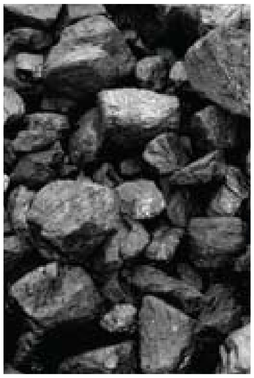


Commodities 2011 Halftime Report

Although it's been a lackluster first half, rising demand and restricted supply should drive growth for certain commodities. Read to see which of the resources we believe will have the biggest gains.

U.S. Global Investors

Commodities don't all perform in the same way.

In any given year, a particular commodity will go gangbusters and outperform the group. Usually that commodity will come back to Earth and underperform over the next year or so. This is why active management is important when investing in commodities. Active managers can benefit by rotating from winners to laggards or by investing in the companies which produce, farm or mine commodities most effectively.

Periodic Table of Commodity Returns

Performance

2002	2003	2004	2005	2006	2007	2008	2009	2010	1st Half 2011
86.34% Natural Gas	133.07% Ni	67.57% Coal	82.55% Natural Gas	154.45% Ni	93.02% Coal	5.77% Au	153.14% Cu	96.60% Pd	12.10% Ag
57.26% Crude Oil	75.44% Pb	42.80% Pb	50.79% Zn	126.16% Zn	76.65% Wheat	-10.65% Corn	152.37% Pb	83.21% Ag	11.95% Coal
25.63% Pt	51.11% Cu	41.30% Cu	40.48% Crude Oil	80.88% Corn	57.22% Crude Oil	-23.01% Ag	129.36% Zn	51.75% Corn	5.60% Au
24.77% Au	35.61% Pt	33.61% Crude Oil	39.79% Cu	61.36% Pb	42.65% Pb	-24.70% Coal	118.07% Pd	46.68% Wheat	3.83% Crude Oil
21.46% Ni	34.55% Coal	25.99% Zn	36.46% Pd	47.68% Wheat	34.33% Pt	-24.87% Natural Gas	77.94% Crude Oil	31.47% Ni	2.16% Pb
12.80% Corn	34.49% Zn	23.52% Al	29.20% Ag	46.40% Ag	30.98% Au	-30.99% Wheat	58.95% Ni	31.39% Coal	1.73% Al
12.46% Wheat	29.23% Natural Gas	14.86% Ag	17.92% Au	37.20% Cu	18.80% Natural Gas	-36.06% Al	56.82% Pt	29.96% Cu	0.00% Corn
5.06% Cu	24.27% Ag	5.90% Pt	16.19% Al	31.24% Pd	16.72% Corn	-38.76% Pt	48.16% Ag	29.52% Au	-0.64% Natural Gas
3.46% Ag	19.37% Au	5.54% Au	12.65% Pt	24.15% Al	14.65% Ag	-49.29% Pd	45.71% Al	20.79% Pt	-2.69% Pt
0.53% Al	17.98% Al	-0.65% Natural Gas	10.33% Wheat	23.15% Au	10.40% Pd	-51.07% Zn	24.36% Au	15.17% Crude Oil	-3.50% Cu
-2.35% Zn	16.00% Wheat	-3.62% Pd	5.37% Corn	17.05% Pt	6.14% Cu	-53.53% Crude Oil	1.84% Corn	11.29% Al	-5.27% Pd
-12.70% Coal	4.35% Corn	-10.29% Ni	4.17% Pb	0.02% Crude Oil	-16.70% Al	-55.37% Ni	-0.89% Natural Gas	5.16% Pb	-6.15% Zn
-16.37% Pb	4.23% Crude Oil	-16.77% Corn	-7.26% Coal	-25.22% Coal	-23.56% Ni	-56.53% Cu	-11.34% Wheat	-5.15% Zn	-6.72% Ni
-45.91% Pd	-18.70% Pd	-18.44% Wheat	-10.12% Ni	-43.88% Natural Gas	-47.13% Zn	-62.52% Pb	-13.36% Coal	-21.18% Natural Gas	-26.38% Wheat

Key

Al	Aluminum
	Coal
Cu	Copper
	Corn
	Crude Oil
Au	Gold
Pb	Lead
	Natural Gas
Ni	Nickel
Pd	Palladium
Pt	Platinum
Ag	Silver
Zn	Zinc
	Wheat

Source: Bloomberg and U.S. Global Research. Returns are based on historical spot prices or futures prices. Past performance is no guarantee of future results.

