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HALLGARTEN & COMPANY

Portfolio Strategy

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Model Mining Portfolio:
Trump Waves in the Metals Pond?

Performance Review – January 2017

Model Mining Portfolio

Trump Waves in the Metals Pond?

- + Gold has crept back to the $1,200 level and has malingered in that region without a breakout to the upside
- + Base metals prices continue to firm up well
- + Uranium's rebound continues in a measured manner
- + A brief Palladium sell-off proved to be a flash in the pan and the metal continues to attract strong demand
- + Rare Earths are poised to gain more attention as the nexus between them and the EV/HEV story driving Lithium/Cobalt gets more airing
- × Interest rates in Europe are starting to uptick noticeably
- × Volumes in Canada appear to be very subdued despite the end of the festive season
- × Takeover activity has shriveled to almost nothing

Trump, Metals and China

While we have declared 2017 to be the Year of Infrastructure Metals on the back of Trump's push to revive expenditure on major infrastructure projects, not all is necessarily rosy. The coin has two sides. The aggressive stance towards China risks other things happening, most notably a recession there that could send demand for the same or other metals tumbling. Rising tensions though also lead to higher military budgets with has always been a money spinner for metals producers.

Many feel that the Chinese economy is more fragile than it looks from outside or than the Chinese would have people believe. It still remains unclear what measures might be taken against China but they are more likely to be targeted at heavy industries than at clothing or the myriad *tchotchkes* that the country turns out. If specific activities like steel are targeted then that could have roll-on effects with the Chinese increasing their dumping of the product into Europe and thus spurring some real pushback from that quarter where the steel industry is really hurting. If the Chinese think they can just displace lost US sales to other parts of the globe then they risk being hit by a proliferation of countervailing measures.

To a certain extent Trump appears to believe he can "do a Reagan". For those who recall, Reagan's Star Wars program drove the Russian economy into a matching effort which ultimately produced an economic breakdown that let loose various other destructive forces that tore the Eastern Bloc to pieces. In China's case there is a hybrid economy which has been booming for decades now and ostensibly in a much healthier condition but that is also a false construct of inflated property values and a credit bubble, not to mention vast overcapacity in almost everything and underutilization in many parts exposed to potential external (read Trump) action. He has threatened action on the “manipulated” currency which has been tumbling of late and subject to defensive support (at a great cost in reserves).

Then there is the issue of cancelling the TPP. This was a chronicle of a death foretold and probably would not have gone anywhere no matter who had won the election due to bipartisan antipathy, though its formal death and burial occurred with almost indecent haste. One is left somewhat bemused though by the idea that a treaty that was designed to create a zone competitive to China’s dominance might morph into a gathering with China as a key party (replacing the US). This is even more bizarre considering the tensions that most of the Asian players have with China anyway.

As campaign promises that seemed outlandish are rapidly being enacted all eyes should be swiveling towards Asia to see how this might play out. The danger is collateral damage to the minerals markets could hit the mining sector, though perversely it might also light a fire under them. We shall see.

Rare Earths – Ready for a Rebound?

It seems that Rare Earths are so deeply in the doghouse that investors have lost all sense of perspectaive when it comes to the subject of Electric vehicles and Hybrid Electric Vehicles. These, with one notable exception, largely rely upon engines employing Rare Earth magnets and as such those who think that there is a Lithium/ Cobalt relationship and attempt to promote and deluding themselves if they think that there is also not a direct correlation between demand for Lithium Ion batteries and demand for Rare Earth magnets for engines in the self-same vehicles that employ the batteries they swoon over.

