₣ollow the ¥€££₩ BRIC Road

Excessive Valuation; Rising Interest Rates; Competitive Currency Devaluations; Global Climate Change; Droughts; Arab Spring; Resurrection of Central Planning; Financial Repression! This is certainly no time to turn to a childrens' book for inspiration, is it? Why, yes it is! And what's with the misspelling of brick? It's just a little preview of the *bullish* message of this commentary. While we will, of course, point out that gold mining stocks are currently one of the most attractive investment opportunities we've ever seen, most of the focus will be on potentially lucrative opportunities in the emerging markets. Stocks look attractive in many industries. Valuations here in the United States give us pause, but the rest of the world looks kind of interesting. Shockingly, many growth stocks look like the best bargains here (true growth, generally in growing economies in contrast to the big, mature, consumer and technology companies that many still believe are growth). Remember the BRICs (Brazil, Russia, India, China)? They are so scorned currently, and yet they were the shining stars of yesteryear. For more on the BRICs, their kin, and other attractive opportunities, please read on.

The Wizard of Oz was a good read (also quite successful in theater and film). But, perhaps even more entertaining is the various ways in which it has been interpreted. This year, Disney put forth a movie told from the Wizard's point of view. Last decade, a successful Broadway play told the story from the vantage point of the misunderstood "wicked" witch. Various past interpretations were political. The original book has been positioned as pro-women, pro-Christian, anti-Christian, anti-adult, pro-gold standard, and anti-gold standard (pro bi-metallic standard). Many are interesting, but it is the monetary interpretations that this commentary will explore.

We'll not spend time on the original story. If you haven't read the book or seen the movie, it might be interesting to do so. If not, Wikipedia has a nice synopsis.

Beyond the normal interpretation, Wikipedia also has this to say: "*Baum did not offer any conclusive proof that he intended his novel to be a political allegory. Historian Ranjit S. Dighe wrote that for sixty years after the book's publication, "virtually nobody" had such an interpretation until Henry Littlefield, a* *high school teacher. In his 1964 American Quarterly article, "The Wizard of Oz: Parable on Populism", Littlefield posited that the book contained an allegory of the late 19th-century bimetallism debate regarding monetary policy. At the beginning of the novel, Dorothy is swept from her farm to Oz by a cyclone, which was frequently compared to the Free Silver movement in Baum's time. The Yellow Brick Road represents the gold standard and the Silver Shoes which enable Dorothy to travel more comfortably symbolizes the Populist Party's desire to construct a bi-metallic standard of both gold and silver in place of the gold standard. She learns that to return home, she must reach the Emerald City, Oz's political center, to speak to the Wizard, representing the President of the United States. While journeying to the Emerald City, she encounters a scarecrow, who represents a farmer; a woodman made of tin, who represents a worker dehumanized by industrialization; and a cowardly lion, who represents William Jennings Bryan, a prominent leader of the Silverite movement. The villains of the story, the Wicked Witch of the West and the Wicked Witch of the East, represent the wealthy railroad and oil barons of the American West and the financial and banking interests of the eastern U.S., respectively. Both these groups opposed Populist efforts to move the U.S. to a bimetallic monetary standard since this would have devalued the dollar and made investments less valuable. Workers and poor farmers supported the move away from the gold standard as this would have lessened their crushing debt burdens. The Populist Party sought to build a coalition of southern and Midwestern tenant farmers and northern industrial workers. These groups are represented in the book by the Good Witches of the North and South. "Oz" is the abbreviated form of ounce, a standard measure of gold.*

Similarly, if one googles "The wonderful wizard of Oz: a monetary reformer's brief symbol glossary", they will find the following:

***"Dorothy** – everyman and woman, a simple, Populist character from the heartland of American Populism, Kansas.*

***Scarecrow** – farmers, agricultural workers, ignorant of many city things but honest and able to understand things with a little education. A strong supporter of Dorothy (Populism).*

***Tin Man** – industrial workers; a woodchopper whose entire body has been replaced with metal parts, thus dehumanized by machinery (robot-like with no heart) in need of oil (liquidity/money) to work, otherwise unemployed (he was idle for a year) without oil.*

***Cowardly Lion** – Wm. Jennings Bryan, a famous politician and Populist Presidential candidate in 1896 and 1900 (Oz was written in 1900) for monetary reform and a terrific orator (i.e., roar). Bryan was attacked as being somewhat cowardly for not supporting the US war with Spain. As a Populist Presidential candidate he sought to go to the capitol city – the Emerald city. Bryan's famous "Cross of Gold" speech is referenced below.*

