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HALLGARTEN & COMPANY

Portfolio Strategy

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Model Mining Portfolio:

Looking to the Infrastructure Surge

Performance Review – December 2016

Model Mining Portfolio

2017 – Year of the Infrastructure Metals

- + Financing activity for gold stocks has held up despite the sloppy gold price. This disregard for reality will not last indefinitely
- + Uranium finally stirred from its slumbers with an 11th hour rally prompted by mutterings from Donald Trump on various matters of nuclear policy
- + Ongoing US dollar strength has helped miners operating in commodity currencies maintain their margins (for the moment)
- × Rising oil prices threaten margins for some producers and many investors have not taken this new situation on board in making their calculations
- × Oil prices threaten to strengthen the Canadian dollar to the detriment of miners
- × Interest rates are on the move upwards
- × Gold remains becalmed and unloved
- × Zinc has pulled back in what we view as end of the year profit taking
- × Many Canadian mining stocks suffered end of the (tax) year sell-offs to crystallise tax losses to be used against gains on other stocks

Infrastructure Metals Roar Back to Life

As we have noted elsewhere the dawning Trump era can be compared to several different periods of the past. The one many found most appealing (and yet least relevant) was the 1950s. This is oft dreamed of in the US and elsewhere as some sort of Ruritanian heaven. We prefer to liken the attitude (and now the makeup of the cabinet) to the 1920s which were not only roaring but memorable for their sleaziness (particularly under Warren Harding) and the maxim "the business of America is business" as enunciated by Calvin Coolidge. However, for our purposes and for those looking for a jobs-driven recovery (rather than a corporate bottom-line focused strategy) the mid-1930s with FDR's massive infrastructure surge and his Work Progress Administration (WPA) which created a lot of the current infrastructure the US relies upon and which is now looking so woefully battered and outdated. Trump may fancy himself as a new FDR but the vast bulk of Republicans would run a mile from such a comparison. That however does not stop an enormous public works program financed by debt from looking exactly like the WPA. In whichever case it spells potentially that 2017 will be the Year of the Infrastructure Metal and indeed that the rest of this decade and maybe through to 2025 will also be dominated by the type of metals that have been dependent solely upon China for their main motor of growth thus far in the 21st Century.

As a result of this trend and the general lack of development of new deposits and projects over the last decade, base metals came roaring back to life in 2016 and the outlook for 2017 looks as promising if not even more so. For us the most pleasant surprise was our favorite, Zinc, actually managing to outperform our target of $1.05 per lb for the year end. Hidden by the actual result ($1.15) was the fact that the metal had even reached a price of over $1.30 per lb if only fleetingly. Most of our other estimates were out to the upside or downside by less than 10%. Our notable “fails” were Uranium which plunged and spent most of the year wallowing in abject misery until a last gasp recovery on a Trump tweet in December and Tungsten which managed to climb above $200 per MTU and then slipped back. We perceive the hidden hand of Chinese manipulation as being involved in this malaise.

Hallgarten & Company - Commodity Estimates Out Three Years

	Unit	Jan 2016	End 2016 Estimate	End 2016 Actual	Undershoot/ Overshoot	End 2017	End 2018	End 2019
Lead	lb	$0.80	$1.00	$0.916	-8.4%	$1.10	$1.15	$1.02
	tonne	$1,763	$2,204	$2,019	-8.4%	$2,424	$2,535	$2,248
Zinc	lb	$0.70	$1.05	$1.152	9.7%	$1.33	$1.45	$1.50
	tonne	$1,543	$2,314	$2,539	9.7%	$2,931	$3,196	$3,306
Copper	lb	$2.11	$2.72	$2.503	-8.0%	$3.05	$3.10	$3.20
	tonne	$4,650	$5,995	$5,517	-8.0%	$6,722	$6,832	$7,053
Gold	oz	$1,080	$1,180	$1,146	-2.9%	$1,270	$1,300	$1,330
Silver	oz	$14.02	$14.78	$16.00	8.3%	$17.00	$17.50	$18.00
Platinum	oz	$890	$1,050	$904	-13.9%	$1,250	$1,280	$1,300
Palladium	oz	$544	$770	$669	-13.1%	$1,050	$1,080	$1,150
Uranium (spot)	lb	$34.40	$31.50	$20.25	-35.7%	$36.00	$44.00	$55.00
Antimony	tonne	$5,100	$8,700	$7,740	-11.0%	$8,700	$9,400	$9,700
Tungsten APT	MTU	$175	$325	$198	-39.1%	$260	$310	$330
Tin	tonne	$14,540	$18,700	$21,100	12.8%	$22,000	$22,100	$22,800
Cobalt	lb	$11.50	$14.10	$14.75	4.6%	$16.00	$16.70	$17.20
Nickel	lb	$3.93	$4.45	$4.58	2.8%	$4.60	$4.50	$4.25
	tonne	$8,662	$9,808	$10,086	2.8%	$10,138	$9,918	$9,367
Moly	lb	$5.44	$7.20	$6.69	-7.1%	$8.50	$9.30	$9.40

