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**To: MJG Capital Limited Partners**

**From: Matthew J. Geiger**

**Date: January 22, 2013**

**Subject: 2012 Second Half Review**

Below is set forth The MJG Capital Fund, LP's performance since inception.

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**Performance Since Inception (9/1/11):**

The MJG Capital Fund, LP (net of all fees and expenses)	(26.67)%
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S&P 500	17.01 %
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S&P/TSX Venture Composite Index	(32.56)%
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**Note:** All returns for MJG Capital partners are estimated and subject to the completion of an audit at a future date. In addition, the returns for each limited partner may vary depending upon the timing of their individual contributions and withdrawals.

## ***Introduction & Partnership Update***

It's a pleasure to present you with MJG Capital's third semi annual review. The limited partnership was formed sixteen months ago and the results are detailed on the previous page. (Remember that the S&P 500 is being used as a gauge for the US economy, while the S&P/TSX Venture Composite Index is the closest proxy for the universe of junior resource companies.)

The results so far have been far from fantastic. However, for long-term contrarian investors, the very best investments (especially in the volatile resource market) will often start off poorly. The partnership has been accumulating cash-rich, management-rich, and resource-rich companies at basement prices during the worst resource bear market in a decade; making the partnership well positioned to enjoy substantial investment gains (likely beginning in the next six months). The divergence from the broader resource market is encouraging and should continue to widen.

In addition, in December two fund holdings (Rio Verde Minerals in Brazil and Afferro Mining in Cameroon) received takeover bids at substantial premiums to their respective share prices. It had been an entire year since any acquisition activity had occurred involving the partnership's roughly thirty holdings. This recent pick-up in activity leads me to believe that companies that have continued to progress during the prolonged resource slump will begin to be rewarded in 2013.

In the most recent fundraising window, the partnership received an additional investment from an original limited partner. 2-3 new limited partners are expected in the upcoming March window. This continued flow of investment funds has allowed the partnership to repeatedly buy in a period where the majority of resource investors have given up or lost interest. If one has the necessary conviction and discipline, it is in these times where the big money is made.

Two site visits were made over the past period. The first of these two was to the Zacatecas Silver Mining District in central Mexico to visit Defiance Silver Corp. Defiance is not yet a partnership holding, but I expect that to change over the next half year. Defiance is an interesting story, as it falls into the category of companies bringing technologically advanced drilling/processing techniques to historical production areas. For around \$4M and after a year of refurbishment, Defiance can begin producing silver from the already existing Santa Gabriela Plant and their fully-owned, past-producing San Acacio mine. This will result in significant positive cash flow and the ability to use this to increase the known amount of silver in San Acacio through intelligent drilling. These exciting future prospects are not being accurately reflected in Defiance's current share price.

Impact Silver, a partnership holding since inception, is an example of another silver-focused company in Mexico that has had great success (a greater than 1000% share

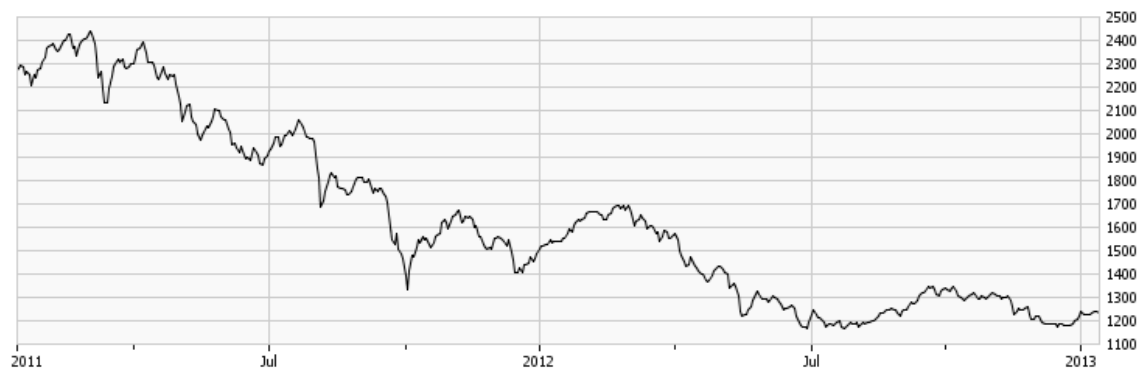
price gain over the past decade) with the model discussed above. In fact, Defiance Silver was brought to my attention by the fact that it is 15% owned by Impact. This is a huge endorsement of Defiance's management team, including CEO Bruce Winfield, VP of Explorations Rick Tschauder, and the local Mexico staff (managed by project manager Felipe Martinez, who led the site visit). The partnership will be well served by owning companies, such as Defiance, with focused and smart management teams, and owning them for long periods of time. Pictures from the Defiance Silver visit can be viewed on the website ([www.mjgcapital.com](http://www.mjgcapital.com)).

The next site visit was to Soltoro Ltd, a second silver-focused company in Mexico that the partnership has owned since Day 1. Soltoro will be discussed further later in this letter as the limited partnership's Featured Investment. Pictures from the Soltoro visit can be viewed on the website ([www.mjgcapital.com](http://www.mjgcapital.com)).

### ***Junior Resource Market Outlook***

In a general sense, the junior resource market (represented by the S&P/TSX Venture Composite Index chart below) is in very bad shape.

**Charting for S&P/TSX Venture Composite Index**



To start, raising capital has proven to be extremely difficult in this market environment. This is very problematic for the capital-intensive junior resource market where, even in the most successful of projects, the vast majority of investment occurs before there is any payback. This difficult fundraising environment stems from three mutually reinforcing factors. First, on one hand, this poor share price performance has both discouraged potential investors and encouraged extreme passivity from even prudent resource investors, resulting in a dearth of capital for the market as a whole. On the other, the low share prices have made it extremely painful for the companies themselves to raise money (if even possible); as in many cases the last fundraising took place at a share price 300% higher than it is at current. The third reason is that the majority of the management teams in this market have had a poor if not abysmal history managing finances in

both bull or bear markets. These compounding factors have resulted in the quietest period of fundraising and deal flow in the past ten years.