***Ruby Slippers –** these are silver in the book. Hollywood changed them to ruby red to take advantage of the new Technicolor used in the movie version, evidently ignorant of the meaning of the silver. Bryan and many other Greenbackers (monetary reformers supporting use of debt-free US Notes like Lincoln's Greenbacks to increase the money supply and thereby end the depression) shifted their tactics to the promotion of adding silver to the lawful coinage of America (i.e., to promoting a bi-metallic standard rather than the theoretically purer, fiat Greenbacks) when they realized they could thereby gain the backing of the powerful silver mining interests and still increase the money supply (without debt) to more* *than just gold. Silver thus became a symbol of overcoming a purely gold standard with the limited money supply and banker control that resulted. Hence, the silver slippers were extremely important in the book, as was the silver coin in reality.*

***Kansas** – a Populist stronghold, home of Dorothy, symbolized the national heartland.*

***Cyclone** (tornado) – the free silver movement, compared at the time to a political "cyclone" that swept Kansas, Nebraska and the heartland and aimed at Washington; also the depression of the 1890's which was compared to a "cyclone" in a famous monetary primer of the time and which robbed people of their homes and farms.*

***Oz** – corresponds to standard measure of gold ounce – "oz."; America, where the gold oz. standard held sway, but where the use of the silver oz. (slippers) could free the slaves.*

***Emerald City** – political center of Oz /Washington D.C. To get there a politician had to take the gold way (gold standard); everyone there was forced to wear "green spectacles" – to see the world through another color (green) of money. This illusion upheld the Wizard's power.*

***Glinda, the Good Witch of the South** – the US South, which solidly supported Bryan and reform, as did much of the North (home of the other good witch in the book). The East and West (homes of the bad witches) supported McKinley.*

***Good Witch of the North** – Bryan's Populist supporters in the North and Northwest. The South and North largely supported Bryan in his Presidential campaign; the wicked East and West supported McKinley who was for the gold standard.*

***Wicked Witch of the East** – Wall Street bankers in NY, led by J.P. Morgan. President Grover Cleveland (of NY) was their pro-gold standard candidate.*

***Wicked Witch of the West** – drought and/or J.D. Rockefeller, by then a Cleveland banker (still viewed as "out West" from a NY perspective). President Wm. McKinley (a gold standard supporter from Ohio) was his candidate. She was a one-eyed witch , i.e., opposed to the two metal bi-metallic system; in the book she enslaves Winkies in the West much as the Wicked Witch in the East enslaves the Munchkins; dissolved by water symbolizing real water curing draught and/or liquidity ending the depression.*

***Wizard** – a charlatan who politician-like can change forms in the book and who tricked the citizens of Oz into believing he is all powerful. Sometimes compared to a behind-the-scenes manipulator "pulling-the-strings" of politicians just as Wall Street's bankers do today. Mark Hanna, such a man at the time, has been suggested as the real life model for the Wizard. He said "There are two things that are important in politics. The first is money and I can't remember the second". Such an all-powerful view of money is a deceit noted under the word "Emerald City," above. Baum was well informed – he knew banks manipulated politicians and the people and commonly used deceit to fool them into submission. $700 billion or we face a "global financial meltdown" ring a bell? Bankers create money – a trickery certainly known to Baum.*

***Yellow Brick Road** – the gold way or standard, composed of gold bricks.*

Deadly Poppy Field *– the anti-imperialism movement of the late 1890's which reformers felt was distracting Bryan from monetary reform (putting him to sleep on the issue), saved from that fate by the mice (the little people, Populist supporters).*

Color *themes, the colors of money: gold (coin), silver (coin), green (paper greenbacks).*

Winged Monkey's *– Plains Indians: "Once we were free people living happily in the forest." – Monkey leader. Like the winkies and munchkins, enslaved by the wicked witch and not freed until water (liquidity) destroys her hold on them.*

Yellow Brick Road *– the gold way, gold standard (yellow bricks).*

Oil *– liquidity, priming the pump of the economy, enabling employment of the unemployed (the Tin Man had been idle for a year without it).*

Toto *– the prohibitionists ("with Toto trotted along soberly behind her"), a movement which followed the bi-metallist Populist Party."*

The article referenced above continues with the full text of William Jennings Bryan's famous "Cross of Gold" speech from the 1896 Democratic Convention. *"You shall not press down upon the brow of labor this crown of thorns, you shall not crucify mankind upon a cross of gold."* Well worth the read! Also interesting is the TV documentary, "The Men Who Built America", a fascinating tale of this time period, looked at from another vantage point. At one point it discusses how three of America's richest and most powerful industrialists temporarily suspended their rivalries and banded together to help defeat Bryan's bid for the presidency. Interestingly enough, Kopernik Partner and Portfolio Manager Isabel Satra's brother-in-law won several Emmys for writing and producing this outstanding documentary.

Perhaps the best write-up on the subject of whether Oz is political satire on monetary reform or merely an entertaining fantasy, is "Money and Politics in the Land of Oz" by Quentin Taylor.

Rather than discuss the merits of the different interpretations of Oz, I'd prefer to presumptuously put forth my own version. After all, the 21st century is vastly different from the late 19th. Using their wildest imagination, the citizens of the gilded age could not have conceived of our current state of affairs.