Notably Platinum and Palladium also undershot our expectations. Three metals we did not make estimates upon, Manganese, Chromite and Vanadium, proved to be stellar risers in the latter part of 2016. With good reason we would expect them to do well again in 2017 as it seems it shall be what we term the Year of the Infrastructure Metal as Trump promises to out-FDR on building programs. Easier said than done but we shall see.

Other base metals will also be invited to this party with us holding high expectations for Zinc and Copper as well (but not Lead) with Specialty metals also counted amongst the winners. Some of these metals however have made their move and should see little in the way of gains like they may have just enjoyed.

The contrast will be poignant with the base and specialty metals sectors. One should note how investors throw credulity to the four winds when gold moves. The slightest gain is the start of a “major uptrend” and yet base metals spent 2016 consistently rising and yet they are always suspected of being a flash in the pan. Zinc more than doubled and yet it was only near the end of the year that financings started to take place and talk of RTOing assets into shells began to surface. Copper’s move happened even later. Nickel also started to get a tailwind. The problem there is that projects in recent decades have tended towards the gargantuan so investors have stopped believing in the more bite-sized plays. One should not discount though that the base metals movers in 2017 will be those with miniaturized projects rather than those thinking (or talking) big.

All that being said, we are tempted to go prophetic and utter the words "the last shall be first and the first shall be last" and predict that Uranium (and Tungsten) will be two of the largest movers (upwards) in 2017.

