Brent Cook's
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Turning Rocks Into Money

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by Brent Cook
www.explorationinsights.com

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2011 Exploration Insights' Portfolio Reflections and Projections

2011 was a bipolar and volatile year that began with widespread elation and ended in widespread despair for junior mining market speculators. During the year we saw a number of rather outrageous price tags for very early stage and highly speculative exploration and development stage projects come crashing down to earth.

Some notable examples of these overzealous valuations we steered clear of include: Atac Resources (ATC.TSX-V), a company with an isolated and very good early stage gold exploration property in the Yukon-- at one point it was being valued at nearly $1 billion; East Asia Minerals (EAS.TSX-V) which had a market capitalization early this year of around $700 million on a gold project in Sumatra that, among other things, did not include mining rights to the property (see EI December 19, 2011); Dorato Resources (DRI.TSX-V) which was trading at ~$1.60 based on a very difficult grassroots property located in enemy territory on the back side of the Peruvian Andes: it is now selling for $0.06 a share; Exeter Resources (XRC.TSX) which has tumbled from ~$8.10 to $2.67, losing about $500 million in market value (post-Extorre spinout) as they advance a low grade copper-gold deposit in Chile; and, Eco Oro (ECM.TSX), formerly Greystar, an obvious disaster we pointed out in our grade distribution discussion (EI April 18, 2009)-- it is down over 75% from its peak in 2010.

It is a long list of disappointing performers, and no one can honestly claim immunity from the devastation in the junior market this year, including EI, with Mirasol (MRZ.TSX-V) down over 50% from the highs set in March; Curis (CUV.TSX-V) off over 75% from its 52 week high; and Glass Earth (GEL.TSX-V) down over 50% since its high in August. The latter two-thirds of 2011 were indeed ugly.

What we said

In our lead off EI market commentary for 2011, I expressed some concern regarding the market and the likelihood that the strong performance we had seen in the two previous years was unlikely to continue. Specifically, our 2011 "un-predictions" went like this:

> "Share and metal price volatility will continue throughout the year and I imagine we will see profit taking early on given the strong run up in the commodity and metal sectors last year. We are due for a correction but by how much and for how long I don't know. The economic and supply

fundamentals behind gold's rise look to continue in 2011 (pick your favorite catalyst) and I expect gold will be higher in December than it is today. On the other hand (that's economist speak for who the hell really knows) if the US and European economies actually are on the upswing, then the fear trade comes off of gold and we could see a serious price decline. The silver price offers a lot more leverage, both to the upside and downside, given its dual personality (commodity and currency). Silver's 80% increase in 2010 versus gold's 28% rise will be a hard act to follow and we should expect some pullback. The base metals, particularly copper, have done very well; future prices will be determined by industrial and speculative demand against what appears to be tight supply. How much metal is tied up in speculation is anyone's guess, but I will point out that base metals are not monetary instruments and eventually they hit the market.

China's economy is the big wild card and trouble there is the most likely source of devastating global economic disturbances, although sovereign debt problems are looming large as well. Ultimately, when all the commodity hedge funds and Exchange Traded Funds (ETF's) that investors have piled into over this ten-year old commodity trade finally decide that it's time to leave, we will see some serious carnage—an unpleasant experience I hope to be mostly watching from the sidelines with cocktail in hand. I am currently sitting on a fairly high cash position (and did throughout 2010)."

What we did

Although I *do* wish we had sold nearly everything in Q-1 2011, and spent the rest of the year with cocktail in hand on some isolated tropical beach, our stock selections did reflect caution. In 2011 we purchased 14 stocks: nine in the main EI portfolio, three in the mid-tier producer category, and two in the Gamblin' portfolio. At year-end we continue to own 12 of those stocks, and are down an average of 6% on those purchases. In 2011 we sold stock eight times for a net gain of 80%, making our net gain for all 2011 buys and sells a decent 21%.

The bad news is that our performance for the year on stocks we owned and held throughout the year (i.e. didn't dump in March) show a paper loss of 37%, based on their January 1, 2011 prices. This dismal result should probably be measured against the S&P/TSX-Venture Composite Index and the Van Ecke Junior Gold Miner ETF (included in the chart below). The TSX-Venture Index is comprised of all Venture Exchange-listed companies with a market capitalization of at least 0.05% of the total S&P/TSX-Venture Index (basically anyone with a property of merit and sufficient capital to stay in business) and was down 35% for the year. The Van Ecke Junior Gold Index is a market capitalization-weighted global index primarily composed of mid-tier gold producers, or companies with advanced properties. It was down 36% for the year. By contrast, gold gained about 11%, while copper lost 21% (as measured in US$) and the US Dollar index (ICEFI) ended the year essentially unchanged.

The poor performance of the general junior market vis-à-vis an 11% rise in the gold price implies that either the junior market was considerably overvalued at the beginning of 2011 or is considerably undervalued now.