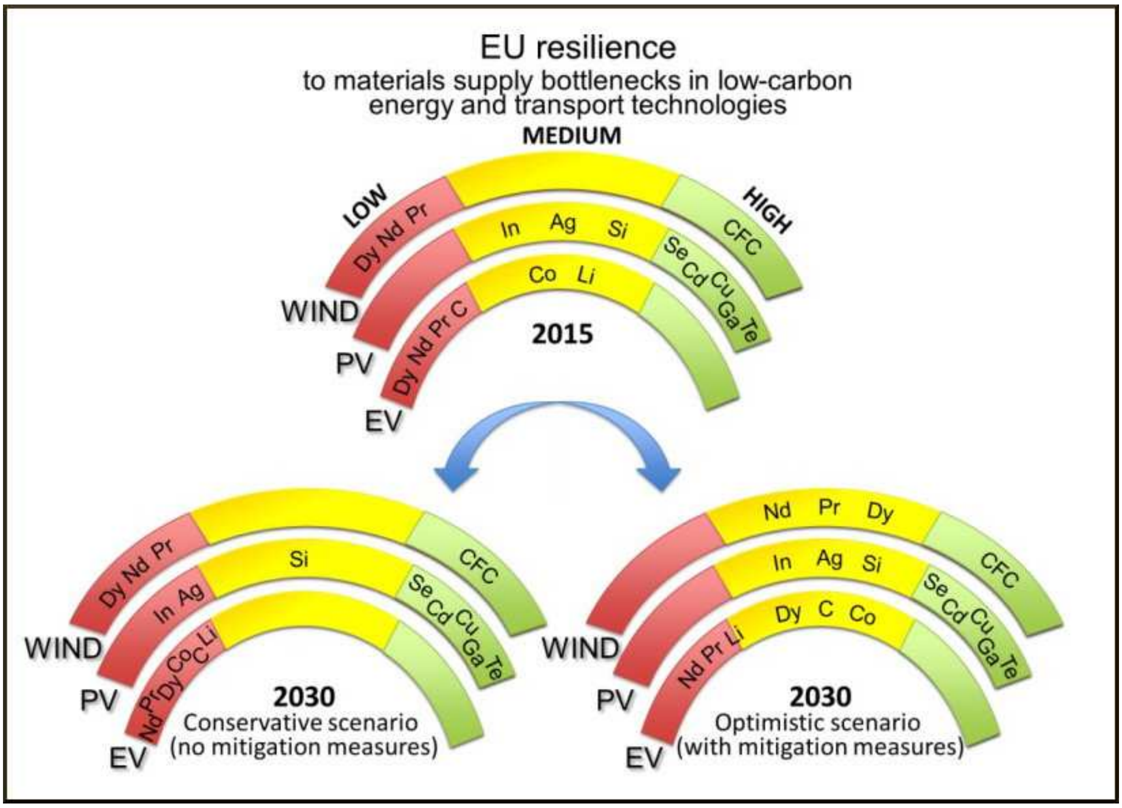
It seems that concern is rising but not amongst investors. Then again how real is any professed concern if it doesn’t lead to action? Japanese and Korean companies have supposedly been concerned for a decade now about their dependence upon Chinese REE sources but what has it actually prompted them to do? Sure we had some Japanese prominently and publicly support some of the most notorious fakers in the Canadian REE space during the last boom but they got burned when they discovered they had been snookered by the perennial Vancouver promoters with zero intention of ever moving to production. On the rebound the Asian end-users retreated into their shells but that doesn’t put bread on the table when one is facing an imminent supply crunch.

The Europeans are just as vulnerable, if not more so. In a recent JRC study, presented at the 9th Conference of the European Strategic Energy Technology Plan, the following was noted:

“The EU resilience to supply bottlenecks is currently low for several materials, such as the rare earths – neodymium (Nd), praseodymium (Pr) and dysprosium (Dy) – used in permanent magnets for wind and electric vehicles technologies, as well as for graphite (C) required in electric vehicles rechargeable batteries. Moderate supply issues are seen for indium (In), silver (Ag) and silicon (Si) required in the photovoltaic technology as well as cobalt (Co) and lithium (Li) requisite in electric vehicles.”

Interesting to note that the hot metals *du jour*, Lithium and Cobalt come at the end of the list of problem metals. And well they might. At least Lithium has three large cartel members (plus Galaxy and Orocobre) churning out product, while REEs have no meaningful suppliers outside China beyond Lynas.

The JRC report produced this interesting diagram showing resilience currently and 15 years out. What they call (in EU-speak) conservative means pessimistic and then they have an optimistic scenario. Interestingly Neodymium and Praseodymium both remain mired in the Low Resilience (read "poor supply") category even in the optimistic scenario.