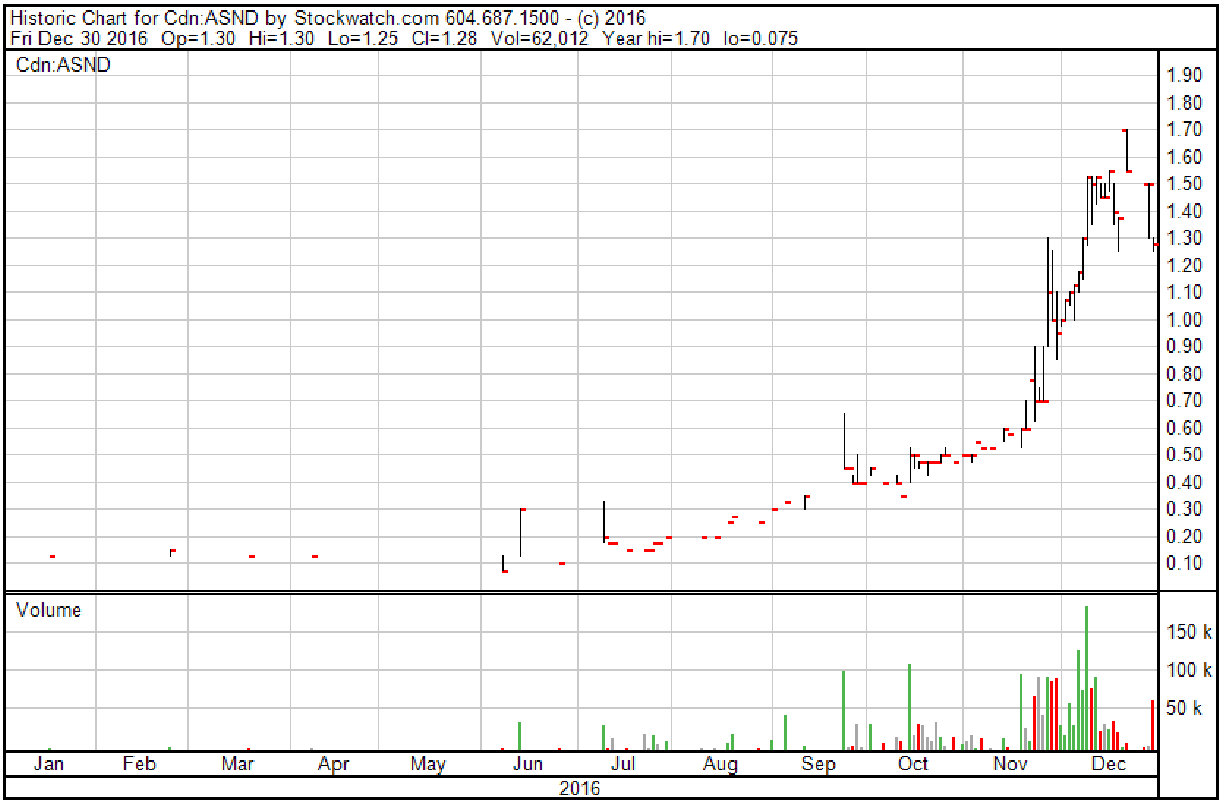
The Portfolio Move

The Model Mining Portfolio ended the year at $4.214mn, up from $4.14mn on the 5th of December. Cash remained at $976,000.

Portfolio Changes

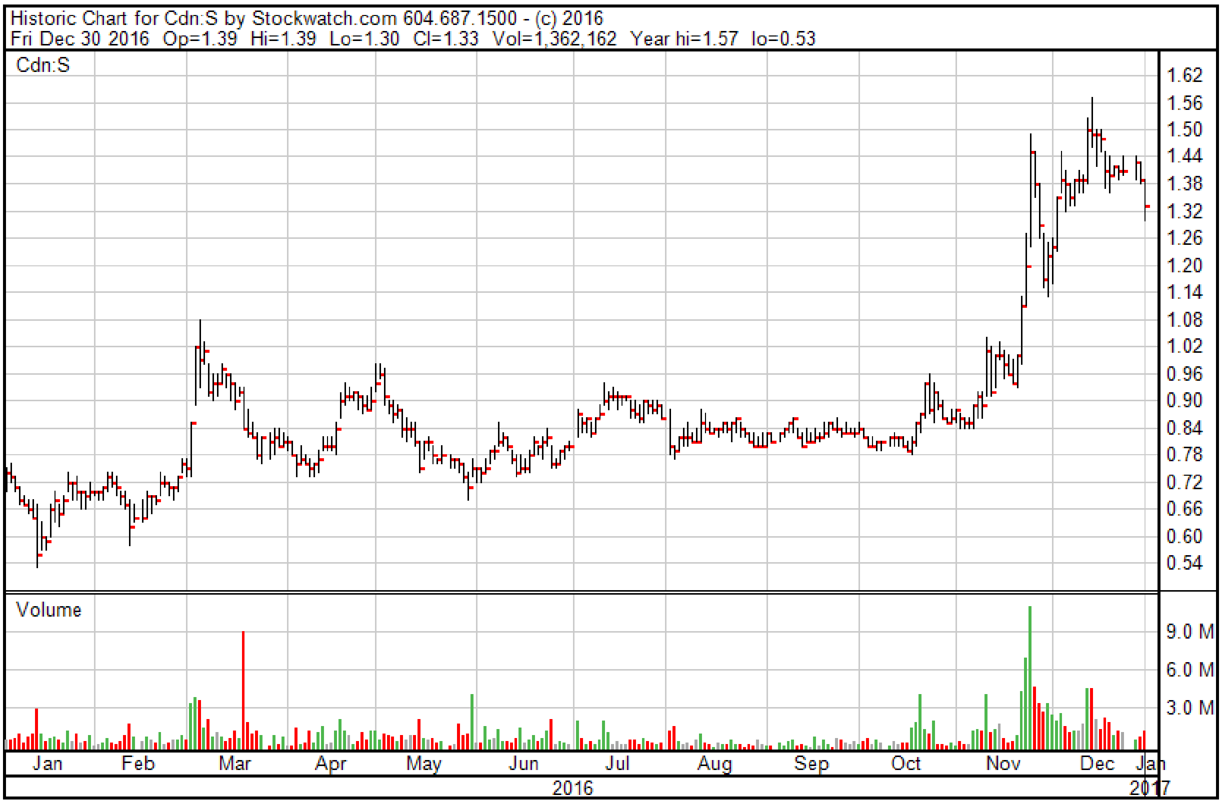
There were no portfolio changes during the month.

The shares of Morumbi, the Zinc miner, were consolidated one for five during the month and it was renamed Ascendant Resources. The value of our holding soared on this change rising nearly 170% in the month.



Sherritt – Will 2017 be its Year in the Sun?

