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Investing in Liquid Gold

Investment Update

A. Second Quarter Action

The second quarter of 2013 will go down in history for a number of reasons. First, the drop in the price of gold, on a percentage basis, during the quarter, was the largest on record since the early 1920's. Second, during the second and third week in June we witnessed the largest back up in interest rates in over 50 years. Third, collectively the US Federal Reserve and the Central Bank of Japan were printing money at the rate of USD\$160 billion per month. This doesn't include other generous central banks. Lastly, the China miracle began to show major cracks, as a liquidity crisis swept through their indebted and overleveraged banking system. These four items ensure that the Third quarter of 2013, will be equally as exciting!

As we have stated many times, the best offensive is a good defense. We continue to play aggressive defense! Warren Buffet often quips that there are only two rules in investing. Rule number 1: don't loss your capital! Rule number 2: go back to rule number 1. These two rules remain the focus of our investing today. Outside of the precious metals sector, we have been able to protect and grow our clients money, despite a Toronto Stock Exchange, that is at the same level as it was 42 months ago, when we started ROCKLINC.

Although we cannot isolate you from market volatility and price swings we are working hard to ensure that we avoid permanent loss of capital by investing in strong long-term assets that should be able to prosper through the current economic challenges. We believe that a conservative and disciplined approach to asset accumulation is the best way to protect and grow your capital. Money buried in the ground is not the answer.

In the current environment we continue to focus on the quality of all our investments. As each of you are aware, we break your portfolios into three types of asset classes: cash, fixed income/preferred shares and equities. The ratios in your portfolios will vary based on your individual circumstances and market conditions.

(i) Cash - we continue to maintain higher than normal cash balances. The cash balances help to moderate volatility and allow us take advantage of opportunities as they arise. We expect that market volatility will remain with us for some time. Late in this quarter we were able to add to most of our client's portfolios by tapping into cash reserves.

(ii) Fixed Income & Preferred Shares - given extremely low interest rates we continue to invest in bonds with less than 4 years in duration. In fact, most of the bonds we own have durations of less than two years. We also restrict our bond purchases to entities with very strong balance sheets with valuable collateral.

(iii) Equities - the most important asset class that we invest in is equities. Ultimately, it is carefully selected equities that will grow your capital. When we evaluate the types of equities we want to own we are searching for assets that are characterized by scarcity, are essential assets, and have few substitutes. The main industries we continue to focus on are; technology, precious metals (gold and silver), agriculture, water, infrastructure, real estate, oil and gas, basic staples, and fee based financials.



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The famous value investor, Benjamin Graham, once stated that the stock market is a voting machine in the short-term but a weighing machine in the long-term. We continue to look for companies that weigh more than the current stock market scales indicate. Although this might not be apparent when you look at the book value of your precious metals investments and compare it to the current market value. We have more on that subject later in the newsletter.

B. Investing in Liquid Gold

Despite the challenges facing the global financial markets we believe that there are a number of sectors that provide our investors with strong long-term growth opportunities. One industry that is supported by excellent long-term growth dynamics is the global water industry. Throughout our accounts at ROCKLINC we have exposure to four firms operating in the water sector. The four companies are American Water Works Co., Ecolab Inc., Pentair Ltd, and Xylem Inc. For the purposes of this update we will highlight our two largest water positions, Ecolab and Xylem.

Ecolab Inc.

Ecolab is the global leader in water, hygiene and energy technologies and services that in conjunction with businesses around the world help to protect our water supply, keep our food safe, and help maintain healthy work environments for thousands of companies. Founded in 1923 and headquartered in St. Paul, Minn., Ecolab serves customers in more than 170 countries across North America, Europe, Asia Pacific, Latin America, the Middle East and Africa.

Their global workforce of 41,000 associates helps protect people and vital resources by delivering comprehensive solutions to meet the unique needs of customers in the food, energy, healthcare, hospitality and industrial markets. Ecolab's more than 23,000 sales-and-service associates comprise the industry's largest and best-trained direct "sales-and-service" force. Their product and service professionals are dedicated to assisting customers as they meet a full range of cleaning, sanitizing and water and energy management challenges.

The current market value of the company is approximately US\$24 billion. Since 2008, when the global economy entered into one of the worst recessions in 80 years, the company has grown its earnings and dividends per share at approximately 7% and 12% respectively. The company has also made key acquisitions, including Nalco, which many of our investors owned, while maintaining a normalized return on equity of over 20%. Bottom line: Ecolab is an exceptional business in an exceptional industry. You can check out Ecolab's website at: www.ecolab.com to learn more about the company and the amazing breadth of their products and services.

