ASPERA REVIEW

Intelligent, Independent Investment Management

4Q 2011 Portfolio Review: Gold Miners Meet Wood Shed

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Aspera offers independent fee-only investment management and advisory services throughout the Triangle area and nationwide.

Every client portfolio is separately managed.

The securities and strategies discussed in this Review may not apply to every client portfolio.

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"You know how screwed up Europe is when you have a German pope and an Italian central banker."

Kyle Bass

Most people assume that the name of my firm comes from one of a few sources:

1. It is a derivative of the word "aspiration" -- sounds good for an investment advisory firm.
2. It comes from the Latin phrase, "per aspera ad astra" which translates to "through hardships to the stars" or "to excellence through effort." Again, very nice for an investment firm.
3. My firm is part of ASPERA – a European network of national government agencies responsible for coordinating and funding national research efforts in astroparticle physics.

I can assure you that #3 played no role in the naming of my firm. My job is far more challenging and mysterious than determining what the universe is made of, the origin of cosmic rays, or the nature of dark matter.

#1 played a minor, secondary role. #2 is actually pretty close, as the primary reason does have to do with the Latin translation of "aspera." It turns out that one of its definitions is "stormy." It also turns out that Stormy is the name of one of my dogs. Yes, my business was primarily named after my dog. Of course, I could have named the firm Stormy Financial, but I was told that it didn't evoke the type of imagery I might by aiming for. So, Aspera it was.

I'm sad to say that my company's namesake was put to sleep in November, after 17 years of loyal companionship. She was an incredibly faithful and loving dog who could always be found under my feet while I worked. She would have made a great investor given her patience, high pain tolerance, curiosity, strong nose, and frugal lifestyle. I'll always be reminded of her whenever someone mispronounces "Aspera."

Farewell 2011 – You Won't Be Missed

The best thing I can say about 2011 is that it's over. 2011 won't go down as one of my favorite years. My workload was as heavy as ever, my dog died, my rental house was hit by a tornado, and my favored gold mining stocks were about the only thing that took Harold Camping's prophecy of Armageddon seriously. The closest I came to taking any serious vacation time was when I read the annual report of a Paris-based waste management company.

Still, I shouldn't complain. I remain much better off than most of the world's population. I was healthy, and shelter, food, and security have never been an issue. I have a wonderful family, a job I love, and I've managed to avoid watching any of the Republican "debates." [I find the Democrats equally ridiculous.] I wasn't accosted by a TSA agent, I didn't short Apple stock, and I've again managed to avoid being elected President or Prime Minister of a Southern European country. All in all, it could've been much worse.

As for the economic and investment climate, we leave 2011 much as we entered it – mired in a secular balance sheet downturn with few bargains to be found. The overriding issue of excessive debt, both here and abroad, is no closer to being resolved. Another year gone and another year wasted. Unfortunately, the great unwind still lies ahead. The only question is whether the reckoning will be gradual and prolonged or sudden and severe.

"Our deficit-reduction plan is simple, but it will require a great deal of money."

The solution was simple from the outset. Our politicians and central bankers should have been limited to ribbon-cutting ceremonies, and the free market should have been left free to administer its swift justice. Those who failed should have filed bankruptcy and gone through foreclosure, regardless of their size or the size of their PAC. Shareholders and bondholders should have incurred losses on their losing investments and businesses, no matter how large. Companies go through Chapter 11 all of the time just as many people go through foreclosure and bankruptcy. Their world doesn't end. Actually, more often than not, companies and individuals come out in a much stronger position since their debt is reduced to a very manageable level, if not eliminated. It is the investors, the shareholders and creditors, who take the loss. If you take a risk and it doesn't pan out, you should incur a loss. This is how the system should work, and it's absolutely critical when it comes to efficiently allocating scarce capital. Capitalism works.

However, we don't live in a capitalist society, and we haven't for a long time. We live in a meddler's bailout fascist state. We are a nation and planet of meddlers. We elect tinkerers who have no understanding of the business cycle and somehow expect them to manage an economy which consists of millions of buyers and sellers with myriad wants and needs supplying and demanding a tremendous number of goods and services. Still, our leaders claim to know just how to tweak a system of such massive complexity to get it to heel and roll over at their command, and we believe them. They say that they know just what to do to avoid the downside of the business cycle and prevent us from paying for past mistakes. Are they more at fault for thinking this, or are we more at fault for believing and electing these ignorant egotistical con men? Regardless, we have gotten what we deserve. The stop light of capitalism at the intersection of Fed Manipulation, Presidential Meddling, Media Interfering, and Congressional Tinkering went out long ago. The result is a nasty traffic jam in which all parties are convinced that everything would be fine if they could only inch their cars forward a little bit more.

