

Today's Notes:

1. The View from Kankakee in 2009

1. THE VIEW ONE YEAR LATER

One year ago today I wrote on "The View from Kankakee." Here's what I said on December 29, 2008 after a year we all were happy to see end. Yet we knew 2009 would be a year fraught with uncertainty and peril. On the surface there were many surprises in 2009. Under the surface there have been many issues "papered" over with Dr. Bernanke's printing press. In spite of all the apparent optimism there are systemic weaknesses. Here are some of my comments last December.

"Traveling back through last year (early 2008) and thinking about the world's credit, capital and commodity markets, the world looked very different. For example the global investment banking system was functioning. Tens of thousands of workers at Bear Stearns, Lehman Brothers (\$75 billion vanished), Merrill Lynch, Goldman Sachs and AIG had no inkling of the disaster that was to befall them."

Since last December almost \$1 trillion of assets have been written down in the global financial system. As you can see in the graph below the equity market capitalization of the commercial banking system has fallen almost 60%, inhibiting banks from raising capital and performing their critical role of liquidity providers through lending."

Not much has changed since then. On March 6, 2009 Citibank leaked an internal memo that suggested the bank was profitable in Q3 2008. That was a catalyst to give the US equity markets hope; and they soared. But how healthy is Citigroup, now struggling to pay back Uncle Sam? The myth that the banking system is back on track is just that – a great myth.



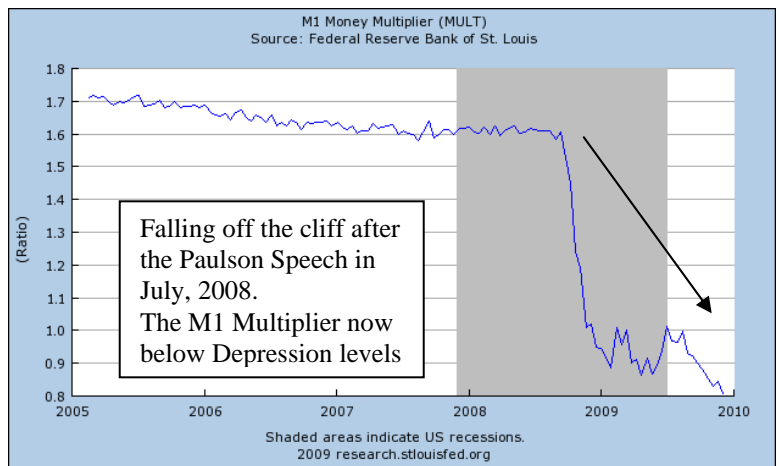
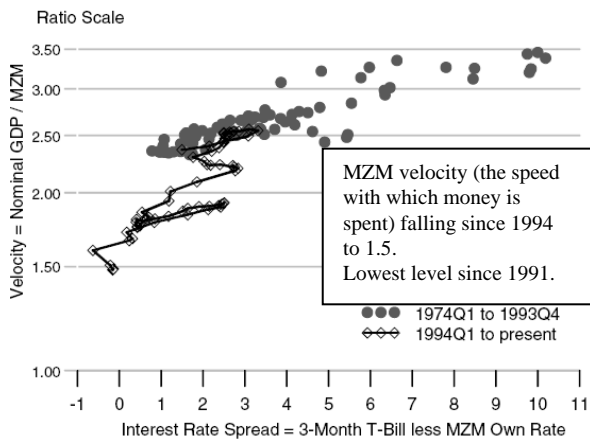
The Citigroup shares are still off 50% from this day last year even with all the press releases on the health of the bank.

Once the world's largest bank shares are off 86% from two years ago today.

One look at the Citigroup graph shows that each time the bank's shares turned down in 2009 it has been miraculously rescued. This bank is still on life support. The modality of the Great Rescue has been to save those companies "too big to fail." The impact of moral hazard on our society has yet to be felt. The concept of risk has been redefined for the lucky few. Meanwhile the FDIC is out of money and 170 smaller banks – "too small to save", have failed since I wrote one year ago. Hundreds more will follow this year. In December of this year, thru the 23rd, 20 community banks failed and went into the protective custody of the FDIC.

A US banking revival is what everyone, from the President to mom and pop in Kankakee, needs badly. But the banks are not lending. A quick look at the St Louis Fed M1 Money Multiplier and MZM Money Velocity shows that the wheels of the fractional banking system are grinding slower to Depression levels. Their performance through December 22, 2009 is ugly. These do not present a vibrant banking/economic system. They are the epitaph of a moribund rescue in trouble.