That being said, the majority of junior resource companies will have to come to the market for more capital soon. In June 2012, John Kaiser estimated that over 50% of the TSX Venture Index had less than 6 months of working capital on hand, judging by historic burn rates. While most of these cash-short companies have avoided bankruptcy up to this point, most have also not raised funds over this period. This indicates minimal “company progress” (a key distinction from a “share price progress”) over the past six months, and more of the same until fundraising is completed.

This leaves us with a large amount of companies that will either become extinct or will have to raise funds at painfully (for management and existing shareholders) low prices in a difficult fundraising environment. Meanwhile, these same companies don’t currently have the capital on hand to make any progress from a company perspective. This set of circumstances indicates lower share prices for these companies, and since these companies make up a substantial majority of the TSX Venture Index, a lower price for the TSX Venture Index as a whole.

From an investor perspective, however, there is immense opportunity to handpick diamonds from the pile of rubble that is the TSX Venture Index. A small minority of companies have been able use their technical and financial acumen to make substantial progress from a company perspective over the past two years, even as their share prices swooned. It is these companies (i.e. the top 20% of Pareto’s Law) that will make the majority of the money in the next market upswing. Nonetheless, over the current bear market, their share price performance has largely mirrored the TSX Venture Index as a whole.

A better anecdote for my optimism from an investment perspective stems from the practice of “card counting” in blackjack. For those not in the know, tens of millions of dollars have been made by the simple practice of betting as much as when the odds are in your favor and as little as possible when the odds are against you. Simplified greatly, by carefully studying the cards that have been already played out of the deck, card counters can deduce which decks contain many high cards (a good time to put your money on the table) and which decks contain many low cards (a good time to move to the next table). This practice was written about extensively in the book *Bringing Down the House* and the accompanying blockbuster “21”.

Right now the Junior Resource Casino is completely empty and, as general partner of the partnership, I’m free to move from table to table placing my bets on the juiciest hands. The partnership has embraced risk in a period where nobody else has, but only where in each case the odds are overwhelmingly in our favor (i.e. the Margin of Safety principle stressed by Ben Graham). In addition, the partnership has distributed commodity, geopolitical, technological, legal, and legislative risk in a manner that is not fully dependent on one factor (akin to placing bets at many

different tables in case a couple of dealers get lucky hands, as they inevitably do, and take your money).

In a bull market that is impossible; the casino is brimming with people and there's very rarely room at the most potentially profitable tables. These bull markets may be the most exciting time to be in the Junior Resource Casino (and possibly the most immediately profitable), but it is not the time to position oneself for long-term investment success. Conversely, the fact that the Junior Resource Casino is virtually empty right now is the reason that, as a long-term contrarian investor, I'm so excited to be here.

### ***Be on the Right Side of the Trends***

For long-term value investing success, it is important to be on the right side of the long-term macroeconomic trends and to do this for as long as possible. If Warren Buffett had dedicated his life to applying the exact value investing principles to, say, public companies in Britain or France, it is implausible that the world would know his name. He would have certainly have done very well, as value investing can be a successful strategy in any market, but not nearly as well. Whether he knew it or not, much of his success stems from the fact that he invested the vast majority of his portfolio in the United States (very selective companies in the United States, of course, but the United States nonetheless) smack in the middle of the American Century. Additionally his unwavering faith in the ability of the US economy to (at worst) plug along decade after decade allowed him to aggressively buy sound companies when the masses were afraid, distracted, or indifferent.

Of course, I'm not here to debate whether Warren is right to continue to invest heavily in America. I do know that whether or not the United States continues to increase our world presence and consume more (in other words "grow"), the world will still need an unthinkable quantity of these resources if they want to live anything remotely close to a Western lifestyle.

Below are three long-term macroeconomic trends that the partnership is well positioned for, through the lens of resource depletion. These trends may sound simplistic, and they are. Keeping it intelligently and consistently simple over long periods of time can produce spectacular results.

***Decarbonization Megatrend*** – Robert Bryce does an excellent job illustrating this energy megatrend in his recent book *Power Hungry*:

*"Decarbonization is the ongoing global trend toward consumption of fuels that contain less carbon. This megatrend was first identified by a group of scientists that included Nebosa Nakicenovic, Arnulf Grubler, Jesse Ausubel, and Cesare Marchetti, who found that over the past two centuries, the process of decarbonization has been taking*

*place in nearly every country around the world. Because consumers always want the cleanest, densest forms of energy and power that they can find, the trend will surely continue. The ratio of carbon to hydrogen atoms in the most common fuels tells the story.*

*From prehistory through, say, the 1700's and early 1800's, wood was the world's most common fuel. Wood has a carbon-to-burnable-hydrogen ratio (C:H) of about 10:1. That is, it contains about 10 carbon atoms for every 1 burnable hydrogen atom. But wood eventually lost its dominance to coal which has far higher energy density and a C:H ratio of about 2:1. Coal lost out to oil, which has even higher energy density as well as easier handling characteristics. In addition, oil has a C:H ratio of about 1:2. Now we are seeing the rise of natural gas (methane), which, as its chemical formula (CH<sub>4</sub>) suggests, has a C:H ration of 1:4, or 1 carbon atom for every 4 hydrogens. In 2005, Marchetti, an Italian physicist, declared that for the next five decades, "methane is to be the dominant primary energy".*

*The hunger that consumers have for cleaner sources fits perfectly with the goal that policymakers have decided should be a top global priority: reducing carbon dioxide emissions. In late 2008, Nobuo Tanaka, the executive director of the IEA, averred that "preventing irreversible damage to the global climate ultimately requires of major decarbonization of world energy sources. Of course, not all countries are decarbonizing at the same rate. And some countries, including China and India, are increasing, rather than decreasing, their coal consumption. But the long-term decarbonization of the global economy is continuing, and given concerns about climate change, that trend is likely to accelerate as countries around the world build more nuclear reactors and increase their consumption of natural gas."*

This trend tells me that it would have been good to invest in coal when the majority of the world was invested in wood, good to invest in oil when the majority of the world was invested in coal, and so on. This leads me to believe that it will be smart to invest in nuclear and renewables (or the materials that make these forms of low-carbon power generation possible) as the world continues to invest in oil and natural gas.