Our leaders will keep meddling, tweaking, and finagling. It's all they know how to do, and it's what we tell them we expect. The best we can realistically hope for is that they don't make things worse, but even this seems fanciful from our bleacher seats. The real issue for us now is this: which form of meddling will be our poison and what does it mean for our portfolios? Which path will our leaders follow?

We could take the slow and torturous path that the Japanese chose and suffer decades of stagnation as loan losses are recognized and bank capital is built up very gradually over time. Sadly, part of the Japanese solution was to increase their government borrowing to offset the decline of their private sector. So far, they've prevented a collapse, but in the process they've accumulated the highest level of government debt to GDP in the developed world as their country has continued to age. 20 years of stagnation only to end up with an untenable debt burden. This doesn't seem like an appealing path to follow. It's a path built on slow-acting quicksand which ever so gradually sucks you down with every unaware step you take.

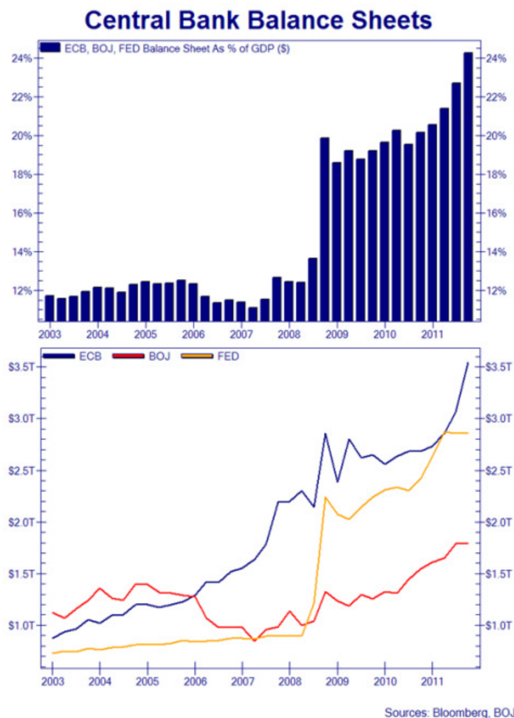
We could follow the current European path and enact severe austerity. We could cut spending and jack up interest rates in an attempt to eliminate the deficit. We're seeing firsthand how this is resulting in a downward spiral in southern Europe. Lower spending and higher taxes are hurting their economies. If you're making less money but being forced to pay more in taxes, you're unlikely to invest much in new hires or equipment. It isn't exactly a confidence-inspiring exercise. It's no surprise that we have seen large-scale protests throughout Europe as despair is setting in. This pretty leaf-covered path appears inviting at the onset, but the leaves are covering a bottomless pit right around the first corner.

Another path would be to grow out of our debt problem over time. If GDP grew strongly enough over the next decade without a further increase in our debt, we would be able to reduce our debt burden by paying it down with higher future income. This is, of course, the path everyone would love to follow. There are no hard decisions to be made or constituents to upset. But where is the growth supposed to come from in a world already burdened by massive debt and excess capacity (thank you China)? Recall that past growth rates were artificially boosted precisely because we borrowed so much. Absent that continued borrowing, how are we to generate strong growth? This sounds like a wonderful path to follow, but years of undergrowth and bramble have made this path impassable.

There is yet another option. We could rely on our "independent" Federal Reserve's magical ability to conjure new dollars with a few simple keystrokes and the Potteresque chant of "Creatio fiatio ad infinitum!" If too little cash is the problem, the Federal Reserve could just run the printing presses full out and create new money to cure our ills! It's a beautiful temptation in the short-term because it seems to easily solve our problems. Just print the money and pay our bills. Alas, there is no free lunch. The cost is hidden in the form of a depreciating dollar and higher inflation. This cost is spread over our entire society, and few understand the link between money printing and higher inflation. Worse still, it's highly regressive, as the poor are hurt the most when the prices of worldly necessities rise. It also ultimately leads to a misallocation of capital as poor investments get funding that they never would have enjoyed in a free market economy. This sows the seeds of yet another bust. Also, there is the risk of inflation overshooting and soaring to painfully high levels. Still, in the short-term, it's easy to see the appeal of this course. We all go skipping down this path hand-in-hand for a while. Unfortunately, there are no berries, nuts, or woodland creatures along this path, and crushing hunger eventually compels us to cannibalize one another.

Which path have our meddlers chosen thus far? Well, they've chosen a hybrid of all of the above. Clearly, they hope and pray that growth will magically reappear and save them from making hard choices, not getting reelected, and having to rejoin the dregs of society back in the private sector. We're Japanese in the sense that we've allowed the banks to ignore their real losses, and we've lowered interest rates to zero, allowing banks to earn a riskless spread on their Treasury purchases in order to gradually rebuild their capital. We're European in that the political mood has soured when it comes to further large-scale fiscal stimulus. We may not be actually cutting the budget deficit in any meaningful way, but there is little talk in Washington of enacting further massive stimulus. And, of course, we have been marching down the money printing path as the balance sheet of our Federal Reserve has ballooned in recent years.