Oz Reprised

(Modernized and Globalized)

Our 21st Century Cast

The Scarecrow - Still represents the plight of the farmer. Maybe he lives in Brazil or Argentina or Ukraine. But he could still be from the U.S. where drought has recently, once again, become a big threat to farmers.

The Tin Woodsman - Is now the Ceramic Assembly Line Worker. He surely doesn't live in the U.S. (I'll believe the U.S. Industrial Renaissance when I see it). Let's say he's domiciled in China. Made of ceramics, he won't rust, but overcapacity, foreign competition, monetary failure, and obsolescence are as much a threat to him as rust was to his Midwestern forefathers. Unchanged is the desire for 'monetary' oil to help the obsolete and redundant factories survive.

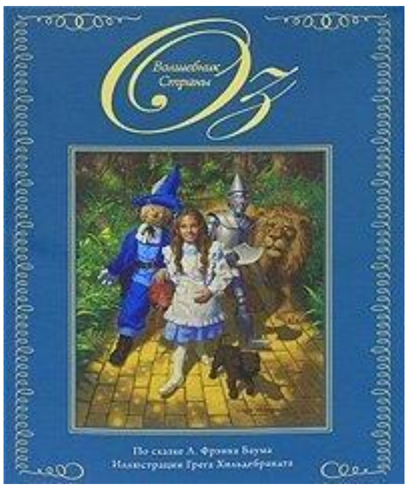
The Cowardly Lion - Could be almost any Head of State who puts populist rhetoric ahead of good government and sound economics. Certainly (Japanese Prime Minister) Abe has made a prominent bid to assume the lead role. But all the same, Obama has a solid claim on the role too. He came into office with a mighty roar, but then meekly followed in the footsteps of his predecessor. George W. presided over the biggest government spending orgy ever witnessed by mankind. It was financed by borrowing and by money printing. Obama kept many of the same people to run the financial and monetary affairs of the country. The massive spending, borrowing, and printing have not missed a beat ever since. It doesn't seem that either party is willing to try anything other than rhetoric and gimmickry.

The Wizard - Let's go with Greenspan! The onetime gold-standard proponent and Ayn Rand disciple turned to the "dark-side", embracing alchemy as the answer to all problems financial, real or imagined (Y2K). His "potions" became more powerful with time. He was knighted and nicknamed "The Maestro." He figuratively started a school of wizardry, alchemy and illusion. Central bankers from virtually every country on earth have enrolled. His primary protégé, Ben Bernanke, took illusion to new levels. Mr. Bernanke, in turn is mentoring Janet Yellen, who is believed to have the desire to one-up her predecessors. Bank of Japan Governor Haruhiko Kuroda also is certainly up to the challenge. Many others have similar aspirations. Who knows how much malicious magic will be conjured before Toto pulls back the curtain.

Winged Monkey - Capable of so much destruction or so much help, depending on who controls the golden crown. I nominate the banks! Destructive CDO–squareds, loans to indebted consumers, and toxic mortgages; OR, healthy loans to growing businesses, low LTV (loan to value) mortgages to qualified buyers, alpha-generating wealth management services. There's a world of difference. End the Fed!

Wicked Witch of the West - Let's stick with Drought/Lack of Liquidity. Could be water or oil or fiat currency. At Kopernik, we believe that it won't be long until water, not currency, is the liquidity that much of the world will be thirsting for.

Wicked Witch of the East - Neo-Keynesians! It seemed like the 2008-9 event dropped a house on her. Unlike the book/movie, she hasn't stayed dead. Academics and the media are still spewing her toxins everywhere.

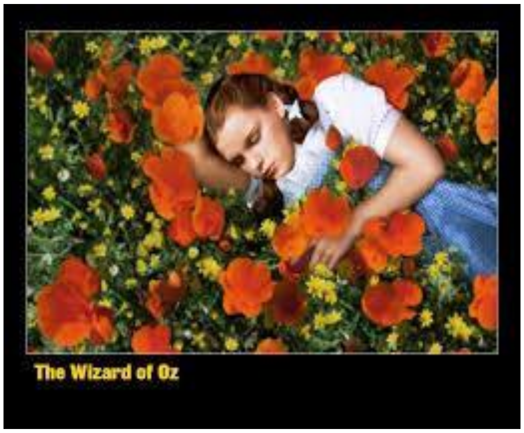


Dorothy - Let's rename her Natalya, and say she now hails from Russia. Like the U.S.A., circa 1890's, Russia is now an emerging market, and as such is growing economically. It has a large agrarian sector, has a strong military, and an educated population. We were still healing from the civil war, they are dealing with the disintegration of the Soviet Union. We had the Robber Barons, they have the Oligarchs. Mafia became a problem for both. We had abundant natural resources, they have abundant natural resources. We argued about the rightful place of gold in the monetary system (we now no longer even give it lip service), they still discuss the matter and are a constant buyer. At any rate, Russia has good assets, very low debt, runs roughly balanced budgets, and is making headway in the corruption problems (they have a long way to go).

