

# Classical Insights

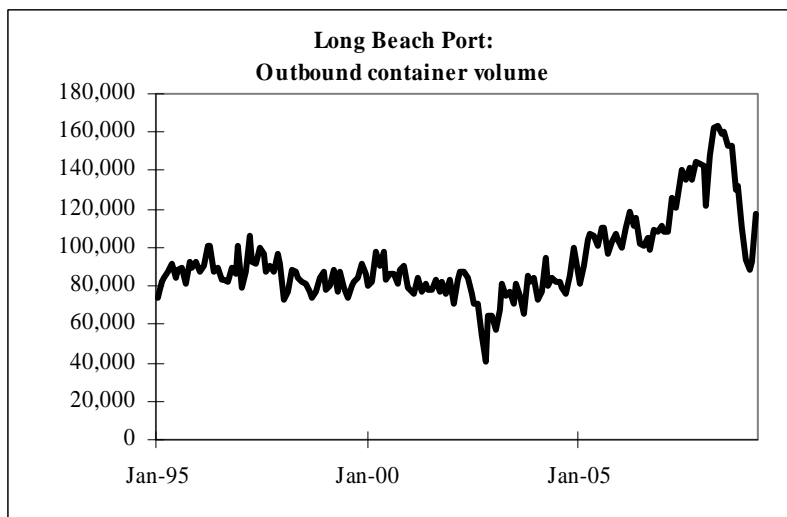
Global Equity Research Based on the Classical Economic Model

## Monthly Portfolio & Themes: Good things happening all over

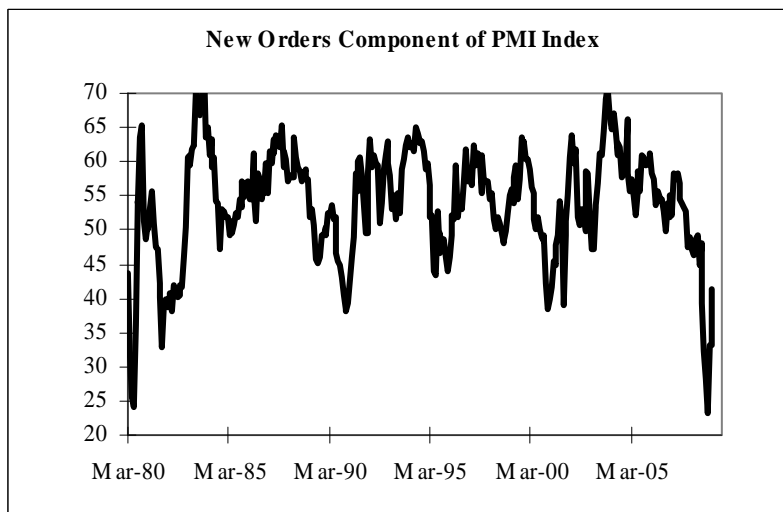
Mike Churchill

April 24, 2009

**The list of good things happening continues to lengthen.** Brazilian beef exports rose 24% MoM in March on rebounding demand from Europe. The ports of Long Beach and Los Angeles are humming again. Long Beach container exports rose 26% MoM in March.



