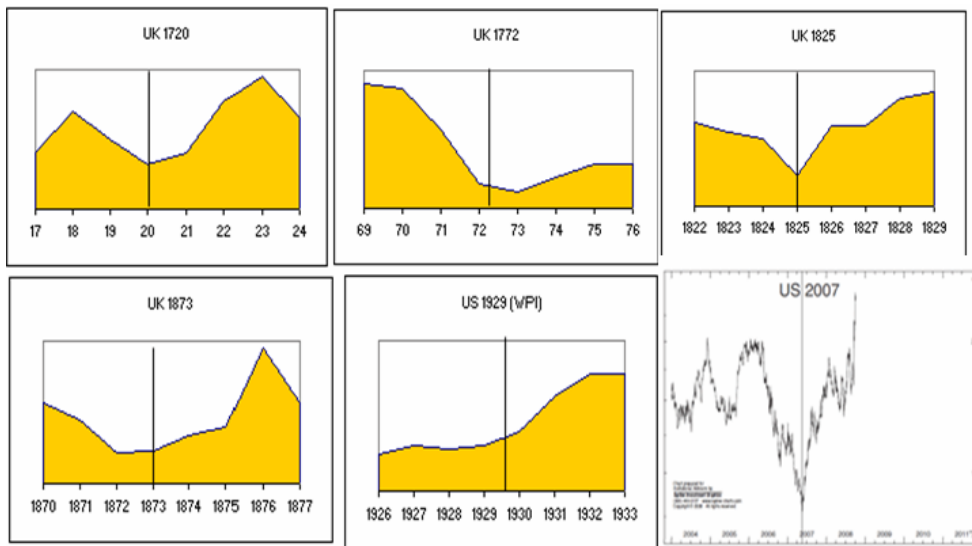


The “Real” Price of Gold Suggest Major Gold Share Bull Market

Gold’s “Real” Price Declines With Financial Manias But Rises With Financial Crashes (Real Price = Gold/Commodities)

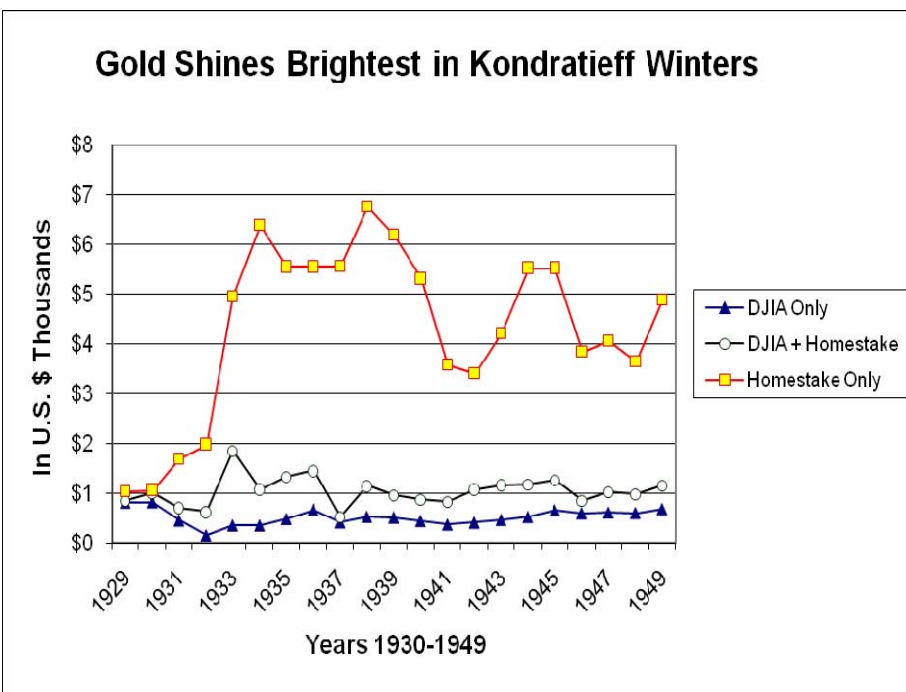


Again, let me remind you why I am so bullish on gold mining in general now more than I have been over the past number of years. One word tells the story and it’s not “inflation.” Rather, it’s “deflation.” The global financial system as well as the global economy is now clearly in a deflationary mode.

That’s bad for almost all areas of the economy but it is good for gold. Why so? Because while gold may decrease sometimes in terms of fiat money, in a deflationary time its *real purchasing power* increases. This is a point made constantly by Bob Hoyer and as he has shown in the charts on your left, over the past 300 years whenever we have experienced huge financial manias, gold’s real price has declined. But whenever these financial manias have imploded or deflated, gold’s purchasing power has increased. In other words, the value of gold—which is by the market’s choice—“real

money,” gains, vis-à-vis nearly everything else.

