

Today's Notes:

1. Who Wants Dollars

1. WHO WANTS DOLLARS?

Foreigners want gold not US dollars. Americans want U.S. dollars not gold.

Last Friday, about an hour and a half after the opening of the COMEX, gold fell a breathtaking \$25 after it had risen \$14 in European trading overnight. Why would such a strong gold showing in Europe be reversed so quickly in the United States? Answering "Why" is difficult. CPM's Jeffrey Christian recently testified in CFTC hearings that the leverage factor between paper gold and its physical counterpart is 100 to 1. Could this possibly be the cause and affect relationship?

Silver suffered a similar fate. At 8:30 AM the silver bid/ask was \$19.59 / \$19.61 up 1%. Between 10 AM and 11:11 silver fell to \$9.07/9.09 a drop of ~2.5% in a very short time. Why are these metals markets so volatile? Is there a predominant futures market manipulation of the spot price? A 3.5% decline in the gold market in an hour is not rational given the worsening EU debt conditions. Why are European markets bidding and domestic markets selling gold before a weekend when the chance for adverse economic and political developments still exist?

We don't have an answer. But please remember that once gold and silver take on the role of money they are not friends to the fiat money central bankers such as Treasury Secretary Timothy Geithner or his companion Ben Bernanke over at the Federal Reserve. Physical gold is no friend to Goldman alums on the street or in Washington. J. P. Morgan has allegedly loved and ravaged the short side of the silver futures market for years as most informed investors believe. Could global sovereign debt fundamentals have changed so much in one hour as to make the Europeans and Asian view of gold and silver so different from that of their Americans compatriots? We all use the risk models.

Maybe Washington could begin to fix the problem right here if they understood it. Citibank, with my testimony and advice, did just this for the futures markets in China in 1995 when China shut her futures markets. But it may not only be futures market reformation that is necessary. Many contend (see Lehrman and Mueller, National Review Dec 2008) that there is a curse to the reserve currency status of the U.S. dollar – that it allows unlimited, unconstrained borrowing. Gartman contends that as long as the U.S. has the strongest military she will be home to the world's reserve currency. Perhaps but this time it might be different. Floating currency exchange rates and powerful, overwhelmingly leveraged futures markets may be the recipe for the disastrous situation in which the world finds itself.

How about a developing currency that is backed by something real and tangible? The confidence and faith in the U.S. government is no longer tangible, let alone believable. You will see that proven in the upcoming November mid term elections in the U.S. Whether Canadians know it or not the Loonie is backed de facto by Canada's real and tangible commodity wealth and her economic and political stability.

The volatility we witnessed in the gold and silver markets Friday between 10 AM and 11 AM was futures initiated meltdown. Markets only allocate capital that way when they panic.

Gold at 8:15 AM NY Time May 14, 2010

Bid/Ask	1246.60	-	1247.60
Low/High	1233.10	-	1250.40
Change	+14.00		+1.14%
<u>30daychg</u>	+91.80		+7.95%
<u>1yearchg</u>	+320.90		+34.67%

Gold at 11:07 NY Time May 14, 2010

Bid/Ask	1221.30	-	1222.30
Low/High	1217.00	-	1250.40
Change	-11.30		-0.92%
<u>30daychg</u>	+66.50		+5.76%
<u>1yearchg</u>	+295.60		+31.93%

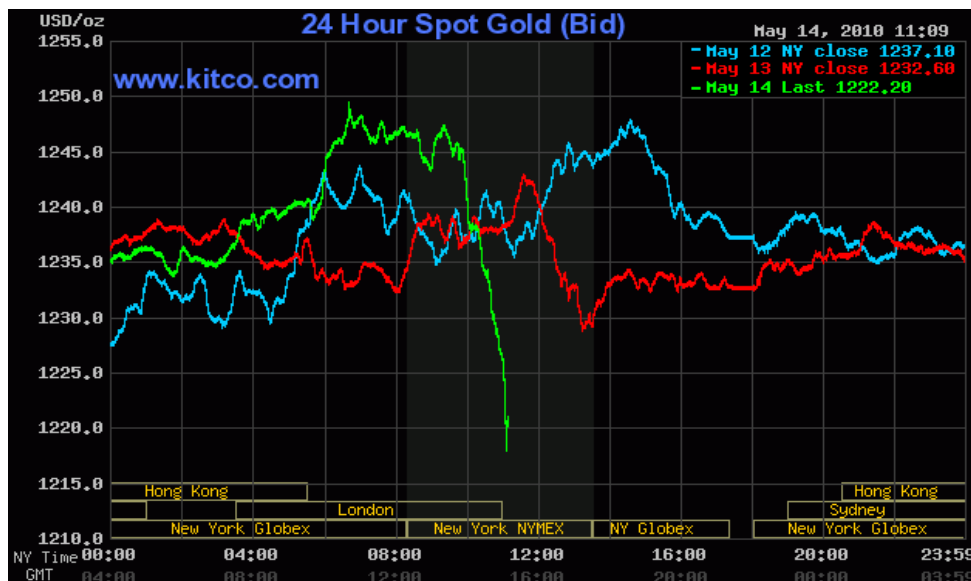
Silver at 8:16 AM NY Time Friday May 14, 2010