After two straight years of tremendous gains for many commodities, the first six months of 2011 haven't been as kind. As of the end of June, only two commodities (silver and coal) saw double-digit increases, and only six of the 14 commodities we track—less than half—were in positive territory.

Silver was the leader, rising more than 12 percent, followed closely by coal (up 11.95 percent). Other commodities increasing in value included gold (5.6 percent), crude oil (3.83 percent), lead (2.16 percent) and aluminum (1.73 percent).

Silver

Silver got ahead of itself earlier this year, climbing 58 percent to nearly $50 an ounce. This skyrocketing price registered a four standard deviation move, representing extreme territory on our models. Thinking silver, which has historically been a narrowly-traded market, had become a potential haven for speculators, officials stepped in and raised margin requirements on the Comex. This quickly deflated the bubble and prices naturally reverted back toward the mean but remain well above where they began the year.

Coal

Strong demand from reconstruction projects in Japan along with reduced supply because of flooding in Australia, Indonesia, South Africa and Colombia led coal to be the second-best performer.

No country was more affected by the lower supply than China as coal powers the Chinese economy. The country is the world's largest consumer, gobbling half of the world's coal. Coal accounted for 71 percent of China's energy in 2008—more than three times the United States' share. The Electricity Council estimates that China's coal demand will reach 1.92 billion tons in 2011, up nearly 10 percent from 2010. Chinese electricity use was up 13.4 percent on a year-over-year basis in May and is now expected to rise 12 percent this year.

Gold

Gold prices passed $1,500 for the first time ever in mid-April of this year and ended the quarter just slightly below that mark as a mixture of the Fear Trade and Love Trade proved to be an enticing concoction for investors here and abroad. The World Gold Council reported that demand for gold as an investment was up 26 percent on a year-over-year basis during the first quarter. In China, demand for gold was so strong it outpaced the combined gold demand of the U.S., France, Germany, Italy, Switzerland, the U.K. and other European countries.

Although gold prices held steady during the first half of the year, the share prices of gold companies have lagged. Yet many gold companies' corporate cash flows and earnings per share have been rising, and more companies are paying dividends. Gold stocks also appear cheap compared to the price of gold. We believe investors will be drawn to these qualities, lifting gold stocks along with the strong bullion price.

Oil

After two straight years of solid gains, oil prices finally surpassed the $100 per barrel mark once again early in 2011. This time, it was a dose of geopolitical risk and a natural disaster that sent oil prices shooting upward. In the first half, that range held up despite U.S. consumers cringing at higher gasoline prices, the International Energy Agency (IEA) releasing an additional 60 million barrels of oil to the market and China's ardent attempts to cool its economic growth.

Despite tightening measures, China's per capita oil consumption has retained its upward trajectory and is headed toward levels similar to Taiwan and South Korea. There's still quite a gap to close before that happens, but China's oil consumption per capita has increased over 350 percent since the early 1980s to an estimated 2.7 billion barrels per year in 2011. Nearly 100 percent of that has taken place in the past decade. In addition, oil consumption per capita has risen sharply in recent decades in other Asian countries such as Malaysia (nearly quadrupled) and Thailand (doubled).

How Will Commodities Perform in the Second Half of 2011?

We expect commodities will fare better during the second half of the year. In a July report, Goldman Sachs wrote that it expects global economic growth to be "generally supportive of rising commodity demand" and "this demand growth will be sufficient to tighten key commodity markets over the next six to 12 months." Some of the commodities which could see the biggest gains are gold, oil and copper.

Gold May Be Headed Higher

As BCA Research puts it, "[gold] prices have benefited from a 'perfect storm' of falling real interest rates, a weak dollar, fears of a double-dip U.S. recession and/or debt default, and European stress." Those factors, which we call the Fear Trade, are what sent gold prices skyrocketing. There was also the release of Federal Reserve meeting minutes that showed a third round of quantitative easing is possible, though not yet probable given Chairman Bernanke's testimony. By the way, if you haven't already seen Bernanke's exchange with Congressman Ron Paul on gold during a July hearing, go to YouTube and check it out for a good chuckle. Washington's reluctance to present a solution to the debt ceiling issue also contributed heavily to gold's performance.