This is the reason why the partnership does not own hydrocarbons and instead owns the materials that allow nuclear, solar, and wind power generation to be possible. Don't get me wrong, the right oil, gas, and coal investments will do very well over the coming years and decades as the world will not stop consuming hydrocarbons en masse during my lifetime. However, the right nuclear and renewable-focused investments will perform even better, aided by the major megatrend discussed above.

Recent actions by the Chinese government support this thesis. In October 2012, the government said that it hopes to generate 30% of China's power from solar, wind, other renewables, and nuclear by the end of 2015. This is up from an earlier target of 15% renewables plus 5% from nuclear by 2020. When you think of the massive

scale of current Chinese power generation, this is a substantial acceleration of their clean-tech program. It's amazing the world did not take more notice of this news, but regardless, it gives me further confidence in the partnership's approach to energy investments.

**Urbanization Megatrend** – Every week roughly 1 million people are born in or migrate to cities in emerging markets all over the world. By 2030, the global urban population is expected to grow by 1.6 billion people and account for 60 percent of all people on Earth, according to the United Nations. The force behind this megatrend is hard to conceptualize. However, one just has to look at China as case study. China is currently undergoing *the greatest and fastest migration of humans the world has ever seen*. In 2011, for the first time in China's history, more people were living in China's cities than the countryside. Amazingly, only two decades before, only 26% of China's population lived in cities. (The pace of this migration can't be overlooked. According to Professor Lu Dadao of the Geographical Society of China, China's percentage of citizens living in cities increased from 17.9% to 39.1% in merely 22 years. It took Britain 120 years, the U.S. 80 years, and Japan more than 30 years to accomplish this.) Additionally, it is believed that nearly 70% of the Chinese population will live in cities by 2035.

Why is this urbanization megatrend not only occurring but also being actively encouraged by governments around the world? The answer, in a very general sense, is efficiency. The below excerpt from David Owen's *The Conundrum* does a good job illustrating the somewhat counter-intuitive efficiency of large cities.

*"The greenest community in the United States isn't Portland, Oregon or Boulder, Colorado, but New York City. To many people, including many New Yorkers, that idea seems perversely contrarian, but the evidence is straightforward. New Yorkers, individually, use less energy in all forms than any other Americans, and they have the smallest carbon footprints (less than 30 percent of the U.S. average). Not coincidentally, they are also the country's only significant users of public transportation. The New York metropolitan area accounts for nearly a third of all the public-transit passenger miles traveled in the United States, and the city itself contains half of all the country's subway stops. In addition, New Yorkers are the last large U.S. population for whom walking is still a primary form of transportation. (In suburbia, when you spot people on foot they're almost always either moving between vehicles and buildings or trying to lose weight.) The United States today is so dependent on automobiles that the average household owns more than two vehicles, and more than a third of all households own three. (In South Dakota, nearly 13 percent of households own five or more.) In New York City, by contrast 54 percent of all households don't own even one car—in Manhattan, the figure is 77 percent—and most of the families that do own a car don't drive it the way other Americans do. (Manhattanites use their cars mainly to make periodic escapades from Manhattan; residents of Staten Island use theirs more like average American suburbanites, though not as much.)*

*The fundamental reason for New York's leadership in all these categories is the very thing that, to most Americans, makes the city look like an ecological nightmare: its extreme compactness. New York is, by far, the most densely populated U.S. city, with more than twenty-seven thousand residents per square mile; Manhattan (which is the smallest of the city's five boroughs in land area) is even denser, with sixty-seven thousand people per square mile, or eight hundred times the average density of the country as a whole. Squeezing people close together may not look green—where are their solar panels, carbon-sequestering trees, and backyard compost heaps?—but it actually reduces environmental impact, because it dramatically shrinks car ownership, makes efficient public transport possible, constrains energy use in all categories, and forces most residents to live in apartment buildings, which are among the world's most efficient residential structures. High-density living also sharply limits residents' opportunities for personal consumption and waste. New Yorkers don't have lawns, sprinkler systems, swimming pools, or rooms they seldom set foot in, and—because living space is tight and expensive—they don't accumulate large inventories of energy-sucking household appliances. The city's visitors (and New Yorkers themselves) often complain about garbage on the streets, but New Yorkers, individually, generate less solid waste than other Americans do: with less room for acquisitions, they acquire fewer things and, therefore, throw fewer things away. (In suburbia, garages nowadays mostly contain not cars but surplus stuff, including the unused recreational equipment and outdoor furniture of people who seldom do anything in their yards other than working on them or watching other people work on them.) New Yorkers also use less water than other Americans do, because, with no lawns or swimming pools, they have fewer opportunities to use it.*

*Intelligently increasing population density—shortening the distance between people, and between people and their destinations—is the key to reducing a long list of negative environmental impacts in mobile, affluent populations. Worldwide, the prosperous communities that use the least energy and do the least damage to the environment are those in which, as in New York, living spaces are small, residential and commercial uses are interspersed, and per capital car use is very low—places like Hong Kong, Tokyo, and older sections of European capitals (which have the significant environmental advantage of having been laid out before the invention of the automobile). Hong Kong contains one of the densest concentrations of people and wealth on the planet, yet the average resident uses only about a third as much energy as the average resident of the United States. Intelligent density is the reason.”*

Viewed from this perspective, it is understandable why urbanization is seen as a positive (and even as a goal) by the countries that are growing fastest. It is also clear to see that this will be a major macroeconomic trend for decades to come.

From the partnership's perspective, the core strategy is to own the metals necessary for urbanization (i.e. copper, iron ore, nickel, etc), and to own them for an extremely long time. These metals (and the top tier of companies that explore, develop, or produce them) will do very well over the coming years relative to most other investments. But the information above also encourages the astute investor to think



differently about some very basic assumptions. For instance, if those gaining the most relative wealth are also moving into densely populated urban centers, do any car manufacturers (even if global GDP growth returns to its highs of the past decade) make compelling long-term investments? I would say not nearly as much as the market assumes.