The resilience to supply bottlenecks for carbon fibre composites (CFC) used in wind turbine blades is evaluated as high. The demand for Selenium (Se), Copper (Cu),Ggallium (Ga), Tellurium (Te) and Cadmium (Cd) in photovoltaic technology is very marginal compared to the global supply. Therefore, for these materials the estimated EU resilience is also high.

US Vulnerability on REEs

The US is especially vulnerable to a REE clampdown by China. With the Japanese having helped Lynas through its dark period, they are first in line for product from the source and as for other sources the US automobile industry might tap, there are pretty much none that come to mind. An incident (or incidents) of sharp elbows and jostling with China (over the South China Sea or even just imposition of tariffs or being labelled a currency manipulator with all the spill-over effects from such a designation) could see an official (or unofficial) clampdown on REE exports to the US. This is exactly what the Pentagon has feared for a long time now and which Congress, and successive Administrations, have ignored.

Nothing would focus attention back onto Rare Earths like such a moment. However if China wanted to get around WTO rules, it might just squeeze supply and implement an export (or re-export) ban to the US in a *sotto voce* manner so there is nothing officially that the US can lodge an appeal over. What more tangible response could the US make? Well, Molycorp's Mountain Pass might have life breathed back into it, but with every day of inactivity the chances of reviving it and particularly of reviving it quickly becomes more distant. Nothing else is even remotely advanced in North America with the "nearest" projects that could be ramped up in Africa and Australia and even those are not something that would plug the hole made by a sudden escalation of hostilities (trade or otherwise) with China.

Beyond this there is the issue that even if things don't get militarily heated the prospect of duties of 20% or more on REE magnets imported from China changes the equation for US production. While Mountain Pass had its own unique limitations it certainly would have been helped in its heyday by hefty duties on competing product.

The Chinese grip on Rare Earths is no less than it was in the days of Great Panic. Indeed in those days there was at least hope that several handfuls of projects were advancing and that the West would become self-sufficient. Those dreams were blown away in an ego rush by promoters and arguably more destruction of value was wreaked in the REE space than ever was done by Bre-X, for instance.

The clear inconsistency between thinking that EVs and HEVs are the way forward, and yet that REEs are "not important" or "crisis averted", is the great fallacy of our times. If one feels that Lithium, Cobalt and other battery metals are in critical short supply then the situation is worse in REEs where future sources of production (even in China) are unclear to say the least.

The trigger for this "wake-up call" might be a Trump-induced trade tussle with China (or worse) but it might also be a creeping realization by automakers et al. that they have almost no guaranteed source of supply and that if the soaring production projections for EV/HEVs come to pass then they will need to be running without engines.

The Portfolio Move

The Model Mining Portfolio ended January at USD$4.565mn, up substantially from $4.214mn at the end of December. Cash remained unchanged at $976,000.

Notably the accident-prone Galane Gold announced that it was mothballing its Agnes mine in South Africa (which it had acquired with a high price in dilution for shareholders) before it had even commenced production. This brings the heightened risk of a cashflow crisis which could prove terminal. We reiterate our **Short** on this stock.

Portfolio Changes

There were no portfolio changes during the month.

Two Tin Cans & a String

One of the original partners of Hallgarten & Company in its current manifestation had the habit of referring to poor communications as being like "two tin cans and string". We thought this an appropriate title for revisiting the African tin space. Hitherto tin has been dominated by the alluvial production out of Malaysia and Singapore but now this is in a gradual but ultimately terminal decline the price of tin has perked up noticeably while the search has revived for new sources of supplies. In the past we have covered tin prospects far and wide with Australia and Alaska being particular focuses. In looking at the situation in Africa there is a rather poignant contrast between the two most notable players of the moment. One is Alphamin Resources (AFM.v) that suffered for a long while in pursuit of its ambitions in the DRC due to being in a troubled zone and suffering mine invasions, which were a sure fire way to scare off nervy Canadian investors. This was particularly the case with tin in a price freefall a couple of years back. The argument was "who needs the grief"?

Then there was Kasbah Resources (KAS.ax), prone like many other Australian miners to "masters of the universe" attitudes particularly when they could get powerful names like Traxys, the IFC, Toyota Tsusho and Nitetsu Mining to endorse the Achmmach project's credibility by putting hard cash into it.

