

Today's Notes:

1. **Global Carnage**
2. **Gold Outperforms the DOW**

1. THE CARNAGE SPREADS

The Asian Development Bank (ADB) estimates, this AM, that \$50 trillion in global financial asset value was destroyed in the 2007 / 2008 timeframe. This is equivalent, according to the Bank (see FT March 9, 2009), to a full year's global economic output. Therefore if you are feeling less wealthy now, you should be. As deleveraging has proceeded apace, asset sales have been forced. Such a vast decrease in global wealth must eventually lead to slower growth as consumerism (50% to 70% of GDP) declines and savings rates increase. The US consumer is now saving at about 2.6% - an increase from zero % in 2008. This seminal contraction, a once in a century event, will require a painful restructuring of the economy. This will induce a "reversion to the mean" quality of life for planet earth which will more likely equilibrate western with developing lifestyles (Quality of Lives). Some QOL will increase as in Asia and the BRICS and some decrease as in North America and Europe. This is coming in the next two to five years as surely as the "Certain Spring."

In Asia the ADB is concerned that the economies in that region are far behind the fiscal spending curve. We hear conflicting reports from both China and India that high growth rates are sustainable, that India is relatively untouched by the carnage and that Russia's leadership does not care about its citizen's Quality of life. We'll see how that plays out.

Given the evident failure of monetary policy, liquidity traps seem to be emerging everywhere as central bankers rush to reduce target interest rates to zero. As most currencies weaken relative to the US dollar (and gold) we might have thought that this competitive devaluation would bring about resurgence of domestic economic growth - fostering trade and inflating away debt.

But the ADB says in its report this AM,

"Even as Asia and Latin America have diversified their investment and trading partners, the effect of the slowdown on exports, finance and investment is earthshaking."

The ADB says that capital losses excluding Japan, amounted to \$9.6 trillion (109% of GDP). 20% of the capital losses are a result of the depreciation of local currencies against the US \$.

The story in 2009 will worsen for Asia. The World Bank now estimates that emerging markets face a financing gap of \$250 to \$750 billion with lower capital inflows. In 2009 \$2.5 to \$3.5 trillion in emerging market debt must be refinanced. This level of financing in cheaper foreign currencies is well beyond the capability of the IMF.

To counter forthcoming Asian wealth destruction, Larry Summers, top economic advisor in the Obama administration, urges increased fiscal spending programs throughout the G20. Yesterday Mr. Summers said,

“The old global imbalances agenda was more demand in China, less demand in America. Nobody thinks that is the right agenda now ... there’s no place that should be reducing its contribution to global demand right now. It is really the universal demand agenda.”

But mom and pop everywhere are afraid to spend. Summers notes that the US, Canada and Europe should “return to living within their means” (translation: lower their QOL) while spending should increase everywhere. **In making a case for BIG government everywhere he noted the inability in this crisis for the market to take care of its own problems.**

“This (traditional) notion that the economy is self-stabilizing is usually right but it is wrong a few times a century. And this is one of those times...there’s a need for extraordinary public action at those times.”

Once again we see the all powerful hand of the new Administration and Congress. They deem themselves smarter than those of us who work for a living. But this is the way it shall be for the present. The politics of fear dominates. We perpetuate a failing banking system, a 7% US GDP decline, 14.8% underemployment rate and an ongoing asset liquidation now amounting to \$50 trillion (ADB) and increasing daily. We had better see some results soon from the spending plans. We think that the US is beginning to run out of fiscal solutions and is now forced to encourage other G20 countries to increase demand through their fiscal programs. One outcome of this global Keynesian strategy will surely be the return of inflation – somewhere, some time. This is a deep global recession quite different from those in the recent past. There is NO growth engine to lead the world out – at least in the 2009 timeframe. Mr., Summer’s statement make it clear that the US cannot lead. He now humbly requests coordinated G-20 fiscal action. If agreed, it had better work.

