

## CHINA – THE KEY TO THE COMMODITY OUTLOOK – PART II

BY GERRY BROCKELSBY, CFA, CHIEF INVESTMENT OFFICER

**I**n our last month's commentary we highlighted how the Chinese economy was likely to see stronger economic growth due to an easing of monetary policy and the completion of their leadership change. Commodity prices have been moving up in the past few weeks reflecting we believe the improving prospects in China. Commodity prices have been range bound over the past year due to the uncertain global economic outlook. The acceleration of growth in China will likely cause commodity prices to breakout out of this range in the next few months. An additional catalyst for stronger commodities is the seasonality around the Chinese New Year.

Prior to China's emergence as an economic power in the past ten years, seasonality of the commodity sector centred around the inventory cycle of the developed economies. This resulted in a seasonal low in August and strong performance into the seasonal peak in March. As China's economy expanded the seasonal demand pattern for commodities became more influenced by the ebbs and flows of the Chinese economy. The seasonal trends in the

JOC-ECRI INDUSTRIAL PRICE INDEX



Source TD Securities

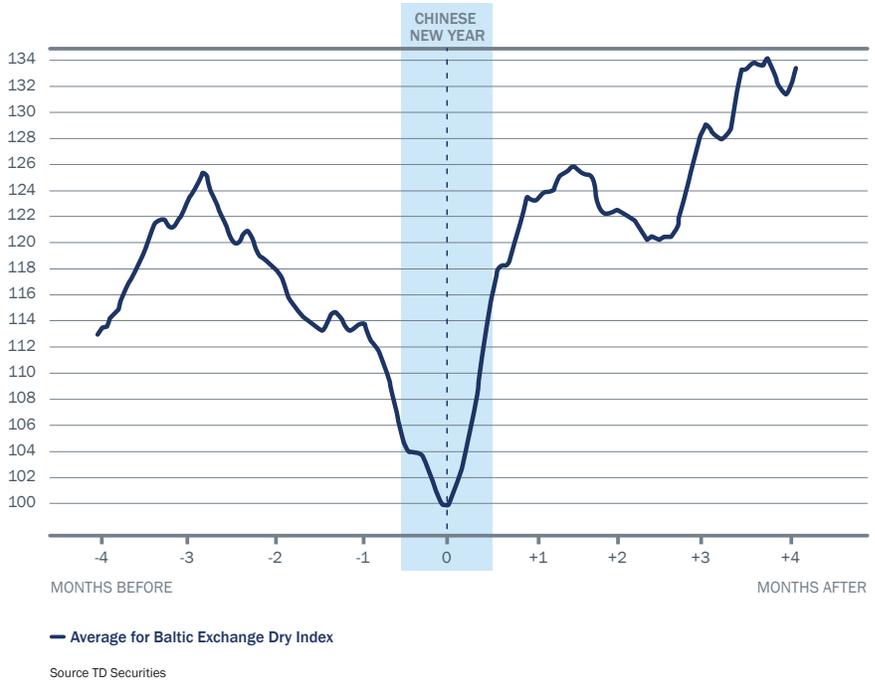
CHINA - THE KEY TO THE COMMODITY OUTLOOK - PART II (CONTINUED)

Chinese economy are greatly influenced by the Chinese New Year which occurs in February. Typically, three to four months prior to the Chinese New Year represents a period of economic weakness while four months after the New Year shows a pronounced strengthening of Chinese economic activity. This is illustrated in the accompanying chart which shows the twelve year average performance of the Baltic Dry Index, a measure of the volume shipments of worldwide bulk commodities four months before and four months after the Chinese New Year. Therefore, the resource sector typically has a stronger period of performance between January and the May-June time frame.

