



Decision Time...

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The shift towards a more positive mood became infectious last week, despite a continuation of at best mixed results from either side of the Atlantic. In New York the brokers were showing good Q2 results, but the bankers are still flushing cash away on an operating basis. Being able to gain on the decline of assets is aiding the traders, while the lenders continue to deal with the losses this creates. The same holds for the European finance side, though the German finance minister put out an opinion that his recession appeared to be bottoming. If the numbers prove correct the German economy will decline by 6% this year. That is good news given much of this would be in the 3.8% decline in Q1 alone. Bottoming is different than improving, but this is another underscoring of the simple reality that those economies which have cash reserves can look for ways to move on. Mostly they will look East (Japan being the exception, geographically speaking).

There has also been an improvement of sorts in the US housing sector, with housing starts gaining for the second month in a row. That permitting speaks to an improved mood, but also possibly other concerns. In Canada, which didn't get into full bubble mode with its housing, there has been a surge in house buying that has bidders paying above asking prices. This is in part to lock in mortgage rates while they remain low. Any interest rate gains near term will have as much to do with risk perception as anything else, so we are cautious about this particular mood shift.

The quick rebound in **metal prices** this mood shift has created is decidedly impressive. **Copper** actually touched a Post-Crunch high despite inventories being steady, and **nickel** has gained in part because of anticipated shut down of the Sudbury complex. It is true that there has been several disruptions to copper supply. There will be reduced output at Teck's Highland Valley operations in British Columbia due to geotechnical concerns, and Freeport McMoran has just told workers who have confronted by local protesters at its Grasberg operation to stay home. A stoppage at Grasberg in particular would be worrying to copper buyers, but it is still too early to assume this will continue.

Some added stocking may be in order given the potential of these disruptions to supply, but that doesn't make us comfortable with gains this is generating for some metal producers. The gains can continue while the mood remains buoyant, but actual cash flow will have to underpin share prices and it is Q2 reporting season. This is not an across the board concern, and we still like those companies that continue to play catch up (see the Capstone update), but we reiterate our caution about wanting to see some market consolidation.

That said, we are in a better mood about the speculative end of the sector. A number of our gold specs have had very good months, in keeping with results they have put out. We think that should continue through the summer, for those with the right goods. We are also getting more interested in the base metal specs despite the above stated concerns. The speculative end of the sector has its own rhythms, and after a general trouncing there will be a lot of people looking at otherwise good companies trading well below perceived values. There is a slow shift towards some of these companies now. As with the gold juniors, it will be selective and for the time being focused on companies that have the cash needed to expand on previous good results. We are not saying a summer rally in for base metal explores is underway, but it is time to be sorting out who you like. If the mood continues to improve, some of these will jump before much longer. **Ω**

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