Which path will be followed in 2012 and beyond? A big part of our investment positioning is predicated on my view that the world will increasingly depend on central banks and money printing as a "solution." Given the size of our debt and deficit and the current state of politics, we're unlikely to see massive new federal stimulus when the next downturn inevitably comes. Our country isn't ready for higher taxes either (which is a good thing since this will do nothing to spur growth). Our banks are busy retrenching to build capital in order to deal with the backlog of write-offs they'll need to take in the years ahead, and few creditworthy consumers and businesses really need or want to increase their borrowing. That leaves the Federal Reserve and its money-printing and lending ability. What other real choice is there? The need to tinker is as strong as ever, but there are fewer levers to pull.



As I've frequently discussed and as we've seen in action for the past few years, the Bernanke Fed is not bashful about stepping on the gas. [As you can see in the chart to the left, Ben isn't alone -- the European and Japanese central banks have also been increasing the size of their balance sheets.] Bernanke's area of expertise is the Great Depression and what could have been done to prevent it. Not surprisingly, his conclusion is that the Federal Reserve should have acted quicker and more forcefully. Well, Ben now has his own secular downturn on which to test his theories, and he's been busy in his lab. We've already seen plenty of fireworks from the Fed with little real improvement in unemployment or growth. Is Ben likely to now admit that he was wrong and that Fed policy is ineffective from here on out? It would take an exceptional person to do so, and I don't believe Ben is such a person. Besides, he doesn't believe it, and this year he has an even more compliant group of voting Open Market Committee members to tell him how smart he is, kiss his ring, and rubber stamp his decisions.

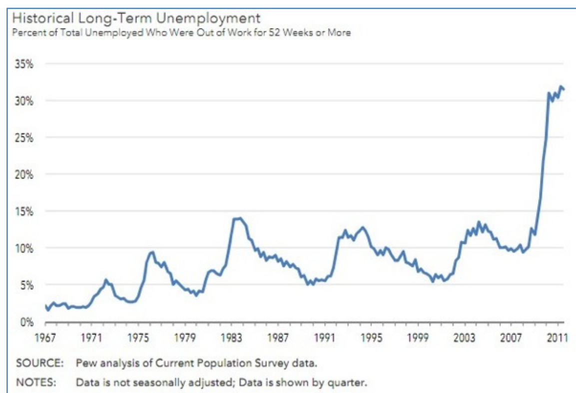
Bernanke will do what most anyone would do in his shoes when push comes to shove. He'll double down and cross his fingers. If it works, he'll be hailed as a genius. He'll eventually move on to the private sector where he'll make tens of millions, bathe in pools of platypus milk, and eat off of the stomachs of supermodels. If money printing fails, he'll claim he had no choice, and he'll put the blame on Congress or Europe for not pulling their weight. If he ends monetary stimulus altogether, he risks going down in history as the man who could have prevented the Second Great Depression but failed. Supermodel stomachs or eternal scapegoat? Ben will print.

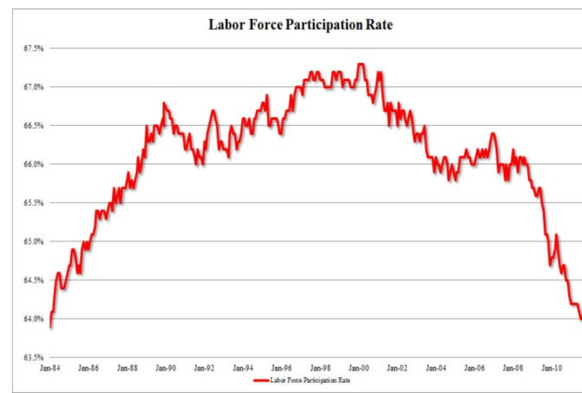
2012=2011=2010

One year ago, I lamented that the beginning of 2011 looked eerily similar to the beginning of 2010. Today, the beginning of 2012 looks awfully similar to the start of 2011 and hence 2010. Each January brings a sense of foreboding déjà vu. We've been discussing the same issues for a while now – government spending, a massive debt burden, loose central bank policy, overvalued markets, a punk economy, currency devaluation, unsustainable credit-fueled growth in China, and increasing turmoil in the European Union, to name a few.