Sherritt-watchers have been a long suffering crowd in recent years (unless they have been of the short disposition. However the second half of 2016 finally delivered a significant stock movement with a combination of the rising nickel and cobalt prices coinciding with the thaw in Cuban relations with the US.



The rise has been good for our Long position in the Model Mining Portfolio but we still feel it undershoots the potential. Sitting waiting for the US attitude to Cuba to change for 30 years does not constitute a sound business strategy. Indeed with the departure of the Cuba-friendly Obama regime, it remains unclear as to what Trump might mean for Cuba. If he likes Russia might he like Cuba just as much? Will the business opportunities trump (pardon the pun) the resistance of the strong anti-Castro Republican clique in Florida? Will Trump care what they think? We suspect he will not.

The main assets of Sherritt in Cuba consist of the Moa Bay nickel venture and some offshore oil production. Moa Bay gets the Sherritt critics all bent out shape. Frankly they probably couldn't name the former owners of the mine who might have a claim but that doesn't stop them airing their opinions. As for the oil concessions, we have seen no indication that they belonged to anyone but the Cuban government in their unexploited state pre-1959.

Sherritt’s operations in Cuba consist of the mining and processing facility at Moa Bay. The Moa JV is 50% owned by Sherritt (the partner being General Nickel) and it has a remaining mine life of around 20 years. Its output is vertically integrated with Sherritt’s nickel refinery in Fort Saskatchewan, Alberta.

This relationship dates back to late 1994, when Sherritt International executed a joint venture mining concession and distribution agreement with the government of Cuba with rights to extract and export nickel and cobalt ores from the nickel mine at Moa Bay. The mine uses open pit mining to extract lateritic nickel and cobalt ore, which is processed onsite into mixed sulphides containing nickel and cobalt. These mixed sulphides are shipped to the east coast of Canada, where they are then transported by rail to the Alberta facility for refining into finished nickel and cobalt. Currently, the Moa Joint Venture produces approximately 37,000 tonnes of nickel and cobalt annually. In FY07 the mine produced 31,392 tonnes of finished nickel and 3,574 tonnes of finished cobalt.

The terms of the joint venture allow Sherritt to repatriate to Canada a fixed level of profits from the processed metals but the agreement also requires that a percentage of the profits be reinvested in Cuba. As a result, Sherritt has, over time, built itself a presence in Cuban non-mining ventures through investments in such things as oil and gas production and power generation.

If Cuba has renown in any metal it is nickel. Unrefined nickel plus cobalt are Cuba's largest exports at around $2 billion in revenue last year. Cuban nickel is considered to be Class II with an average 90 percent nickel content. The ore is processed on the island in two formerly U.S.-owned plants at Nicaro and Moa Bay. Plants are also located at Punta Gorda and Las Camariocas. Holguín Province, where the Moa Bay mines are located, is estimated to contain 34% of the world’s known reserves of nickel, or some 800 million tons of proven nickel plus cobalt reserves, and another 2.2 billion tons of probable reserves.

The Moa Bay mines were once the property of Freeport in its pre-McMoran manifestation. They were initially started up during WW2 and largely paid for by the US government. Of the $119mn in capital of the Moa Bay Nickel Company, some $100mn had come from the US government and the rest from Freeport. The processing plant was closed down in 1947.

The whole nature of the Cuba/US nickel industry evolution was strange and uncommercial to say the least. It is well worth reading up on for anyone who wants to put the controversies in perspective. The muddled (and very Latin) nature of the arrangement is summed up in this extract from a memo from the Deputy Assistant Secretary of State for Inter-American Affairs, Mann to the Assistant Secretary of State for Inter-American Affairs, Cabot, in March 1953.

“The Batista Government like the Prio government wants Nicaro to continue as a permanent Cuban industry. It is willing to grant tax exemptions and other privileges because Nicaro is a non-profit United States Government-financed industry, contributing to hemisphere and free world defense and to the Cuban economy. The Cuban group which purchased participation in the operating company was sponsored by the Prio Government, and its initial spokesman, Inocente Alvarez, was close to Prio and

does not have the confidence of the Batista Government. The Batista Government informed us in July 1952 that it viewed the Prio letter as irregular and as having no validity, and that the United States Government need not feel obligated by it."

Thus the whole arrangement is not as clear-cut as the US would like and thus the ban on Sherritt executives travelling to the US is odious and irrational, but then again most of the Helms-Burton thesis is flawed hence the lack of consideration it gets from other Western world governments. By the sounds of it "a non-profit United States Government-financed industry" was a lost making enterprise for the Cuban government as it would never be able to levy tax revenues on such a "not for profit".

