# Steve Palmer: Timing the Market

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*The dollar's not going to go straight down, according to Steve Palmer, president and CEO of AlphaNorth Asset Management:"I'm expecting the U.S. dollar to rally in the short term and gold to sell off." Forecasting a bit of a pullback in the next month or so followed by another rally before year's end, Steve also explains his 'bigger bang for your buck' penchant for exploration stories in this exclusive interview with* The Gold Report.

***The Gold Report:*** Since the last time we spoke, in February, your performance in your fund year-to-date is up, I believe, 138%. Can you tell us what sectors you focused your fund on during this year to produce that type of return?

**Steve Palmer:** Well, there's no particular sector focus. The fund is very diversified. It's about half resource and half technology, special situations and biotech. But we did have a few big winners that really helped. Bio-Extraction (BXI:TSX.V) is one, and another one I mentioned in our previous interview, Colossus Minerals Inc. (TSX:CSI), was a big winner as well.

**TGR:** Your fund, as well as the market, has had pretty amazing returns this year. In your August monthly commentary you said you're getting cautious on equities, given the strong rally. What are you feeling now that we're in late October? Is there a pullback, or will we continue to move forward?

**SP:** I don't think the market can go that much higher in the short term. I think it needs to consolidate and pull back a little bit, so we have added some short positions in anticipation of this.

**TGR:** Many people have said they're expecting a pullback in the markets, but it never seems to happen. In what timeframe are you expecting this to occur?

**SP:** The next month or two. It's hard to get the timing perfect, but I think maybe a short-term pullback. Not a major correction or anything, but just a breather and then the markets could likely be strong into year end.

**TGR:** Oh, so it's going to have a slight pullback, and then rally again before the end of the year?

**SP:** Yes, that is my prediction. We will see if that pans out.

**TGR:** So you're a small cap long biased fund. What are you doing to your fund to maximize this potential pullback and the resulting rally?

**SP:** We've taken some profits in some of our big winners and we've purchased some ETFs that have an inverse correlation with the market, like the bear units and the double bear units. We are hedging some of the systematic risk.

**TGR:** You indicated that you trade gold on the technicals and there's clearly an inverse correlation with the U.S. dollar. Where do you think the U.S. dollar is going? Have we hit bottom on the dollar, or what do you expect to see in the remainder of '09 and through 2010?

**SP:** The U.S. dollar in the short term, I think, is going to appreciate from here. Almost everybody believes the U.S. dollar is going lower longer term; and I don't disagree with that, but it's not going to go straight down. So I'm expecting the U.S. dollar to rally in the short term and gold to sell off.

**TGR:** Would you see that short-term similar to what you're looking at in the general market in the next month or two?

**SP:** Yes. Gold is probably peaking this week if I were to stick my neck out.

**TGR:** But longer term we're expecting the U.S. dollar to go lower than where it is today.

**SP:** Yes. That's over years—like several years from now.

**TGR:** So are you anticipating it's basically going to bump along at the current level it's at, in a small trading range?

**SP:** I expect it to rally a little bit then take another leg down, but it's not going to happen overnight.

**TGR:** And, as a result, what would you see gold doing for the remainder of this year and into 2010?

**SP:** Gold will just follow the U.S. dollar. There is currently a lot of speculation in the gold market, as well. There are all these ETFs that have purchased a lot of gold—all the dehedging by the producers that has created a lot of demand that's not going to be there in future years; so I'm not a super bull on gold. I do have several junior gold investments, but the expectation is that they will do well regardless of whether gold is $1,100 or $850. The share prices of these companies will be driven by company-specific catalysts.

**TGR:** So you're looking at the juniors rather than the metals as an investment.

**SP:** I like to look at the exploration stories, where you get a bigger bang for your buck rather than just buying a producer.

**TGR:** You mentioned earlier you have a few companies that you're looking at. Can you share any of those companies with our readers?

**SP:** Pelangio Exploration Inc. (PX: TSX-V) I like a lot. They recently raised $7 million to drill a property they have in Ghana, which is right beside a large producing mine of AngloGold (NYSE:AU, JSE:ANG, ASX:AGG, LSE:AGD), which has 60 million ounces on the property, and Pelangio is adjacent to that property. On AngloGold's property the gold is contained in pods of 3–5 million oz each. Pelangio has 15 drill targets, and they're going to be drilling out over the next few months, and hopefully releasing their results early next year. I like situations like that where it's in a proven gold district with high odds of success. So I think that could have some significant gains if they can show that there are similar pods containing gold which extend onto their property. If Pelangio can demonstrate this, it should be a multi-dollar stock.

**TGR:** Any other exploration stories that you're intrigued with that you can share?

**SP:** I still like the Colossus Minerals story. I think there's more upside to come. They just raised money as well, so now they're fully financed into production and they've applied for a mine permit, which they're hoping to get early next year. That could also be a catalyst for a takeout once they get their permit. They've had some fantastic results and they're continuing to drill on that property.

**TGR:** They've had an incredible increase in their stock price this year. Earlier, you mentioned they were a big winner. How much more upside can they have?

