

Today's Notes:

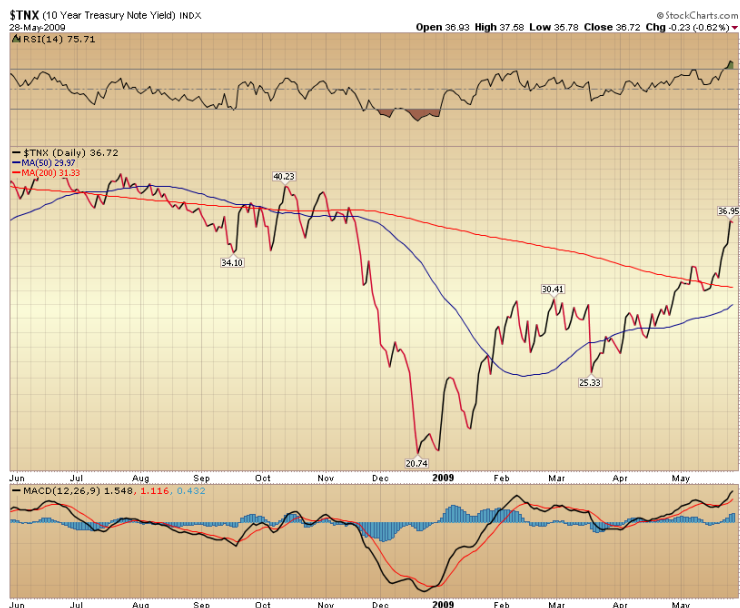
1. **Krugman: Deflation the Clear and Present Danger**
2. **Quaterra: A Joint Venture with The Largest Copper Producer**

1. KRUGMAN: DEFLATION THE CLEAR AND PRESENT DANGER

Nobel Prize winning economist Paul Krugman's vocal left of center thinking may have it right. I used to reject his ultra left-wing writing but I always read his work to calibrate my thinking. As a matter of course I usually rejected his thinking. His Op-ed today in the New York Times was very powerful. I was interested because on Wednesday I wrote that the great tug of war between deflation and inflation is still very much an open question. Krugman believes that inflation is most unlikely – with one caveat. In responding to the current yield curve scare from the bond vigilantes (domestic or foreign) Dr. Krugman claims,

“First things first. It's important to realize that there's no hint of inflationary pressures in the economy right now. Consumer prices are lower now than they were a year ago, and wage increases have stalled in the face of high unemployment. Deflation, not inflation, is the clear and present danger.”

Well, there is a **hint** of inflation. For example take a look at the ten Year Treasury bond yield.

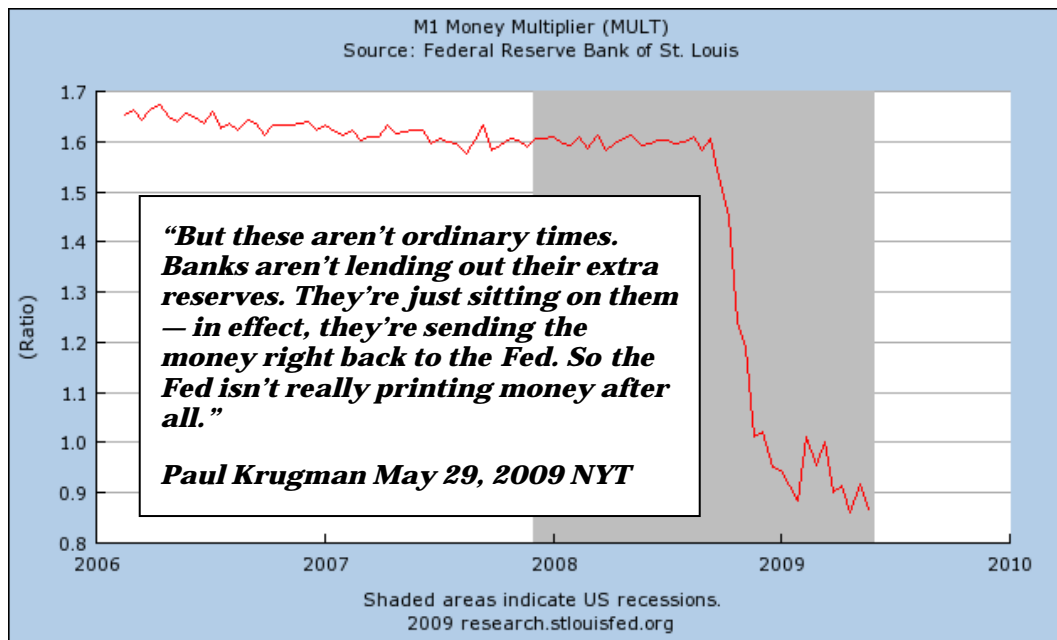


If there are no bond vigilantes (they have been absent for the most of the past decade) why are government bond yields increasing? One idea recently posed is that China, the largest owner of Treasury and government and agency debt, is cranky and is not bidding till yields are higher and prices lower. There is evidence in the press that China wants a better deal to keep coming to the US bond trough even though it is in their best interest to support the US. Could these vigilantes live in Beijing and Shanghai?