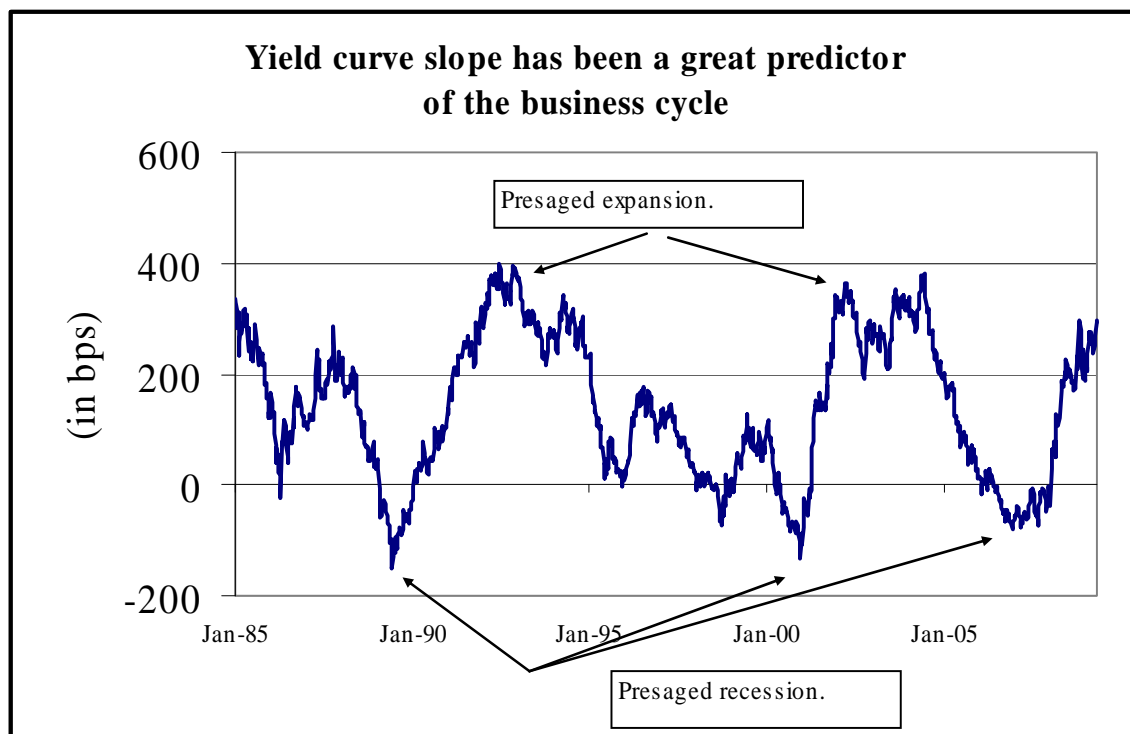
The new orders component of the Purchasing Managers Index rebounded to 41.2 in March from 23.1 in December:



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AK Steel and Steel Dynamics both said the pace of rate inquiries has picked up in recent weeks. That is usually a leading indicator of new orders. Molybdenum prices also have started to firm (albeit only fractionally) in China.

**The yield curve slope is predicting an expansion.** As the chart below shows, the yield-curve slope has predicted recessions and expansions with uncanny accuracy over the past 25 years. Mike Darda at MKM Partners has been doing some interesting historical studies to answer the question of which indicators are *really* leading indicators of the stock market and the economy - and which aren't. His conclusion: among the most reliable leading indicators are the new orders component of the PMI, the yield curve slope, the junk yield spread, the TED and LIBOR spreads and M2 growth. *Every one of those indicators has been improving.*



Last week I was out seeing clients in various spots on the east coast and the main theme was concern that this equity market rally is not real; that it may reverse. "How can the country grow when there's so much debt?," was the oft-stated concern.

My response was four-fold:

- a) Key leading indicators of the economy are improving;
- b) Emerging markets don't have our bank or debt problems, so why not buy them?;
- c) Commodities give you two ways to win: growth or money debasement;
- d) Nineteen out of every twenty people who had a job before still has one now. That should be sufficient to allow the economy to rebound from a reduced base.

I went to a stockpickers' dinner in the middle of the trip, where the overwhelming mood was bearishness. One fellow recommended gunmakers on the expectation of increased civil unrest. There was one bull there, however: The winner of the competition two of the past three years was ravingly bullish on both Africa and gold. He spent the entire month of February traveling to 8 or 10 African cities and said things there look fantastic.

I would say about 30% of our clients are actively bullish. One said the current rally should be called "The Great Bull Market of 2009" because the average stock globally is up more than 20% YTD.

Additional points from the meetings:

\* Two clients with large funds have been participating in recent financings by junior base-metal miners such as Breakwater, Mercator and Crowflight. Secondary offerings are often the only way big shops can get into small names in any size - and these offerings are frequently priced low. One client doubled his money in a week in the recent Breakwater offering. The shares went off at a below-market price and buyers also got half a warrant in the deal. BWR shares bounced after the deal and the warrants shot up to 8 cents.

\* Lundin Mining is getting back on to the radar. A client argued that the Tenke Fungurume copper mine will be a great project and the stock looks cheap based on Tenke plus the zinc mines. Meanwhile, last month in Vancouver, I met with the CEO of a zinc miner who argued that every zinc miner in the world has old & tired assets -- *except Lundin*. I had written off Tenke (for no good reason) but in looking at it again I see that it is indeed going to be a great mine. Another Congo name that is interesting here is Anvil, which we used to cover. We'll be adding some of that to the portfolio and hope to revisit it in detail soon.

\* One client was very bullish on Cirrus Energy (CYR CN), which was interesting because it's a fairly obscure Canadian name. I met with management in Calgary last month and thought it was a great story, but somehow couldn't pull the trigger. With gas still falling, Cirrus becomes relatively more attractive than other gas names because its North Sea gas production will be priced at one-sixth the Brent crude price.