As much as I would love to write about all of the progress that was made last year in addressing global imbalances, there's little positive to say. The best I can muster is that we're twelve months closer to the next secular upturn, though we still have a long way to go. The economy grew in 2011, but the growth was weak. Headline unemployment trumpeted some pretty decent declines as the year progressed, but this was an incomplete picture. The reality is that more and more people are losing hope and dropping out of

the labor force. If you're not counted as being in the labor force, then you're not counted as being unemployed. Had the labor force not declined, the headline unemployment rate would be in the double digits. Furthermore, we're seeing a shift in hiring from high-paying executive and managerial jobs to lower-paying temp and retail positions. To cap it off, wage growth has been anemic, and the percent of unemployed people who have been out of work for more than one year remains at a historically high 30+%.





Will this change in 2012? As alluded to earlier, it's difficult to see where strong and sustained growth will come from in this globalized world of ours. Corporations are at or near record profit margin levels, but this is due in large part to the cuts made in 2008-2010. They are concerned about increased competition and regulation, the risks facing the global economy, and the massive capacity increases still occurring in China, among other things. They are justifiably hesitant to increase their hiring and invest in new projects. Furthermore, demand from Europe is slowing as their austerity measures start to bite. We'll be seeing this flow through to our multinational companies very soon. China is showing signs of slowing, the growth rate in Brazil has ground to a halt of late, and India is once again a political and economic mess. So much for the developing world decoupling and saving the rest of us.

I can't stress strongly enough that a good deal of global growth during the last decade was due to massive borrowing which was used to increase consumption and poor investments (think housing). The growth numbers looked good, but it was growth that was borrowed from the future. It is now the future, and the debt has to be addressed. To expect normal historical growth rates or better in such a world seems naïve. We can and should expect growth to sputter. Europe is in a recession right now, and the U.S. is close.

In 2012, we should also expect to see some change in the Euro membership, as I've been discussing for some time. Some type of breakup or restructuring can be forestalled beyond 2012 if the European Central Bank steps up with massive quantitative easing (money printing). If they decide to buy government debt outright from member countries, then the current setup can survive the year.

Barring such massive stimulus or a referendum by Germany to essentially bail out the whole of Europe, it will be difficult for the euro to end the year with the same membership. I've long believed that Greece would be better served outside of the Euro, and a strong case can be made that Germany may find it in its own best interests to go it alone. [As I proofread this piece, I just read in a Greek newspaper that Greece now considers pedophilia, pyromania, and kleptomania to be disabilities which entitle the afflicted to financial assistance from the government! Massive debt, a terrible tax burden, huge unemployment, and now Greeks are being told that they need to financially support pedophiles. Apparently, austerity doesn't translate well to Greek. It just boggles the mind.] Greece and Italy stole the headlines in 2011. Perhaps 2012 will be the year when we hear more of the troubles facing Spain, Portugal, and Eastern Europe.

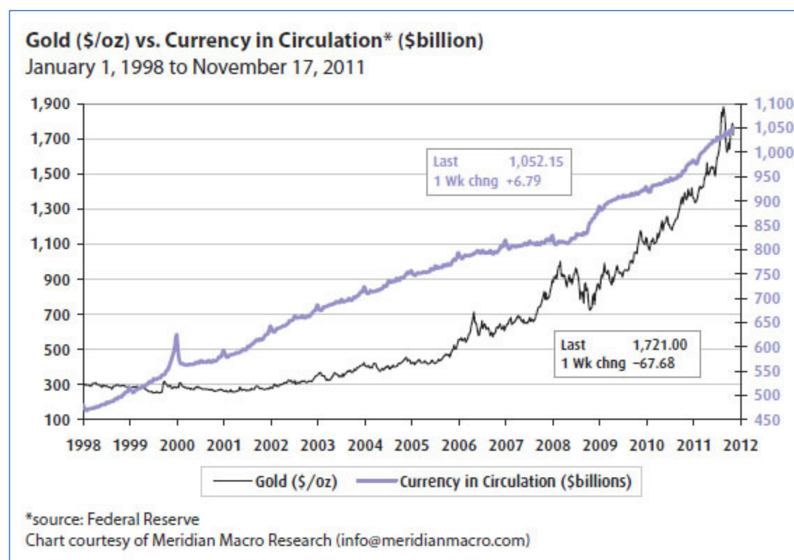
As for China, the real estate bubble that I've been warning about for some time is much more widely recognized today. We've seen a convincing slowdown in the Chinese property market in recent months. Now, the debate is whether they will have a soft or hard landing. We'll see. Chinese authorities have recently come out and reduced growth expectations for 2012. Inflation has moderated but is still fairly high. I've been patiently waiting for an opportunity to rebuild a position in Chinese equities. Their equity market

is down significantly over the past year and is now in bear market territory. Hopefully, 2012 will provide the retching and capitulation that often signify market bottoms.

