Quarterly Newsletter
Walnut Hill Advisors, LLC
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American Outlier?

"Not even gold will save you from what is coming'"

~Marc Faber on Bloomberg (3/30/13) who also said recently that we could experience a possible US market crash later in 2013 if we didn't get a smaller correction in the first quarter. As Mentioned below, there was no correction in the first quarter.

I would like to cover a few points in this letter:

1. **US decoupled from the rest of the world - for a few months**
2. **Grabbing Cheap Asset Plays**
3. **Gold**
4. **Next Client Event**

With the catalyst of the tax compromise just after New Year's, the market launched north in the US firing up ~10% in 3 months. Meanwhile the rest of the world (outside of Mexico, the Philippines, Thailand and a few African countries) is in the gutter.

What's going on? Two things - fundamental and technical. Fundamentally, the rest of the world's major "reserve" currencies - the Yen and the Euro - are in terrible shape, making the US dollar, with all of our debt look better. And with bond yields so low, investors have been buying American dividend stocks at any price to get the yield, often better than bond yields. Some people have espoused the "**TINA**" trade - standing for "**t**here **i**s **n**o **a**lternative" to invest in if you want yield.
And it's true - I've discussed how the Federal Reserve's zero interest rate policy have forced "grandma" to buy junk bonds because she's earning nothing in the bank. Thanks Ben for making Grandma take huge risks to try to earn some yield.

And from a different angle, technically, the powerful start to the trend and its incessant rise feeds on itself. Many traders like a rising chart and will jump in to follow the trend. And it's been a relatively smooth uptrend for 3 months. So more and more traders buy pushing the prices further up. As I write this in April, the markets have risen so steeply that their charts look like good bets to reverse down (price rises that are too steep often correct quickly and nastily).

But for now, the US markets are up strongly while Europe, emerging markets and commodities are either falling or crashing. Including gold.

We participated in this through American Express, Under Armor, Agree Realty and a few other trades. Because we diversify globally, many of our holdings did not participate in the US run up including last month's featured holding Mongolia Growth Group, Altius Minerals, our bet on uranium's revival and our gold holdings. All declined in the first quarter. With gold I had to engage our risk management rules and sell positions. I will discuss gold more below.

2. Grabbing Cheap Asset Plays

Altius Minerals

In the last issue I outlined Mongolia Growth Group as an asset play. I ended up adding it to more client portfolios* as it got cheaper (today as I write this, price is way down). To reiterate, the story there is a small country with huge natural resources next door to China is about to have 2 of those giant resource sources come online (one in June). The inflow of wealth to Mongolia will be enormous, which will in my opinion, push up real estate and financial services in the country. MGG focuses on commercial, retail, and residential real estate and insurance.

Altius is a resource exploration company with highly competent management, excellent assets and a brilliant strategy. Here's what they do. They find promising resource projects (past projects have included Nickel, uranium, gold) and spend a minimal amount of money determining their promise. They then partner with an established mining company and have them pay for all of the exploration and development costs in exchange for usually a majority stake in the project. The kicker is that Altius will ALSO often keep a royalty on the gross production of the mine. So they get paid sometimes in 3 ways - shares in a company created for the project, percentage ownership of the project, and or a royalty.

Their newest project that is close to production is a company called Alderon Iron Ore. Altius created Alderon (NYSE: AXX) out of their Kami Iron Ore project, and a Chinese company Hebei Iron & Steel is now an investor after contributing almost $200M to the development of the project. Altius owns about 1/3 of Alderon's public stock and they hold a 3% gross royalty on the iron ore production that is expected to start in 2015. An Altius executive relayed to me that the amount of that royalty will be likely $15-30M/year depending on the price of iron ore. With Altius as a whole company valued under $300M, and no need for this cash flow (Altius is also sitting on $150M in cash), this will likely make a juicy dividend to shareholders of 5-10%/year.

The valuation summary of Altius is the following:

Share price: $9.40, giving the company a valuation of ~$268M. When I last checked, they had:

$162M in cash
~$95M in stocks and investments
various other development projects.

I list the market value of the company as only ~$10M above the value of the cash and securities owned. That's assigning no value to the future cash flow from Alderon, and the dozen plus other future projects in the works. I believe this represents serious value and a margin of safety I can appreciate. The only risk here is that all commodity prices drop super low, but if that happens, it must mean a depression. Then no one is safe. Barring that, the risk/reward here is compelling.

*Conservative clients may or may not hold MGG or Altius depending on risk profile. I consider these companies speculative, even if I feel there is a nice margin of safety in each. Liquidity is limited

3. Gold in an April Free Fall - What Am I Doing?

Gold has been steadily declining since its peak in September 2011 above $1,900/oz. In April, the decline hit its crescendo as gold dropped almost 20% in 2 days. As I mentioned above, I had to drastically reduce our gold holdings to prevent large losses (our risk management plan). For explanations, they're the same as the explanations for the US stock market performance in the first section of this letter- fundamental and technical.

Fundamentally, people are feeling less and less scared of hyperinflation with all of the major central banks printing money and/or bailing out debtor nations. Perhaps if everyone prints money, no one country will look bad? The US dollar could be the one eyed man in the land of the blind. Furthermore, many commodities have been trending down for some time including copper. And since gold is a commodity (to some it's "money" too) it hasn't escaped the fate of other commodities.

Technically speaking, the chart for gold is a picture perfect chart for traders to sell short. I won't go into the nuances of chart trading but let me just say that traders wait a long time for the set up gold gave them and many sold short, which exacerbated the move down. Where do we go from here then?

Personally, I am doing what I've recommended you all do. I bought more physical gold and silver a couple of weeks ago and recommend you accumulate it too. I also recommend adding platinum and palladium to your metals holdings as not only are they precious metals, they have a solid industrial use in keeping cars from polluting and have supply issues worldwide, which may eventually push prices much higher.

I am also keeping an eye out for opportunities to re-enter gold trades for clients. There are potential huge rewards here and I will attempt to capture them. But as I mentioned above, risk management will take precedence and for now, we are out. One of the research houses where I get paid research, (Charles Nenner, Inc) focuses on price cycles and they put a low in the recent gold cycle for late April. Let's see if they're right.

4. Client Event

Attemtping first week in June now for a client date. I said May 7th in an email newsletter but we are taking more time to make it more fun!

Warmly,

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