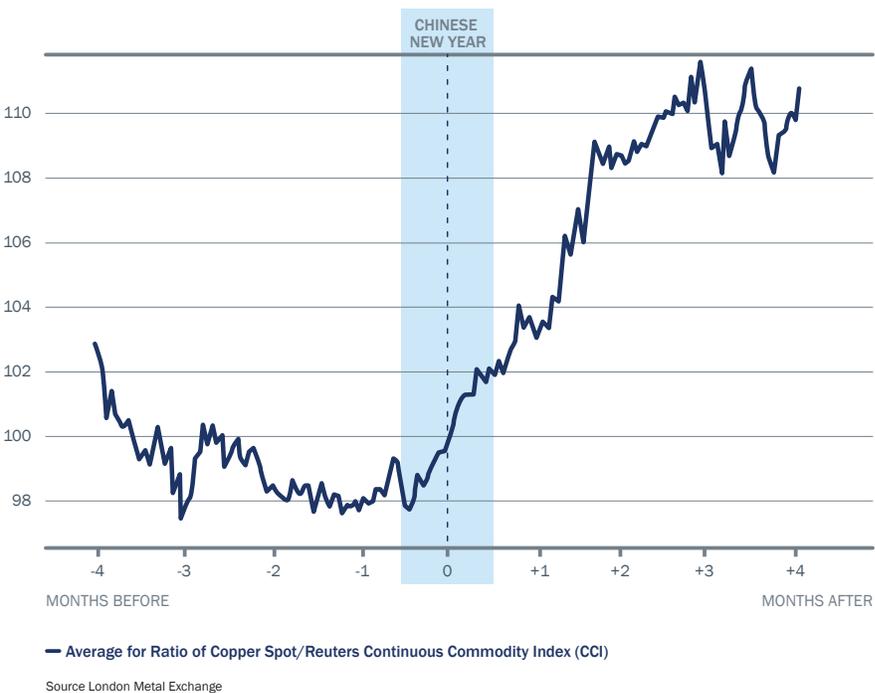
This seasonal pattern has a pronounced impact on individual commodity prices as illustrated on the accompanying chart of Copper price before and after the Chinese new year. Base Metals and Oil prices in particular are significantly impacted by Chinese seasonality. This is why we have been putting and increased emphasis on Base Metals and Oil in our portfolios. We have been reducing our exposure to gold shares as the gold sector seasonality is typically weak between January and June.

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BALTIC EXCHANGE DRY INDEX AROUND CHINESE NEW YEAR 2001-2012



RELATIVE STRENGTH OF COPPER AROUND CHINESE NEW YEAR 2001-2012



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We expect the seasonal weakness for the gold sector to be somewhat muted this year due to the extremely good fundamental value gold stocks are trading at due to the significant decline in share prices compared to the relatively stable Gold price. As can be seen in the attached chart Gold stocks are trading at valuations not seen since the bull market began in 2001. ■■■

GOLD MINER VALUATIONS – ENTERPRISE VALUE/EBITDA



Source Commodity Systems Inc. (CSI), www.csidata.com; Compustat; S&P Capital IQ Compustat

## CANADA ZINC METALS (CZX.V) SIGNS OF LIFE AT CARDIAC CREEK

BY **BARBARA THOMAE**, P.GEO., SENIOR MINING ANALYST

Canada Zinc Metals is setting the stage for underground development at its Cardiac Creek zinc, lead and silver deposit in the Ketchika Trough of northeastern British Columbia. With this year's resource estimate approaching 30 million tonnes, the Vancouver-based junior is planning to expand and boost the confidence of the inferred half of the resource through underground drilling ahead of prefeasibility work. Meanwhile the Company is coming up with encouraging signs in its efforts to find additional SEDEX-style deposits on its adjacent properties along the favourable Gunsteel trend.

