



Mike Kachanovsky: Scoop Up Resource Stocks on Dips

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Over the course of the last 12 months, many analysts and newsletter writers have been discussing precious metals stocks as an alternative to fiat currencies. What opportunities remain—new and old—in Mexico, Colombia and elsewhere for investors? In this exclusive interview with The Gold Report, Mike Kachanovsky, aka 'Mexico Mike', (Investor's Digest of Canada), discusses why he believes the market is better than ever for precious metals, as well as the abating political risk for mining companies in countries such as Mexico, Colombia and Vietnam.

The Gold Report: Mike, in our last interview, you stated you were fairly optimistic about precious metals because government reaction to the financial crisis was to keep interest rates low and issue large amounts of currency. Are you still as optimistic about metals at this time?

Mike Kachanovsky/ Mexico Mike: Absolutely. I've been probably more excited about the precious metals after the way things have unfolded in the last 12 months or so than I was even during our last interview. (See "[Silver's Scarcity Premium](#)" 6/9/09) The same factors still apply in terms of having artificially low interest rates and quantitative easing, where many nations are debasing their currency and printing money. I believe that inflation is only just now starting to become a factor. You're starting to see that commodity prices across the board are increasing and it's decoupling somewhat from the U.S. dollar. The U.S. dollar is showing a countercyclical strength in the last few months that's largely a reaction to what's going on in Europe. But the commodities are holding firm and in many cases are rising, nonetheless. I think it's just a matter of time until the U.S. dollar rolls over again and may begin to lose value relative to other currencies. That's when you're going to see the real upside potential in the precious metals become a reality.

TGR: Do you think the decoupling is ultimately a good thing and how much time is involved for this turnaround that you're forecasting?

MK: It's always difficult to put a timeline on this sort of thing. There's quite a number of moving parts and different factors that are having an impact. I mentioned the troubles going on in Europe. Some of the nations there are having fiscal difficulty in their own budgeting. You have a lot of feedback loops clouding the waters somewhat in terms of when all this is going to come to pass. I don't necessarily like to put a timeline on it. In fact, if you'd asked me a year ago I would've thought we would be much higher now than where gold and silver are priced. Is it a good thing that resources are decoupling from the dollar? Yes and no. I think what you're seeing is that investors are starting to put money into commodities as an alternative

to traditional financial vehicles. People believe that commodities are going to hold value better than, for example, owning short-term treasury notes or owning dollars themselves. And so, in that sense the fact that people are losing confidence in the more mainstream financial investments to me is a bad thing. It's a sign that our economy is under duress and that people don't feel that good about the future. However, if you happen to be an investor in commodities, of course it's a good thing that you have strength.

TGR: What kind of portfolio adjustments are you making right now? Are you accumulating more stock, precious metals, cash?

MK: Well, I've always had a mentality of being a very aggressive investor and as such I buy the dips. My portfolio is almost entirely weighted towards resource stocks. That's not just precious metals. I own oil and gas stocks. I have leveraged to rare earth elements, base metals and coal. I'm also looking at agricultural now as well. I think that's a sector that's going to outperform the overall broader market. When I see a pullback in the market, I use that as an opportunity to continue accumulating in buying the dips. I also buy physical bullion, gold and silver. I've never been a seller. I've always been a buyer. I've owned silver since it was under \$5.00 and I bought another bar just last month on the pullback then. I don't really overreact to what's going on, on a cycle to cycle basis. As long as I'm convinced that the fundamentals are still in place for a long-term secular bull market then I don't try to trade it. I just look for the opportune times to continue to average up as the market progresses higher.

TGR: Are you saying we're in a pullback now?

MK: It's hard to say. Commodities are notoriously volatile. To me a pullback is more a cyclical type of description and I think we're still in an uptrend. However, for gold, a \$100 downside move over a period of two weeks is not uncommon. If you look, you could probably define this gold bull market as being about a 10-year long phenomenon so far. There's probably dozens of occasions where you had similar type dips in the value of similar magnitude and percentage. Did it constitute a pullback? Well, not necessarily, because gold has been up every year.