Time has moved along, tin has lifted off and crossed the key $20,000 per tonne mark while Alphamin's stock price has gone from strength to strength over the last year and Kasbah's has literally shriveled.

Why should Kasbah have come to such a sorry pass? An early warning sign should have been that the original Traxys investment did not have a follow-on and then Nitetsu/Toyota stepped into the breach and the IFC. Our own experience was that we discovered the management moonlighting in Turkey hunting around for Antimony when investors were told they were full-on for all things Morrocan. The Achmmach project's capex was dauntingly large for a grade that was dauntingly small.

When the tin price went into reverse mode Kasbah was dealt a near mortal blow that sent it from around 35 cents down to a recent print of under 3 cts.

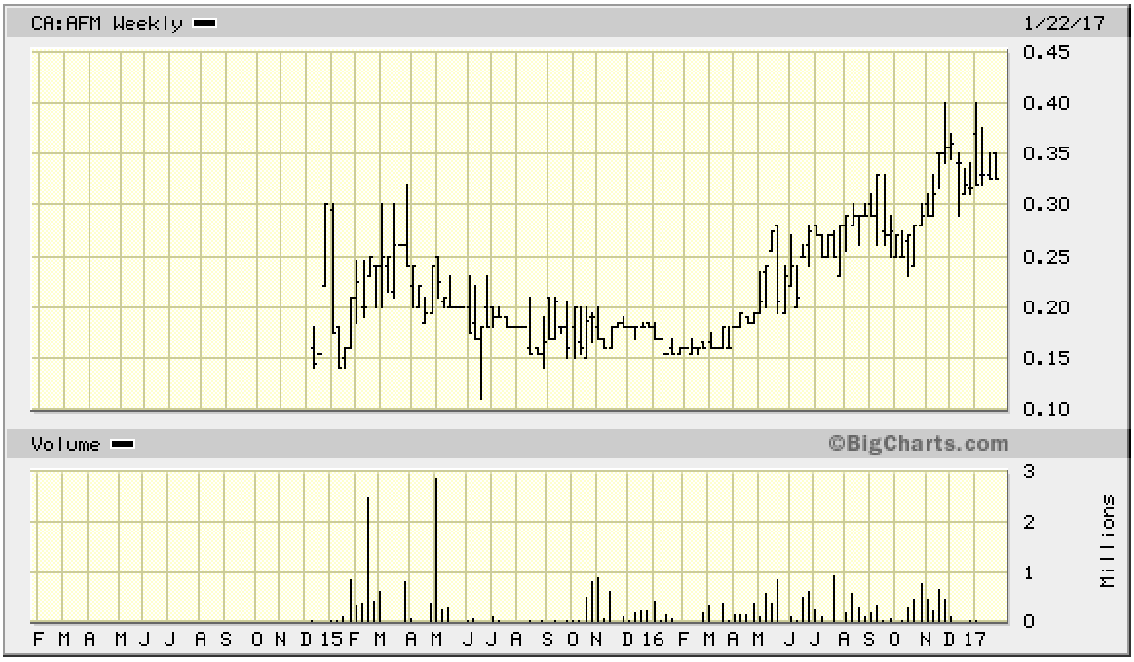
Recently a takeover offer was received from Asian Mineral Resources (controlled by a Russian oligarch, Vladimir Iorich) and that perked up the price slightly in late 2016 but then along came a financing at very low levels with another Iorich-controlled entity Pala Investments (in which the IFC seemed to stump up more cash) and the takeover offer was dropped. Some of the management also were thrown under the wheels of the bus. We were not unhappy to see that in light of our Turkish tussle with these people.

Interestingly in August 2016 a new DFS was published which shrank capex by 53% to US$61.7mn. Meanwhile, a competitive C1 cash cost of US$ 9,001 per tonne and C3 full cost of US$13,811 per tonne came out of the recalibration. This one again shows that supposedly inviolable capex's from bull market days can be reduced no matter how much management and consultants insist that they cannot (in the first go around). Essentially Kasbah and its shareholders were crushed due to stubbornness in refusing to rejig to changed circumstances.

