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MARKETS AT A GLANCE

Sprott Asset Management LP

The Greatest Trade of All Time

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On its way to becoming the world's greatest superpower, the United States pulled off some truly remarkable trades. Two notable transactions come to mind and were both outstanding bargains.

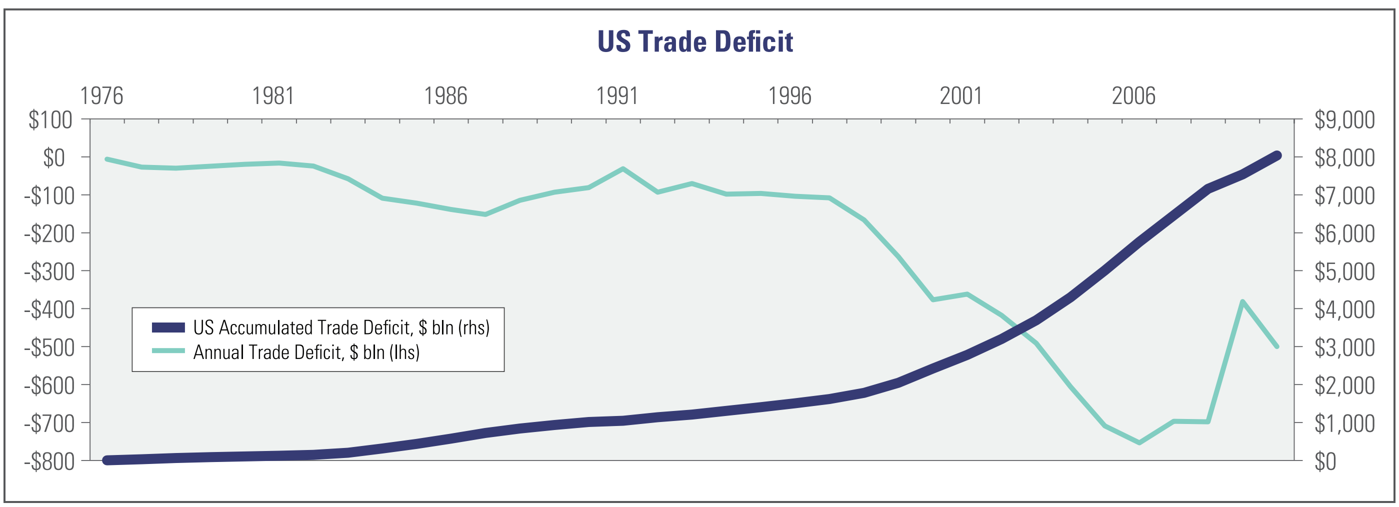
- **The Louisiana Purchase** *(purchased from the French)*
- **Alaska** *(purchased from the Russians)*

For a mere $15 million, America instantly doubled its size with the 1803 purchase of the Louisiana territory.[1] Sixty-four years later, oil-and mineral-rich Alaska was obtained for a paltry $7.2 million.[2] Even adjusting for inflation, the combined value of these deals in today's dollars would be very small.

The Greatest Trade in US History

However, these two transactions pale in comparison to the greatest trade of all time, one which remains ongoing. This particular trade has allowed the US to exchange more than $8 trillion worth of paper for an unbelievably enormous amount of real goods and services over 36 straight years. We're referring, of course, to the United States trade deficit. As Chart 1 shows, imports have exceeded exports every year since 1975. For much of the past decade, America's annual trade deficit has soared past the $600 billion mark, while the accumulated trade deficit has moved relentlessly higher.

CHART 1



Source: US Census Bureau, Foreign Trade Division

1 Source: Library of Congress (http://www.loc.gov/rr/program/bib/ourdocs/Louisiana.html)
2 Source: Library of Congress (http://www.loc.gov/rr/program/bib/ourdocs/Alaska.html)