I think both.

Some of the many 2011 disasters were warranted and some not---therein lies our opportunity for the coming year.

What we think

For 2012 I remain cautious, and suspect that the good, commodity-positive news coming out of China (and all the BRIC's) will slow, meaning: base metal prices are unlikely to improve much in 2012, barring some external event. Gold is a much tougher call, but I continue to be moderately biased toward the upside based on the US and global macro-economic and geo-political situation.

There is no point going into the details of this view here as there will be plenty of commentators, with a better grip on global macroeconomics than I have, for you to read this week and from which to form your own opinions. Suffice to say that, in my view, the global banking, sovereign, and private debt problems have not been, and probably will not be, solved by any government institutions. The least painful "solution" will probably be by way of monetization of much of the debt and pushing the problem on to the next generations. This will be a long term process, during which we will probably see periods of strength in the US dollar and weakness in the gold price (in US dollar terms at least). Ultimately, the monetization and currency debasement should continue to be reflected in the gold price in nearly all currencies, and I expect the gold market to stabilize or possibly re-assert itself over the coming year. I will continue to use $1,500 gold as my base case in economic evaluations, adjusting the high and low assumptions to the market conditions.

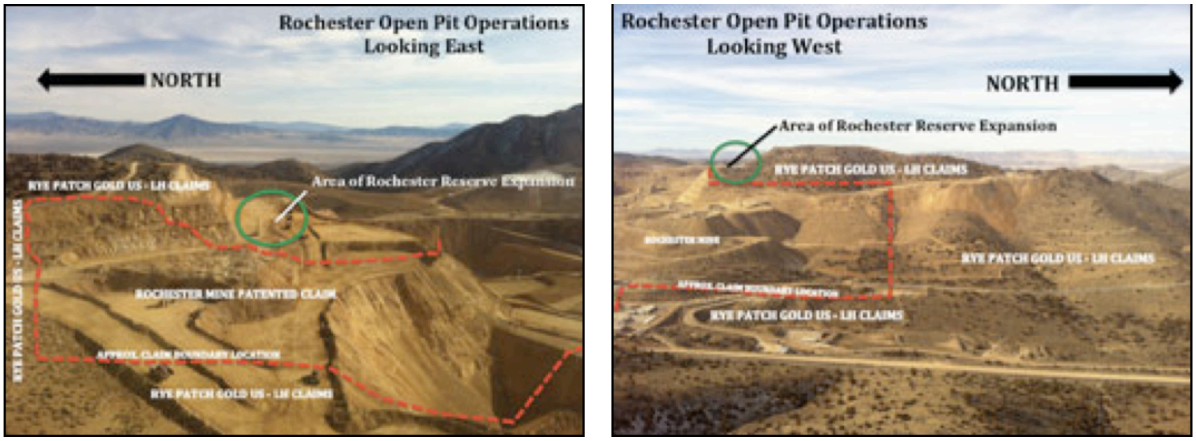
I do of course recognize that I could be completely wrong on metal prices, and will not base purchases in the EI portfolio on the assumption that the gold price is headed higher. We could very well see a continuation of this year's bear market; at a minimum, I expect 2012 will be a tough market in which to make money for anyone employing a shotgun approach. Although difficult, a market like this plays to our strengths in that we will (hopefully) be able to purchase solid companies with legitimate discoveries or resources at reasonable, if not downright cheap, prices.

Our focus therefore will be even more refined: targeting undervalued high margin deposits and those quality exploration companies that appear to be proving up such deposits.

Money will probably be difficult for junior miners to come by and, except for extremely compelling companies or projects, there had better be sufficient funds to carry on the business for at least two years before we get interested. The difficult financing environment may provide us with private placement opportunities; I will keep an eye out for those of you who are interested and qualified to participate. Companies employing the "Prospect Generator" business model tend to do better in markets like this and we are well positioned there. Flat out drill hole plays had better be damn good!

Stock Talk

Rye Patch (RPM.TSX-V) reported that the preliminary injunction requested by Coeur d'Alene Mines Corp. aiming to restrict RPM's access to their LH claims (covering portions of the Rochester Silver deposit) was mostly rejected by the State District Court in Pershing County, Nevada. The judge ruled that, to ensure the safety of Coeur and Rye Patch employees and contractors in active mining areas, Rye Patch would be restricted from accessing about 10% of the 402 new LH claims (see photos below). The ruling does not, and was not intended to, address Coeur's assertion that they have valid possessory interest in the unpatented claims in question. The fact that the judge has allowed RPM access to all but a few of the claims implies that he considers Rye Patch's claims valid; however, the underlying legal dispute as to who owns the claims will be decided in a separate court hearing sometime in 2012.



