

Today's Notes:

1. The Yuan: Sea Change
2. Gold or Silver?

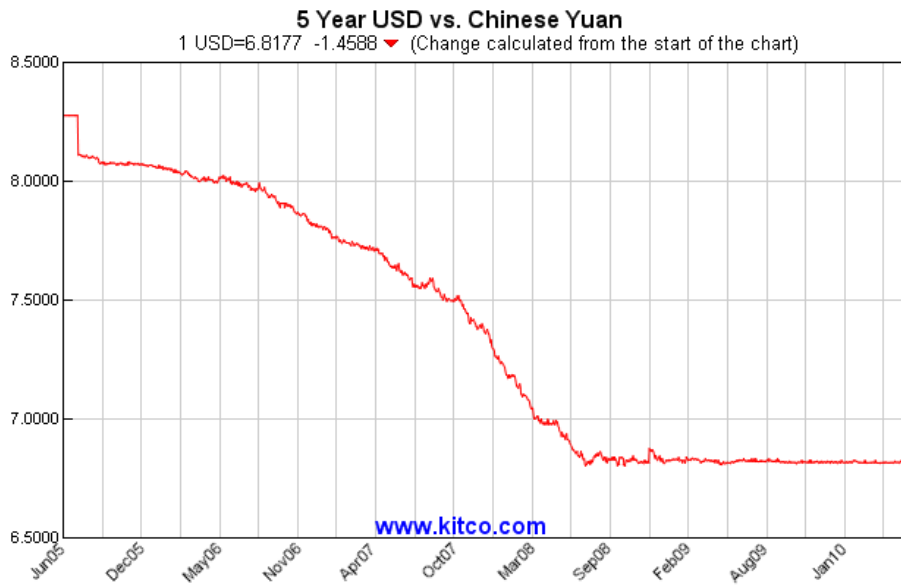
1. THE YUAN

We awake this morning to a new world. The Yuan has gone bid. Last week, in fact over the weekend, the Chinese quietly informed the U.S. and then the world that they would decouple the Yuan from its long-held US dollar moorings and allow it to trade within a "band." As I write the Yuan has appreciated .4%. This may of course be a one-off. China has been under pressure from the U.S. Congress and the Europeans to meet an end of June deadline to decouple the Yuan.

Currency	Chg% X=1\$USD	NY Time	X= 1\$USD	X\$USD =1	Gold Price/oz	Gold Chg	Gold Chg%
US Dollar	--	06/21-04:30	--	--	1261.60	+5.10 ▲	+0.41%
Australian Dollar	+1.37%	06/21-04:21	1.1310	0.8842	1426.81	-13.96 ▼	-0.97%
Brazilian Real	+0.00%	06/18-17:08	1.7668	0.5660	2228.99	+9.01 ▲	+0.41%
British Pound	+0.27%	06/21-04:30	0.6723	1.4875	848.11	+1.17 ▲	+0.14%
Canadian Dollar	+0.52%	06/21-04:30	1.0163	0.9840	1282.10	-1.48 ▼	-0.12%
Chinese Yuan	+0.40%	06/21-04:29	6.7956	0.1472	8573.33	+0.61 ▲	+0.01%
Euro	+0.33%	06/21-04:30	0.8044	1.2432	1014.77	+0.71 ▲	+0.07%
Hong Kong Dollar	+0.13%	06/21-04:29	7.7680	0.1287	9800.11	+27.30 ▲	+0.28%
Indian Rupee	+0.74%	06/21-04:29	45.6950	0.0219	57648.81	-194.17 ▼	-0.34%
Japanese Yen	-0.20%	06/21-04:30	90.8850	0.0110	114660.52	+695.97 ▲	+0.61%
Mexican Pesos	+0.89%	06/21-04:29	12.4373	0.0804	15690.90	-76.92 ▼	-0.49%
Russian Ruble	+0.58%	06/21-04:21	30.7980	0.0325	38854.76	-67.84 ▼	-0.17%
S.African Rand	+0.93%	06/21-04:30	7.4354	0.1345	9380.50	-49.85 ▼	-0.53%
Swiss Franc	+0.37%	06/21-04:30	1.1044	0.9055	1393.25	+0.48 ▲	+0.03%

The significance of this policy change on the eve of the G20 meetings must not be understated. This currency decoupling, if it obtains in the longer run, puts China on course to develop its domestic economy. I am certain the Chinese export sector is fretting this AM.