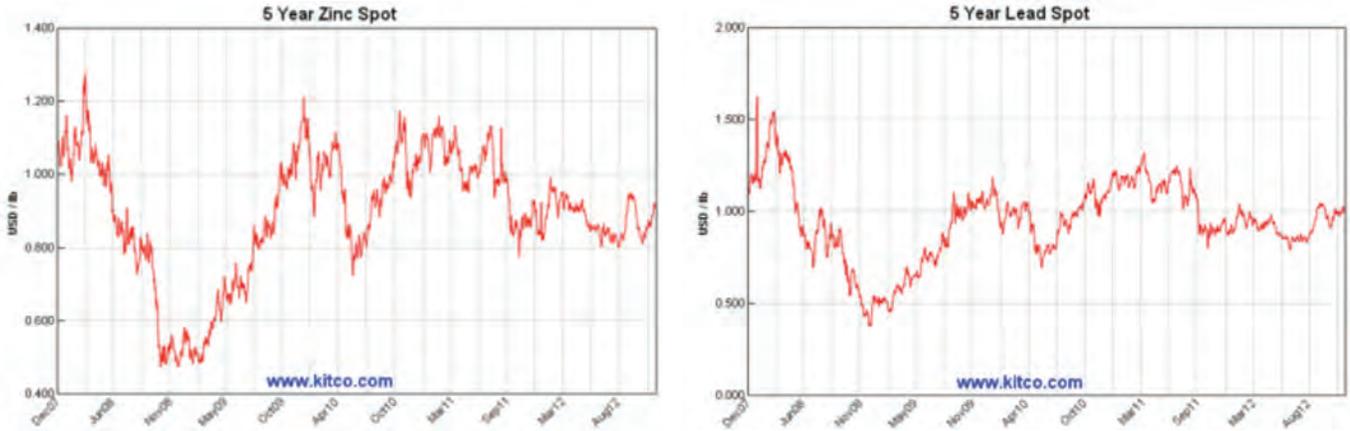
Zinc, which is used in the galvanizing of steel, and lead in batteries, appears to be gaining strength lately. With prices for these base metals near multi-year lows, the sector has taken a breather as a lack of financing meant development of new deposits is on hold and old mines are shut down as they run out of reserves. We believe that the resulting lack of production will result in higher prices as early as next year. Silver prices have nearly doubled over the past few years.

Canada Zinc is headed by Peeyush Varshney of Varshney Capital, who leaves the exploration department under the direction of his VP Exploration, Ken MacDonald, P.Geo. Mr. MacDonald has worked on a wide range of exploration projects during his career as a geological consultant. His experience includes a stint with the B.C. Ministry of Mines as a permitting official which has proven helpful in his current role of smoothing the permitting process for Canada Zinc's planned underground work and in their negotiations with native groups. The Company has an interim agreement with the Tsay Keh Dene and Kwadacha communities towards reaching a formal agreement beneficial to the stakeholders.



Source: Stockwatch

CANADA ZINC METALS – SIGNS OF LIFE AT CARDIAC CREEK (CONTINUED)

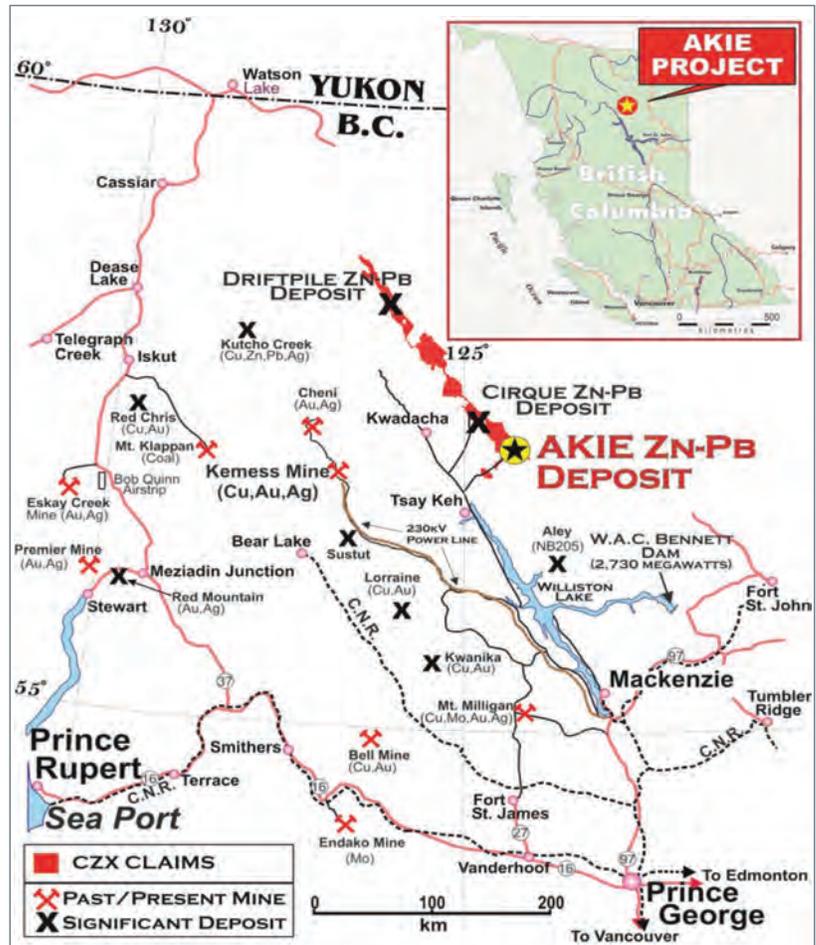


The Company holds a 100% interest in the advanced stage 125-square km Akie property located some 260 km northwest of Mackenzie (Figure 1) where it ties into paved highway and rail access.