And still the US dollar attracts investment and strengthens. The US is still viewed as the safest of safe havens in the world. While in Florida last week watching the Jays beat Team USA one of my Canadian friends puzzled as to why the US dollar remained strong while the US banking system is so threatened. He needed C\$1.30 to buy one US \$. Canada’s banks are much safer than those in the US, an opinion with which we agree. Even as investment falls around the world demand for US dollars increases to pay down debt taken in cheap \$s that now must be repaid. This is very good news for the Obama Administration. The repatriation of dollars and the continued Chinese investment in the US is providing a much needed source of financing for the trillion dollar fiscal, rescue and mortgage credit programs emanating from Washington.

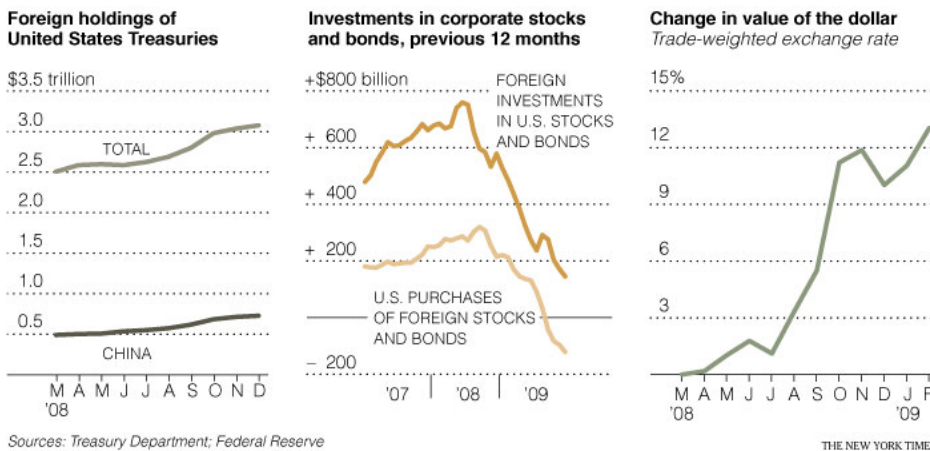
So, for the present, the strength of the US \$ continues unabated at 90 cents. Just look. While its northern cousin the Loonie has fallen 20% the US buck has soared 22% in the past year.



Of course this is a zero sum game. While monies flow to the US via US Treasury markets, the rest of the world suffers. This brings us back to our original topic. Asian and Eastern European economies need dollars to refinance their debts. Their currencies now trade at 20% or more discounts to the dollar. And now the rest of the world will feel the sting of the dollars strength – and the crisis will continue and spread.

Flight to Treasuries Props Up the Dollar

Although the United States deficit has ballooned, foreign investors, particularly China, have increased their holdings of federal debt and abandoned corporate debt and equities. The flight to Treasuries has fueled a surge in the value of the dollar.