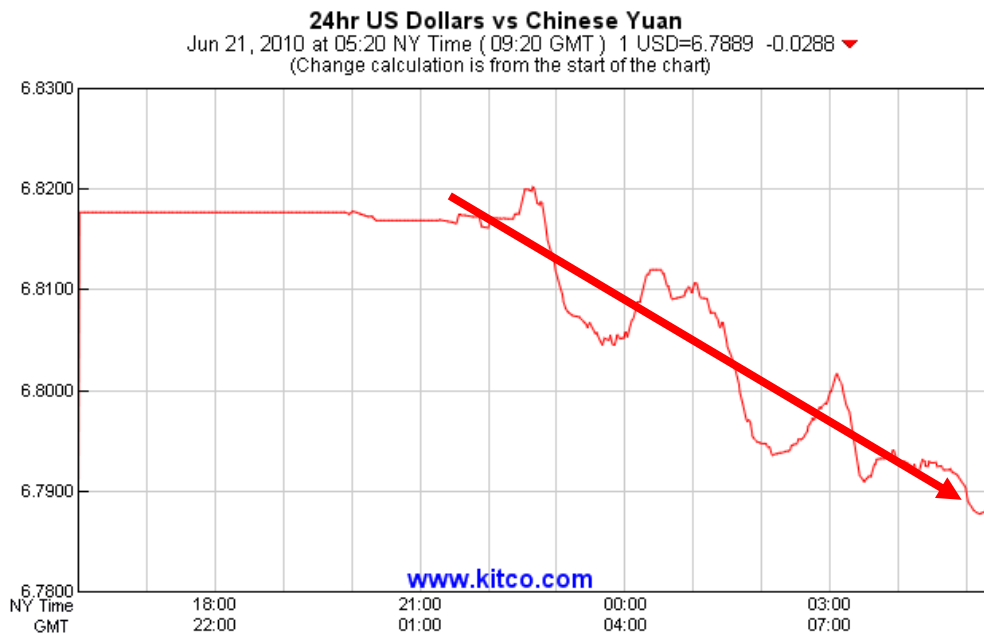
Since at the beginning of the credit crisis, June 2008, China has maintained the Yuan peg at 6.82 Yuan to the U.S. dollar. China had steadfastly maintained that it needed the currency peg. They meant to continue an export-driven economy with a cheap currency. China has suggested the Yuan will be traded within a narrow band. However most Forex analysts believe this is the beginning of an eventual free float in the more distant future. The G20 meets in my favorite city "Toronto the Good" this week. The Chinese announcement will be welcomed at that meeting.



One global economist wrote,

“China’s announcement of greater Renminbi flexibility is positive for Asian asset prices.”

As you can see from the real-time graph below there has been a significant move upward to 6.79 from the Yuan’s 24 month peg at 6.8177 to the dollar.



This policy move may signal China’s growing confidence in its ability to restructure its export-oriented economy. It is clearly a first step and perhaps a sea-change
This policy move however small may signal China’s growing confidence in its ability to restructure its export-orientated economy. It is clearly a first step. Mr. Bill Belchere, an Asian analyst said,

“Stronger currencies mean lower interest rate hikes and this will be good for growth in domestic demand. Consumer cyclicals, banks and properties should benefit in particular.”

The New York Times suggests,

“The move, while small, is also positive for Chinese and regional equities. It could also usher in key structural reforms in China at both the micro and macro levels and give the government additional policy flexibility to deal with any rise in inflation.”

China has never been cowed by threats from the likes of Treasury Secretary Geithner or others in this Administration. So it may be as simple as the realization by China’s authorities that significant inflation is on the horizon for the Chinese economy. As the dollar declines relative to the Yuan, the Canadian Loonie and its resource sector, in which we continue our investment interest, will appreciate. The Times says,

“Beyond the China equities space, commodities, commodity currencies and more commodity-intense Asian markets may find support, as even modest Renminbi appreciation is seen as enhancing China’s overseas purchasing power.”

China says that the move is not one under U.S. pressure but in *“its own best interest.”* The inflation scare seems well founded. The markets should rally at the open. Gold is rallying, as you might expect to \$1271 this AM. In the meantime if this policy is even gradually maintained, we think Discovery stocks in the commodity sector will be favored. This is however not the turn of the global economy but it is a very important decision for what will eventually become the world’s largest economy. There is still much global deleveraging to occur.

2. GOLD OR SILVER

At this point gold has simply run away from silver. The gold to silver ratio is almost completely out of whack at 65.4 times. This is a sign that gold is now viewed as a safe-store asset. In Greece gold is trading at U.S. \$1700. We keep thinking that gold needs a correction. The following chart really doesn’t look much like a parabolic move in gold, does it? Gold will correct at some point because no “tree grows to the sky.”

We have made significant returns from our preferred barbell strategy (which complements our Discovery portfolio). Since 2000 when Don Peters and I worked out the strategy we have “barbelled” the discovery portfolio with cash (T-notes) at one end and gold and silver at the other. This is the inflation- deflation investment strategy about which we have written often. It has worked well and will continue to do so. In the past three years alone gold has doubled and silver is up 65%. Silver has more than doubled since October 2008 (\$8.79 to \$19.44 this AM).

Gold does not look particularly parabolic at this stage – just bullish. Of course our favorite Discovery legacy company is still Goldcorp (GG NYSE) and their Mexican exploration and development proxy Quaterra Resources (QMM NYSE AMEX). We own both companies.

\$GOLD (Gold - Continuous Contract (EOD)) INDX

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Open: **1244.80** Ask: PE:
 High: **1262.30** Ask Size: EPS:
 Low: **1242.10** Bid: Last:
 Prev Close: **1245.20** Bid Size: VWAP:

Friday 18-Jun-2010
 ▲ **+0.92%**
 Chg: **+11.40**
 Last: **1256.60**
 Volume: **0**



The gold silver ratio should be trading in the 40 to 50 ratio range if history has any merit. Since gold has run away from the rest of the world silver has lagged. As we work through global deleveraging over the next two to three years we think this ratio will fall back. At 50 times, rather than 65 times (today), silver would be selling for \$25.50 per ounce. **Silver has longer term upside.** Companies such as Endeavour Silver (EDR AMEX) and Revett Minerals (RVM TSX) are of interest.

\$GOLD:\$SILVER (Gold - Continuous Contract (EOD)/Silver - Continuous Contract (EOD)) INDX/INDX

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Open: **64.92** Ask: PE:
 High: **65.83** Ask Size: EPS:
 Low: **64.78** Bid: Last:
 Prev Close: **66.48** Bid Size: VWAP:

Friday 18-Jun-2010
 ▼ **-1.43%**
 Chg: **-0.95**
 Last: **65.53**
 Volume: **0**



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