Canada Zinc also holds 777 sq. km of land covering some 140 km of the strike projection of the Gunsteel Shale Formation — which hosts its Cardiac Creek deposit and the nearby Cirque deposit are operated under a joint venture between Teck Resources and Korea Zinc. The Cirque deposits, formerly known as Stronsay, situated some 20 km northwest of Akie, contain over 50 million tonnes of 10% zinc+ lead.

Drilling on the Akie property by Inmet Mining from 1994 to 1996 and by Canada Zinc Metals since 2005 has focused on the Cardiac Creek deposit which occurs within the Gunsteel Formation. The updated estimate released this spring comprises an indicated resource of 12.731million tonnes grading 8.38% zinc,

FIGURE 1



Source Company Files

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## CANADA ZINC METALS – SIGNS OF LIFE AT CARDIAC CREEK (CONTINUED)

1.68% lead, and 13.7 grams silver per tonne at a cut-off of 5% zinc; and an inferred resource of 16.28 million tonnes of 7.38% zinc, 1.34% lead and 11.6 grams silver at the same cutoff. (Table 1)

TABLE 1: RESOURCE ESTIMATE

CUT-OFF GRADE (Zn%)	kTONNES	Zn (%)	Pb (%)	Ag (gpt)	Combined Zn + Pb (%)
INDICATED					
2	20,088	6.59	1.31	11.2	7.90
3	17,683	7.15	1.43	12.0	8.58
4	15,195	7.75	1.56	12.8	9.31
<b>5</b>	<b>12,731</b>	<b>8.38</b>	<b>1.68</b>	<b>13.7</b>	<b>10.06</b>
6	10,342	9.05	1.81	14.6	10.86
7	7,798	9.89	1.98	15.6	11.87
INFERRED					
2	48,102	4.62	0.83	8.1	5.63
3	33,016	5.61	1.02	9.4	6.63
4	23,278	6.50	1.19	10.5	7.69
<b>5</b>	<b>16,287</b>	<b>7.38</b>	<b>1.34</b>	<b>11.6</b>	<b>8.72</b>
6	11,026	8.28	1.50	12.5	9.78
7	7,092	9.29	1.67	13.7	10.96

Source: N143-101 report

(1) "Base case" cut-off grade of 5% Zn highlighted in table

(2) Mineral resources are not mineral reserves as the economic viability has not been demonstrated

This accounts for 2.4 billion pounds of zinc, 472 million pounds of lead and 5.6 million ounces of silver in the indicated category plus 2.6 billion pounds of zinc, 482 million pounds of lead and 6.1 million ounces of silver in the inferred in-situ.

But the Company's drilling showed additional wide and higher grade intercepts and the potential to expand the resource further by driving a 1.6 km decline into the deposit from the north side of Cardiac Creek.

A recent airborne vertical time domain EM (VTEM) survey covers Canada Zinc's three properties, including the Cardiac Creek deposit, is at the interpretive stage. However, preliminary data shows the Gunsteel formation shale as well as the associated hanging wall and footwall siltstone have a characteristic signature. From this, the Gunsteel Formation appears to cross the central Pie property where most of the historical drilling was done and points to a newly interpreted Gunsteel shale in the West Pie target area. Hydro-geochemical sampling has outlined areas of anomalous sulphate at Central and West Pie, as well as Mt. Alcock. Interestingly, areas underlain by the previously considered as non-prospective are also high in sulphate, warranting follow up.

Canada Zinc has kept a relatively low profile against a backdrop of decreasing demand for zinc and lead in world markets since the financial crisis of 2008. The Company managed to keep share dilution to a minimum by arranging equity positions for Tongling Nonferrous Metals Group which holds 35% and more recently the Lundin Group with a 5% stake.