Bid/Ask	19.59		19.61
Low/High	19.40		19.75
Change	+0.16		+0.82%
30DayChg	+1.17		+6.35%
1YearChg	+5.54		+39.43%

Silver at 11:11 AM NY Time Friday May 14, 2010

Bid/Ask	19.07		19.09
Low/High	18.96		19.75
Change	-0.36		-1.85%
30DayChg	+0.65		+3.53%
1YearChg	+5.02		+35.73%

“This is euro-generated panic buying,” said Frank McGhee, the head dealer at Integrated Brokerage Services LLC in Chicago. “It’s not a good situation for the Europeans. They see continued erosion of their currency, and they’re buying gold.” But why are Europeans not buying dollars? We think that Kitco’s spot gold chart at, 11:09 AM, showed more than a correction.



Meanwhile US equities were being severely thrashed as the day wore on. The Dow would have closed down more than 200 points had it not been for late plunge protection buying.

It is possible that dollars were being sought at the behest of margin clerks to reverse the dollar gold carry trade. Adam Klopfenstein, a market strategist at Lind-Waldock in Chicago said,

“A lot of cash is coming out of the gold market to meet margin calls. People need to raise cash and sell the positions that have been the most profitable.”

The following currency table seems eerily familiar with bouts of dollar and Yen strength in the past two years. It is possible that dollar/gold carry trade covering occurred. The Picture at 8:17 AM: Yen strong, dollar strong, gold strong in all currencies.

US Dollar	--	05/14-08:17	--	--	19.59	+0.16 ▲	+0.82%
Australian Dollar	-0.38%	05/14-08:11	1.1208	0.8923	21.96	+0.27 ▲	+1.23%
Brazilian Real	+0.06%	05/14-08:16	1.7793	0.5620	34.86	+0.37 ▲	+1.06%
British Pound	-0.20%	05/14-08:16	0.6860	1.4578	13.44	+0.14 ▲	+1.07%
Canadian Dollar	-0.67%	05/14-08:17	1.0274	0.9733	20.13	+0.30 ▲	+1.53%
Chinese Yuan	+0.01%	05/14-05:52	6.8223	0.1466	133.65	+1.17 ▲	+0.89%
Euro	-0.38%	05/14-08:17	0.8005	1.2493	15.68	+0.19 ▲	+1.25%
Hong Kong Dollar	-0.02%	05/14-08:16	7.7784	0.1286	152.38	+1.38 ▲	+0.91%
Indian Rupee	-0.31%	05/14-07:34	45.2150	0.0221	885.76	+10.05 ▲	+1.15%
Japanese Yen	+0.19%	05/14-08:17	92.5150	0.0108	1812.37	+11.79 ▲	+0.65%
Mexican Pesos	-0.38%	05/14-08:17	12.4679	0.0802	244.25	+3.02 ▲	+1.25%
Russian Ruble	-0.49%	05/14-08:11	30.2000	0.0331	591.62	+7.75 ▲	+1.33%
S.African Rand	-0.46%	05/14-08:17	7.5321	0.1328	147.55	+2.02 ▲	+1.39%
Swiss Franc	-0.41%	05/14-08:16	1.1222	0.8911	21.98	+0.27 ▲	+1.26%

Gold’s dramatic drop in such a short timeframe is not likely due entirely to covering of the gold carry trade. If investors really believed that short rates will be held low by the Bernanke Fed and that Europeans are demanding the yellow metal, why would you sell gold to cover this trade?

The Dow had fallen 87 points by 11:45. It closed the day down 167 points. The dollar and Yen strengthened all day. Gold ended down \$22 from its pre open high in the morning. This bear market rally, begun in March 2009 has most definitely topped out and is declining on fears of deficits and subsequent sovereign debt defaults. The forced love affair with the U.S. dollar continues to the detriment of all other currencies and commodities. When will we fix a broken floating exchange rate system and an overwhelming and poorly designed futures market? The current U.S. Congress? Never! You must seek to educate your representatives about these issues.

The Europeans are taking their problems seriously – apparently Americans are not yet worried. But then that would fit in with the Washington-centric view of the world – more domestic entitlements for more domestic votes. It will all end with the price of gold and silver moving higher and the dollar lower. It might also end with a radically different European Union.

One final thought. Perhaps the need for cash is not only a result of margin calls and deleveraging. Perhaps there is, on this side of the world, a real fear that in a deflationary, debt spiral - cash is king.

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