

Today's Notes:

1. Touching the Socialist Nerve
2. Nuclear Power is Green – In Iran
3. A Compressed Natural Gas Car - Honda

1. IS IT SOCIALISM?

Every so often I touch a nerve, sometimes with good friends. Last week I suggested that the Senate **must approve** the bailout of mortgage GSE's Fannie Mae and Freddie Mac. I had also mentioned that home foreclosures seemed to be soaring in both Nevada (1 in 43) and California (1 home in 65). I used two sources for that including Realty-Trac and Bloomberg. I noted that nationwide Realty-Trac reported foreclosures have more than doubled (up 121%) over the same quarter last year. My point was (and still is) that until we see the bottom of the housing price slide, the banking system will be under tremendous stress and the Fed will be limited in its responses to inflation.

"TR," from Colorado, responded to my Morning Note as follows,

"Mike, There are other alternatives to letting Fannie and Freddie "fail" or bailing them out as the current bill in Congress will do. These two monstrosities need to be put into receivership, cleaned out, broken up and sold off over time, and never again allowed to occupy the duopoly in the mortgage market they currently enjoy. They have become vehicles for rampant political corruption, privatization of ill-gotten gains and socialization of losses, and government subsidizing of home ownership for people who cannot afford it. If the current bill in Congress passes, they will emerge not only intact but emboldened to surpass the egregiousness of the practices that got them into such dire straits in the first place, now with even greater political cover. Doubling down on these slimy institutions using taxpayer money is about the worst investment I can imagine."

I must say that I cannot disagree in principal with most of TR's points. Deep down I agree.

My point is this. I am a pragmatist. In a perfect world, one in which we could logically and rationally react to the situation in which we find ourselves we could disengage from these monsters. A world in which Heisenberg's uncertainty principal were not at play, we could just allow them to die and spread out their functions to a revitalized and mortgage market with many players. We all fear that this bailout is another step toward socialism; but is there a real alternative that would not throw the world a gigantic real estate curve ball? It is a tough call but I, for one, do not think so. Are the GSE's too big to fail or too big to save? Of course the downside is that the rescue will cost many times the \$25 billion that Congress estimates. If I thought for one moment that Congress had the moral fortitude to make the right decisions in replacing these monstrosities, I would acquiesce. Alas they do not.

But I hearken to an Op-ed article from the New York Times by former St Louis Fed President William Poole, yesterday. The article relative to Fannie and Freddie was titled, ***“Too Big to Fail or Survive?”*** You may recall that Bill Poole was the person who “rang the alarm bell” two weeks ago that Freddie Mac was technically insolvent and that Fannie Mae would soon follow. In his article yesterday President Poole says, ***“The long-term health of the mortgage market is too important to be left only to two firms ... The wisest move in the end is to carefully let them wither away”***

He also notes, ***“Whatever the amount of the bailout, even if only \$25 billion, the real question is not the immediate survival of the loan giants but their long-term future. Instead of being regarded as too big to fail, we should look at them as too big to liquidate quickly.”***

This has been my opinion for two years as we saw this disaster approaching. Opinions differ, of course, but allowing outright failure at this point in our history could be a mistake. The Senate approved the **Housing Relief Bill** this weekend. I do not like the particulars of this bill which allows the Treasury to buy shares of the GSE's. Chris Low reports that the bill's passage was accompanied by an \$800 billion rise in the debt ceiling. PIMCO and other bond investors suggest that the GSE debt is perhaps the best place to be at present.

On another matter, CSP from Washington wrote to suggest that the reported foreclosure rates were far too high according to the LA Times. He said,

“Mike, There are some 20mm active home mortgages in California. There are currently 47,000 houses in the process of foreclosure. That (ignoring unmortgaged homes) comes out to close to 1 in 425 homes in foreclosure not the 1 in 65 number you have....or, to be more positive about it, 99.76% of mortgages remain current in California, one of the worst hit states. (the numbers here are from the LA Times)

<http://latimesblogs.latimes.com/laland/2008/04/california-fo-1.html>.

Please note that this is first quarter as of April. Some of the distortion may be in the use of language: “foreclosure” and “foreclosure-related”....the latter includes the notification of default/missed payment(s) which is a larger number than outright foreclosure/repossession. Here is the comment to the earlier noted LA Times article:

Let's face it, we do have a problem in the housing market, but it is WAY, WAY, WAY, WAY overblown by ridiculous and misleading headlines such as this.

Dave, April 22 2008”

My point here is that I do not care about Nevada's reported 1 in 43 or California's 1 in 65 foreclosure rate or even the quoted foreclosure rate of 1 in 171 nationwide. They are indeed sensational. My concern is simply, and properly, focused on the acceleration or deceleration of these rates. At this point in time foreclosure (or foreclosure-related) rates are accelerating. It is the second moment (acceleration) of the dynamic that I am focused on. Thus, it seems to me, that until we see these foreclosure and default rates begin to decline housing prices and the banking system will remain under duress. This means that interest rate increases by the Fed are out of the question.

I must point out however that it will be most interesting to watch the shape and level of the Treasury yield curve evolve. As our government spends the \$25 billion (or \$200 billion) in this rescue attempt they will be inflating the currency. One hopes that the Bond Vigilantes will have something to say about this. If we do not see Treasury market interest rates increase, as the government prints, then we shall be in for more asset deflation – Dr. Bernanke’s worst nightmare.

