

Today's Notes:**1. The Damage****1. THE DAMAGE**

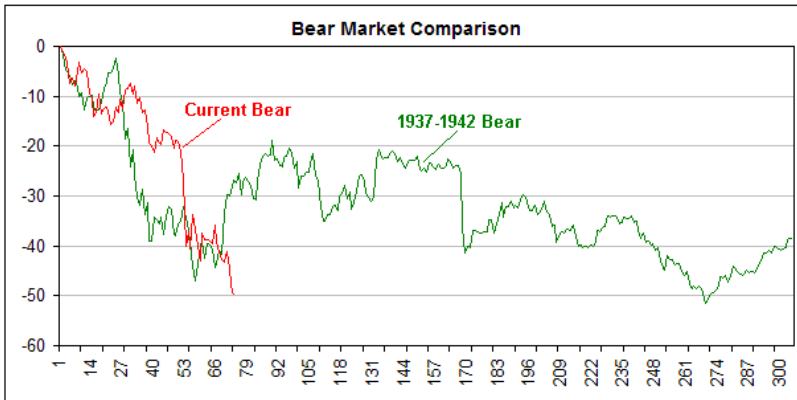
In a word, “extensive.” In another word, “global.”

The global de-levering perpetrated by Secretary Paulson's speech in July, either purposely or inadvertently, has taken a massive toll. In this case world equity markets met their “Minsky Moments.” Nevertheless at Morning Notes we have been inundated with the rash of political changes that have materially affected our Discovery thinking. While we disagree with some of these proposed changes we believe they will spur even more interest in Discovery. What, you ask, are those changes? The new administration in Washington eschews nuclear and domestic drilling and coal production. They have staked the future of our country on the untried economics of renewable sources of energy before we know if we really need to suppress greenhouse gas emissions.

Don't misunderstand. I support Discovery in the energy space – solar, wind, geothermal, biodiesel from algae and jatropha and other renewables. But it must be economic and it is not yet. Nevertheless they most definitely have their place. They can become valuable supplements to the US energy equation. A very good friend of mine, Mark Cox, wrote me yesterday. He said that he has seen a new wind turbine, new battery and a new solar technology that can make us green. Joe Inman, one of the world's best geophysicists wrote to say that a California solar program near Edwards Air Force base could replace 3 nukes (according to NYT columnist Thomas Friedman). I don't doubt the sincerity of my friends. But alternative technology is untried, particularly on scale up.

Alternatives are clearly more expensive than any of the three: coal, nuclear or natural gas. That is why they are still alternatives after all these years. A few billion dollars from Washington cannot change that in the next decade. For all the wind turbines in Denmark the country still buys electricity from nuclear Sweden. Discoveries in alternative energy sources will be crucial and we shall partake of them. However, it is risky policy not to fully diversify our energy programs for the next two to three decades, at a minimum. We are going to need nuclear (provides about 20% of the cheapest electricity of any source and it is clean), oil, natural gas and coal in this country for the next half century. Would it not be optimal to develop domestic energy resources for these categories starting with this Obama fiscal program? These technologies are proven while the human greenhouse gas conundrum is still hotly debated. Take a look at the rest of the world – they are all moving ahead on nuclear, for example. **Otherwise in an all alternative world a severe energy tax will be levied on all Americans, not just the “fat cats” earning over \$250,000.** This will reduce the quality of life so dependent on cheap and yes clean energy. Nevertheless, the electorate has spoken and so be it.

But I must return to the topic of interest which is the damage report on the markets. How much damage has been done? Everyone hopes (audaciously, I might add) that we are at the bottom of the asset deflation. Alas it seems we are not yet for equities and our homes. A comparison of the 1937 – 1943 bear market (300 weeks) to this one shows that we may have quite a long stay in Purgatory. Realistically no one knows for certain.



Even the venerable Warren Buffet has fallen victim to this vicious downturn. Berkshire Hathaway, reported a 62 % decline in net income for 2008. Book value of the fund fell for only the second time since 1965. Shares of the company, peaked in late 2007 at \$148,000, closed Friday at \$78,600, **a decline of 47%**. The picture below tells the story. The decline has been constant, buffeted by the shoes that just keep dropping. Since its peak in October of 2007 the Industrials have dropped 50%. Think about that. 50% of the wealth of the largest 30 stocks has evaporated. These are dividend paying and widely owned. Half the wealth we had so carefully nurtured over the years vanished in 17 months.



From the beginning of 2008 the Dow declined 44%. This year there has been no respite. The Dow Industrial Average fell 14% further from peak. The good news is that sooner or later the Dow will find its bottom. The broader S&P 500 stocks fared worse, losing 52%.



The Russell 3000 index value stocks are supposed to be undervalued. You might think that value stocks performed better. But as you can see these companies were drubbed as badly – or worse. Value stocks did not hold their value nor did growth stocks. Large cap and small cap alike were pummeled in this frenzy of short dollar covering and debt liquidation. The **Russell’s 3000 Value Index fell 57% over 17 months.** They show no sign of bottoming.



Most of our Discovery names are resource, renewables or bio tech stocks. Many trade on the American Stock Exchange or the Toronto Venture Exchange. The TSX venture stocks were hit especially hard as the commodity cycle was repealed. At one point the index had fallen a stunning 86% in the liquidation frenzy. The moderately good news is that we may see a bottoming of this index. The AMEX index seems to confirm this. While the AMEX shares have fallen 51%, in line with other larger cap indexes, they have not fallen further since the October 2008 troubles of the US financial system. We shall watch these indexes carefully to discern a turn in the commodity sector and our Discovery Universe, in part.

In the meantime we are focused on gold and silver companies with current or near term (two year) production. Discovery names in this category include Midway Gold, Golden Predator, Quaterra Resources, Endeavor Silver, Minco Silver and Minco Gold and our old favorite and largest current position, Goldcorp.



But, buyer beware. 2009 is likely to be a very tricky year for investors. Companies that we are examining now are either in production (cash flowing and profitable) or very near production. We are also interested in companies with strong balances sheets such as Goldcorp our favorite legacy name. Dividends help of course – BUT dividends are being cut almost everywhere. Still Freeport McMoran is a solid pick as well. We think Goldcorp is worth \$50 as gold and silver finds their higher level. Houston Lake (HLM TSXV) piques our interest because they keep discovering significant gold near Kenora, Ontario on the Canadian Shield. Bravo Venture Group (BVG TSXV) has shown results that seem like they may have another Eskay Creek-type discovery. But many of our Incubator names now sell

for pennies. They are mostly in hibernation and rightly so. I like lithium, tantalum, uranium (in spite of the Obama curse) and rare earth metals potential. We'll review the Incubator names in another missive. I will also review the cancer and stem cell discovery names. In the meantime have a great day and "be careful out there."



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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.