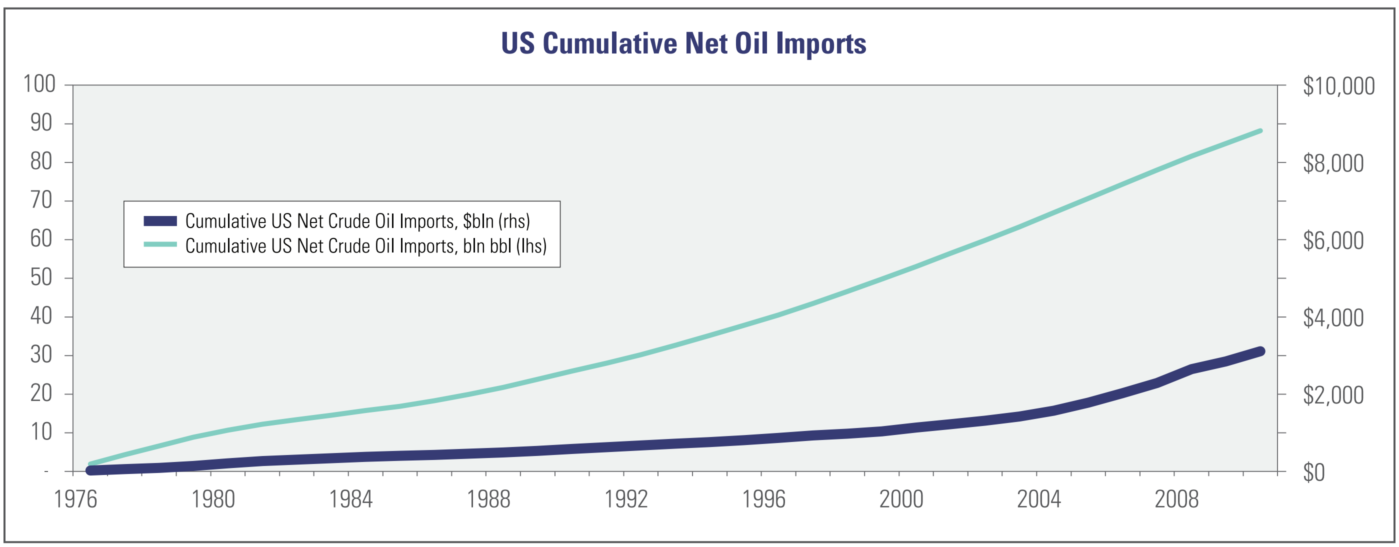
Back in November 2003, Warren Buffett penned an article for Fortune magazine warning that America's trade deficit could no longer be ignored.[3] He felt that America's "net worth" was "being transferred abroad at an alarming rate." At the time, the accumulated trade deficit had only reached a few trillion dollars, but it has grown over the last seven years by an average of over $600 billion per annum.[4] As Buffett wrote at the time, "our national credit card allows us to charge truly breathtaking amounts. But that card's credit line is not limitless." Makes you wonder what he must be thinking now that the accumulated trade deficit has since ballooned.

Charts 2 and 3 below demonstrate how much of the deficit resulted from imported oil and autos, two major items of which the United States is a net importer.

Addicted to Imported Oil

Nearly 40 percent[5] of the $8 trillion[4] trade debt is a direct result of America's continuing dependence on foreign oil. Even though the US is the world's third largest oil producer, it has had to import 90 billion barrels of oil at a net cost of $3.1 trillion since 1975.[5] Nearly $2 trillion[5] of that was incurred over the past ten years, as the prices, rather than volumes, of imports rose. Roughly two-thirds of the oil consumed in the US over the past decade is imported, and overall the US has consumed over 12 percent of the rest of the world's oil production since 1975.[6] America's rapidly widening oil deficit may even accelerate as demand from China, India and other emerging economies pushes oil prices ever higher.