2. NUCLEAR POWER IS GREEN - IN IRAN

NBC news reports that **Mahmoud Ahmadinejad** deems nuclear power green. NBC News Anchor Brian Williams reported from Teheran, this AM that the Iranians are willing to listen if Washington sends the right message. Last week the Iranians announced that they had now installed 6,000 gas centrifuges and were working on more powerful P2 gas centrifuges which are able to enrich uranium to weapons grade two to three times faster than older P1 centrifuges. The apparent nascent rapprochement between the Bush Administration and Iran has sent oil prices spiraling down. But the Iranians are likely playing for time until either Senator Obama or McCain can come to the White House and replace President Bush’s axis-of-evil, hard line policy. It is true that Washington has seemed to offer an olive branch. One hopes that there is real intent on both sides of this dangerous equation. Yet Mr. **Ahmadinejad** recently suggested, once again, that Israel will vanish from the map.



Which is it to be? Is Iran playing for time? China and Russia back Iran's position while the EU and the US seek "peaceful" Iranian nuclear development and have offered a package of appropriate goodies. The resolution is critical for many reasons. A war of attrition in the Middle East will be disastrous for the world. Oil is beginning to fall, thankfully, back toward the century mark.

As you can see while the decline has been steep and fast we are still well above the 50 week (\$105) and 200 week (\$73) moving averages for the "black gold." Should a resolution of any reasonable sort occur with Iran (and the interview given to NBC news today is highly significant in that regard) oil should find a base in the \$80 to \$100 range.

Why is this important? First, it will not reduce the amount of global demand destruction ongoing in the world. The current Quality of Life cycle will have very strong headwinds at \$150 oil. \$150 brings with it the potential for armed conflict and **intensive resource nationalism**. (Please listen to my discussion of this on CKNW 980 radio the Corus Network on Saturday, www.cknw.com.) The downside risk, of course, is that we will backslide into the addiction of "easy" Middle East oil and not move forward on the alternatives. The Iranian president told NBC's Mr. Williams, "***We are not working to develop a bomb.***" It is most interesting that he suggests that nuclear is "***green.***" On this aspect of nuclear energy he and I agree.

So we must now determine if the Iranians, and particularly President **Ahmadinejad**, are once again playing for time till they accomplish what Pakistan and India have accomplished in joining the nuclear armed community. Or do they want to become a responsible member of global society? This is a most important question, not only for the US and the OECD but also for Russia, China and the rest of humanity. Israel is watching with utmost interest given the antipathy and hatred espoused by this man.

Just a side note but another actor on the stage has made his grand play. After visiting Russia and Spain President Chavez of Venezuela has decided to sell Spain its oil for \$100 per barrel. This dual pricing structure is another emanation of **resource nationalism**. Spain will, in return, provide other goods and supplies for Venezuela. Meanwhile President Chavez, while in Russia, was reported to be involved in a large arms procurement. Now couple these actions with the Russian threat, to be reiterated when the leaders meet in China next month, that if the US moves ahead with its missile shield defense in Eastern Europe, Russia will consider placing missiles in Cuba. Is this an idle threat or real?

All these ongoing issues are threats and promises at present. But the outcome of each crucial for the ongoing QOL cycle in the world.

3. COMPRESSED NATURAL GAS

Many thanks to “AP” from Atlanta for the email to alert me to Honda’s new compressed natural gas car. This **discovery** by a car maker shows that there are solutions at hand, partial though they may be, to our choking dependence on foreign oil.

I do agree with Mr. Boone Pickens’ plan that natural gas should be used to power our cars and not used, almost exclusively, to produce electricity. However I think his wind to electricity approach is unlikely to have merit. Why not build out the nuclear infrastructure in the next decade? Fuel would be no problem and fourth generation reactors will soon be on the scene. Some of these reactors will “burn” all the uranium – cleanly. In the meantime we still have a tough job on our hands. One issue I support Mr. Pickens on is that this problem will not be solved in Washington. That, my dear Discovery Investors, is a near impossibility under either of the candidates. And so to Honda’s new compressed gas car and AP’s comments. Notice his comment “*decades early.*” Sadly enough , where there is a will

“Mike,

Please take a look at this Honda natural gas car. What a pleasant surprise as Honda has done the complete job by providing a home refueling station. This concept makes fantastic sense given the 200 mile range and economics. Actually burning the gas directly in an engine is superior than converting it to liquids as the only efficiency loss is the compression costs of the gas vs. conversion to liquid, but you lose range and flexibility and mobility. A natural gas vehicle like this is far simpler than a battery unit and the time frame decades early. The issues that must be dealt with will be more electricity to pressurize the gas, safety issues for the refueling stations, and most important the supply of gas. It amazes me that no energy policy to date emphasizes the natural gas potential of the nation and particularly the methane hydrates. NG vehicles have institutional issues - like road taxes - how does one tax the NG? the decrease revenue for the oil companies, and more. Lots to think about. In a sky blue world one could visualize abundant low cost non-polluting electricity (nuclear), processes to recycle CO2 into liquids (diesel and gasoline), and an infinite domestic supply of NG.

Augie”

Please see the Civic PDF attached.

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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, 200,000 options from Aura Silver (strike C\$.30), 150,000 options which strike at \$.50 from Birch Mountain for Corporate Finance consulting services. He has been awarded 100,000 options of Derek Oil and Gas exercisable at C\$.47. He is a consultant to Piedmont Mining (250,000 options), Valcent Products (300,000 options), Global Green Solutions (400,000 options) and War Eagle Mining. He owns shares in Goldcorp, Golden Predator, Senesco Technologies, Birch Mountain Resources, DataMeg, Immtech International, Horseshoe Gold, Midway Gold, Derek Oil and Gas, Terraco Gold, Stealth Ventures, Kenrich-Eskay Gold, US Silver, Galway Resources, Neuralstem, Oil Sands Quest, Enhanced Oil Resources, 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 consultant. He has also been retained as an advisor by Dejour Enterprises (200,000 options plus retainer of \$2,500 per month), Grande Portage (210,000 options, \$5,000 per month retainer and Galway Resources (200,000 options and \$5,000 per month). 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.