest Mining - (GDQMF, GQC.V - US\$0.15) - GoldQuest Mining is developing the Romero Project in the Dominican Republic, a gold/polymetallic project that sits adjacent to the north of Precipitate's Juan de Hererra Project. Romero currently has 1.1 million ounces of probable gold-equivalent reserve, 2.3 million ozs of indicated gold-equivalent ozs and 240k ozs of inferred gold-eq ozs. The reserve resource contains silver and high-grade copper; the indicated/inferred resource contains silver, copper and zinc. Agnico-Eagle (AEM) invested US\$17.6 million (C\$22.8 million) in cash for 15% of GQC.

Currently GQC has a Prefeasibility Study that shows a project with a \$203 million NPV and an after-tax IRR of 28%. The study assumes \$1300 gold, \$20 silver and \$2.50 copper. The mining operating would produce 109k ozs of gold annually, on average, over 7.3 years.

The stock, which has been as high as US\$0.50 in mid-2016 and was trading at US\$0.36 in January, took a cliff dive last week when the local jurisdictional court in the San Juan Province issued an injunction against GQC which required that the Company suspend its activities at

the Romero Project until certain certificates and licenses are issued. The injunction was issued last Tuesday. The stock has been trading around 15 cents US\$ since the injunction was issued, down 58% from its January high.



If you have no interest in being exposed to potential political risk, you probably do not want to look seriously at this idea. However, based on my conversation with CEO, Bill Fisher, this is a situation that will be resolved and the injunction has created an opportunity to buy into a great project at a highly attractive valuation level.

The reason for the injunction is still not entirely clear to the Company or its attorneys. The Company was awarded two new exploration licenses in mid-November. An exploitation permit was approved by the Minister of Energy and Mines on January 18th this year and sent to the President of the DR for ratification. The exploitation license is conditional on GQC's preparation of an Environmental Impact Study (EIS). Both are needed to advance the Project to production.

As mentioned earlier, only a summary of the decision was released and it was unclear in several respects, including the extent of the activities that must be suspended and the exact area on the Romero property to which the Decision pertains. It is expected that the Court will issue a written explanation/clarification for the basis of the ruling any day now. The Company will then understand what needs to be done to address the injunction.

With the exploitation license literally sitting on the President's desk waiting to be signed, some local citizens in the San Juan Province filed a complaint against the Company with respect to the Project in the local court, which then issued the injunction. The issue is concern over the environmental impact of the Project. Ironically, the Company is prohibited from commencing with an EIS while the injunction is in place.

This matter should ultimately be resolved fairly quickly because both the President and the Ministry of Finance are in favor of the Project. Tax revenues from mining represents 40% of the Government's revenues. This project per the Pre-Feasibility Study will provide \$300-350 million in revenues to the Government over the life of the mine (the mine-life will likely be longer than the 7 years in the PFS).

Bottom Line - As mentioned earlier, this situation involves a large element of political risk, though I believe considerably less risk relative to the Tahoe Resources risk in Guatemala. CEO Bill Fisher has extensive experience the development and operation of mines in numerous jurisdictions. He formerly led Globestar Mining's development of the Cerro de Maimon copper/gold mine in the Dominican Republic until it was sold for \$186 million from an initial investment of \$350k. Bill is also on the board of directors of Treasury Metals.

I see this as an opportunity to invest in a high quality gold/polymetallic project at a fire-sale valuation level. The current market cap is \$38 million - essentially \$11 per ounce of gold and gold-equivalent in the ground. Once this matter is resolved, it will take 12-18 months for the EIS and 7-8 months for the Feasibility Study to be completed. Both of those activities will run concurrently. The Company will also need to upgrade the roads to get a road usage permit and upgrade the power lines. Once the Company can move forward, it will be a little more than three years to have an operating mine in place.

GQC has \$23 million in cash, which translates into 9 cents per share. That should be the downside for this stock in the worst case scenario. In my opinion, the risk of the worst case outcome is more than compensated by the potential upside that will be realized if the injunction is removed and the President signs the exploitation license.

Assuming a resolution to this situation, I believe the stock is an easy double by the end of the summer, if not sooner, from the current price of 15 cents (US\$). With a \$203 million PFS Net Present Value using conservative assumptions, absent the political issue the Company's market cap should be closer to US\$80-100 million (30-40 cents). Furthermore, the Project has significant exploration upside. Assuming this matter is cleared up, there will be a lot of exploration and project advancement news released that should drive the stock price considerably higher.

In my view, the upside potential more than compensates for the risk being taken at the current market price. Keep in mind that the Dominican Republic Government has never said "no" to a mining project. Bill told me that he's spoken with a couple of large funds who said they would buy shares up to 40 cents when the injunction is removed. We have put an underweighted position in the fund (about the same weighting as Precipitate Gold). As I get more comfortable that this situation will be resolved, we will overweight the position and hold until the stock reaches at least 45-50 cents.

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