In fact, the partnership holds a company that has the potential to greatly benefit from this misperception. The company, Galaxy Resources, is a vertically integrated lithium producer that manufactures electric batteries for scooters and e-bikes. Galaxy has a producing lithium mine in Australia, a lithium mine under development in Argentina, and multiple manufacturing plants in China, where lithium batteries are produced and sold. The partnership came to own this company under interesting circumstances. Just months after the partnership launched in September 2011, Galaxy acquired one of the holdings (an Argentina lithium developer named Lithium One) in an all-stock transaction. In the majority of situations, I would have waited for the acquisition to be finalized, sold the shares, and re-invested the proceeds back into the partnership's holdings. However, Galaxy is so well-positioned for vertical success over the upcoming years that I decided to hold on to the shares (average cost of ~\$0.51 per share, market price of \$0.395 per share as of Jan. 18).

***“Loose Money” Megatrend*** – I use the term “loose money” in jest because, while it is fixated upon by many Westerners as the root of all evils, “loose money” merely a symptom of the power and growth shift from the developed world to the emerging world; and the developed world not realizing or not wanting to realize that it is happening. In the case of the United States, the money printing, “Quantitative Easing”, and even ballooning of the national debt are simply manifestations of the fact that Americans don’t yet realize that our next thirty years as a country will be starkly different from our past thirty.

Remembering that on a daily basis the average American consumes 32 times more “stuff” than roughly 40% of the world’s population, the imbalances around the world are so stark that it is only natural for there to be some reversion to the mean. (“Reversion to the mean” in this case describes our consumption, growth, etc. decreasing relative to the emerging world and global economy as a whole.)

In my opinion (for what it’s worth – as this is more of a philosophical question if anything), the Loose Money Megatrend will ultimately produce a more fair and stable world. When looked at through a Marxist lens, the United States and a select number of western countries are certainly “the bourgeoisie” of the current global order, while the emerging economies and the rest would be aptly characterized as “the masses”. But rather than the masses revolting, they are drawing closer and closer to the bourgeoisie standard of living. Ignoring the obvious fact that “a more fair and stable world” means nothing if we consume all of our resources in the process of getting there, the Loose Money Megatrend may have a silver lining from a western perspective.

But, in a more practical sense, this Loose Money Megatrend is here to stay for western countries, including the United States. Therefore, those investors that own more “hard things” than most people will have portfolios that perform better than those of most people. Or put another way, for those that are particularly negative about the United States’ current position: own less US dollars and government/municipal debt than most people, and you will do less bad.

### ***Overview of Partnership Holdings***

I want to provide more clarity on how the partnership has diversified risk by owning companies with exposure to different commodities, in different jurisdictions, and in different stages of the development cycle. Below is an approximate breakdown of the partnership’s holdings for each of those criteria (as of Jan 18). Special thanks to Kes Rittenberg, an investor-in-the-making and student at USC, for helping compile the numbers.

<b>Holding Allocation By Primary Commodity</b>	
<b><i>Food</i></b>	
Potash	11%
Phosphate	5%
<b><i>Energy</i></b>	
Silver	26%
Uranium	16%
Heavy Rare Earth Elements	11%
Graphite	7%
Scandium	7%
Lithium	2%
<b><i>Infrastructure</i></b>	
Copper	9%
Iron Ore	4%
Nickel	2%

<b>Holding Allocation By Country (Flagship Project)</b>	
Canada	29%
Russia	23%
Sweden	9%
Australia	7%
Mexico	6%
Eritrea	6%
Turkey	6%
Brazil	3%
Botswana	2%
Argentina	2%
Mali	2%
Cameroon	2%
Ethiopia	2%
Chile	1%

<b>Holding Allocation By Stage of Development</b>	
Exploration	22%
Development	77%
Production	1%

### ***Why no water?***

I remain very optimistic on the long-term outlook on water, so why doesn't the partnership currently own anything water related? The reason is that the few water investments I'm truly excited about may take ten or fifteen years to realize their intrinsic value. These investments are slow moving and not as remotely cyclical as the other natural resources that the partnership has exposure to. Therefore, from Day 1 the partnership's plan was to buy water investments during the times the cyclical resources (silver, uranium, potash, graphite, etc) are fairly valued or over-valued, and to buy the cyclical resources themselves when they are undervalued. Since the fund launched in the midst of a severe resource bear market, the partnership has been buying the cyclical resource investments hand over fist. However, as the cyclical investments themselves converge toward fair value and then likely beyond fair value in the eventual resource market upturn, I expect water investments to swell to around 30% of the portfolio.

### ***Why no gold?***

As you'll notice, the partnership does not have major exposure to gold (aside from being or potentially being a by-product in production). Furthermore, the partnership will *never* have major exposure to gold. (We do own silver but for its industrial properties; this is discussed further in this letter's Featured Investment.) The reason for this is simple, but before I divulge, the reader must keep in mind how we operate: applying long-term value investing principles to investments supported by powerful macroeconomic trends, and doing it longer than anyone else.

With that in mind, our thesis is that the emerging world will continue to make substantial relative gains to the developed world over the coming decades, just as it has over the past 15 years. This is directly linked to the megatrend mentioned earlier.

Put another way, Rick Rule often discusses the "3.5 billion people in the world who are becoming gradually more free... and as a consequence, are becoming rapidly more wealthy." (In 2010, OECD estimated that 1.8 billion people were currently part of the global middle class. Even if the projections are off by 50%, these are powerful trends.) What are these people going to want? Are they going to want stacks of gold bars stored in underground Zurich vaults?



No they won't! They'll want cheap food & water, cheap electricity, and affordable housing (the vast majority of which will be in cities; supported by the Urbanization Megatrend mentioned above). And that is why the partnership owns the materials that will be needed in staggering quantities for this trend to continue.

If gold is restored as an accepted global currency in the upcoming ten or fifteen years, that will undoubtedly be very good news for long-term holders of the metal. However, the partnership believes that superior investment returns will come from the materials that this “gold currency” is ultimately used to buy (i.e. an ounce of gold for a ton of potash, one hundred ounces of gold for a heavy REE wind turbine, one thousand ounces of gold for a copper-dependent infrastructure investment, etc). Again, the true value lies in the materials that allow the world to live the way we do.