Canada Zinc has just under 143 million shares outstanding and a market capitalization of \$48.6 million. Having just completed a \$3 million financing, the Company has some \$15 million in working capital. The current market capitalization makes Canada Zinc

CANADA ZINC METALS – SIGNS OF LIFE AT CARDIAC CREEK (CONTINUED)

look undervalued when considering this would reflect about 1% of the insitu value of the metals in the ground.

Teck Resources, operator of the largest zinc mine in the world, has reportedly been kicking the tires at Akie, as it works toward developing a strategy for its nearby Cirque deposits. Xstrata has also been kicking the tires and the Lundin Group is an important zinc miner on the world stage.

The Company has purchased back its own shares lately which is a strong vote of confidence in its projects. According to Varshney Canada Zinc is considering a spin-out of its regional exploration properties down the road.

We believe this is a good opportunity to invest in Canada Zinc ahead of a busy season that should see an increase in the underground resource at Cardiac Creek. We agree that the regional prospectivity for additional SEDEX deposits is heightened by the recent geophysical data and there is plenty of upside from drilling success. The proximity of both the Cirque and Driftpile deposits held by Teck and the Cardiac Creek deposit could be of strategic importance and perhaps a take-over target for the major ahead of development on its own properties. ■■■

FIGURE 2

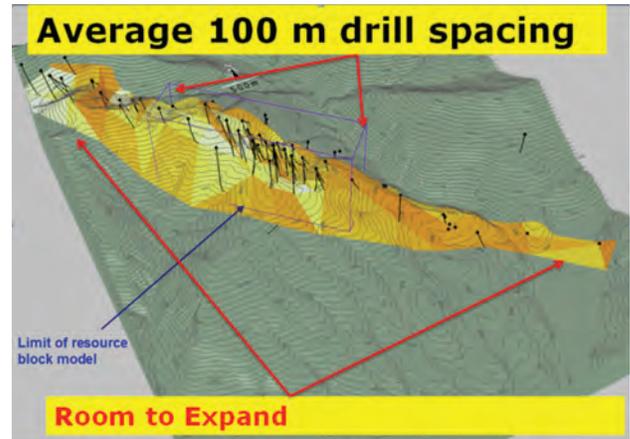
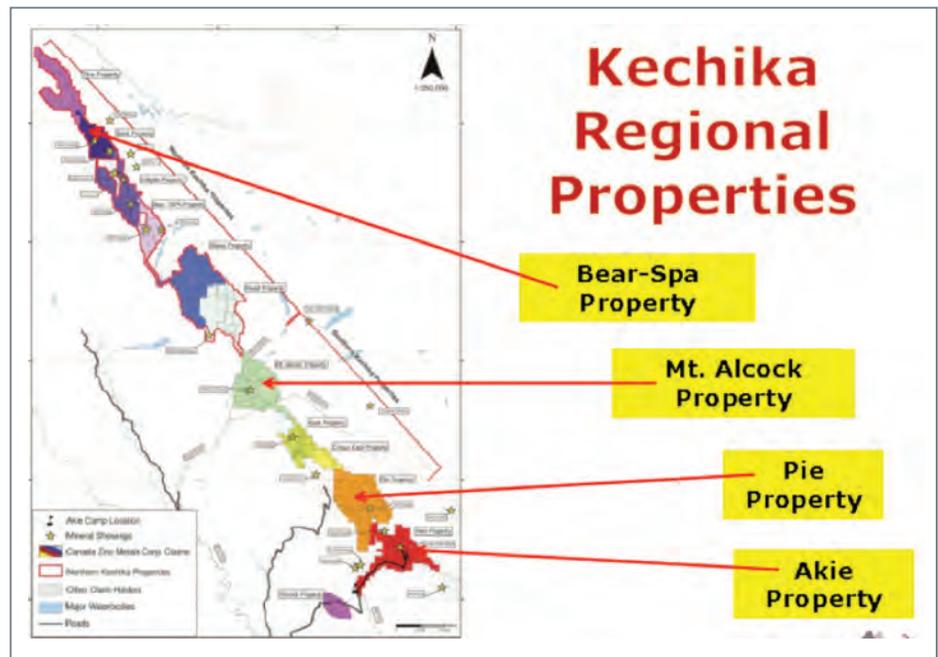


FIGURE 3



Source: Company files

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