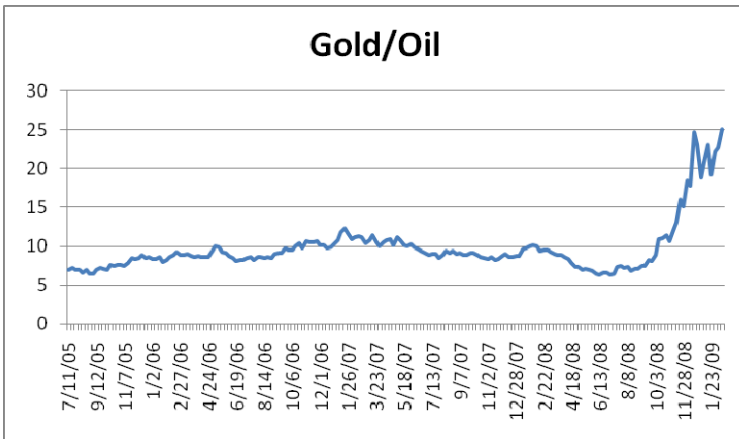
Currently, starting in 2007, gold’s real price has gained dramatically. Previously in the U.S. we had the experience of the 1930s, during which time gold mining companies did exceedingly well. Homestake Mining is the poster child for this illustration. We took



year-end Dow and Homestake share data to construct three hypothetical portfolios during the 1930s to illustrate just how useful investing in gold shares was during the Great Depression, which was a deflationary episode. The red line (yellow data points) portfolio is a 100% Homestake portfolio. Note that at its peak a \$1,000 investment grew to nearly \$7,000. The biggest surge in the value of Homestake was taking place during 1932-33, during which time the Dow actually lost nearly 90% of its value!

The middle portfolio was comprised of 15% Homestake, 85% Dow. Note that with just 15% invested in Homestake, that portfolio managed to stay in positive territory during most of the Great Depression. And that was actually a better performance than it appeared to be, because the dollar actually gained purchasing power during this deflationary timeframe.

The bottom portfolio was comprised of 100% Dow stocks. You can see that the Dow was deeply under water for a 20-year period from 1929 through 1949! Will the same dynamics hold true during this deflationary depression? What will happen if at some point a deflationary depression flips over to a hyperinflationary depression? How will gold shares perform then?

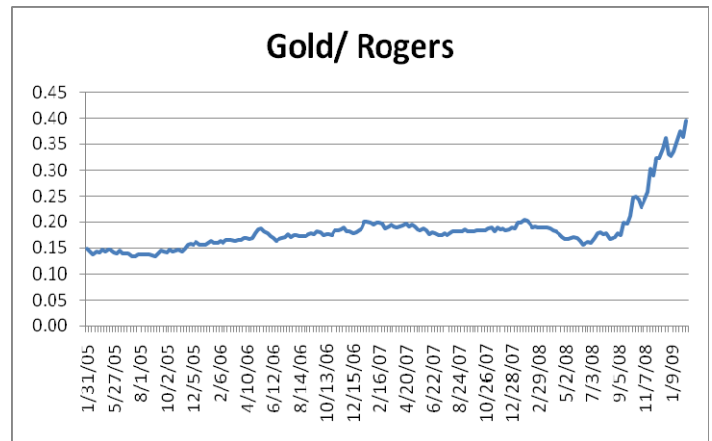
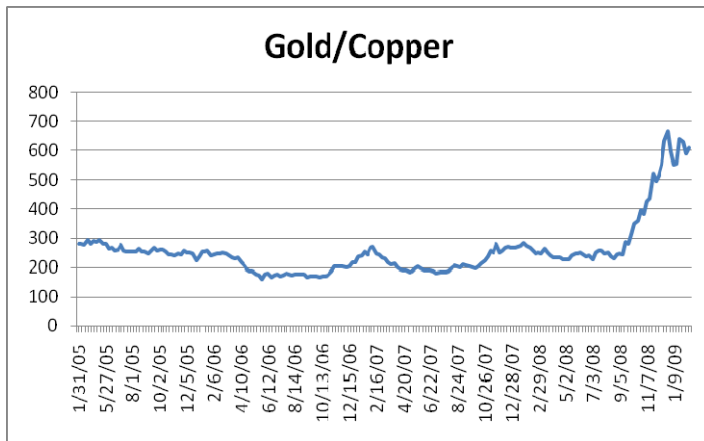


First, with respect to whether gold shares will once again perform well if we continue down the deflationary path, I'm betting the answer to that is "yes." The three charts on your left should help to paint a picture as to why in my mind gold mining companies may be about to show solid earnings while virtually all other industries are reporting down to horribly down earnings.