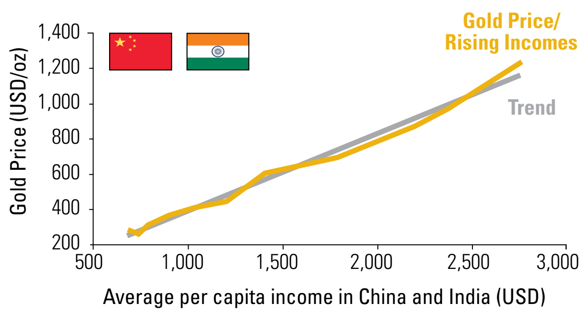
Gold could get even more attractive as we head into the fall and winter gift-giving season.

Paul was bringing attention to the threat of currency debasement, a major reason investors all over the world are turning to gold as a safe haven. According to U.K. research firm Capital Daily, the U.S. monetary base has increased more than 200 percent since September 2008. Meanwhile, gold prices have risen only about 70 percent over the same time period. Capital Daily says "if the two had been directly related, gold should already have risen to around $2,800 [an ounce]." That's obviously a lofty expectation but illustrates that gold prices haven't appreciated nearly as much as currencies, such as the U.S. dollar, have been debased.

In fact, don't believe what you read about record high gold prices. Yes, gold hit a high in nominal terms, but in July the price is more than 30 percent below the 1980 peak of $2,400 an ounce if you adjust for inflation.

Although the Fear Trade drove prices over the first half of the year, don't discount the Love Trade. Gold could get even more attractive as we head into the fall and winter gift-giving season. This is the time of year when gold jewelers typically do their biggest business. The kickoff is the Muslim holy month of Ramadan, which starts in August and ends with generous gift-giving at the end of the month.

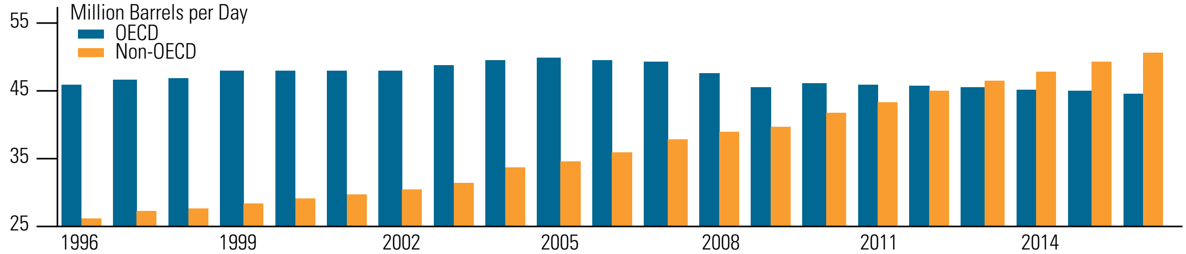
Strong Correlation Between Rising Incomes and Gold from 2000 to 2010



Source: Bloomberg, Standard Chartered Research

Developing-World Oil Demand Steadily Rising

OECD vs. non-OECD Oil Demand



Source: IEA

Developing-country oil demand has dramatically increased since the mid-1990s. Developed-world demand has decreased.

The key to this seasonal strength over the past few years has been demand from China and India. You can see from the chart on the previous page that the rise in gold prices has been closely tied to the rise in gold demand from China and India. Back when the average per capita income in China and India was well below $1,000 a year, gold prices hovered just above $200 an ounce. As average incomes have approached $3,000 a year over the past decade, gold prices have followed. With the long-term outlook for wages in both these economies rather rosy, gold demand should continue to feel the trickle-down effect.

Those investors looking for more of a technical indicator can take a look at the ratio of gold and oil. Capital Daily says that the ratio of the price for one ounce of gold to one barrel of oil (Brent crude) is currently 13.5. Since 1970, the average has been around 16. Gold prices would need to rise to $1,870 an ounce in order to reach historical ratio levels with $117 per barrel Brent crude oil, according to Capital Daily.

Based on seasonal demand strength and sovereign debt fears of the U.S. and several European countries, we think gold prices could be headed higher.