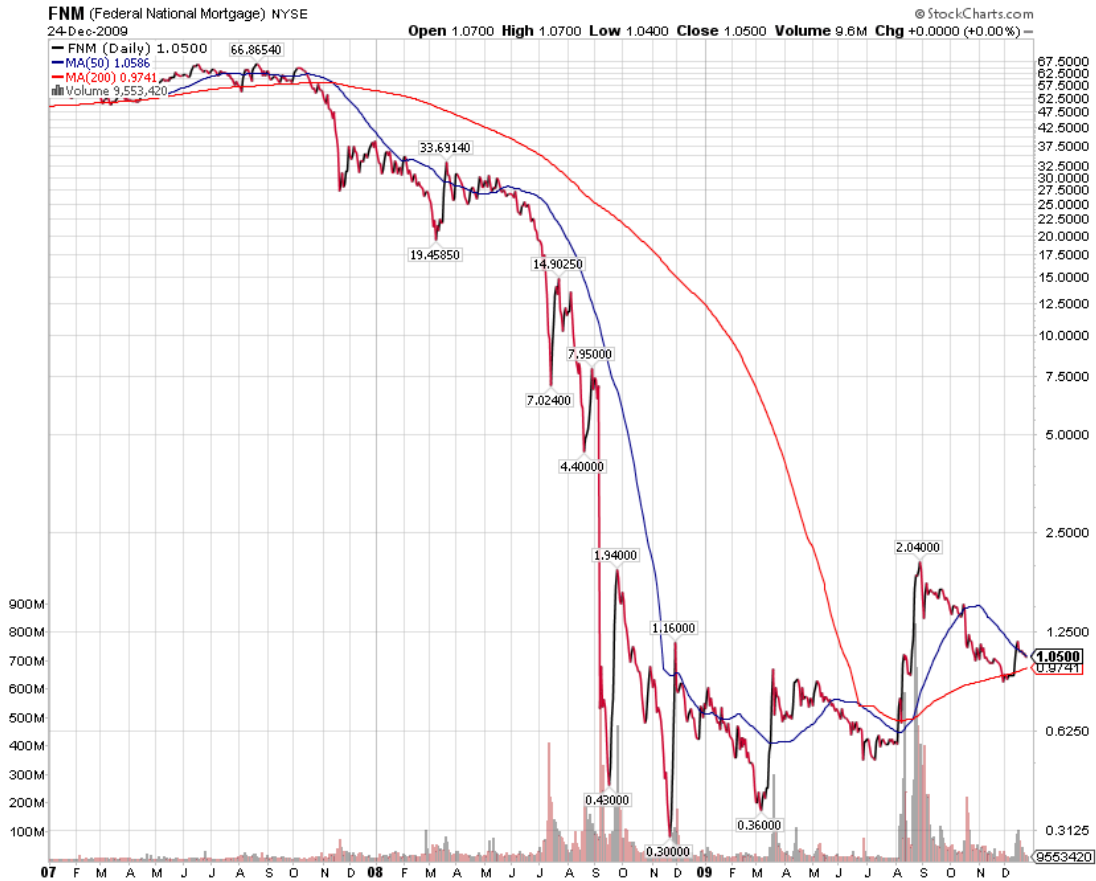
MZM Velocity and Interest Rate Spread



The Philadelphia Bank index (2008 on left, 2007 to 2009 on right) shows that the US banking system is still bucking strong capital headwinds. Even after a voracious equity rally banks are still selling for 66% less than they were two years ago. To add to the misery the bank index now appears to be turning down. These indicators are NEVER discussed in the press or on CNBC?



Finally our old mortgage-maker friends Fannie Mae and Freddie Mac are in the news – but very quietly of course. The government has decided to remove the limits on how much support the government owned housing market makers can request. The limit was set at \$200 billion by the Paulson speech of July 13, 2008. No more. Fannie and Freddie are now wards of the government - forever.



One year later and 17% of the population are unemployed or underemployed. Q3 GDP was revised down last week even though technically we are no longer in a recession. Let's just call it an economic malaise. We must create at least 300,000 jobs a month for years to restore employment in the US. In the meantime GDP has been revised down and the housing situation is still not fully transparent. Last week, before fleeing Washington, our Congress raised the debt ceiling by another \$290 billion. Who will pay for this legislation?