TGR: When you're talking about dips for the purpose of taking advantage of them, you'd like to see some sort of long-term trend more than just a few days right?

MK: That's correct. I should emphasize that part of the strategy of playing the dips is you have to be willing to sell the spikes. My personal strategy and philosophy is to maintain a core position in the stocks that I think are the best stocks that an investor has to be positioned in. Then I also maintain a trading position. I'll buy extra stock in some of these companies when they sell off. Then as they spike high, I'll unload that trading position and capture that net profit.

TGR: What stocks are you favorable towards right now?

MK: I still think silver is going to be one of the best commodities to be leveraged to. Silver is a frustrating metal for anyone that's been aware of it and following it. It doesn't seem to rise as quickly as we expect or hope. I still think silver has the potential to be one of those metals that can go from \$15.00 to \$50 or to have that 200% to 400% potential gain in one year that we've seen from some other metals like uranium. I believe that's sometime in the future for silver as well.

When I'm looking at specific stocks to gain leverage to, I want to find companies that are developing silver deposits that are cash-flow positive, have a number of projects on the go and are aggressively acquiring other prospects in this market. Then they are better positioned for when silver lifts off. I also look at market valuations relative to the peer group. When I see a company that I think is above average in terms of its fundamental strength and it's trading at a discount to its peers in any sector, I'm going to want to buy some of that company. I feel that it's just a matter of time until the market recognizes that strength and prices it in.

TGR: Are there any of those companies that that you'd like to share with us?

MK: One of them in particular is [MAG Silver Corp. \(TSX:MAG;NYSE.A:MVG\)](#). We can look at the chart for that company just in the last few weeks and see that it's been rapidly rising in price. It appears to have been under accumulation and to me it's one of the go-to stocks in Mexico for leverage in silver. Of course I own shares in it. I was a recent buyer of more stock and I know the management. It has a strong balance sheet, plenty of cash in the bank, no debt and a number of very good projects on the go. If you're a bull and are expecting that silver has a lot further to run, I think MAG Silver is an exciting stock to own.

[Paramount Gold and Silver \(TSX:PZG;NYSE:PZG\)](#) is another Mexico resource play. They're not in production, but they have several years of positive development in Mexico on their main asset. Paramount at this point is still priced way below their peaks from a few years ago. It's achieved a much higher overall mineral inventory that is much more leveraged to gold and silver despite the fact that it's a cheaper stock today. In fact they just announced last week another very good discovery hole that's probably going to add significantly to their overall resource.

Very few of these companies that we talk about today were active in Mexico prior to 2000. One of them is [Avino Silver and Gold Mines Ltd \(TSX.V:ASM;OTCBB:ASGMF\)](#). They are a very small company and actually have a majority ownership of a Mexican mine that they have maintained going all the way back to the early '90s. They are just now getting production recommencing. They completed development work. They call it a bulk sample, but it's actually going to be a recommencement of mining. If you look at Avino on the basis of its peers, it's a very cheap stock. They've been very efficient managing their capital. It's a very tight share structure with superb exploration potential for future upside. It looks like their operations are going to be running at a fairly good margin to earn a profit at current prices. That's the kind of company I like to look for as one that has a great upside, but it's priced very far down the scale relative to other producers.

TGR: Do you have a preference in terms of companies that are speculative in their focus and are hoping to sellout versus a long-term viable production company?

MK: Again, I look at the market value of a company and decide. If I feel like I'm getting a discount of what the fair market premium should be, then I'm going to go after that company. Most of the time, the established producers are more conservative. A lot of the risk is out of the equation but their upside potential is also going to be less. I do not necessarily have a preference to more speculative stocks. I think it's more accurate to say I have less fear of risk. I'm willing to take a gamble and try a position in a stock that has more risk if I believe it's priced fairly and the upside risk is justified by the potential rewards that I'm going to gain by investing in those stocks.