Certainly the increase in US bond yields (and not less impressive, the rise in commodities and their equities) are propelled by some extremely powerful force. If it is not inflation perhaps we are seeing the “re-coupling” of the BRICS who may become - sometime in the future - the locomotives that pull the world out of its economic malaise.

If this is true the geopolitics of the world will have changed forever. It will be the BRIC countries – particularly India and China in the long run that set the global economic pace. Given the demographics of Brazil, India and China this eventuality has some likelihood. Russia’s population decline and health problems may eliminate her from the BRIC revival. The fate of the US\$ was decided very long ago. The ardent advocates of decoupling hypothesis from 2007 will, based upon the new quality of life awareness, be proven correct.

On several issues Dr. Krugman’s arguments for deflation make sense. It is a Bernanke policy that targeted inflation (10%) is the goal for central bank policy. So far, as Krugman points out, there is little evidence of any inflation anywhere. In fact the opposite is true. In spite of higher bond yields / lower bond prices and higher precious metals’ prices, unemployment is still rising (to 12%?), housing prices still declining, and personal savings rates are still rising. Perhaps most important the money multiplier has not yet turned up, much less bottomed.



Central bankers, – especially our Fed Bank presidents, are divided. The talk of Green Shoots is starting to wither on the vine. There is a large split in those who watch central banking. Dr. Krugman (and Dr. Nouriel Roubini) represents the deflation school of that split. The current Fed bank presidents represent, for the most part, the inflation school – some even advocating that the Fed should begin to raise rates before it is too late and hyper inflation obtains.

This split best defines the Achilles heel of modern central banking. Rate policy has helped generate continuous asset bubbles – about that there is no doubt. However there is doubt about how to control the onset of inflation due to aggressive monetary and fiscal policy. The new administration in Washington has pulled all the fiscal and monetary

levers it has at its disposal. In spite of throwing money at the banks, they are not lending – period. Mom and pop (20% of global GDP), so important to the global economy and all those exporting countries, are saving and not spending, Green Shoots or not. And finally mortgage rates are rising along with bond yields, threatening another death knell to the retail and commercial real estate industry. 30 year mortgages have increased 30 basis points in the past 2 days to 5.3%. The Treasury and Fed want lower mortgage rates and have initiated some quantitative easing to try to ensure that; so much for quantitative easing in the US. Even the PPIP (the favored purchase of toxic assets from the banks) program is falling apart as bidders see more toxicity in the system.

Today we live in a world in which central banking (as well as many other institutions, Wall Street, etc.) has failed us. We are likely headed, inflation or deflation, to a much different future. New regulatory rules are planned for the Fed, FDIC, OCC and S&L regulators. For now school is out on the future. As Dr. Krugman points out, Japan, and the US in the great Depression were examples of deflationary pressures obtaining. He maintains the assumption that the US will either tax or inflate away (or both) its now massive debt to GDP ratio is unlikely; the assumption of inflation through the printing of money is wrong. Finally one must ask the extent of debt-inspired overcapacity in the world and the speed and extent to which that over capacity is being liquidated. I think we have further to go in that regard judging from the real estate markets.

Obviously a country can only live with 100% or more debt to GDP for a short while and continue to have a strong currency.

Gold is rallying this AM. The US dollar is much weaker relative to everything except the Brazilian currency. Copper is also stronger and silver trading much higher. The great tug of war between deflation and inflation is still on and in fact it is increasing in force.



Gold is up another \$13 this AM and silver has risen \$.46 to \$15.46. We will become believers in the inflationary hypothesis if and only if the prices of these metals rise to \$1200 and \$25 respectively and establish new base levels.

But please remember that precious metals are the arch enemy of central bankers that predicate policy using fiat currency. The IMF has plenty of gold (actually they own none of the gold they hold) they can sell if they have to.

2. QUATERRA: A JV WITH THE WORLD'S LARGEST PUBLIC COPPER MINER

Good news for the economy and good news for Quaterra Resources (QMM) shareholders. This AM the company announced the signing of a joint venture deal with Freeport McMoran (FCX). The two companies will explore Quaterra's Southwest Tintic (Utah) copper property. Quaterra has owned the property 100% since 2007. The southwest Tintic is part of the Tintic district which has been one of the most prolific metal producers in the US for over 100 years.