\* Quadra Mining has more fans than it did a couple of years ago. Clients recognize it as a solid mid-tier producer with three good mines and a low valuation. This name came up in nearly every meeting.

\* Two clients said they were skeptical about the sustainability of potash prices, a point on which I agree. One noted that potash is not a rare commodity (it's not) and another said the Russians are willing to sell potash below the price being charged by Potash of Saskatchewan (also agree). On a related note, yesterday POT management said potash sales have fallen to a standstill. Basically, the problem is that potash makers are pricing way above what the market will bear - and since potash can sit in the field for a year or two farmers are not compelled to buy it every year.

\* Several clients wanted to plow through our list of stocks with 500%+ upside potential, on the grounds that if the nascent rally keeps going, some of these little stocks will go vertical.

\* There were split opinions on natural gas, with some bulls and some bears. One client noted that finding costs on natural gas have fallen by more than \$1/mcf due to lower input costs. It's interesting that gas stocks have been rising even as the gas price keeps falling. Forecasts I've heard for gas prices range from \$1/mcf to \$20/mcf. Both are possible (\$1 for the near term and \$20 for the medium term).

**We'll be doing a portfolio rebalancing to boost positions in names that should respond positively to a reflationary recovery.**

**Portfolio Rebalancing Trades (prices as of 11 a.m. today)**

	US\$ price	Shares	Total US\$	target	Notes
<b>Buys</b>					
Orko Silver (OK CN)	\$0.66	13000	\$8,595	\$1.78	Good project. Partnering with Pan Am Silver to build.
Anvil Mining (AVM CN)	\$0.92	9000	\$8,256		Kinsevere is big, low cost and only requires \$200mm to finish.
Great Basin Gold (GBG)	\$1.30	6000	\$7,800	\$2.07	6.6x 2010 EPS and some of the cheapest ounces around.
AK Steel (AKS)	\$12.23	600	\$7,338		Stainless rebound may be looming.
Lundin Mining (LUN CN)	\$1.79	4000	\$7,174		Has among world's best zinc mines, Tenke coming along.
Quadra Mining (QUA CN)	\$5.40	1300	\$7,016	\$14.12	Perhaps the most attractive copper. 4.2x @ \$2.35/lb. Cu.
Thompson Creek (TC)	\$5.35	1200	\$6,420		Moly inching up in China. Good play on stainless rebound.
		<b>total buys</b>	<b>\$52,598</b>		
<b>Sells</b>					
				<b>% selling</b>	
McDermott (MDR)	\$16.44	1050	\$17,262	100%	Approaching our target price.
Mosaic (MOS)	\$40.40	245	\$9,898	100%	Potash market is dead for now.
Arch Coal (ACI)	\$13.84	600	\$8,304	100%	Coal is fairly inelastic relative to economic activity.
Peabody Energy (BTU)	\$27.27	275	\$7,499	100%	Coal is fairly inelastic relative to economic activity.
Rainy River Resources (RR CN)	\$1.90	2500	\$4,752	100%	Other exploration projects offer better value.
Tyhee Development (TDC CN)	\$0.11	25000	\$2,756	100%	Potentially a good project but something feels wrong here.
Agrium (AGU)	\$40.11	50	\$2,006	100%	Other things more interesting.
		<b>total sells</b>	<b>\$52,477</b>		