(Fig. 4- Photos looking east and west showing Rye Patch claim boundary in red in relation to Coeur's Rochester mine. Link here for higher quality image.)

The chain of claim staking and claim jumping events at Rochester goes something like this:

Rye Patch staked the LH claims between October 27 and November 21 over ground that Coeur had legally held up until September 1, 2011. Coeur had neglected to file the proper documentation or pay the fees to maintain those claims with the County or the Bureau of Land Management; therefore, the land was open to staking. On November 29th RPM informed Coeur that they had located the claims and intended to explore and develop minerals. Coeur apparently made an offer to buy the claims or Rye Patch itself, but the offer was rejected as too low by RPM. Coeur subsequently over-staked RPM's LH claims and, on December 5th, filed a legal complaint in Pershing County asserting that its unpatented claims are valid and that it has a lawful possessory interest in such claims.

We are now in some nebulous legal ground here that is way outside the realm of my expertise and this little letter about rocks.

Nonetheless, from my research into the topic it appears that Rye Patch did legally stake the LH claims on open ground, and that Coeur made a mistake in letting these claims lapse. Although antiquated, that is how the Mining Law of 1872 works; once a claim lapses it is open for staking. The case could be made that Coeur clearly did not intend to let the claims go-- they had proven resources and a mine plan over some of the area—simply a clerical error, if you will. Still (and I am no lawyer) I doubt if that protestation would hold up in court, as there is previous legal precedence of companies losing claims which they clearly intended to hold but inadvertently let lapse.

Coeur's legal strategy will probably be based on the concept of a "discovery" where it can be argued that for a mining claim to be valid there must be a discovery whereby a "prudent man would be justified in further expenditure of his labor and means with a reasonable prospect of success in developing a valuable mine". Coeur's drill holes on the LH claims would qualify, and they have hired Parsons and Bailly, one of the best natural resource firms in the US, to litigate their case. Coeur faces the additional big headache of probable lawsuits from the underlying claim holders who would have likewise lost their rights to any royalties or payments and will be in a very bad mood.

Rye Patch apparently recognized the possibility of Coeur using the "discovery" strategy and has collected samples from every LH claim. My suspicion is that nearly all the samples will show good mineralization at surface that a prudent man would be justified in pursuing. Whether this sampling will qualify as a discovery is hard to predict. RPM also has much of the historical data (soil, rock, drill, etc.) from the previous owners (Coeur) that could qualify as a discovery on their LH claims.

RPM is currently exploring the LH claims to which they have access, and have lined up a drilling contractor to begin as soon as possible, probably mid-January. They are sufficiently funded through 2012 with $7.3 million in cash, as a result of the recent exercise of 11.8 million warrants at $0.35. If I were Rye Patch, I would also be filing a request for a restraining order to keep Coeur off *my* LH claims and demand that the goddamn claim jumpers provide me the details of production and mine plans for the claims Coeur is currently occupying.

I think it is most likely that Rye Patch's LH claims will be found to be senior to those claims staked by Coeur after being informed by RPM that their previous claims had lapsed. Therefore, the trial comes down to: does a discovery by a company (Coeur) on senior claims held by another (Rye Patch) constitute a legal basis for granting the company possession of the claims? Furthermore, if a discovery is a valid basis for over staking senior claims and gaining possession of said claims, what constitutes a discovery? Mineralized float? Rock samples? Drill holes? Even more problematic for the US mining industry would be that if it were ruled that a discovery trumps senior claims, does that ruling then put all the claims that are not being actively explored in the US up for grabs? If not, which ones are and which are not, and how is that determined?

As mentioned above, the legal battle and its ramifications are beyond my expertise. The legal proceedings will undoubtedly be complicated, and the outcome could have serious implications for mining claims throughout the US.

Ultimately, I don't believe either Coeur or Rye Patch want to take this through a long, drawn out trial for which the outcome is uncertain. Coeur has the most to lose (mine expansion potential at Rochester and in the order of 50 to 70% of their 108 million ounces of silver and 708,000 ounces of gold resources), Rye Patch obviously the most to gain. Coeur had originally stated that up to 20% of their reserves were also impacted by the LH claims, but has since indicated that none of the reserves are impacted (if the claim boundaries shown in Figure 4, above, are accurately drawn, I find this hard to believe).

A compromise and settlement makes the most sense and, although we can't predict any dollar figures, it seems the downside to RPM's share price is limited, at least until the legal proceedings begin. Additionally, while we wait out the Coeur situation, we have a free ride on the very high risk, high reward drill results expected early in the year from Rye Patch's Garden Gate property. The property lies directly on trend from Barrick's recent Red Hill and Goldrush discoveries on the Cortez Trend. If they hit big here, and it is a *big* if, we are in for quite a ride, irrespective of the situation with Coeur.

That’s the way I see it.

Brent Cook

Brent owns shares in all the portfolio positions mentioned.

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