Xylem Inc.

The company is a leading global water technology provider. It enables, through the manufacturing of specialized equipment, its customers to transport, treat, test and efficiently use water in public utilities, residential and commercial buildings, and industrial and agricultural settings. In particular, the company is a global leader in the manufacturing of analytical instruments, water pumps, controllers and valves, and water and wastewater treatment equipment.

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The company does business in more than 150 countries through a number of market-leading product brands, and its people bring broad applications expertise with a strong focus on finding local solutions to the world's most challenging water problems. Launched in 2011 from the spinoff of the water-related businesses of ITT Corporation, Xylem is headquartered in White Plains, N.Y., with 2012 annual revenues of \$3.8 billion and 12,700 employees worldwide.

The company generates substantial free cash flow, pays a dividend of \$.47 per share (yield of approximately 2%), trades at a price/earning multiple of 15 and has significant long-term growth opportunities. Check out Xylem's website at: www.xylem.com to learn more about the company.

Rationale for Investing in Water Businesses

The best way to explain the rationale for investing in some of the globe's best water businesses is to consider some of the main global water facts. The bottom line is that there is an increasing shortage of clean fresh water for human use. Within the next decade, "trillions of dollars" must be spent to improve the world's water infrastructure network. Companies such as Ecolab and Xylem are well positioned to receive a piece of this growing expenditure. Think about the following sobering water facts.¹

1. Water Supply

- About 70 percent of the Earth's surface is water-covered.
- The oceans hold about 96.5 percent of all Earth's water.
- 96% of all of Earth's surface water is saltwater and must be desalinated for human use.
- 68.9% of the earth's fresh water exists in the form of glaciers and permanent snow cover.
- About 30.8% of the world's total freshwater supply is groundwater (this includes soil moisture, swamp water and permafrost) **whereas only about 0.3% of total global fresh water is stored in lakes and rivers.**
- Although there is a great deal of water only a small amount of the water is immediately available for our use without costly investments in technology and specialized equipment.

2. Water Demand

- Around 3,800 cubic kilometres of fresh water is withdrawn annually from the world's lakes, rivers and aquifers. This is twice the volume extracted 50 years ago.

¹ www.albertawater.com

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- Universal water metering has proven to reduce overall residential and ICI (Industrial-Commercial-Institutional) water consumption by 15-30%. Companies such as Xylem and Pentair manufacture valuable metering equipment.
- Asia has the greatest annual availability of fresh-water and Australia the lowest. But when population is taken into account the picture looks very different. By the mid-1990s, 80 countries home to 40% of world population encountered serious water shortages. Worst affected are Africa and the Middle East.
- In all regions except Europe and North America, agriculture is by far the biggest user of water, accounting worldwide for about 69% of all withdrawals. As the world's population grows the demand for water increases. The increasing complexity of our diet also requires greater use of water.

3. Scarcity

- Water scarcity affects one in three people on every continent of the globe.
- Almost one fifth of the world's population (about 1.2 billion people) live in areas where the water is physically scarce. One quarter of the global population also live in developing countries that face water shortages due to a lack of infrastructure to fetch water from rivers and aquifers.
- Water scarcity occurs even in areas where there is plenty of rainfall or freshwater. How water is conserved, used and distributed in communities and the quality of the water available can determine if there is enough to meet the demands of households, farms, industry and the environment.

4. Infrastructure

- There are almost 1 billion people without access to an improved drinking water source.
- Developed economies with significant water infrastructure have not invested enough money in those systems to maintain their efficiency.
- 46% of the world does not have drinking water piped to their premises. Over time the amount of capital that must be spent to increase the availability of water to the end user is enormous.

5. Health and Sanitation

- There are currently 2.5 Billion people without access to improved sanitation
- Over 70% of the people who lack sanitation, or 1.8 billion people, live in Asia.
- Every year almost 4 million people die from water related diseases.
- A typical individual in the United States uses 500 litres of water each day.