**SP:** I think that if the drill results keep coming in as they have been and they progress towards producer status by obtaining the permits it will trade over $10.

**TGR:** Will they be reliant on the price of gold staying above $900?

**SP:** Not particularly, because it's more of a building resource type of story; the grade is very high and they don't *just* have gold. They have very high grades of platinum, palladium and some other minerals like rhenium as well, so their operation would be highly profitable regardless of whether gold is above $1,000 or not.

It's still a developing story. Further catalysts could come from proving up other zones on the property that they're doing some work on, or if they were to acquire additional land in the area.

**TGR:** Any other companies that you're following in exploration or near production?

**SP:** Another company I like that's not in the gold space is Puget Ventures Inc. (TSXV:PVS).. It has quite a small market cap. The company has a cobalt property that produced in the 1940s, and they still have infrastructure on site. Recently, they've raised money to go back and do some further drilling to increase their reserves and mine life. They could be back in production in a relatively short time frame. One of the reasons I like it is that recently investors have been very interested in lithium companies and have bid up share prices of many lithium companies dramatically this year. I think Puget is another play on the same thing, Cobalt will be in increased demand for batteries as a result of the electrification of vehicles. There is actually twice as much cobalt in a lithium battery as there is lithium; and cobalt sells for roughly four times the price of lithium, so it's a similar play on the whole electric vehicle market.

**TGR:** Back on to energy, as we also have a sister report called *The Energy Report*. What trends are you looking at in energy that you feel look like good investment opportunities?

**SP:** Colombia's attracted a lot of interest recently; several companies have had a great success in there. The government has moved the army into certain areas to make it safe for foreign companies to operate, so that's opened up a huge opportunity for many companies. One of the ones I have been buying is a company called Quetzal Energy Ltd. (QEI-TSXV). They recently announced that they acquired a property in Colombia which is highly prospective for oil. They are in the process of raising some money now to fund some work on that. That property is of particular interest because, first of all, a lot of the other companies in Colombia have had great success—but all the properties surrounding this property are producing oil properties, so it's highly prospective.

**TGR:** Where do you see oil going compared to some of these alternative energies, which are getting a lot more press?

**SP:** A lot of the alternative energy initiatives are highly dependent on government programs and grants. Obama and other politicians remain highly supportive of these initiatives so alternative energy companies should do well. Natural gas inventories are very high right now relative to the past several years thus the price of natural gas has been trending lower in North America, while oil has rebounded strongly from the $30s where it bottomed. It is probably unlikely that oil goes much higher in the short term. It's probably at a reasonable level right now.

**TGR:** It sounds like you have a similar focus in terms of looking at gold. You're looking for exploration plays that will have appreciation regardless of the price of the underlying commodity.

**SP:** Yes. If you can eliminate some of the variables that are not easy to predict like the direction of commodity prices or currencies and just focus on the company specific catalysts, it lowers your risk.

**TGR:** So Quetzal is an exploration story at this point? Are they producing anything?

**SP:** They have some small production—very small—in Guatemala. They had some technical issues drilling a well there and I now they've acquired an additional avenue for growth in Colombia.

**TGR:** And is the oil play here more interesting *because* it's in Colombia, or do you like the oil sector in general?

**SP:** I am somewhat indifferent to overweighting the oil sector. I like Colombia because of the recent changes there and the huge drilling success several companies have had there recently. Obviously, areas of the country are highly prospective for oil. Companies I mentioned like Pelangio and Quetzal are ground-floor type situations where there are very good odds of success. And if they have success, the shares would be revalued upwards by multiples. These are the type of situations I like.

**TGR:** Thank you for your time.

***DISCLOSURE:*** *Steve Palmer*
*I personally and/or my family own shares in the following companies mentioned in this interview: AlphaNorth owns shares of all companies mentioned.*

*I personally and/or my family am paid by the following companies mentioned in this interview: None.*

*Steve Palmer and Joey Javier, an investment team since 1998, took three key assets—their excellent track record, their experience and their belief that exploiting inefficiencies in the Canadian small-cap universe would produce superior long-term equity returns—to AlphaNorth Asset Management, launching the Toronto-based investment management firm in August 2007. By year-end 2007, the long biased small-cap hedge fund they built made its debut. Until Lehman Brothers' liquidated, credit markets froze, massive investor requests for redemptions forced hedge funds to sell out of their positions and "volatility" no longer came close to describing the frenzy in financial centers, the fund was flush and its investors were as happy as clams. Its first seven months netted a return of 35.6%, significantly outperforming the major Canadian indices. During that period, the TSX Venture Index declined by 3.7% and the TSX Composite Index rose by 7.4%.*

*Steve, who is a Chartered Financial Analyst, earned his BA in Economics at the University of Western Ontario. After starting in the investment community as a research associate, he moved to a major financial institution in mid-1998, where he met Joey and built his career. As Vice President of Canadian Equities, he managed* *assets of approximately $350 million, including a pooled fund that focused on small-cap companies.*

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