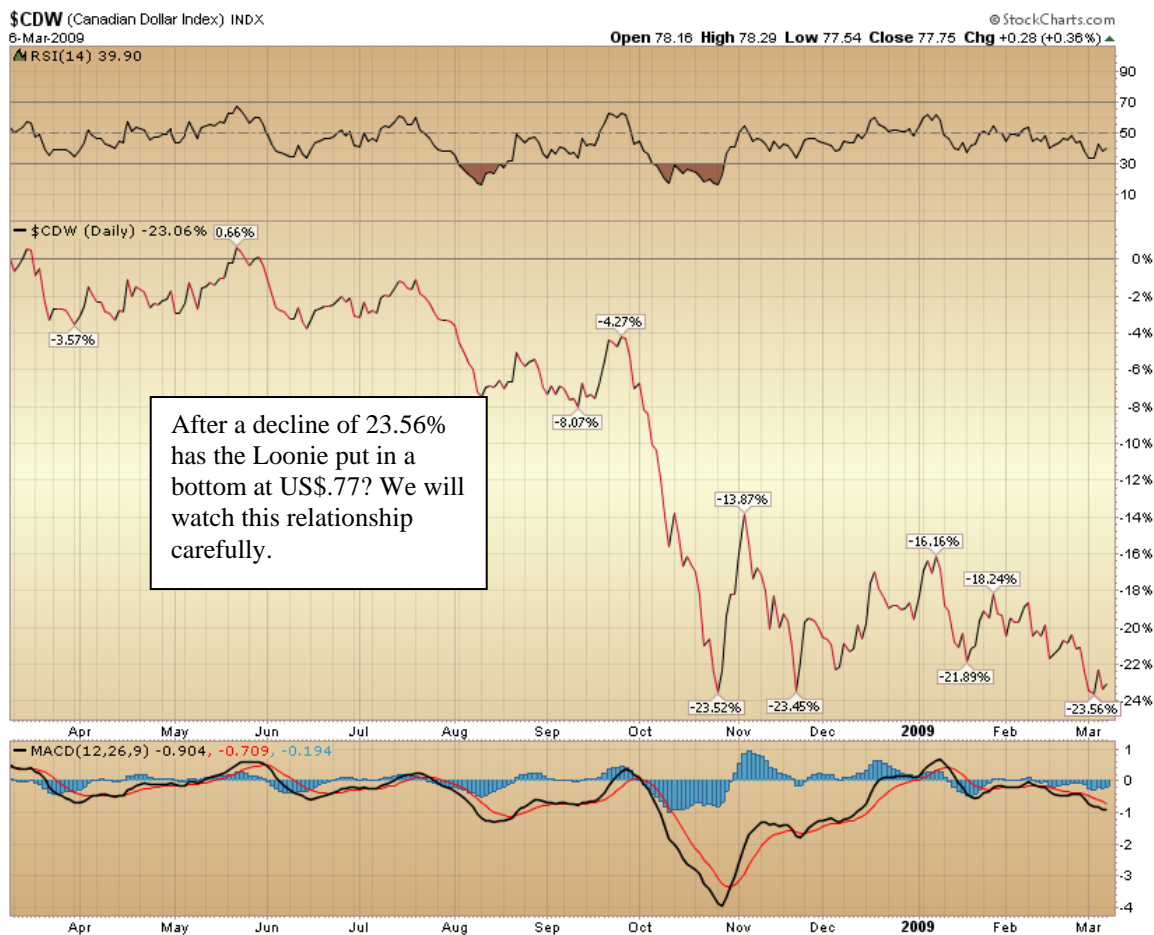


Eswar Prasad, a former official at the International Monetary Fund and a senior fellow at the Brookings Institution said,

“Virtually all of the low-income countries are in very serious trouble ... This is the third wave of the financial crisis. Low-income countries are getting hit very hard. The flow of private capital to the emerging market has dried up.”

With foreign currencies and demand worldwide falling there is no country to take advantage of cheap imports. Thus Mr. Summers admonition today for G20 governments to spend, spend spend. Yes, Dear D.I., government everywhere is about to expand significantly. Someone, somewhere, soon is going to start printing paper money. Dr. Bernanke suggested this as a solution to falling demand in 2002. You must remember the infamous statement that the “government has a printing press.” There are no other good solutions left for government to assert its control. Gold and silver should be part of your planning exercise. It is not the west but the world that is sinking as I write today.

For Canadian readers you can see the impact of the current deleveraging, commodity deflation and Canada’s close economic linkage to the US.