Our main critique of Sherritt would be that it has failed to rethink its Cuban exposure and restructure to minimize damage from US sanctions to its core business (which includes the Ambartovy mine in Madagascar). As we have said before the electricity generation, oil & gas assets (and indeed the nickel/cobalt assets) in Cuba would provide three listings to kickstart a new stock exchange in Havana. This would turn the arrangement into a more arms-length relationship and with an influx of international investors make it harder for the US malcontents to continue with their chest-beating ways.

As we have said before a demerger (or multiple demergers) into more focused businesses would give Sherritt investors their reward and distance the company from those in the US that would wish it ill. Our twelve month target price for Sherritt is $2.50 but that presupposes the company gives the market something interesting to base their investment upon and that Trump doesn't take Cuban relations back down the dead-end alleyway weher they spent most of the last half century.

Parting Shot

In a year in which we lost Mohammed Ali (aka Cassius Clay) we can't help but be drawn to the likeness of the gold price to an aged prize fighter that decides to refill the coffers via a career-reviving bout in Las Vegas with punters paying big bucks in the hope of seeing that old spark of genius.

Gold strode back into the ring in 2016, full of brash confidence, and ended the year carried off on a stretcher having barely lasted two rounds and being KO'ed by reality. Like an old slugger, gold needs to find some new tricks because the old ones are well-known, tired and can be pre-empted.

Political or event risk… doesn't work anymore… monetary base debasement.. yawn.

Precious metals bears see the gold space's self-appointed loons coming with their $2,000, $4,000 or even $10,000 per ounce scenarios and know that they can knock these arguments over with a feather.

When 2016 began the gold price was $1,080 and we ventured a twelve month target price of $1,180 for which we had scorn heaped upon us by the gold fanatics. As it has turned out our estimate overshot for the year end number, and the gold enthusiasts have gone away to lick their wounds and await another opportunity to tout their wares.

The two stimuli for gold during the year were the Brexit vote in July which inexplicably fired gold up by over one hundred dollars per ounce in a matter of weeks and then the Trump victory, which contrary to expectations, pulled the rug from under a gold price that was already on the slide from its post-Brexit highs. Both moves were made upon false premises so is it no wonder that gold has "gone the wrong way" in both cases? Brexit was not the end of the world and ironically it was gold bugs listening to "elite" opinion on a Doomsday scenario that led to gold being pushed up ahead of the "slump" which failed to materialize. Then in the case of Trump, we had a surprise result, but such an outcome was supposed to signal instability and a rise in risk (which may yet happen) but instead gold went down because of an interpretation (rightly) that interest rates would rise because of loose fiscal policy. In that they were not wrong but they failed to carry through the scenario to its inflationary end.

A Trump administration augurs the greatest chance of an inflationary breakout since the early 1980s and while an associated jump in interest rates will crimp those gold bulls who buy on borrowed money (we can't imagine who they are) the prospect of inflation and a rebalancing of asset distribution away for the multi-decade "no-brainer" of property towards savings in either fixed income or ingot form should be welcomed by gold bulls. Inexplicably though they are dumbstruck by the new scenario and unappreciative of the potential of inflation to be a real motor for the gold price. Our estimate for the yellow metal is for it to end 2017 around $1,270.

The surge in gold in the middle of 2016, made financial markets back into a happy hunting ground for gold juniors that were staring at enfeebled bank accounts after the long drought from 2011. Investors were prepared to throw ever larger amounts at the financings on the back of the thesis that gold had definitively turned up. All that cash is sitting in bank accounts now and execs are on record as saying that it was "for exploration and general administrative purposes" however with gold looking so flaccid and even bulls unable to enunciate a story that might fire up the price the very strong temptation will be for execs at gold juniors to "fake" some low level exploration in early 2017 and basically keep their cashpiles *virgo intacta* so that they don't face the danger of running out of cash and crimping their own lifestyles. A lack of work eventually produces a lack of results and thus announcements and from that no progress towards production or expanded resources. Investors should maybe brace themselves for a frustrating period where juniors sit on the cash they have gathered in 2016 and don't spend it (at least not on exploration work).