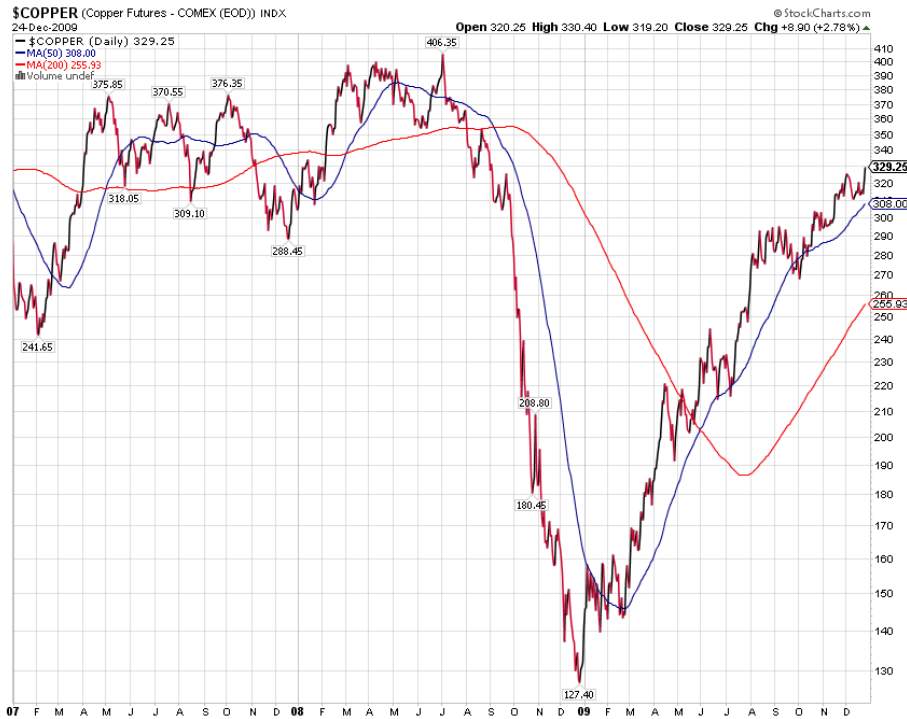
Last year, on this day, I said,

“I can be long hard assets and paper based on hard assets. I stand ready to do that. Gold has broken out this AM and it is trading at \$882. Gold is in backwardation while oil is in contango still seeking storage. Within two to three years a combination of first, fiscal spending, and second, renewed economic growth, will propel commodities forward as humanity seeks higher QOL once again. By that time these hard assets will be in short supply.

Please do not play the “When Game.” Everyone is asking “When” Treasuries will burst. When will commodities turn? Given the proclivity of the authorities to print money and

their evident inability to stabilize currencies, reflation will likely propel these assets. As Jim Rogers said, "The dollar is toast." Do not ask "when?"

As for hard assets, 2009 was a great year and my call was right on the money. Take a look at copper's run in 2009 for example. Yes our copper plays have been, and will continue to be, Quaterra Resources and Freeport McMoRan. Everyone says this is a commodity bubble.



I do not think so.

Copper is sought after because there is a global Quality of Life Cycle emerging in the world. The world is running out of low cost copper. The US imports 37% of our domestic copper requirements. The QOL cycle will eventually trump the Chinese asset bubble because the search for lifestyle is a much more powerful secular force. As for gold and silver- 2009 was a stellar year and yes we need a correction here. It is also time to start accumulating uranium stocks in your discovery portfolio. **SEE GRAPHS OF GOLD IN 2008 and 2009 BELOW.**

Have a wonderful holiday season and be sure to stay long the discovery space as your level of risk aversion dictates. The world is not coming to an end. Niall Ferguson (*The Ascent of Money*) and Martin Jacques (*When China Rules the World*) see a new leadership. There will be hiccups along the way. But the way forward will require years, perhaps decades. Stay in the discovery space.



US Bank Failures in December 2009

First Federal Bank of California, F.S.B.	Santa Monica	CA	28536	18-Dec-09	23-Dec-09
Imperial Capital Bank	La Jolla	CA	26348	18-Dec-09	23-Dec-09
Independent Bankers' Bank	Springfield	IL	26820	18-Dec-09	23-Dec-09

New South Federal Savings Bank	Irondale	AL	32276	18-Dec-09	23-Dec-09
Citizens State Bank	New Baltimore	MI	1006	18-Dec-09	23-Dec-09
Peoples First Community Bank	Panama City	FL	32167	18-Dec-09	23-Dec-09
RockBridge Commercial Bank	Atlanta	GA	58315	18-Dec-09	22-Dec-09
SolutionsBank	Overland Park	KS	4731	11-Dec-09	15-Dec-09
Valley Capital Bank, N.A.	Mesa	AZ	58399	11-Dec-09	15-Dec-09
Republic Federal Bank, N.A.	Miami	FL	22846	11-Dec-09	15-Dec-09
Greater Atlantic Bank	Reston	VA	32583	4-Dec-09	15-Dec-09
Benchmark Bank	Aurora	IL	10440	4-Dec-09	8-Dec-09
AmTrust Bank	Cleveland	OH	29776	4-Dec-09	8-Dec-09
The Tattnell Bank	Reidsville	GA	12080	4-Dec-09	15-Dec-09
First Security National Bank	Norcross	GA	26290	4-Dec-09	8-Dec-09
The Buckhead Community Bank	Atlanta	GA	34663	4-Dec-09	15-Dec-09
Commerce Bank of Southwest Florida	Fort Myers	FL	58016	20-Nov-09	15-Dec-09
Pacific Coast National Bank	San Clemente	CA	57914	13-Nov-09	18-Nov-09
Orion Bank	Naples	FL	22427	13-Nov-09	15-Dec-09
Century Bank, F.S.B.	Sarasota	FL	32267	13-Nov-09	15-Dec-09

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