In the past year, Warren Buffett supported this view when he stated:

*“I will say this about gold. If you took all the gold in the world, it would roughly make a cube 67 feet on a side...Now for that same cube of gold, it would be worth at today’s market prices about \$7 trillion that’s probably about a third of the value of all of the United States...For \$7 trillion...you could have all the farmland in the United States, you could have about seven Exxon Mobils and you could have a trillion dollars of walking-around money...And if you offered me the choice of looking at some 67 foot cube of gold and looking at it all day, and you know me touching it and fondling it occasionally...Call me crazy, but I’ll take the farmland and the Exxon Mobils.”*

But the major irony of this is that even though the fund will never own gold, in a relative sense gold will likely perform very well. This is product of both the Loose Money Megatrend discussed earlier (while we like other hard assets better, gold is still a hard asset) and gold’s properties of liquidity. In fact, I would certainly encourage individual investors to own gold both as a hedge against the US dollar and a means of liquidity in times of panic. Of course, from the partnership’s perspective, the ten-year lock up and the fact that the fund does not have major exposure to the US dollar gives us little incentive to own the yellow metal in large quantities.

## **Featured Investment: Soltoro Ltd (CVE: SOL)**

Soltoro Ltd is a silver exploration company with 7 significant district scale land positions in Jalisco State, Mexico. Soltoro has been operating in Mexico for the past seven years and has assembled one of the most intelligent, cost-effective exploration teams currently working in the country. This exploration team is the primary reason that the partnership has held a Soltoro position since inception; as in the junior resource space, a dedicated and experienced team is the cornerstone of any long-term investment success.

The partnership owns Soltoro at an average cost of \$0.48 per share; Soltoro is trading at \$0.54 with a ~\$32M market capitalization as of January 18. Just after new years, I visited Soltoro's El Rayo Project just outside of Guachinango, Jalisco State, Mexico and was able to spend the day with the company's VP of Explorations Steve Priesmeyer. Steve is one of the two key figures in this seasoned exploration team (the other being CEO Andrew Thomson); his role and expertise will be discussed later in this analysis. This site visit added to my confidence of the company's impressive progress over the past two years and their positioning for the next two.

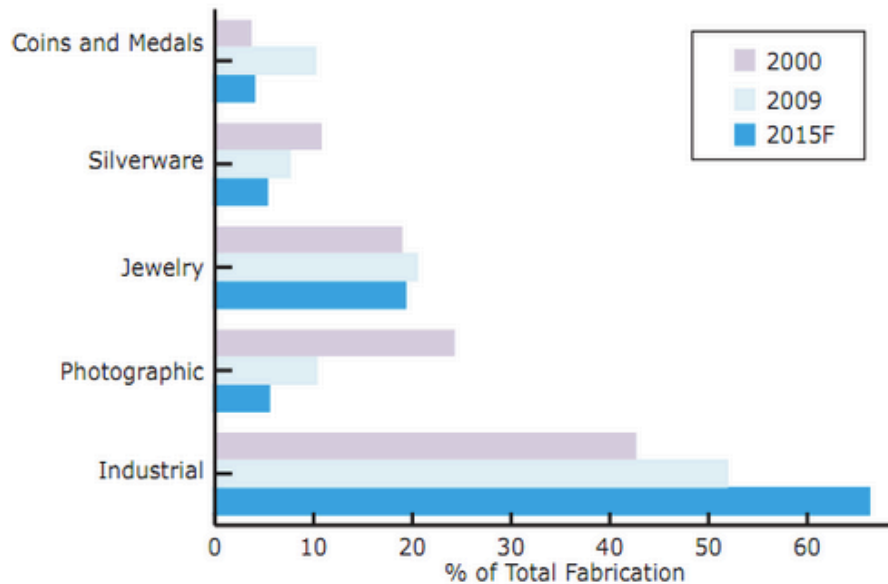
Please keep in mind that this is a speculative investment, albeit one that I have deemed to have very good speculative value. This is an important concept to understand. Even a project with a 40% chance of "success" can be very attractive if the payout (in the case of a success) is 10x or 20x. The trick of course is to scatter bets across projects that are geographically, geologically, and technologically different, but still offer excellent speculative value.

### ***Investment Thesis for Silver***

There are a myriad of investment theses pertaining to silver, the majority of which focus upon its wealth-preserving properties as a precious metal or the fact that it has a recent history of manipulation by those who benefit from the current financial order. Whether true or false, these theses have no major relevance to the partnership; we seek to hold the "stuff" that allows the world to live as we do for a very long time, not to profit from potential market manipulations or the like.

The partnership has large holdings of silver-focused companies due to its increasing use as an industrial metal, particularly in clean tech. Due to silver's unique properties (it is the most conductive metal), the metal has had a long history of use in the photography, medical, dentistry, and electronics fields. Over the past decade silver's industrial usage (as a percentage of total silver production; chart below) has grown at a surprising rate. This growth in industrial usage is occurring in spite of the major pick up in demand over the same period of silver as a precious metal investment.

### Industrial Demand's Growing Importance



Source: GFMS

In addition, silver demand has continued to grow explosively in an application that is of peak interest to the partnership, solar energy generation. In fact, silver demand for use in photovoltaic cells is expected to double between 2012 and 2015. China's October announcement that it hopes to generate 30 percent of China's power from solar, wind and other renewable sources by the end of 2015 (up from an earlier target of 15 percent from renewables plus 5 percent from nuclear by 2020) may make this expectation very conservative. Below is a look at silver's 2010 usage in PV cells and other established industrial applications.