Oil Outlook Remains Strong

It's been an eventful year for the oil patch. Natural disasters, revolutions, terrorist attacks and political maneuvering kept oil bouncing around $100 per barrel and 3.8 percent higher on the year at the end of June. Despite the volatility and large number of external forces affecting oil prices, the IEA said in its most recent Oil Market Report that "the bull run evident since autumn 2010 therefore looks in large part to be justified by supply and demand fundamentals."

Oil Demand

Oil industry analyst PIRA estimates incremental demand will outpace supply by 1.1 million barrels per day on a year-over-year basis during the third quarter of 2011. The U.S. Energy Information Administration (EIA) says long-term supply and demand drivers indicate the market will remain tight for the foreseeable future as growing demand from emerging economies for liquid fuels and slowing non-OPEC supply growth "maintain upward pressure on oil prices." The IEA forecasts oil prices to average $98 per barrel this year and $103 per barrel in 2012.

The IEA forecasts the world will use 91 million barrels of oil per day in 2012, an increase of 1.5 million barrels per day. The IEA also revised its 2011 oil demand projections upward by 0.2 million barrels per day. Projecting outward to 2016, the IEA's baseline scenario assumes a healthy 4.5 percent global GDP growth and an average oil price of $103 per barrel. With these assumptions, annual oil demand growth should average 1.2 millions barrels per day through 2016.

Emerging markets are almost entirely the source of this increased demand, with China accounting for 41 percent of demand growth over that time period, the IEA forecast says. The chart above illustrates how developing-country (non-OECD) oil demand has dramatically increased since the mid-1990s while developed-world (OECD) demand has decreased. Through two financial bubbles and a global financial crisis, non-OECD demand has stair-stepped its way to nearly doubling in less than 20 years.

How is this possible? Many non-OECD markets have favorable demographics, rapidly urbanizing populations and industrializing economies that have returned many developing economies' GDP growth rates to pre-crisis levels.

Rising incomes have also outpaced rising oil prices and sustained emerging market demand despite a general reduction in subsidies, the IEA says. Rising wealth has also established a new global middle class that the World Bank estimates will be more than 1 billion strong by 2030. In fact, the World Bank was cited in a *National Geographic* article earlier this year forecasting that for the first time ever, more people in the world will be classified as middle class than poor in 2022. Today, roughly 70 percent of the world's population is classified as poor.

Major emerging market countries, such as China, India and Saudi Arabia, have reached the important GDP per capita range ($3,000-$20,000) where oil demand historically "takes-off."

China carries the biggest stick among emerging markets when it comes to oil demand. Strict tightening measures from Beijing and rising inflation slowed the country's oil demand growth to its lowest level since 2009 in June. However, China's oil demand is still expected to grow 7 percent this year, which is in line with the country's five-year average demand growth rate, according to Deutsche Bank. The summer months have historically been weak periods for oil demand in China but Deutsche Bank estimates growth rates will recover during the fourth quarter.

Chinese auto sales growth has slowed but still registered 10.9 percent year-over-year growth in June. In an interview with Maria Bartiromo for *USA Today*, Ford CEO Alan Mulally called China's car market a "very exciting development." The company is projecting China's auto sales will reach 32 million by 2020—28 percent of the entire global market. Ford isn't the only U.S. auto manufacturer tapping into China's booming auto market; General Motors' Buick brand is one of the most popular in the country. According to the Brookings Institute, General Motors sold 10 cars in the U.S. for every one car sold in China in 2004. Today, that figure is nearly 1-to-1.

In the developed world, the outlook for oil demand is less bullish. OPEC says the "austerity measures, combined with high levels of both debt and unemployment, are likely to dent the fragile recovery in major OECD countries."

While demand growth in OECD countries is underwhelming, consumption rates have recovered from recession lows at a much faster rate than many expected. In the chart below, you can see that OECD demand contributed heavily to the recovery in global oil demand from early 2009 to late 2010. In fact, the developed world contributes little to global oil demand growth but still consumes more than half of the world's total demand.

Despite China's rise, OPEC says the fate of the U.S. economy is the most influencing factor for oil over the next 12 months. Oil demand in the U.S. was revised upward in May and the U.S. economy is forecasted to see 2.5 percent GDP growth in 2011.