One thing that we are likely to see more of in 2012 is stomach-churning volatility. Remember, this is a good thing! Where there is volatility, there is opportunity. Yes, it will negatively impact our returns at times, but short-term volatility is the friend of the long-term investor. It provides more opportunities to buy great securities at a discount and to sell others that have run further than warranted. The long-term trend is one of deleveraging, but the authorities aren't going to sit idly by and just let this happen. They will meddle from time to time, and this meddling will exacerbate investor sentiment swings and market moves. As we've seen in the past couple of years, fear can swiftly shift to calm and greed and right back again in a matter of weeks. I see no reason why this will change. It's more likely to intensify as the imbalances build and the policy responses strengthen and become more creative. Speaking of volatility…

Precious Metals Update

I won't spend much time on precious metals this quarter since a recent "Update" covered this sector. We saw plenty of volatility in the metals and miners this past year (discussed in detail in the Performance section below). 2012 is likely to provide more of the same. The earlier discussion and the chart below help explain my now decade-long affair with gold. We have been experiencing unprecedented expansion of central bank balance sheets in recent years. With the banking system and economy as fragile as they are, it's difficult to imagine this changing any time soon. The path of least resistance at this point is for central banks to rev the printing presses. It is so much easier to risk unleashing the hidden tax of inflation and currency devaluation on your citizens than to default on your debt, campaign on promises of higher taxes and/or less spending, or risk setting off the next Great Depression. We may have to wait for the economy and equity market to deteriorate meaningfully before the next significant round of printing occurs, but I suspect it's just a matter of time.



This long-term trend of fiat currency devaluation, both here and abroad, is a prime driver of gold and silver prices. Gold and silver can't be printed and have been used as currency for thousands of years. They have been the best historical store of value over the very long term. Paper currencies come and go, but gold and silver have stood the test of time. More people are gradually once again coming to understand the benefit of these precious metals in a world of unbacked money creation and counterparty risk. Central banks themselves are now net buyers of gold, after gradually liquidating their holdings for many years. In a world of zero percent interest rates, there isn't much of an opportunity cost to storing gold.

My job when it comes to our precious metals exposure is relatively simple: to keep you from panicking and selling your holdings when the inevitable pullbacks occur. Few investors have the stomach to sit tight when the group suffers a pullback and the bears come out from under their rocks to tell them how senseless it is to own a metal that doesn't produce a yield and has no significant industrial uses. I've sat through this for a decade now and still chuckle at the predictability of their rants and the horror of their track record. The other part of my job is to make sure that we pack up and move on when either a mania develops or central banks actually start defending their currencies. The latter seems almost quaint now that even Switzerland has pegged their currency to the Euro in order to limit gains in the Swiss Franc.

Market Performance

In the fourth quarter, the U.S. equity market was up strongly while developed international markets, many commodities, and the aggregate bond market were fairly flat. Gold dropped 4% in the quarter, but the real losers occurred in select developing markets. Although the Vanguard Emerging Markets ETF posted a solid gain, China fell 7% and India dropped 14%.

Index/Market	4Q11	2011
S&P 500	11.15%	0.00%
DJIA	11.95%	5.53%
Nasdaq	7.86%	-1.80%
Vanguard Total Stock Market (VTI)	11.40%	-0.97%
Vanguard International Stock Index (VGTSX)	1.08%	-17.13%
China - Shanghai SE A Shares	-6.76%	-21.64%
Wisdom Tree India Earnings (EPI)	-14.05%	-40.89%
Vanguard Emerging Markets ETF (VWO)	6.64%	-20.64%
iShares Aggregate Bond (AGG)	0.13%	5.88%
Dow Jones Commodity Index (DJP)	1.20%	-14.01%
Gold (SPDR Gold Trust - GLD)	-3.84%	9.57%
Oil (Cushing WTI spot)	25.21%	8.15%
U.S. Dollar (UUP)	0.72%	-1.06%

2011 results were all over the map. U.S. markets were flat, along with the dollar. Developed international markets were down in the mid-teen percent range, while emerging markets dropped into bear market territory. VWO finished the year down over 20% despite having a solid fourth quarter. China shed nearly 22% while India collapsed by 40%. Most commodities dropped significantly given concerns about global growth, but oil managed an 8% gain and gold climbed for an 11th straight year. The other winner was the U.S. bond market, which benefited from a flight to safety, Fed purchases, and a weak economic outlook.

The charts below demonstrate how some of the major markets fluctuated over the year.

Aspera Performance

2011 was a see-saw year for our portfolios, particularly our more aggressive accounts. Those accounts were down 5-6% before the month of January was out but then rallied back to close out April up 5-10% on the year. By early June, those gains had been given back. We had clawed our way back to being up in the 5-10% range by early September, but apparently that was the day that I angered the Precious Metals Gods. The balance of the year was rough for the precious metals group with gold, silver, and the mining equities falling between 15-35%. As a result, our aggressive accounts ended the year down 8-14%. More conservative portfolios followed a similar pattern but closed the year out with much more modest losses.