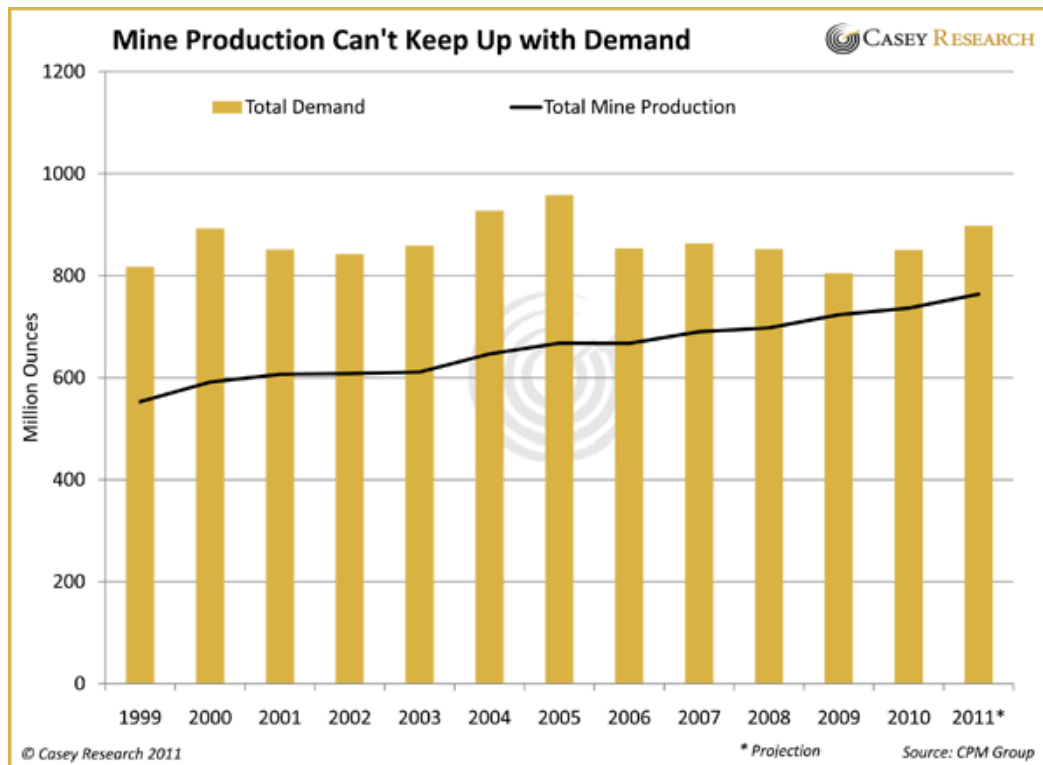
### Silver Consumption by End-Use, 2010

© GFMS Limited

	Silver Consumption per Unit of Demand <sup>4</sup>	Product Demand <sup>5</sup>	Total Silver Consumption <sup>5</sup>
Cell phones	250mg/handset <sup>1</sup>	1.6bn	13 Moz
PCs & laptops	1g/unit <sup>1</sup>	690m	22 Moz
Automobiles	10-30g/vehicle	72m <sup>3</sup>	36 Moz
PDPs	10g/screen	19m	6 Moz
Thick film PV	0.15-0.25g/cell <sup>2</sup>	14GW	47 Moz
Button batteries	1g/unit	156m	5 Moz

Source: GFMS, <sup>1</sup>Umicore Precious Metals, <sup>2</sup>Technic Inc; <sup>3</sup>Light duty vehicles, Global Insight; <sup>4</sup>indicative and/or average metal content; <sup>5</sup>estimated

Shifting our focus to the supply side, silver can be produced through primary silver projects (Soltoro's El Rayo project would fall under this category) or as a byproduct in mining operations with a different primary metal. Below is a chart of silver mine production in comparison to silver demand.



This doesn't quite make sense: why has supply remained roughly flat during a decade of sky-high silver prices (in the context of this chart, silver prices averaged just above \$5 per oz in 1999 compared to just above \$35 per oz in 2011) and robust demand growth? It is because there frankly is not enough silver out there to satisfy the rate at which the world will expect to consume silver over the coming years, and once the investment community begins to realize this, those that already have intelligent silver exposure will be rewarded.

As long as these industrial demand trends are in place, the partnership will continue to buy intelligent silver investments if the price is right. However, my ultimate belief is that there will be a silver price explosion over the next 4-5 years, particularly as industrial silver demand and investment silver demand continue to butt heads. I would not be surprised if the investors won, sending silver back into the domain of a precious metal (similar to gold; where 90% of demand is for investment), and demand destruction from industrial applications that, due to simple economics, have to switch to inferior materials. If we see this becoming the case, where silver industrial demand is dropping as a total of silver production at



the benefit of investment demand, the partnership will move out of silver. The good news is that, if this scenario plays out, the partnership's silver holdings will perform exceptionally well before the selling ultimately takes place.

### ***Investment Thesis for Mexico***

During resource bull markets, it is interesting how knowledgeable the investment community becomes about different jurisdictions around the world. In the case of 2010 and 2011, the herds of institutions and retail investors that rushed into different global projects could all confidently list of the reasons why their jurisdiction (whether it be a specific state in Mexico or the country of Ghana) was the place to be invested.

However, especially as this long-term bear market unfolds, it is amazing how quickly this knowledge evaporates during down markets. In these times, owning resources is perceived as a risky strategy; but if you must do so, the collective wisdom tell us, you'd be insane to invest anywhere other than Canada and possibly the United States. And as the herds follow the collective wisdom, in the case of Mexico, all properties (whether they are in the best or worst jurisdictions of this large and diverse country) are sold off and hated alike. This of course creates opportunity for those willing and able to distinguish between the different properties and jurisdictions.

I'd like to discuss why, all else equal, I have a bias towards Mexican resource listings relative to their US/Canadian counterparts. This stems from my simple beliefs that (a) the chance of a countrywide chaos in Mexico is not substantially different from the chance of the 48 continental United States simultaneously collapsing and (b) just as mining differs between New York State and Nevada, there are huge discrepancies between Mexican jurisdictions.

Addressing the first point, Mexico is far more similar to United States than Americans like to believe. Besides sharing a nearly 2000-mile border with the United States, Mexico is a developed, diverse, and resource-rich country that has inseparable links with its neighbor to the north. Even the social structure of Mexico (when viewed through the lens of wealth inequality) mirrors that of the United States. The CEO of Impact Silver (a partnership holding since inception) goes as far as to say that Mexico is more mining-friendly than the United States itself. Whether or not this is fully true, the discount that even premium companies operating in Mexico receive during times of uncertainty is unwarranted and an opportunity for astute investors.

The second point, regarding the tremendous differences between different Mexican jurisdictions, is best illustrated through a personal anecdote shared by Soltoro's VP of Exploration Steve Priesmeyer (who led the recent site visit to El Rayo). In a previous exploration job, Steve worked on a copper-molybdenum project located in

Mexico's Sinaloa State (two states to the north of Jalisco). Everyday, he and his technical team had to commute for up to four hours on foot/ATV in order to reach the project itself, in the process passing dozens of marijuana and poppy fields. In addition, the American members of the technical team weren't allowed to communicate with some of the locals due to their violent dislike of Americans (particularly DEA agents). While certainly exciting, these are not the conditions under which successful mineral exploration and development occurs.