CHART 2



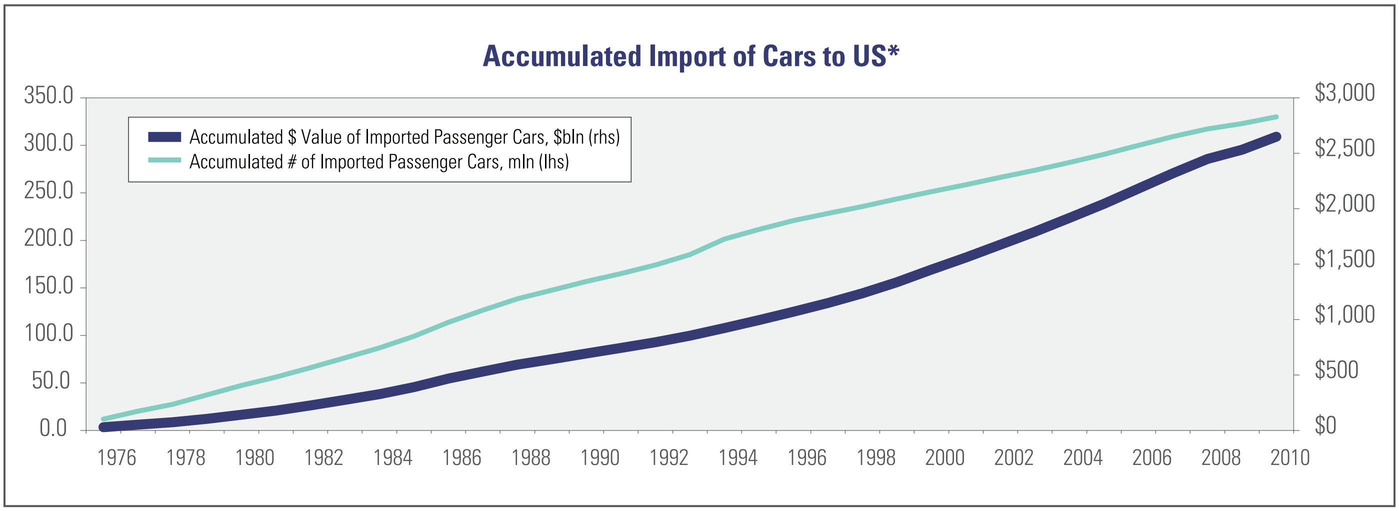
Source: US Energy Information Administration

…And Imported Automobiles

$2.65 trillion.[7] That's the total cost of the 330 million[7] imported cars Americans have purchased over the past 36 years. There's little indication that import purchases will slow down anytime soon, as imports surged to $115 billion in 2010, exceeding exports by $76 billion.[7]

3 Source: Berkshire Hathaway (http://www.berkshirehathaway.com/letters/growing.pdf)
4 Source: US Census Bureau, Foreign Trade Division
5 Source: EIA
6 Source: US Energy Information Adminstration
7 Source: US International Trade Commission

CHART 3



*1976 – 1988: Estimated by Sprott as we could not find actual historical data
Source: United States International Trade Commission

We could include countless examples and all of them collectively would not do justice to what an amazing trade this has been for the United States. Stop and think for a moment about how many hours of labour, manufactured goods and non-renewable resources the United States has been able to acquire over 3.5 decades in exchange for paper promises that promise nothing but additional paper. It is truly remarkable.

When a Dollar was a Dollar

"[US dollars] have value because everybody thinks they have value. Everybody thinks they have value because in everybody's experience they have had value." – *Nobel laureate economist Milton Friedman*[8]

Exporting nations have willingly financed this $8 trillion trade deficit by accepting US dollar denominated paper promises in exchange for tangible goods sold. But perhaps most important of all, they've continued to hold and accumulate these paper promises rather than exchange them for real assets.

Presumably, they have done so on the belief that one day they will be able to convert these paper promises for at least an equivalent value of goods and services. This requires faith that the purchasing power of the US dollar will not decline by more than the returns of their paper promises and that someone in the future will be willing to give up a tangible asset in exchange for them.

We believe that the growing US budget deficit, the Federal Reserve's "Quantitative Easing" program and the ongoing US dollar decline has caused holders of US dollar reserves to question their faith, re-examine their desire to accumulate additional US dollar reserves and also look to convert their existing US reserves into real goods. Holders of US dollars had the chance to see how the Federal Reserve and the United States government would react to fiscal difficulties and we believe this 'look behind the curtain' has permanently altered their faith in US dollar denominated debt and sovereign paper promises, generally. Foreign investors are not being properly compensated for the risk associated with holding US promises today. We believe they are beginning to realize that this exchange of real goods for paper promises is a losing trade.

[8] Source: A Monetary History of the United States, 1867 – 1960, Milton Friedman and Anna Schartz

Investors are NOT Being Compensated for Risk

"We have a sense that bond investors are not being rewarded relative to the risks that they are taking at the current moment."
– *Bill Gross, PIMCO*[9]

As Table 1 illustrates, US debt has soared from 33 percent of GDP in 1975 to a staggering 95 percent of GDP today, and may surge past 100 percent of GDP by the end of 2011. At the same time, budget deficits have already climbed past 8.8 percent of GDP and are expected to average over $1 trillion for the next several years.[10] This number may prove conservative if interest rates ever rise from their current, unprecedented low levels.