TGR: Are you more likely to take those risks on a region like Mexico than you would anywhere else in the world right now?

MK: I think a lot of the places that investors consider risking today are maybe not as risky as they think. A few years ago I didn't want to touch stocks from Brazil. I had this impression that Brazil was a very risky place to invest and I just didn't want to go there. Instead you look at some companies that have been active in Brazil. [Yamana Gold \(TSX:AUY;NYSE:AUY\)](#) comes to mind. It has been very successful and basically built from its base in Brazil to become a worldwide reputable and strongly performing stock.

I think a lot of people still have this impression that Mexico is risky. Part of the reason is that the media focuses on what's going on in certain border cities and there's a lot of violence that's over-reported. I think Mexico has its challenges like any other nation, but overall it's a very stable country with a strong tradition of mining. There's well-documented legal processes in advancing mining claims. It's pro-mining, allowing foreign companies to come in and invest. You're seeing a lot of companies now that have been in Mexico for a year or two or five that are producing fantastic earnings and drilling their operations. Other places like China are very popular for investing. I don't see that same track record of strong performance for foreign companies that have been able to go in there and actually make money and build value for investors. So I don't look at Mexico as a risky place to invest. There are other places that I think are risky and I'll still go in there and look at them. If the value of those stocks is fairly discounted to that risk, I'll still participate. In my opinion, Mexico is not a risky jurisdiction. It's a great place to invest.

TGR: Do you think the investment "window" there is still wide open? Are there any new plays?

MK: I think it is still wide open. I think in a way this market meltdown and nasty correction that the entire precious metals mining sector went through over the last 18 months has been beneficial in some ways because it's really helped to separate out a lot of the pretenders. There were a lot of companies that just staked a property and raised some money and I'm not necessarily convinced they were seriously into advancing to become stable, producing mining companies. Those companies have disappeared or gone bankrupt or moved on to other speculative sectors. So the companies that are still there and still focused are able to raise capital and develop projects and increase the scope of their activity.

It's much clearer now to find who the winners are. Those companies continue to behave strongly and have that profile that I look for when I'm trying to pick from all the different companies that I think will be the best performers for the next few years ahead. Are there any new plays? I think just about every week you hear about another company that has established a position or bought up an old project or closed a transaction. Within the last couple of years, two that have really gained my trust are [Endeavour Silver Corp. \(TSX:EDR;NYSE:EXK\)](#) and [Great Panther Silver Ltd. \(TSX:GPR\)](#). They're both companies that have been in Mexico for a number of years. Only in the last year have they really achieved traction in their operations to the point where they're self funding. They're earning a profit from their operations. They still have tremendous potential for future exploration. These are companies that are no longer spinning their wheels. It took probably a year or two for them to get that level of stability and become less risky.

TGR: Any companies in the rare earth space you're following?

MK: Sure. [Commerce Resources Corp. \(TSX.V:CCE; Fkft:D7H;PK SHEETS:CMRZF\)](#) is one. One of the reasons I like Commerce is I believe it has a very strong management team. This is not just a new story.

Rare earth elements burst into public awareness about five or six months ago. There was a mini-mania in a lot of the stocks that had leverage to them because people began discussing how China had a stranglehold on the metals and they're very essential for many industrial applications. All of a sudden you had a lot of investors scrambling to find projects with leverage to these metals. Commerce is not just rare earth. It's also exotic metals like tantalum and again, most investors or retail buyers have never heard of these things. The reason that I like Commerce is that it's been committed since 2005 or perhaps even earlier to projects that are primarily leveraged to these exotic metals. They have an advanced project and a strong balance sheet with plenty of cash. I believe they're sincerely focused on advancing to development, in which case the stock will probably have a much higher value at some point in the future if they're successful. I think it's very attractively priced in the market at this time and much cheaper than it was a year or two ago. Any time I can buy something that has great value at a lower price I tend to be interested in that kind of a stock.