Over at Alphamin there is quite a contrast as there the mood has been upbeat after several hairy years on the frontline of African civil wars. The company's main asset is the Bisie Tin Project in the DRC. The holds 80.25% ownership (with the DRC owning 5% and strangely the South African government owning 15%) over five exploration permits which cover 1,470km^2 of prospective ground in the North Kivu Province. It is located roughly 140 km west-northwest of the regional centre of Goma and about 40 kms from the Ugandan border.

Tin was first discovered at Bisie in 2004 and was mined by artisanal miners (down to 80 metres) from two main target areas, Gecomines and Golgotha. Both targets are located along 1.5km of a ridge which extends over more than 9km. Artisanal mining from Bisie in the past has dominated the DRC's production by supplying up to 70% of the cassiterite exported from the country.

The company claims it has a unique style of mineralisation at Bisie, which includes high-grade tin, copper, zinc, lead and Rare Earths.



As can be noted the stock has more than doubled in the last year as hostilities have drifted off to other parts and as Tin has returned to an upward trajectory. The company is not intending to reach full production though until 2019, so that is quite a way off as yet. The mine will create approximately 450 permanent local jobs during operations. It is estimated to produce an average of 10,000 tonnes of tin in concentrate per annum over the 12-year mine lifespan, which represents about 3% of the world's current production and will double the DRC's current tin exports. Capex is USD$134.2mn, so rather ironically the slashing of capex at Kasbah now puts it at half the cost of Alphamin.

So this tale of two tin seekers is not fully played out yet. With its lower capex and without its former management Kasbah might actually stand a chance of getting back into contention in the race to produce meaningful quantities of tin out of Africa.

Parting Shot

We have long been enormous fans of micromining or best put as “crawl before you walk before you run” and a number of exponents of this “art” have appeared and prospered through the grim times that have beset the mining industry during most of this decade. While the market may have improved somewhat the amounts of money being raised by smaller wannabe producers is only sufficient for exploration (or bootstrapped production) rather than grandiose consultant-generated projects. Therefore the smaller players committed to production are still dependent upon micromining if they want to see the “rubber hit the road” and differentiate themselves from the mere talkers in the industry.

Unfortunately one of the highly negative side effects of this is that managements would like the market to see their production and reward them for it but the companies are not prepared to be transparent in the way these formative businesses are operating. Therefore they will announce production in ounces (or relevant units), maybe the amount of this production that is sold but them will not reveal revenues or costs hiding behind the argument that they have not reached commercial production yet. Sometimes this process can go on for very long periods, indeed years. Our *bête noire* from the last boom was the dubious ECU Silver which long hid its production using this mechanism. We see no-one around this time that is so shameless in exploiting this loophole. However much to our chagrin several companies of our acquaintance that we are enthusiastic about are more than a few quarters into trial production and refuse to disclose anything but the sketchiest details of what their output is and its commercial viability.

Frankly how can a company have revenues and costs for a business activity (albeit small) and they do not appear in the earnings statement, not even as a net number away from the topline? This is downright deception. How can one produce thousands of ounces, sell those ounces and then say “sorry, no revenues”?

The companies are only doing what they can get away with to hide the profitability or lack thereof of the trial operations, but it is the regulators who are condoning and enabling this. If micromining and extended trial operations are the new normal then it’s time for regulators and exchanges to crack the whip and demand more disclosure from the rising tide of companies indulging in the practice.