One of the most important features in the book were the slippers. Hollywood opted to change them from silver to ruby. Being true to the times, the 21st century demands that we change them yet again. They are henceforth made of dollars, still the world's reserve currency (i.e. made of fiber since the dollar is printed on paper that is made mostly from cotton). They are green, and undoubtedly sport a designer label. Could the "Silverites" in the nineteenth century have imagined "quantitative easing"? Would they have approved? They wanted "easy money" in the form of silver being monetized at a fixed value of 1/16 ounce of gold. Since mines in the west were cranking out silver at a brisk pace, that would have been inflationary. But fiat currency of unlimited quantity would have been unthinkable. To put things into perspective, back in 1900 when Oz was written, the dollar, like silver, traded at a ratio close to 16 to 1 (it took 16 ounces of silver to buy 1 ounce of gold, but a slightly higher 20.67 dollars to buy 1 ounce of gold). The U.S. dollar remained fixed at the ratio of 20.67 to 1 until 1933 when FDR famously devalued it almost 70% to 35 to one. This arrangement lasted nearly 40 years when President Nixon notoriously defaulted on the U.S. obligation to honor the dollar's exchangeability into gold. Silver was easy money then. It is hard money now. It is now virtually as good as gold in our humble opinion. (The market price of silver has "devalued" from the aforementioned 16 to 1, to currently near 60 to 1.)

Investment Outlook

Deadly Poppy Fields or Fields of Gold?



"From the far north they heard a low wail of the wind, and Uncle Henry and Dorothy could see where the long grass bowed in waves before the coming storm. There now came a sharp whistling in the air from the south, and as they turned their eyes that way they saw ripples in the grass coming from that direction also. 'There's a cyclone coming, Em,' he called to his wife, 'I'll go look after the stock.' Aunt Em dropped her work and came to the door. One look told her of the danger at hand. 'Quick Dorothy!' she screamed, 'run for the cellar!'" - The Wizard of Oz, by Frank Baum

In the book, the poppy fields were beautiful, yet they were a diversion, a potentially deadly one. We, at Kopernik, have always been fascinated by the fact that, often, things that seem risky aren't especially so, while things that seem so beautifully safe often prove treacherous.

Oh, the beauty of the "Nifty Fifty" stocks in 1972 (one-decision stocks, just buy and hold forever), or gold in 1980, or Japanese stocks in 1989, or technology stocks in 1999. And now, how attractive consumer/luxury goods stocks appear to many people in 2013's exuberant market place. There is something simultaneously exciting, yet reassuring about stocks that are moving parabolically ever higher. And how soothing to hear the pronouncements of the modern-day wizards at the Fed and Wall Street, and in the ivory towers of academics. The following is a sampling of prominent investment community lexicon:

"Luxury goods are no longer cyclical", "There is a (Greenspan/Bernanke) put option under the stock market", "There is a put under the bond market", "Risk can be boiled down to a metric like Beta, VAR, or tracking error", "Quantitative Easing will save the day", "We have an exit strategy", "Inflation is under control", "Deficit spending can go on indefinitely", "The multiplier effect enables us to get wealthier by spending more than we make", "Profit margins can stay at double normal levels despite a ZIRP (zero interest rate policy) environment". The list goes on. Yet, we believe that all of these decisions are wrong and that the storm is coming.

Before you drift off into a blissful slumber, take heed of the following:

Valuations for bonds and cash markets continue to be obscene, in the face of open and deliberate financial repression by the world's central banks. Artificially low rates have led to abnormally high prices for many other things: Art, collectibles, corporate bonds, high yield bonds and real estate, among others. This has led many observers to conclude that, a la 2007, "there is no place to hide." Others might argue that 2013 is worse than 2007 when bonds and cash were still reasonably attractive. Many astute investors have recently gone on record as quite bearish: Stan Druckenmiller, Jeremy Grantham, Seth Klarman, Jim Rogers, Felix Zulauf, Charles de Vaulx, and Fred Hickey.