A big determinant of U.S. demand and consumer spending is gasoline prices, which the EIA forecasts to average $3.56 a gallon in 2011—up from $2.78 in 2010. U.S. consumers have already shown to be sensitive to higher prices with total motor gasoline consumption down more than 2 percent on a year-over-year basis during the second quarter. While OPEC expects U.S. gasoline consumption to return to normal rates, OPEC calls it oil's "wild card" for 2012. Gasoline consumption could be negatively impacted by economic turbulence, such as a dip in employment.

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Oil Supply

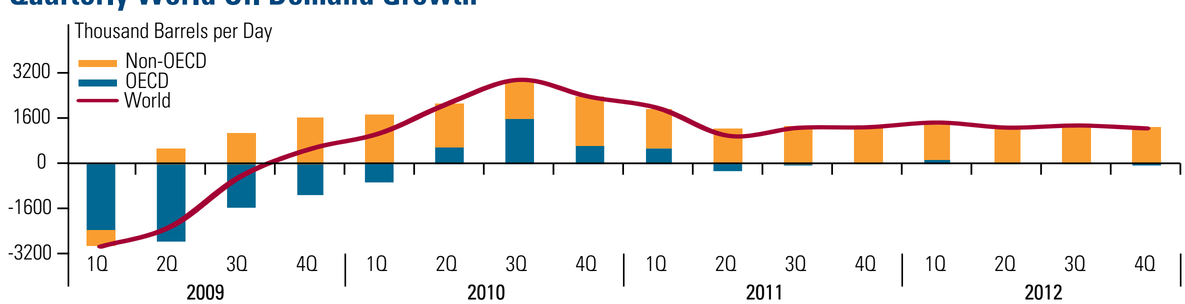
Oil production was rocked by several unexpected outages during the first half of 2011. The revolution in Libya, political divisions in Iraq, terrorist pipeline attacks in Nigeria, accelerating drug violence in Mexico and instability in Yemen have all negatively impacted oil production. PIRA puts the total loss of non-OPEC production at 74 million barrels. This is more than the entire amount of production losses in 2010, as the chart on the next page shows.

Supply in the second half could also be affected by various factors such as hurricanes, maintenance issues and decline rates. The EIA is projecting non-OPEC crude production to increase by 540,000 barrels per day in 2011 and 740,000 barrels per day in 2012.

The IEA sees global production increasing by a little more than 1 million barrels per day annually until 2016. This is a result of increased capital expenditure, which has positively impacted existing assets and accelerated new projects, the IEA says. High oil prices are generating new supply, but non-OPEC growth is coming from higher cost areas, such as tar sands. Countries such as Colombia, China, Canada and the U.S. are expected to see the biggest gains.

OPEC production is expected to decline by roughly 300,000 barrels a day in 2011 and the EIA projects OPEC spare capacity to fall by 12.5 percent this year from 2010 and then another 11 percent in 2012.

Quarterly World Oil Demand Growth

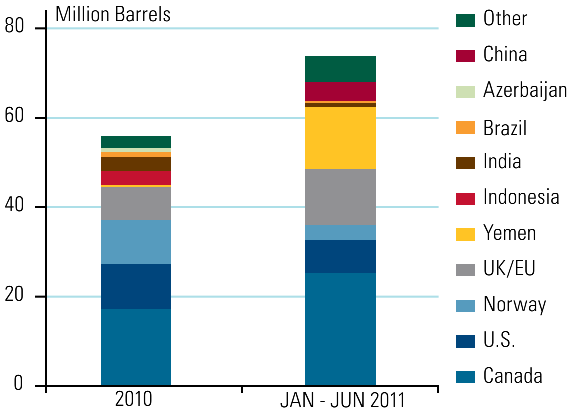


Source: OPEC

Non-OECD demand contributed heavily to the recovery in global oil demand growth.

Oil production was rocked by several unexpected outages over the first half of 2011.

Rise in Non-OPEC Supply Disruptions in 2011



Source: PIRA

A Different Kind of Bull Market for Oil

During the oil shocks of the 1970s, prices skyrocketed and Americans waited in long lines to fill their cars with gas. Today's prices might conjure up some of those memories but we're living in a different kind of bull market today. BCA Research says there are a few key reasons today's bull market for oil is much different than the embargo-driven bull run from 1973-1980:

- Non-OPEC supply jumped from 27 to 41 million barrels per day in response to the embargo. Today, non-OPEC countries don't have the ability to ramp up production like that. Even if they did, BCA says it wouldn't be enough to keep pace with rising demand from developing countries.