Mining Model Portfolio as at: 1-Feb-17

	Security	Initiated	Currency	Price Avg.	Price Current	Portfolio Weighting	Increase in Value	Target
			Long Equities					
Various Large/Mid-Cap	Capstone Mining (CS.to)	5/29/2009	CAD	2.32	1.45	1.50%	-37.50%	$2.00
	NevSun (NSU)	3/23/2012	CAD	3.45	4.1	4.50%	18.80%	$5.00
	Sherritt International (S.to)	7/11/2013	CAD	1.78	1.44	4.70%	-19.10%	$2.50
	Palladium ETF (PALL)	10/16/2014	USD	72.08	72.25	4.20%	0.20%	$74.00
	Metals X (MLX.ax)	29/5/2014	AUD	0.98	0.78	2.30%	-20.30%	$1.00
Uranium	Uranium Participation Corp (U.to)	10/20/2010	CAD	7.01	4.2	2.30%	-40.10%	$6.00
	Western Uranium (WUC.cx)	7/5/2016	CAD	2.25	2.3	3.00%	2.20%	$4.80
	GoviEx (GXU.cx)	6/29/2015	CAD	0.08	0.17	4.50%	106.90%	$0.50
Zinc/Lead Plays	Zinc ETF (Zinc.L)	1/15/2010	USD	7.04	8.31	2.40%	18.00%	£9.00
	Canadian Zinc (CZN.to)	12/9/2011	CAD	0.82	0.25	0.70%	-69.50%	$0.70
	Ascendant Resources (ASND.v)	10/31/2016	CAD	0.48	1.56	6.80%	228.40%	$1.70
	Nyrstar (NYR:BR)	9/28/2009	Euros	65.1	16.48	10.40%	-74.70%	€ 11.00
	Southern Silver Exploration (SSV.v)	8/25/2016	CAD	0.46	0.485	2.70%	5.40%	$0.94
Gold Producers	NewGold (NGD.to)	5/31/2013	CAD	7.05	3.47	2.30%	-50.80%	$8.00
	Patagonia Gold (PGD.L)	10/2/2013	GBP	3.6	1.73	1.20%	-51.90%	£4.00
	Komet Resources (KMT.v)	11/25/2016	CAD	0.47	0.38	1.70%	-19.10%	$1.28
	Westgold (WGX.ax)	12/6/2016	AUD	2.01	2.02	3.90%	0.50%	$2.40
	Eldorado Gold (EGO)	6/21/2012	USD	9.12	4.6	4.00%	-49.60%	$7.00
	Teranga Gold (TGZ.to)	6/21/2012	CAD	1.57	0.88	2.30%	-44.00%	$1.50
Copper Producer	Coro Mining (COP.to)	2/23/2015	CAD	0.03	0.17	3.70%	466.70%	$0.30
	Royal Nickel (RNX.to)	11/17/2016	CAD	0.33	0.26	1.70%	-21.20%	$0.60
Processor	IBC Advanced Alloys (IB.v)	4/29/2016	CAD	0.3	0.38	0.80%	26.70%	$1.40
Driller	Cabo Drilling (CBE.v)	9/28/2016	CAD	0.025	0.02	0.90%	-20.00%	$0.08
Gold Explorers	Everton Resources (EVR.v)	4/17/2012	CAD	0.08	0.05	1.10%	-33.30%	$0.10
Tungsten Producer	Almonty Industries (AII.v)	7/31/2015	CAD	0.36	0.28	3.10%	-22.70%	$1.00
Copper Explorer	Asiamet Resources (ARS.v)	4/28/2016	CAD	0.05	0.05	1.60%	0.00%	$0.24
Nickel Explorer	Sama Resources (SME.V)	23/2/2015	CAD	0.16	0.09	1.60%	-43.80%	$0.30
Lithium	Neometals (NMT.ax)	7/31/2014	AUD	0.04	0.39	4.30%	954.10%	$0.60
	Galaxy Mining (GXY.ax)	6/28/2016	AUD	0.35	0.59	2.80%	70.70%	$0.70
Scandium Explorer	Scandium International (SCY.to)	8/23/2016	CAD	0.14	0.31	4.10%	121.40%	$1.00
Graphite Producer	Elcora Resources (ERA.v)	29/5/2014	CAD	0.2	0.36	4.00%	80.00%	$0.64
Graphite Developer	Talga Resources (TLG.ax)	8/25/2016	AUD	0.27	0.42	4.60%	58.50%	$0.42
REE Explorer	Northern Minerals (NTU.ax)	6/9/2011	AUD	0.73	0.12	0.40%	-83.60%	$0.28
	NET CASH					**976,740**		
			Short Equities					
						Weighting		
Shorts	Bacanora (BCN.v)	12/4/2015	CAD	1.53	1.21	48.50%	20.90%	$0.80
	Galane Gold (GG.v)	4/28/2016	CAD	0.06	0.07	51.50%	-16.70%	$0.03

Current Cash Position	**976,740**
Current Liability on Shorts Not Covered	**114,198**
Net Cash	**1,090,939**
Current Value of Bonds	**0**
Current Value of Long Equities	**3,474,061**
TOTAL VALUE OF PORTFOLIO	**4,565,000**

Important disclosures

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