This experience juxtaposes nicely with the working conditions at El Rayo and in Jalisco State in general. I was able to drive a rented car, alone as a Gringo, from Puerto Vallarta to Guachinango in a little over three hours. While only two lanes, the highway was safe and well paved, and there wasn't one marijuana or poppy field to be seen. Furthermore, the locals were very hospitable because (a) they are a lot more used to seeing American and Canadian faces, (b) many in the town rely on Soltoro either directly or indirectly for their livelihood, and, most importantly, (c) they have no reason to dislike me, as major drug-related incidents are virtually non-existent in Jalisco State. Both Steve and I are convinced that Soltoro's properties are in an environment conducive to mineral exploration and development success.

### ***Investment Thesis for Soltoro Ltd***

The partnership owns Soltoro because the company has a rare mix of attributes: a seasoned exploration team capable of generating new targets in a prudent and cost-effective manner, and a defined resource that on its own is being significantly undervalued by the market. I'll first discuss the merits of Soltoro's management team and their history of "shareholder-friendly" exploration success. I'll then discuss their El Rayo flagship resource, which I visited in early January 2013.

Soltoro is led by CEO Andrew Thomson. Thomson has fifteen years of mineral exploration experience in Central America and has led Soltoro since 2006. While not from a mining background, he has been successful with Soltoro for three reasons: (1) his obsession with minimizing costs, (2) his ability to selectively build a strong technical team *and* put the necessary faith in them, and (3) his promotional talent. Focusing on the first point, over Soltoro's history, the company has been able to put roughly 80% of its working capital "into the ground". As junior resource G&A expenses have exploded alongside commodity prices over the past ten years, this is an impressive achievement and one that gives Soltoro shareholders confidence. There is no doubt that Thomson has been the main thrust behind this cost-effective approach to silver exploration.

Of course cost-effectiveness is only half of the battle when it comes to mineral exploration. For this reason, Thomson has assembled a strong technical team led by VP of Exploration Steve Priesmeyer. Steve is an experienced geologist with 25 years of mineral exploration experience in Latin America, much of that in Mexico. He

joined Soltoro in 2011 and has been an integral part of their accelerating progress over the past two years.

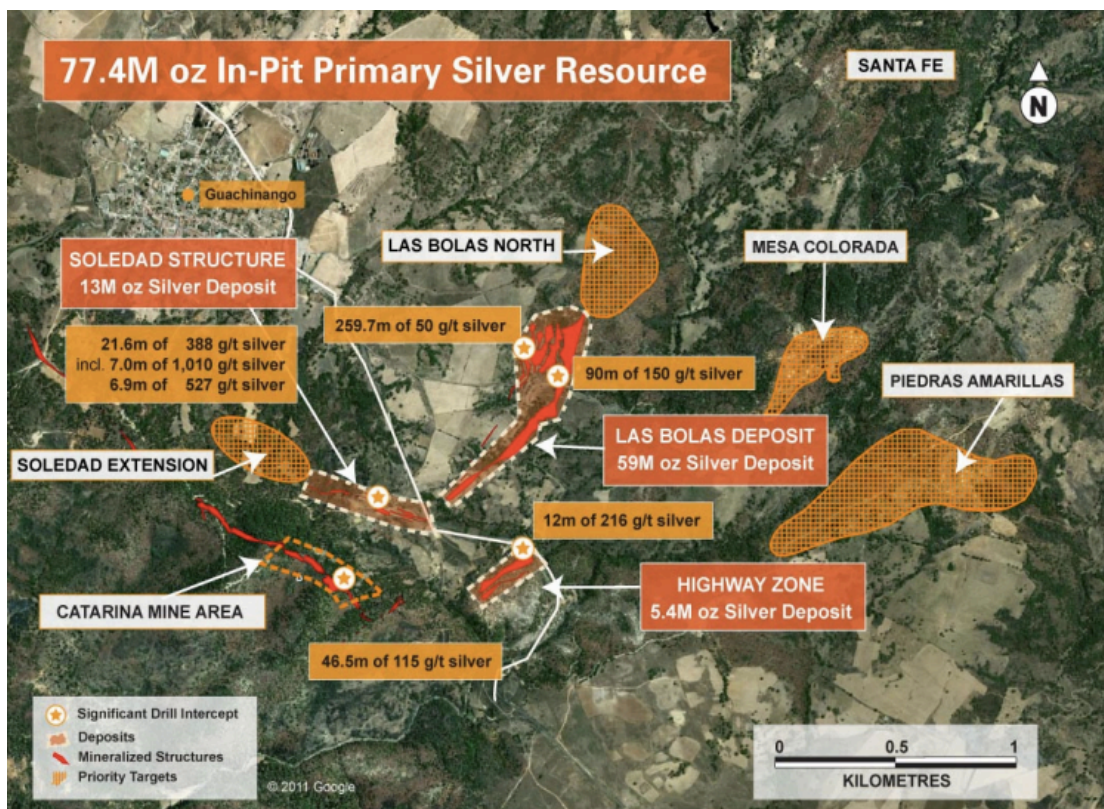
Aside from the El Rayo Property, Soltoro owns or has joint ventured multiple large, under-explored land packages both in Jalisco State and elsewhere in Mexico (see properties in map below). In fact, the company recently relieved VP of Operations Patrick Toth of much of his responsibilities at El Rayo so he could focus his energies on prepping these land packages for exploration. For the reasons outlined above, as a shareholder, I'm excited to see a push for further exploration once Soltoro either captures value from its El Rayo project or the fundraising environment improves.



The description of the management team above indicates why I'm optimistic on Soltoro's goal for continued exploration success in Jalisco State and similar Mexican jurisdictions. As a shareholder, I'm confident Soltoro's exploration approach will continue to build long-term value. However, the main appeal to this investment comes from the El Rayo Property, which on its own makes the company very undervalued.