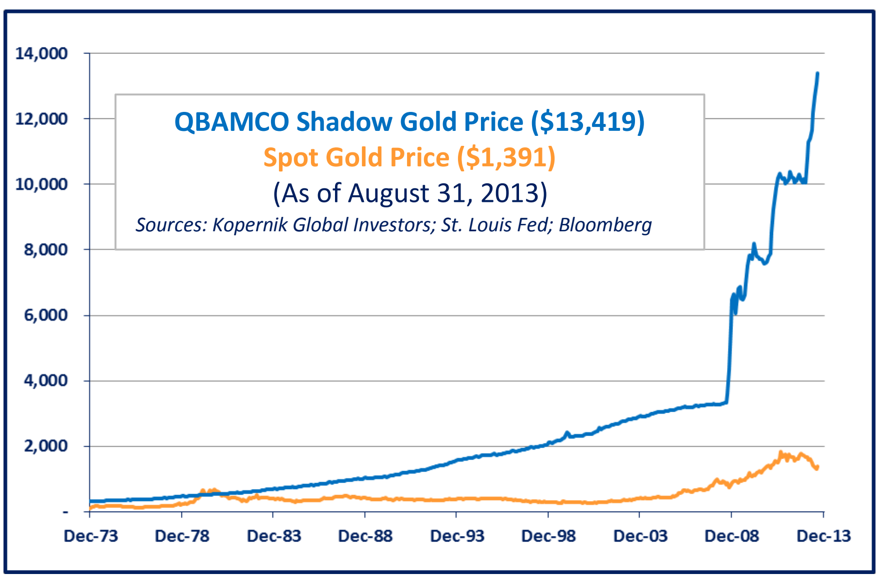
In the High-Tech Strategist Mr. Hickey quotes Mr. Rogers as saying, "this is going to end very badly. Everybody will suffer – be very, very careful as these are perilous times." And Mr. Klarman has written, "Investing today may well be harder than it has been at any time in our three decades of existence, not because markets are falling, but because they are rising, and not because there are no opportunities, but because the underpinnings of our economy and financial system are so precarious that the unabating risks of collapse dwarf all other factors." Dr. Faber points out that these major tailwinds from the past thirty years probably won't be there for investors in the future; falling interest rates, peaceful times, abundant and cheap resources, and relatively little social unrest.

We share most of the worries of these esteemed market veterans, and agree that the future should be much more difficult than the past. But… this is much different than 2007!

Investment Strategy "Follow the Yellow BRIC Road"

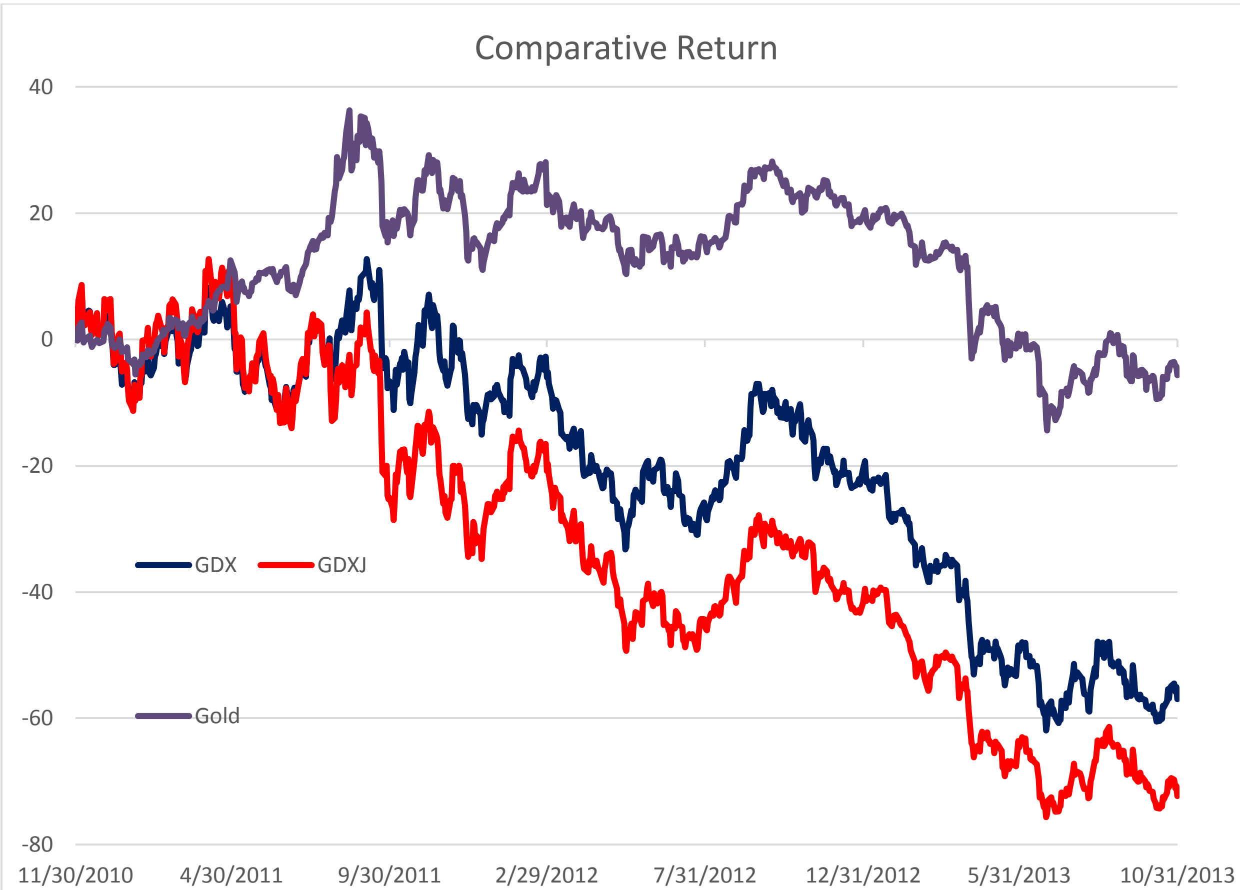
What should investors, recognizing that "we aren't in Kansas anymore", do now? Certainly, blindly following the route that worked in prior environments is far from guaranteed and could prove perilous. Kopernik Global Investors have some strong views and believe we see promising opportunities.