The early September inflection point in the precious metals complex is highlighted in the following charts (GDX represents larger mining companies and GDXJ tracks the more speculative junior miners):

These types of pullbacks are not unusual for these volatile securities, but we haven't seen the miners and the metals pullback strongly in unison in a while. I devote a little bit of real estate in just about every Quarterly Review to warning everyone that these pullbacks will happen and that they are a normal part of a bull market. I make a point of consistently warning that these pullbacks will happen for a very good reason. It's because these pullbacks WILL HAPPEN.

It's much easier to roll with these punches when you know that they will inevitably occur. The futility of trying to time short-term moves is wonderfully summed up in the chart of GDX above. It experienced 9 distinct and reasonably significant pullbacks and 8 rallies in 2011 alone. It ended at one of its troughs, but it could have easily ended at one of its peaks. December 31 is an arbitrary measuring point, as is any date. Had we closed the books on September 8th, we would have posted solid positive returns as compared to a loss for virtually every global equity market. I can assure you that I wouldn't have been touting my genius. As I always stress, <u>my concern is with our long-term positioning and performance, not with the quarterly spasms of our holdings</u>.

I've owned gold, silver, and the miners now for a decade, and I wouldn't be surprised if I still own them for many years to come. I've been through many swings with these securities, particularly with the miners. Some of you have participated alongside for many years, but others are fairly new to this sector. The longer you've owned this space, the more comfortable you have probably become with the sometimes

violent moves (both ways) that occur. Newer clients may still find it unsettling, at least the pullbacks. We will experience some serious volatility as long as we own these names, particularly in aggressive portfolios. It's inevitable, and I warn about it regularly. The volatility is nothing but noise and a distraction. Whether these names end a calendar year at a peak or trough is also nothing but noise. The thesis for owning these names today is as strong as it has been at any point in the last decade. The miners in particular are extremely compelling given their recent sell-off. Importantly, I eat my own cooking. I have a greater portion of my personal portfolio allocated to gold, silver, and the miners than even my most aggressive clients.

Trading Activity – Closed or Reduced Positions

A good deal of our trading activity in the quarter was related to tax-loss selling for taxable accounts (more on this below). We also closed out, initiated, and added to some positions, but our trading activity was modest in the quarter.

Salesforce.com (CRM)

Salesforce.com may have a good product, but I haven't liked the stock for a while. Management spends quite a bit on stock compensation, while touting their non-GAAP (generally accepted accounting principles) earnings. Take their most recent quarter. The summary at the top of their earnings press release boasted earnings per share (EPS) of $0.34. Four paragraphs later, however, we learn that their real EPS was a loss of 3 cents per share. Much of the difference is due to the fact that they paid $57 million in stock-based compensation in the quarter. This very real shareholder expense gets left out of the non-GAAP numbers that the company, the media, and the analyst community report.

Even using the misleading non-GAAP figures, the bullish Wall Street analyst crowd only expects CRM to earn $1.63 in 2012. We shorted CRM at two different times this year at prices in the mid-$140s and about $130. At those times, the stock was sporting a forward P/E of 80-85! Remember, this is using the fluffed up earnings estimate which ignores the massive stock compensation expense.

CRM has been a momentum stock for a while, but the valuation is ridiculous and competition has been heating up in the cloud computing space. Recent concerns over slowing growth have helped drive the stock lower, and we took advantage of the drop to cover our shorts near the end of the year for a nice gain. The stock is still overvalued, in my view, and I would expect to short it again if it heads back up.

Tax-Loss Selling

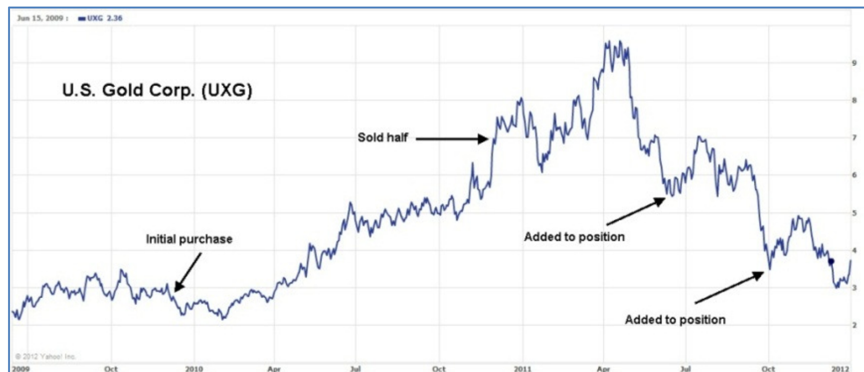
As I discussed in a prior email, a good deal of our fourth quarter trading was focused on tax loss selling for those of you with taxable accounts. The tax-loss sales were primarily focused on the precious metals group. As discussed above, the miners took a pounding as year-end approached, particularly the small junior mining firms. When this happens, it's often a very easy decision to sell positions which have losses, capture the loss for tax purposes (to offset current and/or future gains), and then roll the proceeds into other equities in the same space (precious metals) which are equally as attractive. This is exactly what we did.