El Rayo is located just outside of the town of Guachinango in Jalisco State. The property has a Measured and Indicated Resource of 77.4M ounces of silver at an average grade of 57.1 g/t. (For some perspective, Orko Silver Corp, with an M&I Resource of 99M ounces of silver at 104 g/t at their La Preciosa Deposit, was

recently acquired for roughly \$400M.) Soltoro is well positioned to expand the resource in both size and grade through further drilling. This was demonstrated on Jan. 18, after my visit to El Rayo occurred, when the company announced excellent drill results, including an intercept of 91.3 meters at 129 g/t silver equivalent. Future drill results like this will likely push El Rayo past 100M ounces silver equivalent, making the project itself a prime acquisition target (possibly by \$2B silver producer Coeur D' Alene Mines, who owns 7% of Soltoro).



The property has three main zones of silver mineralization:

*Las Bolas*- This mineralized zone (59M ounces of silver) makes up the majority of El Rayo's M&I Resource. This was the first stop when Steve showed me around the property, as it's less than ten minutes outside of Guachinango. The Las Bolas area has been mined for centuries and there were multiple trenches and tunnels from previous work. However, there was still silver mineralization present at surface (see below).





It was assumed for decades (the Mexican government drilled Las Bolas in the 1980's) that the Las Bolas structure ended where I stood taking the below picture. However, a hypothesis by a Soltoro geologist in the past three years has led the company to discover a large extension to the structure. It turns out this portion of the Las Bolas structure, called Las Bolas North, was pushed hundreds of meters from its original position. The upper left fourth of the below picture is where the mineralization begins, and it extends dog-leg-left onto the hill in the background. The company is calling this a "high priority area" for future drilling.





*La Soledad* – The Soltoro team discovered this prospect in mid-2011 through an aggressive drilling and trenching campaign. While it is only a five-minute drive from the middle of the Las Bolas project, it does not compare in size to its larger neighbor (13M oz of Ag vs. 59M oz of Ag). However, La Soledad is the highest grade, near-surface prospect at El Rayo, giving it importance to the project's overall economics. It is estimated at 104 g/t silver, but recent drill results indicate that this may be conservative.

*The Highway Zone* – The Highway Zone, nicknamed for the fact that its literally located alongside the highway that leads in Guachinango, is the least important of the three main silver zones that comprise El Rayo. Its M&I resource is only 5.4M oz of Ag at 57.39 g/t and it does not have much potential for resource expansion. However, it is interesting for a couple of reasons. The first is that can undoubtedly be economic despite its low grade, as dump-trucks could literally be backed against the mineralization and earth could be shoveled in; a low-cost operation indeed. (This won't happen, as the future producer of this deposit will almost certainly begin with three open pit mines that ultimately converge into one. But it does demonstrate how easily extractable much of the silver is at the El Rayo prospect.) The second reason is that the deposit demonstrates the continuity of silver mineralization throughout the El Rayo prospect. The Las Bolas deposit to the north has been known for centuries to host silver, but people had been driving past "The Highway Zone" (shown below with a glimpse of the actual highway) for over a decade before Soltoro discovered that the rock face and area beyond contained economically minable quantities of silver.



As of September 30 2012, Soltoro had \$3.8M in working capital. Based off of their monthly overhead, the company will likely have to raise capital in 2013 if they want to continue aggressive advancement of El Rayo, and will certainly have to raise capital if they want to push forward their other prospects on top of that. This may not be a bad thing; junior resource prices can move extremely quickly and the dilution of fundraising will not hurt nearly as much if Soltoro is trading at a much higher price when it takes place.

However, as a long-term shareholder, I am willing to accept this possible dilution because (a) getting cash in the hands of a seasoned and cost-efficient exploration team is rarely a poor strategy, particularly when everyone else has (temporarily) stopped looking for minerals and (b) El Rayo's value alone is likely many multiples higher than Soltoro's entire market capitalization. I expect a joint venture partner to be added or for El Rayo to be sold outright in the next year to year and a half. In this scenario, Soltoro could turn from a good to a great investment once they push the value realized from El Rayo back into their fully-owned, underexplored projects located throughout Jalisco State and similar jurisdictions. This of course will take incredible patience, which is why I'm willing to be a Soltoro shareholder for as long as management continues to make intelligent, cost-effective decisions.

## **Update on Past Featured Investments**

### **South Boulder Mines (ASX:STB)**

Featured In: **July 2012**

Partnership Average Cost per Share: **\$0.58**

Current Market Price (Jan 18, 2013): **\$0.435**

South Boulder Mines continues to be a long-term partnership holding. The company's share price slumped significantly over the past six months, as the Eritrean government asked for 50% of the Collulli Project versus the expected 40%. The partnership added to its STB position in the past month, as geologically and logistically, the Colluli Resource is the #1 major undeveloped potash deposit in the world; the only major risks for the company are geopolitical. The company is going to have fantastic deal flow over the next three quarters as they come out with their feasibility study/related reports and the updated agreement with the Eritrean government.

I'm looking for one of two things: (a) a takeover by a Chinese sovereign wealth fund (they're comfortable with Eritrea as demonstrated by the recent purchase Eritrea's Kola Gold Deposit from Chalice Gold) which would make STB a good investment or (b) STB actually being able to take Colluli to production, which would be a home run investment. While both of these options would result in the mine reaching production; the market is not valuing the company as if this is remotely possible (with ~\$20M in the bank, the IPV of Colluli is remarkably low at ~\$35M).

### **Northern Graphite Company (CVE:NGC)**

Featured In: **January 2012**

Partnership Average Cost per Share: **\$1.10**

Current Market Price (Jan 18, 2013): **\$1.31**

Northern Graphite Company (and its Bissett Creek property) continues to be a long-term partnership holding. The company's share price has been on a roller coaster for the past year, trading between \$0.58 and \$3.42. From a company perspective, NGC has made good progress; two notable advancements being the publication of their Feasibility Study in July and the recent signing of an "Equipment Financing Deal" with Caterpillar on Jan. 8, 2013.

These developments indicate that the mine is close to commencing construction, which should occur in the first half of this year. Assuming that NGC can continue their advancement towards production, they should be the next graphite mine to reach production outside of China (the only possible exception being Flinders Resources; another partnership holding).