For starters, we have not changed our view on gold. Everyone should have a portion of their wealth secured upon a solid foundation of yellow bricks. With each dollar the Fed prints, gold becomes intrinsically a little more valuable (in dollar terms). I've written enough about gold over the past decade; there is no need to say more here. But, I will leave you with the following chart from QB Asset Management. It shows the "shadow price" of gold, i.e. the price that would be required to fully back the existing money stock. This suggests that if the U.S. was to fully back the money supply with gold, the price would need to be more than $13,000 per ounce. A Bretton Woods sort of arrangement (partially pegged) would call for a price in the neighborhood of $4,000/oz. This analysis is theoretical at best, but thought-provoking nonetheless. For several years now I've viewed the guys from QB as among the most insightful in the business. I'm pleased that they have joined us at Kopernik. It is great having them as an integral part of our daily research meetings and investment vetting process.



Whereas the battle was once between gold and non-gold metals (primarily silver) for official status as money, today it is more a battle between tangibles and intangibles as de facto stores of value. We are happy to include bricks/coins of silver and platinum amongst the bricks of gold. Gems and base metals seem reasonable too. We're open to art and collectibles, though they are far from our sphere of competence.

	Security	Currency	Price Change	Total Return	Difference	Annual Eq
1.	GLD US Equity	USD	-5.67%	-5.67%	51.32%	-1.98%
2.	GDX US Equity	USD	-57.82%	-56.99%		-25.09%
3.	GDXJ US Equity	USD	-76.77%	-72.46%	-15.47%	-35.70%



Source: Bloomberg

A Silver Lining?

For starters, our journey down the "yellow brick road" will lead us far from the conventional (index constituents, etc.) and well beyond U.S. borders. It is important to remember the long term potential of emerging markets during this time of challenging valuations in the U.S. stock market.

A half-century ago, John Templeton, one of the great investors of all time, invested in Japan. He made a tremendous amount of money even as the U.S. market went down from 1966 through mid-1982. Where others saw risk, corruption, a war loser, and a maker of cheap goods, he saw a strong work ethic, a developing middle-class, high level of education, high savings rate, and a seriously undervalued stock market!

A dozen years ago, Marc Faber wrote "Tomorrow's Gold". It is not at all about the yellow metal. It builds a compelling case for investing in Asia. Readers who heeded that advice made a lot of money, and they did so over a decade where no money was made (in aggregate) investing in the developed markets of the West. In his August 2013 issue of "Gloom, Boom & Doom" Dr. Faber further discusses his forty years in Asia. I highly recommend the issue. He discusses how the Hong Kong market went from 150 to 31,000 (with six corrections of over 50% along the way). Over half a century, China's GDP went from $100 billion to currently over $8 trillion. Taiwan's stock index went from 421 (1982) to 12,495 (1990). Korea's went up 25 fold over a quarter century.

We don't know which markets, if any, will provide these kinds of returns over the next quarter-century. Given its size and valuation, the U.S. is unlikely to be a top contender. It is logical to believe that the emerging economies will likely post much higher returns.

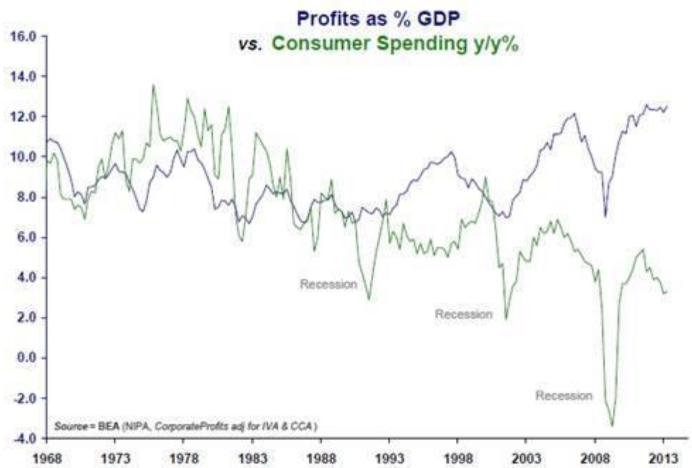
Ticker	Name	Mkt Cap	Chg YTD %	P/B	Curr EV/T12M Sales
+ MERVAL d	ARGENTINA MERVAL INDEX	957,404.31	+68.21%	.31	.17
+ IBOV	BRAZIL IBOVESPA INDEX	1.59MLN	-10.89%	1.05	1.85
+ KOSPI	KOSPI INDEX	1.14BLN	+.62%	1.18	1.14
+ INDEXCF	MICEX INDEX	21.20MLN	-.48%	.78	1.03
+ SPX	S&P 500 INDEX	15.68MLN	+19.08%	2.50	1.90
+ SENSEX	S&P BSE SENSEX INDEX	33.75MLN	+2.44%	2.58	2.21
+ SHCOMP d	SHANGHAI SE COMPOSITE	15.75MLN	-2.12%	1.52	1.30

