

SUPERIOR GOLD GROUP

"Should I buy gold coins or gold stocks?"

Instead of gold or silver bullion, many investors opt for precious metals mining stocks because they normally yield higher percentage increases than gold and silver when metals prices rise. However, investing in precious metals stocks carries risks beyond buying gold or silver bullion.

The risks are many and varied, and sometimes unforeseen problems can send stock prices plummeting, which, of course, is true of all stocks. Management mistakes cause most mishaps. With precious metals and other mining stocks, the sizes and grades of ore deposits can be overestimated or the cost of extracting the ore can be greater than expected, resulting in lower profits or even losses.

Additionally, businesses always struggle with economic downturns, interest rate increases, labor troubles, governmental interventions, and environmental requirements. Increases in energy costs--even energy shortages--could plague some mining companies, notably those operating in Nevada's famed Carlin Trend.

For disastrous management decisions, Sunshine Mining and Refining Company comes to mind. Once a favorite of silver stock investors, Sunshine traded at \$13 in early 1998 on the NYSE. However, by 2000 Sunshine was in Chapter 11, and its stock has traded at less than a nickel on the NASDAQ.

In 1996, Sunshine's management borrowed \$30 million and in 1997 an additional \$15 million for development of its West Chance ore body at the Sunshine Mine, after which the company is named. Part of the borrowed funds were used to delineate what the company calls a "world-class" ore body in Argentina.

Although management claims the West Chance efforts were successful, management misjudged cash flow and was unable to meet interest and principal payments on the \$45 million. Efforts to refinance were unsuccessful, and the lenders took control of the company and mothballed the famed Sunshine Mine. Shareholders wound up with about 3.6% of the company. Unfortunately, this was not Sunshine's only brush with disaster.

In 1972, a fire in the Sunshine Mine nearly destroyed the company. While Sunshine's stock price suffered, the company managed to survive. Now, Sunshine Mining essentially has been taken over by its creditors.

Ashanti Goldfields (Ghana) and Cambior (Canada), two gold producers, also exemplify what can happen to share prices when managements make bad decisions. In early 1996, Ashanti (ASL) traded at \$25; in 2000, Ashanti's stock traded below \$1.50. In early 1996, Cambior, traded at \$16; in late 2000, Cambior's stock traded at twenty-five cents.

Both companies got caught up in forward sales, and their balance sheets were severely damaged by margin calls in 1999 when gold rallied from the \$250s level to \$338 on the announcement that 15 European central banks would limit gold sales and leasing for five years (The Washington Gold Agreement). Gold's price move caused Ashanti and Cambior to liquidate assets and/or convert loans to equity shares at rates that severely damaged the value of their stocks.

Forward selling remains a threat to other gold mining companies because the amount sold short via forward sales is disproportionate to the size of the gold market. Some estimates have total forward sales equivalent to three to five years of production. One or two small short positions could be unwound with only minor price increases. But, the total position is enormous, and reversing it without the price of

gold skyrocketing will be difficult, if not impossible.

Forward selling involves borrowing gold and selling it, and it is done mostly by mining companies because, logically, they should be able to replace the borrowed gold out of future production. Forward selling is profitable because the lenders, primarily central banks, lend with charges (lease rates) of about 1%, sometimes even less. The borrowers sell the gold with effective returns of somewhere between 6% and 10%, depending on the borrower's credit rating.

If the funds from the sales of the gold are invested in high-grade bonds, the borrowers receive probably 6% to 8%, for a tidy margin of 5% to 7%. However, if the borrowers use the funds in operations, thereby permitting them to forego borrowing in the credit markets, then they effectively receive higher rates, depending on the companies' credit ratings.

Hundreds of millions of dollars are made via forwarding selling. The central banks earn fees on an otherwise "sterile" asset. The mining companies earn 5% to 9%, and the bullion houses that arrange the central bank loans and handle the gold sales earn huge fees. Forward selling pays off like a broken slot machine--except for gold mining companies' shareholders. Shareholders lose because forward selling distorts gold's supply/demand fundamentals and puts downward pressure on the price of gold. However, forward selling is not without its risks.

If the price of gold rises, the lenders want additional margin deposits, which is what hammered Ashanti and Cambior. (Despite the borrowers having millions of ounces of gold in the ground, the central banks require "margin deposits," usually US treasuries. This works much the same way as margin deposits do on futures and stock exchanges.) It is believed that some bullion houses have even given the central banks guarantees that the borrowed gold will be replaced. If so, then adverse developments in the forward sales arena could force government bailouts, such as was the case with the Fed-engineered rescue of Long-Term Credit Management.

Precious metals stocks are a way to participate in the gold and silver market; however, compared to gold and silver bullion, stocks are risky. No one ever went broke holding gold or silver. The same cannot be said of paper assets. Call the Superior Gold Group today and start your account NOW!