**Classical Insights Portfolio as of April 23, 2009**

	Date of orig purch.	Price		shares	value	% chge since first purch.	% of total portfolio
		initial	Current				
Chariot Resources (CHD CN)	1/5/2009	0.10	0.24	155000	\$37,339	141%	10.9%
Northgate Minerals (NXG)	7/1/2008	2.80	1.39	23500	\$32,665	-50%	9.5%
W&T Offshore (WTI)	3/18/2009	5.73	9.09	3500	\$31,815	59%	9.3%
Quadra Mining (QUA CN)	1/5/2006	5.39	5.10	5980	\$30,520	-5%	8.9%
Mercator Minerals (ML CN)	8/8/2007	7.31	1.00	27000	\$27,119	-86%	7.9%
Taseko Mining (TGB)	7/11/2007	4.17	1.31	15000	\$19,721	-68%	5.7%
Atwood Oceanics (ATW)	3/18/2009	18.15	22.05	800	\$17,640	21%	5.1%
McDermott (MCD)	11/7/2008	8.52	15.93	1050	\$16,727	87%	4.9%
Imperial Metals (III CN)	3/18/2009	2.22	3.25	4500	\$14,625	46%	4.3%
AK Steel (AKS)	6/29/2004	5.23	11.38	1175	\$13,372	118%	3.9%
Great Basin Gold (GBG)	1/18/2008	3.23	1.25	10500	\$13,125	-61%	3.8%
Thompson Creek (TC)	3/27/2007	10.17	5.12	2350	\$12,032	-50%	3.5%
Chicago Bridge (CBI)	11/24/2008	7.15	8.96	1300	\$11,648	25%	3.4%
Breakwater Resources (BWR CN)	3/19/2009	0.11	0.11	100000	\$10,616	-3%	3.1%
Airtran Holdings (AAI)	7/24/2008	2.82	7.56	1400	\$10,584	168%	3.1%
Mosaic (MOS)	4/24/2007	29.96	38.21	245	\$9,361	28%	2.7%
ATP Oil and Gas (ATPG)	6/9/2008	3.98	6.24	1500	\$9,360	57%	2.7%
Arch Coal (ACI)	10/27/2008	17.68	14.91	600	\$8,946	-16%	2.6%
Peabody Energy (BTU)	12/22/2008	23.01	26.42	275	\$7,266	15%	2.1%
Crew Energy (CR CN)	4/14/2009	4.25	4.69	1500	\$7,031	10%	2.0%
Crowflight Minerals (CML CN)	1/6/2009	0.18	0.17	40000	\$6,696	-7%	1.9%
Selwyn Resources (SWN CN)	3/2/2009	0.07	0.07	100000	\$6,533	-7%	1.9%
Legend International (LGDI)	12/22/2008	0.40	0.60	10000	\$6,000	50%	1.7%
First Trust Aberdeen (FAM)	12/22/2008	9.98	11.37	465	\$5,287	14%	1.5%
Canplats Resources (CPQ CN)	2/20/2009	1.75	1.39	3500	\$4,859	-21%	1.4%
Rainy River Resources (RR CN)	2/20/2009	1.64	1.93	2500	\$4,818	18%	1.4%
Agco (AG)	12/27/2002	22.70	23.60	200	\$4,720	4%	1.4%
Ladish Co. (LDSH)	8/18/2008	27.79	8.63	475	\$4,099	-69%	1.2%
Los Andes Copper (LA CN)	1/6/2009	0.09	0.07	50000	\$3,266	-27%	1.0%
Candente Resource (DNT CN)	1/5/2009	0.23	0.31	10000	\$3,103	35%	0.9%
Helix Energy (HLX)	11/28/2008	6.14	7.93	350	\$2,776	29%	0.8%
Tyhee Development (TDC CN)	2/20/2009	0.16	0.11	25000	\$2,756	-29%	0.8%
Foster Wheeler (FWLT)	11/7/2008	21.29	21.48	125	\$2,685	1%	0.8%
US Airways (LCC)	7/24/2008	4.74	4.80	450	\$2,160	1%	0.6%
Agrium (AGU)	5/28/2008	84.99	38.60	50	\$1,930	-55%	0.6%
Continental Airlines (CAL)	6/3/2005	14.46	13.48	40	\$539	-7%	0.2%
United States Steel (X)	11/29/2005	45.48	27.03	15	\$405	-41%	0.1%
Scan Geophysical (SCANG NO)	10/5/2007	4.31	0.07	700	\$49	-98%	0.0%
<b>Cash</b>							
PW Money Market (or short pos.)	12/19/2002	1.00	1.00	(64,817)	(64,817)	0%	-18.9%

**Classical Insights Portfolio Performance (4/23/2009)**

Value at inception on 12/19/02	\$102,144
Current value	\$343,709
<b>Gain since inception</b>	<b>236%</b>
S&P 500 total return since 12/19/02 including dividends	14%
<b>Year-to-date performance</b>	<b>30.1%</b>
S&P 500 year-to-date performance including dividends	-4.7%

The Classical Insights portfolio has gained 69.0% in the six weeks since the last update. The portfolio is up 30.1% year-to-date and up 236% since inception on Dec. 19, 2002.