- OECD countries drove global oil consumption in the 1980s, accounting for 70 percent of total demand. Today, that figure has dropped to 50 percent as the demand growth has shifted to emerging markets. Developing countries are less susceptible to higher prices because of subsidies, making similar demand destruction unlikely, BCA says.

- Global spare capacity has vanished so much that almost any oil-producing country, not just top producers such as Saudi Arabia and Russia, can cause a price spike by withholding access to its resources, BCA says.

Today's oil market is much different than what we experienced back in the 1970s. Back then, countries such as China, India and Russia had no global footprint; they were isolationists. Russia was tucked away behind the Iron Curtain. Today these countries are building their economies and squeezing the existing supply of the world's resources, including oil.

These factors indicate that growth in global oil demand will likely outpace increases in production capacity and create a "tighter market" than what the IEA expected back in 2010. As the IEA sums it up, "[the] market will ultimately adjust to higher prices, albeit supply and demand remain unresponsive in the short term. Indeed, oil's price inelasticity underpins the recent extended upward price shift in the face of resilient non-OECD demand growth and perennial supply-side risks."

The Cues for Copper

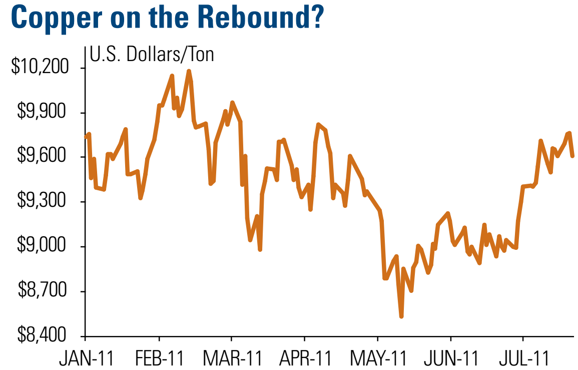
Copper slightly disappointed investors, ending the first half of the year with a decline of 3.50 percent. Worries about global inflation and, more specifically, the potential slowing of China's economy weighed on copper's price. The red metal rose 5 percent quickly in the new year, but similar to zinc, lead, palladium and platinum prices, declined sharply at the beginning of May.

Through the start of July, copper has been slowly inching its way up. Part of this rise is due to reduced supply issues. Chile, the world's largest copper producer, has been plagued by power outages, strikes, accidents and heavy rains. Reuters recently reported that a "once in a half century winter storm" caused more than 12 mines to slow or stop operations after the open pit roads became too slippery in the South American country that mines about one-fifth of the world's copper.

The election of Ollanta Humala in Peru—the second-largest producer of copper—has also been a drag on copper prices as investors debate the probability of Humala electing a mining-friendly cabinet. Investors have worried the president-elect could retract policies that encourage mining-investment.

In mid-July it was announced that Humala will appoint Luis Miguel Castilla, Peru's former deputy finance minister, as the new finance minister. Carlos Herrera will lead the mines and energy ministry. However, according to the *Financial Times*, it is still not clear whether Humala will increase the corporate tax rate paid by miners and enforce tighter state controls. The actions of this leader will have an influence on the direction of copper prices for the remainder of the year.

Copper on the Rebound?



Source: Bloomberg

In terms of demand, copper is a necessary ingredient for numerous building projects. Electrical power cables, electrical equipment, automobile radiators, cooling and refrigeration tubing, heat exchangers and water pipes all require copper. With all the construction and infrastructure building in China over the past several years, it's not surprising that this country is the No. 1 world consumer of copper. It's estimated that China accounted for nearly 40 percent of global copper consumption last year.

Because of this large demand, similar to our outlook for oil, copper prices hinge on China's ongoing development. While some have begun to wonder about the health of the country's continuing growth and development, Macquarie Research believes that "real demand in the country remains robust."

Take developer activity, for example, which Macquarie says has been a huge driver of construction growth in 2011. The media has focused its attention on ghost cities and lagging sales of property in China. Yet Macquarie thinks it's important to consider the property sales across all different sizes of cities. In its Commodities Comment, subtitled "Chinese social house—another reason to buy copper and iron ore," Macquarie acknowledges a weakness in property transactions in China's larger cities. This was due to the government restricting investment demand to slow growth. However, these larger cities only account for 20 percent of the total market, says Macquarie.