TGR: Do you continue accumulation in a company like that or do you have a position and just hold on to it?

MK: Well, I bought a position originally in that story, I think about two years ago, and I actually did add to it just when the rare metals started to get hot and the investors started to get excited about them. Then I added again just recently on the bit of a price dip that we just had in late January. I don't believe I've ever sold a share of that company. I just patiently accumulate.

TGR: Any other companies from our last interview that you could comment on?

MK: Let's see. [Eastmain Resources \(TSX:ER\)](#). I've been a holder of Eastmain probably since 2003 and have never actually traded it. The management is superb. They've been focused and remain focused on the same part of the world. Year after year good markets or bad they just continue to move things forward. They've attracted some exceptional senior partners to work with, [Goldcorp Inc. \(NYSE:GG\)](#) being the most obvious one that most investors are familiar with. I think the best validation of that story comes from the fact that they've just recently closed a placement to raise additional money that I believe was 60% or 70% above the market price. If you're familiar with the way most companies raise money, they usually have to dangle some sort of a market discount in order to attract a large financing. For Eastmain to be able to secure millions of dollars so far above market price tells me I'm not the only one that believes this company has a great future. Quebec is one of the best mining jurisdictions in the world. There's just not that same upside initial discovery potential in Quebec that you may have from somewhere like Mexico that hasn't seen a lot of that development exploration work. Eastmain is a bit of an anomaly in the fact that they grabbed a lot of their landholdings back in the late '90s when the mining sector was in a severe recession. For a very small Canadian junior to have such excellent property holdings that are now attracting major partners is just another feather in their cap.

TGR: Are there any other parts of the world that you like and that you're looking at right now?

MK: I just returned from a trip to Vietnam to review the only Canadian mining stock that's active there. That company is [Olympus Pacific Minerals \(TSX:OYM\)](#). They actually own two mines that are both in production right now. The potential from these mines is fantastic. They have a mineral inventory above 1.6 million ounces of primarily gold. My opinion is if these mines were located in other more mining-friendly or more commonly accepted mining districts in the world this stock would be priced at several dollars a share. But Vietnam is considered far off the radar and is not known as a great mining center, and a lot of

people still have misgivings about investing in communist countries. This stock is trading very far under the radar but has fantastic potential upside. I don't own Olympus Pacific yet in my portfolio. I was under a confidentiality agreement to review the project. I've only just now been freed from that restraint and I can begin buying that stock in the market. It's one of the most exciting stories I've looked at in a long time and I think it has a great future. The other country that I think is also very similar is Colombia. Much of the media's presentation of Colombia was that it was a very risky, violent country and there's almost no exploration because of an insurgency that was ongoing in that country for many years with drug lords and cartels. It's similar to what we hear about Mexico today. Colombia has a lot of the same geology as countries like Guyana, Venezuela and Peru, where you have tremendous history of mining and superb resource potential. Because Colombia was basically closed for the last 15 years to foreign companies that were unable to operate there, you have all of that potential that's only just now starting to become realized as the threat from war and from drug insurgence is diminished. There are a couple of companies that arrived early and achieved great things. One story that I like is [Bandera Gold Ltd \(TSX.V:BGL\)](#). I discovered the stock because they own a mine in Mexico and also a fantastic project in Colombia that they've only begun exploring now. They've begun reporting some very good numbers from it. Bandera is another of those companies with very good management, strong insider ownership and it's done a very good job of navigating through difficult circumstances. I believe the upside is very high.

TGR: Thank you very much for a fantastic interview, Mike.

Mike Kachanovsky is a consultant providing analysis of junior mining and exploration stocks. His work is published on a freelance basis in a variety of publications, including the Mexico Mike column in Investor's Digest of Canada. Mike is a founder of the website www.smartinvestment.ca, which serves as an online community for the discussion of all topics relating to junior mining stocks.

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