Mining Model Portfolio as at: 31-Dec-16

	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	1.26	1.40%	-45.70%	$2.00
	NevSun (NSU)	3/23/2012	CAD	3.45	4.15	5.00%	20.30%	$5.00
	Sherritt International (S.to)	7/11/2013	CAD	1.78	1.33	4.80%	-25.30%	$2.50
	Palladium ETF (PALL)	10/16/2014	USD	72.08	65.21	4.20%	-9.50%	$74.00
	Metals X (MLX.ax)	29/5/2014	AUD	0.98	0.56	1.70%	-42.80%	$1.00
Uranium	Uranium Participation Corp (U.to)	10/20/2010	CAD	7.01	3.8	2.30%	-45.80%	$6.00
	Western Uranium (WUC.cx)	7/5/2016	CAD	2.25	1.7	2.40%	-24.40%	$4.80
	GoviEx (GXU.cx)	6/29/2015	CAD	0.08	0.17	4.90%	106.90%	$0.50
Zinc/Lead Plays	Zinc ETF (Zinc.L)	1/15/2010	USD	7.04	7.4	2.40%	5.10%	£9.00
	Canadian Zinc (CZN.to)	12/9/2011	CAD	0.82	0.21	0.60%	-74.40%	$0.70
	Ascendant Resources (ASND.v)	10/31/2016	CAD	0.48	1.28	5.90%	169.50%	$1.70
	Nyrstar (NYR:BR)	9/28/2009	Euros	65.1	16.48	11.60%	-74.70%	€ 11.00
	Southern Silver Exploration (SSV.v)	8/25/2016	CAD	0.32	0.485	2.90%	51.60%	$0.94
Gold Producers	NewGold (NGD.to)	5/31/2013	CAD	7.05	4.71	3.40%	-33.20%	$8.00
	Patagonia Gold (PGD.L)	10/2/2013	GBP	3.6	2	1.60%	-44.40%	£4.00
	Komet Resources (KMT.v)	11/25/2016	CAD	0.47	0.43	2.10%	-8.50%	$1.28
	Westgold (WGX.ax)	12/6/2016	AUD	2.01	1.65	3.60%	-17.90%	$2.40
	Eldorado Gold (EGO)	6/21/2012	USD	9.12	4.32	4.10%	-52.60%	$7.00
	Teranga Gold (TGZ.to)	6/21/2012	CAD	1.57	0.82	2.30%	-47.80%	$1.50
Copper Producer	Coro Mining (COP.to)	2/23/2015	CAD	0.03	0.15	3.60%	400.00%	$0.30
	Royal Nickel (RNX.to)	11/17/2016	CAD	0.33	0.28	2.00%	-15.20%	$0.60
Processor	IBC Advanced Alloys (IB.v)	4/29/2016	CAD	0.3	0.43	1.00%	43.30%	$1.40
Driller	Cabo Drilling (CBE.v)	9/28/2016	CAD	0.025	0.02	1.00%	-20.00%	$0.08
Gold Explorers	Everton Resources (EVR.v)	4/17/2012	CAD	0.08	0.06	1.40%	-20.00%	$0.10
Tungsten Producer	Almonty Industries (AII.v)	7/31/2015	CAD	0.36	0.27	3.20%	-25.50%	$1.00
Copper Explorer	Asiamet Resources (ARS.v)	4/28/2016	CAD	0.05	0.04	1.40%	-20.00%	$0.24
Nickel Explorer	Sama Resources (SME.V)	23/2/2015	CAD	0.16	0.08	1.50%	-50.00%	$0.30
Lithium	Neometals (NMT.ax)	7/31/2014	AUD	0.04	0.34	3.90%	818.90%	$0.60
	Galaxy Mining (GXY.ax)	6/28/2016	AUD	0.35	0.52	2.60%	50.40%	$0.70
Scandium Explorer	Scandium International (SCY.to)	8/23/2016	CAD	0.14	0.27	3.90%	92.90%	$1.00
Graphite Producer	Elcora Resources (ERA.v)	29/5/2014	CAD	0.2	0.31	3.70%	55.00%	$0.64
Graphite Developer	Talga Resources (TLG.ax)	8/25/2016	AUD	0.27	0.29	3.30%	9.40%	$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	1.01	40.80%	34.00%	$0.80
	Galane Gold (GG.v)	4/28/2016	CAD	0.06	0.08	59.20%	-33.30%	$0.03

Current Cash Position	**976,740**
Current Liability on Shorts Not Covered	**110,896**
Net Cash	**1,087,636**
Current Value of Bonds	**0**
Current Value of Long Equities	**3,126,508**
TOTAL VALUE OF PORTFOLIO	**4,214,143**

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