### Trading since last portfolio update (March 9, 2009)

date	b/s	name	shares	price (US\$)	total (US\$)
9-Apr	BOUGHT	AK Steel	800	9.65	\$7,720
19-Mar	BOUGHT	ATP Oil & Gas	1500	3.98	\$5,970
18-Mar	BOUGHT	Atwood Oceanics	450	16.46	\$7,407
19-Mar	BOUGHT	Atwood Oceanics	350	18.15	\$6,352
19-Mar	BOUGHT	Breakwater Resources	50000	0.11	\$5,250
14-Apr	BOUGHT	Breakwater Resources	50000	0.12	\$6,150
13-Apr	BOUGHT	Chariot Resources	35000	0.25	\$8,575
14-Apr	BOUGHT	Crew Energy	1500	4.25	\$6,374
14-Apr	BOUGHT	Crowflight Minerals	30000	0.16	\$4,860
18-Mar	BOUGHT	Imperial Metals	3000	2.22	\$6,651
14-Apr	BOUGHT	Imperial Metals	1500	3.29	\$4,941
19-Mar	BOUGHT	Mercator Minerals	15000	0.50	\$7,560
13-Apr	BOUGHT	Mercator Minerals	13000	0.91	\$11,804
19-Mar	BOUGHT	Quadra Mining	1400	4.31	\$6,034
13-Apr	BOUGHT	Quadra Mining	1200	5.40	\$6,479
14-Apr	BOUGHT	Quadra Mining	1000	5.35	\$5,347
18-Mar	BOUGHT	Taseko Mines	4000	0.98	\$3,916
9-Apr	BOUGHT	Taseko Mines	6000	1.48	\$8,856
14-Apr	BOUGHT	Thompson Creek	1300	4.79	\$6,227
13-Mar	BOUGHT	Troy Resources	7000	0.82	\$5,726
18-Mar	BOUGHT	W&T Offshore	1500	5.73	\$8,595
19-Mar	BOUGHT	W&T Offshore	1000	6.70	\$6,700
23-Mar	BOUGHT	W&T Offshore	1000	6.53	\$6,530
19-Mar	SOLD	AAR Corp	375	12.49	\$4,684
19-Mar	SOLD	Agrium	250	38.77	\$9,693
19-Mar	SOLD	Airtran Holding	1000	3.98	\$3,982
14-Apr	SOLD	Barnes Group	175	12.15	\$2,127
9-Apr	SOLD	Brett Resources	10000	0.45	\$4,460
12-Mar	SOLD	Buenaventura Mines	1250	19.56	\$24,453
9-Apr	SOLD	Jaguar Mining	220	4.92	\$1,082
9-Apr	SOLD	Jaguar Mining	1150	4.91	\$5,647
14-Apr	SOLD	Mercator Minerals	20000	1.19	\$23,780
9-Apr	SOLD	Minefinders	1200	6.99	\$8,388
9-Apr	SOLD	Northgate Minerals	12000	1.24	\$14,880
19-Mar	SOLD	Peabody Energy	125	28.96	\$3,619
19-Mar	SOLD	Shaw Group	75	28.79	\$2,159
23-Mar	SOLD	Terra Industries	170	27.89	\$4,741
9-Apr	SOLD	Terra Industries	175	27.39	\$4,793
20-Mar	SOLD	Troy Resources	8000	0.86	\$6,856
14-Apr	SOLD	Troy Resources	7000	0.90	\$6,300
23-Mar	SOLD	Wesdome Gold Mines	6500	1.08	\$7,046
12-Mar	SOLD	Yamana Gold	300	8.19	\$2,458
12-Mar	SOLD	Yamana Gold	700	8.20	\$5,741

#### Key trades this past month were:

- Added to base-metal miners;
- Added to oil-and-gas E&Ps (and one offshore driller, ATW);
- Sold gold names that seemed more or less fully valued;
- Sold fertilizers.

At present, it looks as though one mistake in recent months was selling down the airlines. If oil remains calm and the economy picks up, airlines can make an absolute killing. We need to revisit that theme.