QMM's Southwest Tintic is comprised of 5 square miles of mineral rights with 85 lode claims and an additional 1.5 acres including highly regarded precious metal targets at Treasure Hill. Six widely spaced drill holes by Bear Creek in the early 70s discovered an estimated **historical** resource of 400 million tons of ore in a porphyry copper system including copper (.33%), gold (.002 OPT), silver and molybdenum (.01%).



The joint venture deal with Freeport includes a 70%/30% carry of QMM to bankable feasibility with Freeport the operator. Freeport must spend \$4.725 million over 4 years and make an up front land payment of \$250,000 to earn in. They can opt out at any time if results are not satisfactory. If Freeport discovers metal to its liking it will spend much more than \$4.725 million.

This is a seminal event for Quaterra's management and shareholders. It demonstrates that the property acquisition and development strategy of the company is paying off.

In 2008 Quaterra completed two 43-101 resource estimates (MacArthur oxide copper and Nieves silver). I expect the company will be raising more exploration funding to focus on more drilling and resource accumulation on these two properties. Meanwhile Freeport, the world's largest publically traded copper producer, will explore the Tintic. I would not be surprised to observe further deal potential with Quaterra's considerable property portfolio.

CEO Dr. Thomas Patton has now taken the company through the three phases of his business plan. The first phase involved property acquisition, which is still ongoing. His philosophy of acquisition is to acquire the best property available (world class potential). With a strong purpose he has built a significant portfolio of North American mining properties to diversify metal and geographical risk.

Phase two has been the focused exploration of the projects. There is no "Moose Pasture" in QMM's portfolio as evidenced by today's Freeport deal. Discoveries have included three uranium pipes on the Arizona Strip, 800 million pounds of oxide copper at MacArthur, 30 million ounces of silver resource (all categories) at Nieves and the acquisition of a significant molybdenum resource on state of Texas land near El Paso. The money has been well spent. There are numerous other properties in various stages of exploration (Duke Island PGMs, Herbert Glacier Gold, Las Americas silver).

Quaterra has now entered the third phase of its business plan. In this phase the company will joint venture, develop to production and /or spins off assets by geography or metal type into separate companies.

Dr. Patton has often noted that you must take your dilution in the ground or in the stock. Given the strong property portfolio of 100% owned properties his strategy will now play out in favor of the shareholder as monetization occurs. Perhaps the strongest piece of the QMM game plan is that following the recent credit crisis there is now a wide range of excellent properties up for grabs in the market. I am confident that the QMM game plan will come to fruition.

Remember that track records matter in Discovery Investing.

Dr. Patton, along with Mexican field boss Tom Turner, discovered and developed the Peñasquito deposit in Zacatecas Mexico. It is now the largest silver mine in the world (1.8 billion ounces) and a significant gold producer and it is still growing.

It is true that the company has been derailed by the credit crisis – as have most exploration and junior producers. I expect that with a recovery, and either renewed BRIC metal demand or inflation (see MN 1 above) Quaterra will do well. The third phase of the Patton plan is the monetization phase. Unless the world melts down into an economic depression Quaterra is on the road to success, in my opinion. I own shares in Quaterra Resources, have owned them for the past 7 years and never sold a share.

The material herein is for informational purposes only and is not intended to and does not constitute the rendering of investment advice or the solicitation of an offer to buy securities. The foregoing discussion contains forward-looking statements within the meaning of the

Private Securities Litigation Reform Act of 1995 (The Act). In particular when used in the preceding discussion the words “plan,” confident that, believe, scheduled, expect, or intend to, and similar conditional expressions are intended to identify forward-looking statements subject to the safe harbor created by the ACT. Such statements are subject to certain risks and uncertainties and actual results could differ materially from those expressed in any of the forward looking statements. Such risks and uncertainties include, but are not limited to future events and financial performance of the company which are inherently uncertain and actual events and / or results may differ materially. In addition Dr. Berry may review investments that are not registered in the U.S. Dr. Berry has been awarded 10,000 stock options exercisable at \$7.50 from Senesco Technologies. He has been awarded 100,000 options of Derek Oil and Gas exercisable at C\$.47, Valcent Products (300,000 options), Global Green Solutions (400,000 options) and War Eagle Mining. He owns shares and in Goldcorp, Senesco Technologies, DataMeg, Immtech International, Horseshoe Gold, Derek Oil and Gas, Terraco Gold, US Silver, Neuralstem, Piedmont Mining, MegaWest Energy, Valcent Products, CGX Energy, MacMillan Gold and Quaterra Resources. He has been awarded 250,000 options on Terraco Gold exercisable at C\$.50 for 5 years, for services as a financial advisor. In his role as advisor he has been awarded 75,000 options from Polymet which strike at C\$2.76. We cannot attest to nor certify the correctness of any information in this note. Please consult your financial advisor and perform your own due diligence before considering any companies mentioned in this informational bulletin.