*Source: Bloomberg *KOSPI=KOREA, MICEX=RUSSIA, SENSEX=INDIA*

We are excited that the current market appears to have much more in common with the markets of 1972 and 1999 than with the aforementioned 2007. Outside of bonds and cash, 2007 offered no place of refuge (and bonds required massive fed purchases to achieve their advances). 1972 and 1999 were dominated by obscenely expensive stocks which camouflaged a lot of attractively priced stocks. We believe the contemporary marketplace is similarly bifurcated, pricing some industries, sectors, and countries at stratospheric valuations while relegating other industries, sectors and countries to the bargain bin.

Many years have passed since those summer days
Among the fields of barley
See the children run as the sun goes down
Among the fields of gold
You'll remember me when the west wind moves
Upon the fields of barley
You can tell the sun in his jealous sky
When we walked in fields of gold

-Sting



Rather than drifting asleep in a field of beautiful platitudes, Kopernik Global Investors has traded in our "green slippers" for "chariots of aluminum" and has been diligently searching for "fields of gold."

As has been the case for some time now, we like scarce goods that meet basic human needs! We like businesses that provide clean water, electricity, gasoline, food, and transportation. We love the inefficiencies in the marketplace. Two short years ago everyone wanted natural resource funds, non-dollar currency funds, infrastructure funds, agriculture funds, and even gold. How easily people forget lessons from the past!

At the same time, we eschew investing in the expensive stocks of companies that sell expensive goods that, while clearly satisfying human wants, do not meet actual human needs. (Such as the adjacent $12,900 Hermes basketball!)

Kopernik is buying fields of barley. As the nearby chart illustrates, prices of farmland in the U.S. have skyrocketed. It now costs almost $7,000 per acre in Iowa. We are agnostic as to whether current prices are justified. We are thrilled to invest in publically traded, corporate farmland selling at one-tenth that cost in Argentina, Brazil, and Ukraine, places believed to have "Iowa quality" top-soil. Similar properties in Southeast Asia also seem like a bargain. We believe that ownership of good quality, well-managed farms diversified across multiple countries is a sound, and potentially lucrative strategy.

	ADECOAGRO SA	BRASILAGRO	SLC AGRICOLA SA	CRESUD SA	KERNEL	MHP SA-GDR	ASTARTA	GOLDEN AGRI-RESO	IOWA FARMLAND
Adjusted Earnings Yield (ex. Bio Assets)*	**-3%**	**4%**	**4%**	**0%**	**5%**	**18%**	**8%**	**6%**	**3%**
EV / planted area (acres)	**$2,524**	**$1,266**	**$2,146**	**$1,335**	**$2,241**	**$3,783**	**$510**	**$7,291**	**$7,000**

*Reflects Oct 27, 2013 * Last FY Earnings adjusted for Biological Assets*

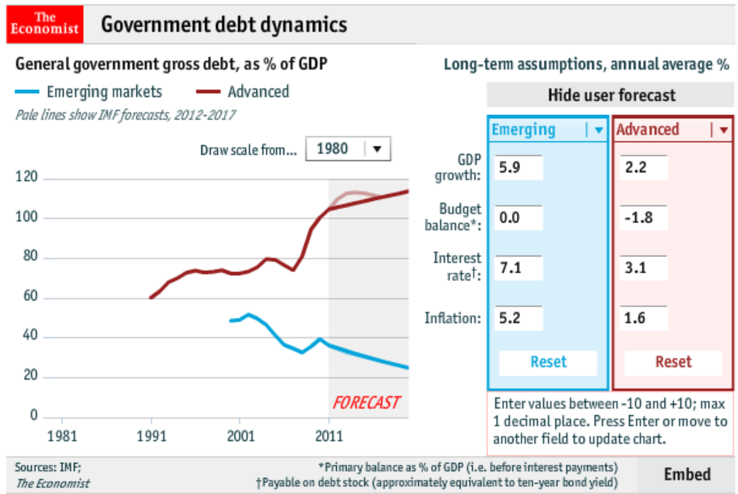
Similarly, while investing in generators of cheap, clean, CO2- free electricity can be expensive, we're happy to report that significant discounts are available across the globe. In the emerging markets we are finding quality franchises that due to the significant short-term challenges they face, trade at 90% discounts to our estimate of their replacement value.

Having illustrated that what appears safe can be a perilous illusion, let's discuss where risky appearances can be reasonably safe.

Is it risky to take the road less travelled?