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- Every day, 2 million tons of sewage and industrial and agricultural waste are discharged into the world's water, approximately the weight of the entire human population of 7.0 billion people.
- Sanitation and drinking water investments have high rates of return: for every \$1 invested, there is a projected \$3-\$4 economic development return.
- In developing countries about 70% of the industrial wastes are disposed of untreated into waters where they contaminate existing water supplies.
- 10% of the world's population consumes foods that have been irrigated by wastewater that can contain chemicals or disease-causing organisms.
- Worldwide, infectious diseases such as waterborne diseases are the number one killer of children under five years old.
- More people die from unsafe water annually than from all forms of violence, including war.

Investing in the water industry is like investing in liquid gold. The most important commodity on earth is water. Humans can live without many things water is not one of them. The reality is that clean and safe fresh water is not available to the human population, without significant investments. We own a handful of the businesses that are investing in the future of water!

C. Update on Precious Metals

One of the world's most successful and recognized precious metals investors, Rick Rule (Chairman, Sprott US Holdings), helps us focus on the relevant facts in the midst of real turbulence in the precious metals sector. In a recent conference call Rule provided investors with the following ten questions. Considering these questions helps us make more rational, rather than emotional decisions, when it comes to investing in the new most hated sector in the world! Which can only mean one thing, precious metals are going to go higher!

10 important questions for investors with exposure to precious metals.

1. Is the financial crisis in the Western world over?
2. Have any of the G20 countries balanced their budgets?
3. Have the major global banks managed to become solvent?
4. Are real interest rates positive or negative?
5. Is the global competitive devaluation of currencies, in order to increase exports, continuing unabated? (Beggars your neighbour through currency debasement)
6. Is the European periphery (Italy, Spain, Greece and Portugal) still financially challenged, not to mention the core?
7. Do the Asian countries still have a cultural affinity for precious metals and continue to buy the physical metals at record levels?
8. What are the U.S. budgetary issues and are there any solutions at all being offered?
9. Are the global derivatives sold by the large banks still a problem for economies and client portfolios?
10. Can liquidity (money printing) solve the issue of insolvency?

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Honest answers to these questions suggest that the economic fundamentals in precious metals have not changed. The set of circumstances that drove gold to USD \$1900 oz. and silver to USD \$49 oz. have not changed, in fact they have become worse and more supportive of precious metals. Only the perception of the facts has changed.

We continue to invest in a handful of businesses that provide us with the highest quality exposure to the precious metals we can ferret out. These include the major royalty companies, two mining companies and some direct bullion positions. In truth, all our major holdings are taking advantage of the weakness in the sector and are either buying companies on the cheap, such as NewGold buying Rainy River or expanding their royalty and streaming investments such as Franco-Nevada, Sandstorm and Silver Wheaton. This is an environment that weeds out the weak players and firmly entrenches those businesses with the strong balance sheets. Our companies will emerge from this bear market in precious metals in fine form and be in an improved position to create substantial wealth in the future.

Despite the volatility in this area we are keeping our client portfolios somewhere between 3 to 9 percent invested in this sector. As we have stated many times this area remains a hedge in the event things go horribly wrong in the global economy. We believe this is a very real possibility given the economic policies that are being pursued and that we have discussed in previous newsletters.

D. Looking Ahead

There are a number of major headwinds facing the global economy and we are doing our best to both prepare for these headwinds and invest through them. As we have explained in previous newsletters, the world is awash in too much debt, and this living beyond our means will come back to bite us in the future. Printing money (quantitative easing), zero real interest rates, growing unfunded liabilities, aging demographics and less than honest accounting throughout our global financial system will result in some major price swings in the days ahead. We must be able to take advantage of these swings.

Our focus continues to be on essential industries, and within those industries, exceptional businesses, we can purchase at attractive prices, based on economic fundamentals. We continue to broaden our portfolios with increased exposure across a range of industry sectors. This not only dampens portfolio volatility it provides you with a broader range of growth opportunities. Industries in which we are consciously broadening our exposure include, water (discussed in this newsletter), agriculture and technology.

The area of greatest interest to us, and our investors, has to be the precious metals sector, given the historic price swings we have witnessed in the second quarter. The bottom line is that we are staying firm in our convictions. All of the fundamentals support higher long-term precious metals prices. Stated another way, we believe in more debasement of our paper money. The businesses we own, are some of the best in the sector, and have massive upside potential.

We will be contacting all of our clients over the next two months, and arranging times in which we can go through an update with you. We appreciate your support and confidence in our firm. I trust all of you have a safe and blessed summer with family and friends.

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