TABLE 1

	1975	31-Dec-10
GDP, $ Bln	$1,637	$14,660
Fed Debt to GDP	33%	95%
Nominal Fed Debt, $ Bln	$533	$13,871
Nominal Budget Deficit, $ Bln	-$53	-$1,294
Budget Deficit vs GDP	-3.2%	-8.8%
Nominal Trade Deficit, $ Bln	$12	-$500
Trade Deficit vs. GDP	0.8%	-3.4%
90 Day T-Bill rate	5.2%	0.01%**
5 year rate	7.5%	0.96%**
10 year rate	7.8%	2.25%**
30 year rate*	8.0%	3.73%**

*Data for 1977, no data available for 1975
**Data as of 12-Aug-11
Source: Bloomberg LP, US Census Bureau, TreasuryDirect.gov, Bureau of Economic Analysis, Congressional Budget Office

Do these figures justify lower investor returns?

Where's the Risk/Reward for US Debt Holders?

Yet in the midst of all this fiscal chaos and increased risk, the debt holders – the ones absorbing the risk – are being offered virtually zero return on short term paper (0.01 percent on 90 day notes), and between 0.9 percent and 3.7 percent return on medium to long term debt. Clearly there's a disconnect, and much of it stems from the fact that the Federal Reserve is buying up unsold bonds, which keeps demand artificially high and yields artificially low.

How long will investors accept such low returns on debt issued by a government that PIMCO bond fund manager Bill Gross calls "one of the serial abusers of deficits"?[11] How long will foreign investors hold rapidly depreciating debt denominated in an increasingly unstable currency when investors like Buffett state publicly that the dollar will not hold its value and would "recommend against buying long-term fixed [US] dollar investments"?[12]

Investors Always Have a Choice

"We can say that the essence of normality is the refusal of reality." – *Ernest Becker*[13]

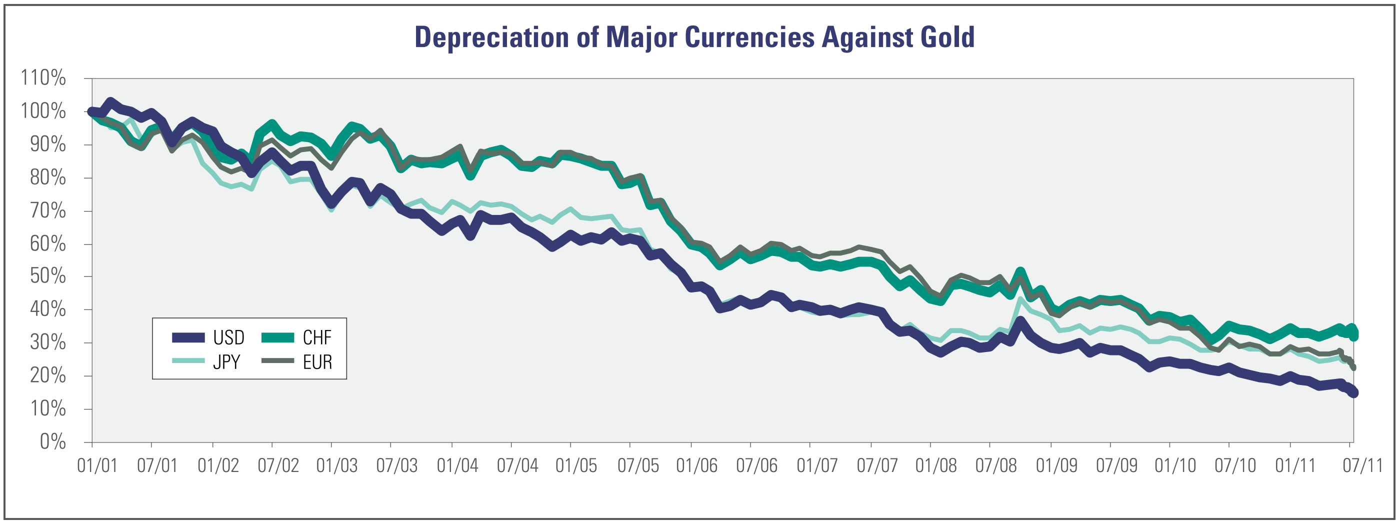
Where can those exporting nations dissatisfied with holding US dollar debt choose to place their surplus dollars? While they could diversify their US paper promises into Euro, Yen or other sovereign paper promises, this would require another leap of faith – and given the fiat nature of all currencies and the fiscal situation of nearly all sovereigns, it would likely be another bad trade for them. Although we have focused on the US dollar and America's fiscal condition, other advanced economies have similar economic issues and there is no other viable reserve currency. In our view, surplus generating nations would be wise to immediately 'settle up' and stockpile 'strategic reserves' of real assets rather than sovereign paper promises.