The first chart on your left is the ratio of gold to oil. Note that on September 12, right before the Lehman Brothers collapse, an ounce of gold would buy 7.57 barrels of oil. As of Friday, February 13, an ounce of gold bought 25.11 barrels of oil. **An ounce of gold will now buy 213% more oil than it bought a mere five months ago on Sept. 12th!** In other words, with the bursting of the credit bubble, gold's purchasing power in

terms of oil—the lifeblood of the industrialized world—gained dramatically. That is nothing short of phenomenal, in my view.

What about copper, the most important indicator of industrial demand and economic growth? Here the increase isn't as spectacular as for oil, but the increase in purchasing power for gold with respect to copper also grew dramatically. **On September 12th an ounce of gold bought 245 pounds of copper. On Feb. 13, 2009 it bought 610 pounds of copper. That's a 149% increase the amount of copper and ounce of gold will now buy.** I also like to look at the relationship between an ounce of gold and the Rogers Raw Materials Fund because that fund represents a broad range of hard and soft commodities although hydrocarbon products have by far the largest weighting in that index. On September 12th, an ounce of gold would buy 17% of a share of the Rogers Raw Materials Fund. On February 13, 2009 it would buy 40% of a share of the Rogers Raw Materials Fund. So gold will now buy 135% more of a broad basket of commodities as represented by the Rogers Raw Materials fund than it would have bought before the Lehman Brothers collapse triggered what is arguably the start of the biggest credit contractions of all time.



So gold has gained enormous purchasing power in just five months. But that isn't all that is favoring gold mining firms. Many base metals mines are shutting down so there is now an ample supply of labor whereas when commodity prices were booming, many gold projects had trouble getting adequate supplies of good skilled labor. In addition, all manner of supplies and drill rigs are available not to gold miners that were not available previously.

This is not what we want, but increasingly in our view Ian Gordon's view of a Kondratieff Winter is looking more and more likely. A look at Dr. McHugh's work on page one and two and then from a fundamental point of view, the exciting rise in the purchasing power of gold and declining mining costs, suggest to me that we could be looking at one of the most exciting gold bull markets in history. With respect to the 1930s, we noted the results of Homestake above. But Homestake wasn't the only company drawing in capital to its shares. An excellent book titled *Free Gold, The Story of Canadian Mining*, forwarded to me by Ian Gordon, documents the fact that a huge amount of capital flowed into the Canadian gold mining fields during the Great Depression. As major gold mining companies begin to report Q-4, 2008 earnings this week, we are anticipating some positive earnings news even as most other sectors continue to report declining earnings. If that is true, we would expect a major rise in capital flowing into the gold mining sector, first to the majors and then down the food chain so that eventually even our "D" Progress stocks will do well. In fact, I'm ready to say that the current period is shaping up to be the most exciting time for gold mining since I started publishing this letter in October 1981. Indeed, as our Model Portfolios suggest, gold shares have started to reward us handsomely so far in 2009. Stay tuned.

J Taylor's Model Portfolio as of: 5/12/2009			
Category	Weight	YTD Gain	Tot Gain
Progress "A" Gold Producers	38.73%	30.24%	58.71%
Speculative Mining Shares	24.89%	55.65%	128.93%
Uranium Stocks	7.99%	114.90%	-25.10%
Oil & Gas Stocks	5.68%	52.71%	-19.34%
Prudent Bear Fund	10.77%	-3.44%	-3.44%
Gold & Silver Cash (CEF)	7.63%	2.56%	57.41%
Rydex Inverse Long UST RYJUX	4.32%	5.29%	5.29%
J Taylor's Model Portfolio	100%	34.51%	148.86%
S&P 500		0.56%	-37.52%

J Taylor's Low Budget/Low Maintenance Portfolio (LBLMMP) from Jan 1, 2003 through 5/12/2009			
Category	Weight	YTD Gain	Total Value
World Prec Minerals Fund (UNWPX)	65.92%	27.93%	\$ 862.93
Prudent Bear Fund	11.97%	-3.44%	\$ 156.70
Rydex Inverse Long UST RYJUX	4.44%	5.29%	\$ 58.09
Gold & Silver Cash (CEF)	8.48%	2.56%	\$ 110.96
Van Eck Nuclear Energy ETF	4.81%	16.37%	\$ 62.95
S&P Energy ETF	4.39%	6.37%	\$ 57.54
J Taylor's LBLMMP Portfolio	100.00%	21.01%	\$ 1,309.16
S&P 500		0.56%	

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