Conversely, many smaller cities, such as Anquing, Guizhou, Luzhou, Mudanjiang and Shijiazhuang, have had double-digit year-over-year growth in unit sales so far this year. In the case of Hohhot, the capital city of Inner Mongolia, sales growth has tripled. Government investment has led to urban space increasing from 80 square kilometers in 2000 to 150 square kilometers last year, according to the city's government website.

Hohhot, which means "green city" in Mongolian, has grown to more than 2 million people and has become a hub for agriculture and manufacturing.

Most importantly, Macquarie says the tremendous sales activity in these smaller cities indicates "there has been enough cash to keep construction activity going."

In addition, China's social housing project should drive incremental demand for copper. Macquarie indicated that China is "aiming for 10 million social housing units, up from 5.8 million in 2010." The country has built only 3.4 million units so far this year, but based on China's habit of exceeding its objectives, Macquarie thinks the target will be met.

Even if the naysayers think China's growth will slow because of the government's monetary policy restrictions, there's consensus among research experts that the country's inventory of copper is getting low. Goldman Sachs' discussion of the copper market indicated that in the second half of 2011, the "winding down of destocking will lead to a stronger Chinese pull on global supply." China seems to have no choice but to go back to the market for copper, if only to replenish its supply.

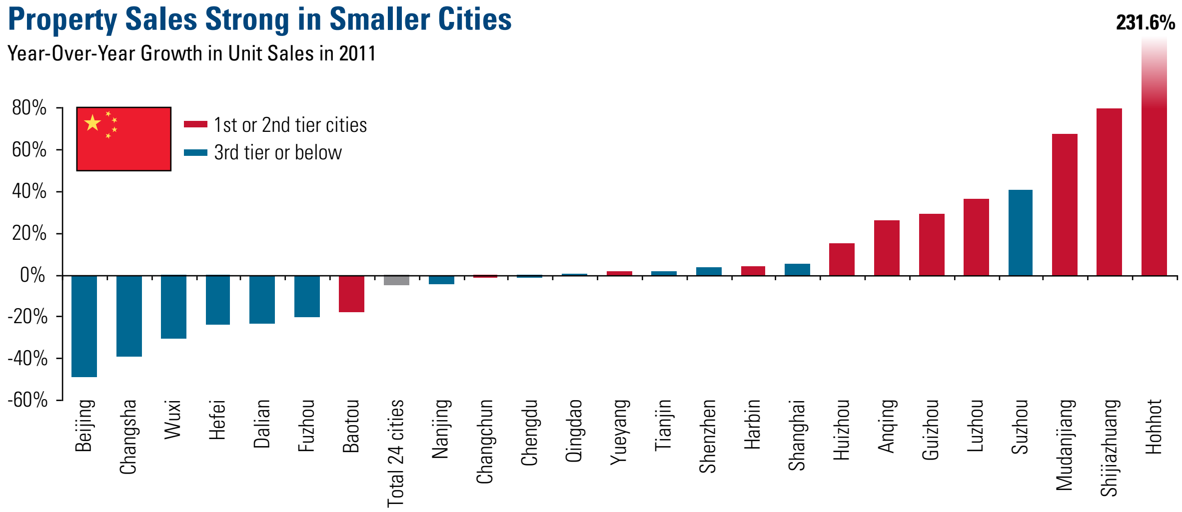
Tom Kendall, Credit Suisse's vice president for commodities research, agrees. In a Mineweb interview on copper's fundamentals and expectations of further growth, Kendall stated he has seen a "very sizeable drawdown" in Chinese copper inventories this year. He goes on to say, "some point in time, they will get to a point at which they have run down inventory levels to an uncomfortably low level and then there is no alternative to coming back to the international market."

During the second half of the year, our investment team will monitor the volatility inherent in commodities while incorporating the above macro ideas into our statistical models to identify stocks with superior growth and value metrics that we believe could benefit the most.

China seems to have no choice but to go back to the market for copper, if only to replenish its supply.

Property Sales Strong in Smaller Cities

Year-Over-Year Growth in Unit Sales in 2011



Source: CEIC, Macquarie Research

Macquarie says the tremendous sales activity in these smaller cities indicates "there has been enough cash to keep construction activity going."







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