### Target prices and implied upside (April 23, 2009)

	Target	current	Upside	Last rev'wed	
Tyhee Development (TDC CN)	0.49	0.11	<b>346%</b>	Mar-09	<i>need to review (down?)</i>
Nevsun Resources (NSU CN)	3.85	1.11	<b>247%</b>	Mar-09	
Orko Silver (OK CN)	1.78	0.63	<b>183%</b>	Feb-09	
Quadra Mining (QUA CN)	14.12	5.10	<b>177%</b>	Apr-09	
Chicago Bridge (CBI)	20.67	8.96	<b>131%</b>	Dec-08	
Taseko Mining (TGB)	3.01	1.31	<b>129%</b>	Apr-09	<i>need to review (down?)</i>
Imperial Metals (III CN)	7.32	3.25	<b>125%</b>	Apr-09	
Arch Coal (ACI)	32.93	14.91	<b>121%</b>	Dec-08	
Mercator Minerals (ML CN)	2.04	1.00	<b>103%</b>	Apr-09	
Great Basin Gold (GBG)	2.07	1.25	<b>66%</b>	Mar-09	
Airtran Holdings (AAI)	12.35	7.56	<b>63%</b>	Dec-08	<i>need to review</i>
Northgate Minerals (NXG)	2.15	1.39	<b>55%</b>	Mar-09	
AAR Corp (AIR)	22.77	14.92	<b>53%</b>	Nov-08	
Wesdome (WDO CN)	1.50	1.08	<b>39%</b>	Feb-09	
Jaguar Mining Inc (JAG)	7.65	5.91	<b>29%</b>	Dec-08	
Acergy SA (ACGY)	9.45	7.35	<b>29%</b>	Dec-08	
McDermott (MDR)	18.53	15.93	<b>16%</b>	Dec-08	
Yamana Gold Inc (AUY)	8.69	7.95	<b>9%</b>	Dec-08	
Minefinders (MFN)	7.50	7.23	<b>4%</b>	Jan-09	

### Forward P/E and P/FCF Estimates (April 23, 2009)

	price	08 EPS	09 EPS	10 EPS	11 EPS	10 P/E (e)	08 FCF	09 FCF	10 FCF	P/FCF
Imperial Metals (III CN)	3.25	1.69	0.94	0.99	1.28	<b>3.3</b>	0.91	1.23	1.19	<b>2.7</b>
Mercator Minerals (ML CN)	1.00	-0.38	-0.14	0.30	0.41	<b>3.3</b>	-2.11	-0.45	0.28	<b>3.6</b>
Quadra Mining (QUA CN)	5.10	0.61	0.55	1.21	1.73	<b>4.2</b>	-3.26	0.19	0.91	<b>5.6</b>
Airtran Holdings (AAI)	7.56	-1.10	0.83	1.76		<b>4.3</b>	-2.69	0.83	1.76	<b>4.3</b>
Chicago Bridge (CBI)	8.96	-0.58	2.04	2.07		<b>4.3</b>	-1.04	1.58	1.61	<b>5.6</b>
Taseko Mining (TGB)	1.31	0.18	0.10	0.24	0.37	<b>5.4</b>	-0.30	0.04	0.22	<b>6.1</b>
Great Basin Gold (GBG)	1.25	-0.28	0.01	0.19	0.22	<b>6.6</b>	-0.39	-0.27	0.10	<b>12.1</b>
Northgate Minerals (NXG)	1.39	-0.02	0.20	0.19		<b>7.3</b>	0.01	0.28	0.06	<b>24.8</b>
AAR Corp (AIR)	14.92	1.77	1.75	1.98		<b>7.5</b>	2.03	1.89	2.07	<b>7.2</b>
Acergy SA (ACGY)	7.35	1.23	0.76	0.79		<b>9.3</b>	0.31	1.01	0.87	<b>8.4</b>
Wesdome (WDO CN)	1.08	0.05	0.13	0.10		<b>10.6</b>	0.03	0.11	0.09	<b>12.4</b>
McDermott (MDR)	15.93	1.97	1.59	1.35		<b>11.8</b>	1.44	1.14	0.90	<b>17.7</b>
Jaguar Mining Inc (JAG)	5.91	0.04	0.31	0.37		<b>16.0</b>	-1.06	-0.32	0.13	<b>46.1</b>
Minefinders (MFN)	7.23	-0.46	0.16	0.40		<b>18.1</b>	0.28	0.37	0.59	<b>12.3</b>
Yamana Gold Inc (AUY)	7.95	0.32	0.43	0.41		<b>19.4</b>	0.10	0.39	0.45	<b>17.7</b>

### **Important Note About the Portfolio**

The Classical Insights portfolio is Mike Churchill's actual brokerage account. While there are drawbacks with this approach, using a real portfolio should eliminate the performance-tracking problems associated with hypothetical portfolios. The policy with the Classical Insights portfolio is that clients are informed of all trades in new positions prior to those being made. Subsequent trades are sometimes done without notice. Performance measurement will automatically include transaction costs, fees and "slippage." The account is held at UBS. Commissions are paid in the form of a flat annual fee of 1.0% of total assets. That fee is reflected over the course of the year in the performance of the overall portfolio.

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