Everyday is a winding road
I get a little bit closer
Everyday is a faded sign
I get a little bit closer to feeling fine

-Sheryl Crow



For some, the "great rotation" from bonds into "quality" dividend-paying stocks produced enough anxiety. The volatility and tracking-error of emerging market stocks present a bit too much "risk" for many.

However, risk is a complicated subject. For years we've viewed permanent loss of capital/purchasing power as highly undesirable and thus the primary type of risk that we strive to avoid. We've rejected the relevance of beta, volatility, tracking-error, and other measures of "risk" popularized by academics, since we believe that they don't apply to true long-term investors (we further view short-term investing as an oxymoron). Rather than delve once again into our rationale, I'll refer you to the superb book, written by Howard Marks, "The Most Important Thing." Three whole chapters are devoted to the topic of risk. I've included some excerpts. (I don't mean to infer that he shares our views on the BRICs, as I have no idea.)

"A hugely profitable investment that doesn't begin with discomfort is usually an oxymoron."

"When everyone believes something is risky, their unwillingness to buy usually reduces its price to the point where it's not risky at all. Broadly negative opinion can make it the least risky thing since all optimism has been driven out of its price."

"I'd say the necessary condition for the existence of bargains is that perception has to be considerably worse than reality. That means the best opportunities are usually found among the things most others won't do."

"The greatest risk doesn't come from low quality or high volatility. It comes from paying prices that are too high. This isn't a theoretical risk; it's very real."

Could it be that the highly esteemed stocks of "high quality" companies, sporting abnormally high profit-margins, will prove to be risky a la the Nifty-Fifty circa 1972, while the "broadly negative opinion" regarding the BRICs will make them “the least risky thing since all of the optimism has been driven out of the price”? Quite plausible.

Several years ago, investors were fleeing the U.S. Dollar, perceived to be vulnerable at the time. One of their favorite places of refuge was the BRICs. And why not? China was on route to becoming bigger economically than the U.S., resource-rich Brazil and Russia were going to become very prosperous satisfying China’s never-ending thirst for resources, and India had hit the lottery when the Internet was invented, allowing many high value jobs to be outsourced to an intelligent, industrious workforce. For a variety of reasons, the stock markets are now way cheaper than they were then. What fascinates us is how “way cheaper” is considered to be “way more risky” by most investors; a massive distortion of reality. The Wizard of Oz himself would be envious of such an illusion. The current lower risk, higher potential upside prospect has captured our attention.

Figure 10: Average corruption perceptions index (lhs) for groups of countries* across various $5,000 per capita GDP brackets

Note: * Examples are given of countries in each per capita GDP range , e.g. for the 4 states with per capita GDP of $35-40k (rhs), which includes Canada, their average corruption index level is nearly 9.0 on the left hand scale

Source: Transparency International, Renaissance Capital estimates

The following two charts from “The Economist” magazine show that the U.S. is growing important relative to the rest of the world in terms of market capitalization, but not because U.S. companies have become relatively more profitable vis a vis the rest of the world. No, it is because U.S. stocks have become much more expensive relative to their intrinsic value compared to non-U.S. domiciled stocks. Utilities in the U.S. trade at 1.6 times book value, **versus 0.33 in Russia and 0.21 in Brazil.** Railroads trade between 2.5 and 5 times book value in U.S., **versus less than 1.5 in Japan** (post this year’s run-up) **and 0.85 for our Chinese holding** (also post run- up). Phone companies trade at 20 times earnings **versus less than half that for similar companies in the growth economies.** Farmland in Iowa trades at $7,000 per acre **versus one-tenth that level for publicly traded farmland in Argentina, Brazil, Ukraine, Russia, and Southeast Asia.** (See table on page 12.)

And finally, for those bothered by the spelling of BRICs, the valuations of Korean and South African stocks are intriguing. Let's add them. We like the BRICKS!

Conclusion

In the book, Dorothy et al head off on all kinds of adventures and face all sorts of adversity, only to find out that it had been unnecessary. All along, the solution to their problems had been right there with them. She needed merely tap her slippers. Silver was the answer! Whether Frank Baum was serious or facetious we'll never know for sure, although the case that it was a parody of the Populists and Silverites is persuasive. In our current tale, all Natalya needs to do is click the heels of her "greenback designer slippers" and it will be home sweet home. If she won't do it, it seems that we can rest assured that Janet Yellen will. Repeatedly! Lest there be any doubt, this commentary is absolutely meant as a parody of the world's central banks, elected representatives, Neo Keynesian academics and the rest of the central planners. We don't believe that printing currency can create wealth, only redistribute it.

We, at Kopernik Global Investors, plan to forsake the easy gimmicks and travel the "yellow brick road" in search of stores of value that should prove far superior to fiat currency. Our quest is for assets that are intrinsically valuable, be it farms, electricity generators, fuel providers, communications franchises, transportation enablers, and many others. And of course heavily discounted owners of gold reserves! We like what we're finding!

Cheers,

David B. Iben, CFA
Chief Investment Officer
Kopernik Global Investors

November, 2013