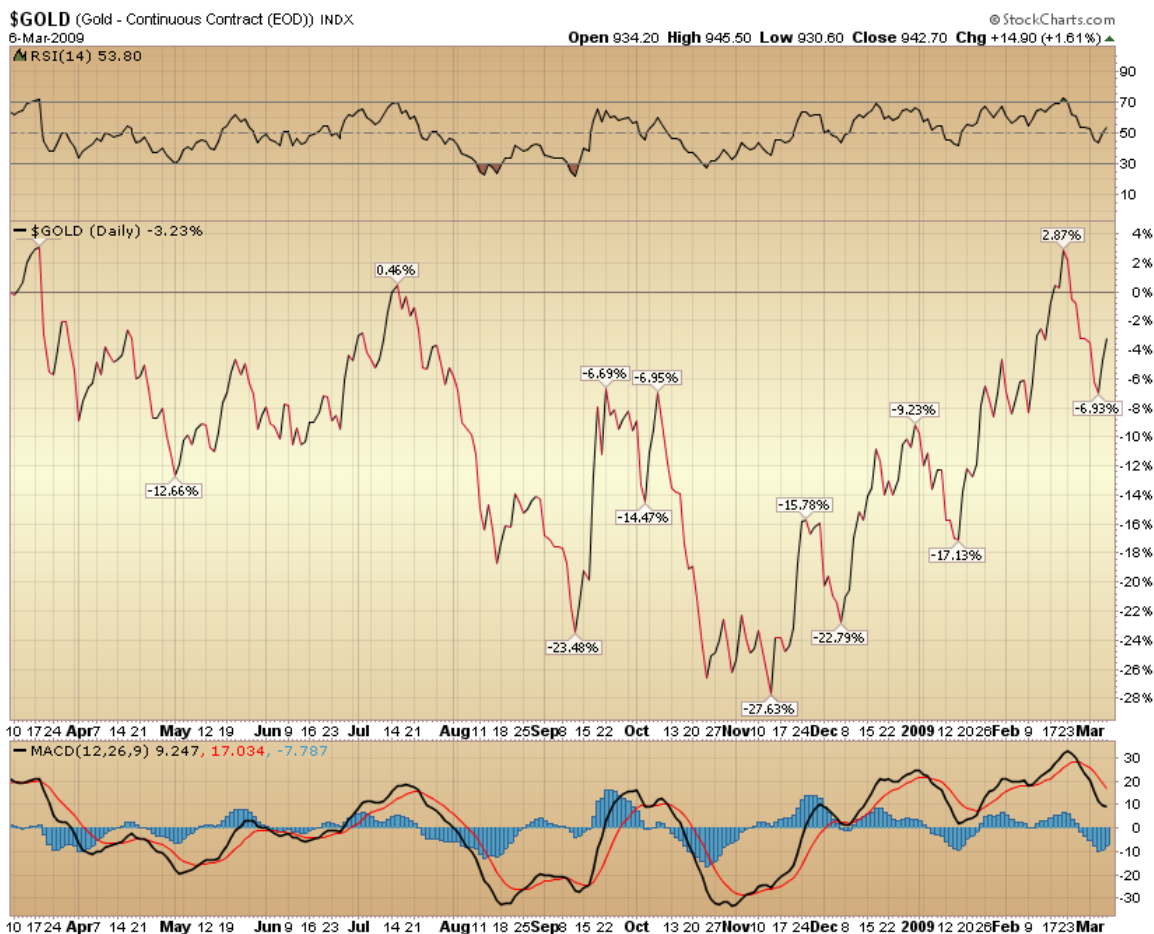


A professor at Simon Fraser recently wrote in Canada’s National Post that Canada should consider pegging its currency to the US dollar to lessen exchange rate volatility. Sounds like an idea that merits consideration. Certainly a new global currency framework will be

necessary as we move forward. Still, the Loonie may have put in a bottom. If so this is a good omen for the commodity cycle. Keep your powder dry for a while longer till **ALL** the shoes have fallen.

2. GOLD

Gold has been a stellar performer in the past year. It is perhaps the one asset class that has maintained its historical reputation as a store of value – even in the face of a nascent deflation. The FT opined on the weekend that hedge funds were starting to buy gold once again. It is a unique time in our history. Even as the dollar has strengthened gold has flourished. Silver has been the bridesmaid and followed gold more slowly. Below you can see that gold has fallen only about 3% in the past year. Gold’s role as a surrogate currency is clearly showing itself. We think this shall continue, particularly in light of the overriding request for fiscal spending.



“We are fans of gold. It is in a long term uptrend.” John Roque Natexis Bleichroeder

One look at the Dow / Gold ratio really tells the story. This ratio has fallen 43% in the past year and much further since the market decline of September 2008.

We have advocated a position in gold discovery stocks for the past three years. Goldcorp is our main vehicle based on its Peñasquito property. Nevertheless, Houston Lake (rapidly maturing), Terraco Gold (Incubator) and Midway Gold (Mature) all deserve your attention here in North America and Minco Silver and Gold (legacy) are very interesting discovery plays in China. I shall cover the Mexican and Colombian gold companies in a future MN.



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