I can't stress strongly enough that these sales were for tax purposes only and do not reflect a change in my outlook for these firms. As evidence of this, these securities were not sold in tax-deferred accounts. Furthermore, they may be bought back in taxable accounts once the 30-day wash sale period expires. If the concept of tax loss selling is still confusing, please don't hesitate to contact me.

Trading Activity – New or Increased Positions

U.S. Gold (UXG)

UXG is a very good example of how I like to invest in the precious metals space (and in general). We initiated our position at a little under $3 per share near the end of 2009. About a year later, the security had more than doubled. We sold half of our holding, taking out our entire cost. The stock ran another 35% higher before petering out. We added to our position at mid-year, after it had fallen 40% and we added once again last quarter after a further 35% decline.



When I first bought the stock, few were interested in it, and the group was out of favor. Within a few months we already had a 25% loss on our holding. I often warn that I expect positions that I buy to keep falling before they turn since I'm often buying after they've already dropped a bit. This is a good example of that. We pared the name back after it more than doubled, but we didn't sell the entire position because I ultimately expect it to go much higher if/when the mania phase occurs. Of course, I didn't expect the name to come all the way back to nearly where we initially bought it, but we've taken advantage of the decline to once again increase it to a full position. As is typical, I added gradually as the price fell since I had no idea where the bottom was. We added first at a very good price and later at a terrific price. We may add yet again if it falls to a ridiculously cheap price. Once it turns around, we'll likely pare it back again after a double.

Extorre Gold Mines Limited (XG)

Our trading activity in XG is actually quite similar to that of UXG. Extorre was spun out of our holding of Exeter Resource Corp. (XRA) in late 2009 at about $2 per share. We added it to more accounts in the $5 range in early 2011. It then went on a terrific run to nearly $15 in July. We sold half of our holding near $13 on the way up. After declining about 50% from those July highs, we boosted it back to a full holding in late October near $7 per share. Should it drop back to the $5 range with no change in fundamentals, we'll likely add again, and should it head back toward its highs, you should expect to see the position reduced again.

Tanzanian Royalty Exploration Corp. (TRX)

TRX is a new name that we added to our more aggressive portfolios. This is a small firm exploring for gold in Tanzania. We get a small company exploring for gold in a sub-Saharan African country which is in the process of re-writing its constitution while being surrounded by less than stable neighbors. What's not to like!?

This stock had run from $3 in late 2009 to $7.50 as recently as June of 2011. Since then, it has collapsed all the way to $2 before bouncing slightly. We made our purchase on November 10th at about $2. The general decline across the mining group combined with uncertainty as to the Tanzanian government's plan to revise its mining royalty agreements with firms and the presence of a large share seller led to the selloff. At $2, the price is right.

Nokia Corp. (NOK)

If you were wondering when I was going to add another has-been technology stock to our portfolio, your wait is over. We added shares of Nokia to our accounts in mid-December at a price of $5. You can see in the chart that this has been one ugly stock for the last 4 years, falling from $40 to $5. This is another wonderful reminder of how hard it is to stay on top in the world of technology.

I began keeping a close eye on Nokia about 18 months ago when it was at $12. They announced some significant management and strategic changes at that time. The new CEO hails from Microsoft, and the company has decided to hitch its wagon to Microsoft's Windows Phone architecture. Given the decline in the company's stock since the time of these announcements, it's clear that investors are skeptical, as they should be. I am as well. However at the current share price and company valuation, the risk/reward trade-off is compelling.

Nokia is well-recognized for building great phones (the hardware), but they've dropped the ball on the software side and have been late to the smart phone game. The early reviews of Microsoft's next-generation software have been very good, and it looks like Microsoft may have gotten this one right. If this hardware-software partnership works, there is plenty of upside for Nokia shares. Nokia still has terrific global distribution and a large, though shrinking, market share. Of course, even if the technology is wonderful, it doesn't necessarily mean that customers will buy it. Nevertheless, at $5 per share we're getting paid to take the risk. I should also note that the current dividend yield on these shares is 11%. There is a decent chance that this could be lowered by the company if sales and profitability don't pick up when the new phones are released, but even a cut of 50% would leave a healthy dividend yield.