9 Source: Bond Investors Not Being Rewarded By Risk Today (http://www.morningstar.com/cover/videocenter.aspx?id=376646)
10 Source: Projected Deficits and Surpluses in CBO's Baseline, Congressional Budget Office
11 http://www.washingtonpost.com/business/economy/the-dollar-less-almighty-big-investors-see-possible-long-term-currency-weakness/2011/04/19/AFxVaKLE_story.html
12 http://www.bloomberg.com/news/2011-03-25/buffett-says-avoid-long-term-bonds-tied-to-eroding-dollar-value.html
13 Source: Denial of Death, Ernest Becker

All Fiat Currencies are Suffering the Same Fate

All major currencies have been in rapid decline for the past decade when measured against the world's oldest monetary asset: gold. As Figure 4 shows, the decline of the Yen, Dollar, Euro and Swiss Franc is currently running between 60 and 80 percent since January 2001, and, in our view, further declines are likely.

CHART 4



Source: Bloomberg LP

Real Assets

We are of the view that the appetite for sovereign paper promises will continue to decline, and such promises will continue to lose their value relative to real assets, like gold. What needs to be understood is that paper promises (sovereign debt and fiat currencies) are 'faith-based assets'. They have no inherent value. They have perceived value in that they have historically been convertible into real assets. With their value decreasing against real assets, however, we are of the view that holders of faith-based assets will be increasingly unwilling to store their wealth in them. This will drive up the prices of real assets versus faith-based assets, a process which we have already begun to see en masse.

The move to diversify out of US dollar reserves by surplus generating nations may be the trigger that causes a complete revaluation of the risk associated with holding faith-based assets generally, and we believe that holders of faith-based assets will increasingly look to convert them into real assets as quickly as possible. Inevitably, the accepted hold time duration will diminish until people begin to fear even overnight losses in purchasing power – as we've seen during the hyperinflation currency crises that have been experienced in Argentina, Zimbabwe and Weimar Germany.

History has shown us that fiat currencies always suffer the same fate and eventually become worthless. Despite this fact, we continue to exist in a purely fiat world clinging to the promise that this time will be different. It is hard to predict exactly when people will awaken from this mass delusion in faith-based assets. But, it is certain that in these times it is wise to avoid gambling your wealth in faith-based assets when the system that you must trust has a clear history of being untrustworthy. We therefore advise you to question your faith and know what you own.

For more information about Sprott Asset Management's investment insights and award-winning investment capabilities, please visit www.sprott.com.

Sprott at a Glance

With a history going back to 1981, Sprott Inc. offers a collection of investment managers, united by one common goal: delivering superior long-term returns to our investors. Sprott has a team of best-in-class portfolio managers, market strategists, technical experts and analysts that is widely-recognized for its investment expertise, performance results and unique investment approach. Our Investment Team relentlessly pursues a deeper level of knowledge and understanding which allows it to develop unique macroeconomic and company insights. Our team-based approach allows us to uncover the most attractive investment opportunities for our investors. When an emerging investment opportunity is identified, we invest decisively and with conviction. We also co-invest our own capital to align our interests with our investors.

Our history of outperformance speaks for itself.

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The company currently operates through four distinct business units: Sprott Asset Management LP, Sprott Private Wealth LP, Sprott Consulting LP and Sprott U.S. Holdings Inc.

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For more information, please visit ***www.sprott.com***

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Founded in 1993, the firm is led by Rick Rule, a leading authority on investing in global natural resource companies. More than just brokers, the team is comprised of geologists, mining engineers, scientists and investment professionals.

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"Performance has always been the core objective of our firm and in 2010, Sprott Asset Management delivered significant out-performance for our investors."

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