<u>Bought Put Options on the S&P 500 (SPY)</u>

We did add some protection to certain accounts during the quarter in the form of put options on the S&P 500. As a reminder, these should be viewed just like homeowners insurance. We hope we don't need them, but they're nice to have in an emergency. I expect these to expire worthless, as they provide some protection to large and sudden downturns which occur infrequently. We tend to add these positions when volatility is muted (which makes the cost of these options cheaper) which also tends to occur after the market has rallied somewhat. We'll continue to use these index puts from time to time for risk management purposes.

<u>Sold Put Options On Research in Motion (RIMM)</u>

We sold puts on RIMM late in the quarter. We received the premium (about $90 per contract) for this sale, and the options expire on January 21 of this year. The strike price on the puts is $13, so RIMM shares would have to fall to just over $12 by January 21 for us to incur a loss on this position (shares are near $15 currently). I made money betting against RIMM last year, so this position is a bit of a departure. We benefit from the stock not dropping further. Part of my expectation is that a rebound from year-end tax-loss selling would boost the shares in January. Additionally, the stock is no longer grossly overvalued, the value of its patents should provide some support, and takeover speculation should underpin the shares.

<u>Sold Put Options on Sears Holding Corp. (SHLD)</u>

Similarly, we sold January 21 puts on Sears. This is another name which has been taken apart in 2011, falling from over $90 per share to just over $30. We sold puts with a $35 strike for $400 per contract. Shares would have to drop below $31 for us to incur a loss. The bet here is similar to RIMM – that the shares will rebound somewhat due to a reverse of tax-loss selling and some value investor buying. In addition, the company is run by a well-known hedge fund manager with a significant stake in SHLD. I would expect some significant announcements from him (the company) in the near future.

I'll discuss this put selling strategy in more detail in a separate piece this year, but one of the keys is that we sell the puts at a time of high volatility in the shares in order to receive a higher premium. Additionally, we use this strategy with names that we wouldn't mind owning if the share price falls and the puts are exercised (the buyer of the puts is entitled to sell us 100 shares of the stock per contract at the strike price). In other words, we typically hope to just receive the premium (income) and have the puts expire worthless to the buyer, but we don't mind if the put is exercised and we end up owning the underlying shares at our breakeven price (the strike price less the option premium we received).

<u>Portfolio Positioning and Outlook</u>

> *"I gave you my advice, because I didn't want it anymore. I wanted my new advice, and you can have my old advice."*
>
> Addy Bell (age 3) 12/24/11

It must be nice to be young and have new advice. My new advice has that "old advice smell" about it. We remain mired in a low-return world in which central bankers are keeping safe yields at or near zero percent in an effort to help recapitalize banks, encourage more unnecessary borrowing, help governments fund their deficits, and push Grandma and Grandpa into inappropriately risky securities to generate any income. It's a challenging investing environment, as returns are very dependent on the whims of policymakers versus the ebb and flow of the business cycle and company-specific performance/valuation.

So, we may be writing a new year on our checks (if anyone still uses those), but little else has changed for us. I remain focused on the elephants in the room but remain aware that it's often unanticipated developments which set off panics. So, I continue to try to anticipate the unanticipated. Our returns will continue to be volatile and largely track the precious metals sector. At some point, I expect our precious

metals names to break out to new highs. I can't promise that this will happen in 2012, but the stars are aligned.

Although we're in a low-return world, this does not mean that every asset class will generate a low-return every year. We've seen big up and down years in the markets in the recent past, but the average return during the past decade for many risk assets has been meager, and the current decade looks to be shaping up for more of the same. None of us should be expecting big returns for the time being. Until valuation becomes compelling and/or the massive investment headwinds that we face are largely resolved, this will be our reality.

Still, opportunities are always being created. We've seen some pullbacks in commodities and some emerging markets. I'm watching those closely and would love to rebuild positions in those asset classes if my buy targets are reached. As always, I hope for continued high volatility and the opportunity it brings. There are a number of securities that are one good market decline away from finding their way into our portfolios, but I'm in no rush. We still have ample cash and cash reserves to draw on when warranted. Patience is key – in terms of putting cash to work as well as sitting tight with our core positions.

My strongest conviction still lies with the precious metals sector. The mining equities, in general, have yet to help our performance much during this gold bull cycle, but I expect that to change at some point. Gold itself has now registered gains for 11 straight years. The current year may well extend the record to 12, but this is a long time for a bull market to run without a gut-wrenching pullback. As much as I hope that the decline in gold from $1900 to $1500 was the worst we'll see, it wouldn't be shocking to witness an even larger shakeout before the metals make their big push to new highs. What I do know is that as long as policymakers remain bent on money printing and currency devaluation, my gold, silver, and mining shares will have to be pried from my cold dead hands. Actually, in the event of my untimely demise, my wife has strict instructions not to sell these securities. I love her dearly, but I've threatened to haunt her if she does. I don't make idle threats.

Have a great quarter!

Best,

Ken Bell, CFA, CFP
President
Aspera Financial, LLC

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