

Today's Notes:

1. In The grip .
2. Recent Site Visits

1. In the Grip ...

The 3rd Quarter of 2011 ended on Friday, September 30. The world's markets were down – lockstep. Of the world's 38 major equity markets 35 fell, some more, some less with an average decline of almost 1%. US equity market declines averaged a heady 2.53%. North and South American markets declined 1.65% on average. Russia was off almost 3%. Only markets in Israel, New Zealand, Bangkok and Taiwan, of the 38, achieved positive returns. 82% of the 3rd quarter's decline occurred in August and September. Volatility of the global equity markets increased during the two months.

Year-to-date the global equity picture is bleaker – mostly a 3rd quarter phenomenon. World equity markets have declined 19% on average year to date, 16% in the 3rd quarter. The bear market line-in-the sand is considered 20%, so we appear to be there. Of the 38 markets only New Zealand showed a positive YTD return + .5%. (Table 1).

Have the world's equity markets, so bullish since early March 2009, surrendered to the reality of global economic fundamentals, looming debt, sovereign or otherwise, and jobless America? Americans still owe \$13 trillion in consumer debt down a mere 15% since the halcyon days of 2006 and 14 million are out of work. 6 million have been unemployed for longer than 27 weeks and 22 million are either unemployed or underemployed. The biggest equity losers since January 1, 2011 - YTD are:

Greece	ASE	-43.8%
Italy	MIB	-27.4%
Brazil	Bovespa	-25.7%
Hong Kong	Hang Seng	-24.9%
Denmark	KFX	-24.2%
France	CAC 40	-23.5%
Portugal	PSI 20	-23.0%
Sweden	OMX	-22.7%
Euro 50	STOXX	-22.3%
Dutch	AEX	-21.9%
Norway	OSEBX	-21.4%
Germany	DAX	-21.3%
Russia	MICEX	-20.3%
India	Sensex	-20.0%

Surprised? Greece isn't much of a surprise. She announced this AM that she will miss her deficit reduction goal. Nevertheless a loss of almost half her equity value seems significant. 37% of her equity evaporation occurred recently, since July 1st.

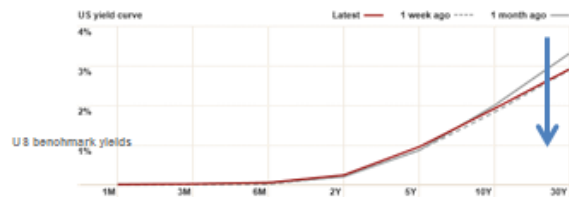
Germany, France, Sweden, Norway and Hong Kong are all markets we did not expect to see decline so deeply and rapidly. For example Germany's 21.3% YTD loss represented a 112% 3rd quarter decline from a 2% plus performance in the first half of 2011. The French equity decline (CAC 40) of 25.6% was a 109% decline from a 2.1% positive performance in the first half. Even here in the US, where the YTD S&P 500 equity decline is a minimal 11.1%, 13.7% or 123% occurred in the 3rd quarter. Canadian equities followed suit. The Toronto Exchange (TSX) has declined 13.2% so far in 2011 and 12.6% has occurred since August 1. Canada's performance was the fifth best in the world through Q3.

It is the rapidity and recency of the decline in global equities that is significant. It is amazing how quickly and lethally change of confidence can impact value - globally.

On September 20th and 21st the FOMC met for an unusual two day meeting and decided to try another approach to the growth conundrum, this time intervening in the Treasury bond market. They call it "the TWIST." It is an attempt to sell short term bonds, purchase longer maturity bonds and hence flatten the US Treasury yield curve. It may be the last "Hail Mary" of the Bernanke generation. Below you can see how rates have changed since this announcement. Short maturity yields have increased and longer term decreased. The Federal Reserve will now lengthen the maturity of its \$2.6 trillion bond portfolio and place the risk of the lengthened maturity on the necks of US taxpayers – once again.

After the "Twist" US Treasury Yield Curve

August 30 and September 30 2011



Maturity	Yield	Today's change	1 week ago	1 month ago
1 Month	0.01%	0.00	0.00%	0.01%
3 Month	0.03%	0.00	0.00%	0.02%
6 Month	0.06%	0.00	0.02%	0.05%
2 Year	0.25%	0.00	0.22%	0.20%
5 Year	0.96%	0.00	0.87%	0.87%
10 Year	1.92%	0.00	1.83%	2.00%
30 Year	2.91%	0.00	2.89%	3.31%

Negative real rates obtain as well. As you can see from the following table the real rate on the 30 Year US Treasury bond was 1.02% - hardly enough to create real wealth. There is virtually no real return on the 10 year bond.

Negative Real Interest Rates: Sept 2011

DATE	5 YR	7 YR	10 YR	20 YR	30 YR
09/20/11	-0.82	-0.49	0.04	0.68	1.03
09/21/11	-0.78	-0.47	0.02	0.66	0.98
09/22/11	-0.70	-0.43	0.01	0.56	0.87
09/23/11	-0.59	-0.33	0.10	0.65	0.97
09/26/11	-0.56	-0.30	0.12	0.72	1.06
09/27/11	-0.60	-0.33	0.12	0.72	1.06
09/28/11	-0.58	-0.25	0.16	0.74	1.05
09/29/11	-0.56	-0.24	0.17	0.73	1.03
09/30/11	-0.54	-0.22	0.17	0.72	1.02

Source: US Department of the Treasury

The bottom line is that the global equity market Bear is strengthening like a hurricane offshore in Miami's warm waters and is on its way to the US. We are about to be in the icy grip of the bear. This is significant because following the post 2008 credit crisis we have had, thanks to the world's central bankers, comforting equity market wealth creation that has given mom and pop as well as fund managers hope. Equities have been perhaps the only positive indicator on the planet and they have been so visible. Every morning for over two years we have heard the CNBC cheerleaders rave.

Early in August the equity waterfall began when the Standard and Poor rating agency, properly in my opinion, downgraded the rating of US Treasury market due to evident political gridlock. Below we show the result. Perhaps a dawning awareness has now materialized that things are not well in spite of equity performance in 2009 and 2010. We think a loss of confidence, a Minsky Moment, is upon the investment world. In 2009 through 2011 equity markets alone held the line. They are now in broad retreat.



In spite of the gridlock evident in the Federal Reserve's FOMC (the Fed's decision making body) we think that as a last gasp the Fed will be forced to turn to the money creation spigot. It is not only equity wealth destruction that is now clear but with all asset liquidation in full force deflationary forces are strengthening. We know that the Fed prefers inflation to deflation.

Chairman Bernanke has repeatedly indicated this. His oft quoted 2002 "printing press" declaration now comes back to haunt him. Here he said he could lower the value of the currency to cause inflation. Yet today demand pull inflation is not evident – anywhere in the world.

His first speech as a Fed Governor was, *"Deflation: Making Sure It Doesn't Happen Here."*

That eventuality is no longer certain. Thus we are likely to see another attempt at targeting inflation and this could mean that QE 3 or a similar money printing program.

Let me further point out that once the money multipliers do turn up (who knows when?) the Fed will be forced to drain the system quickly in order to avoid very high rates of subsequent inflation. This is a concern of at least three of the FOMC members. Hyperinflation has been a common companion of deflations in the history of the world.

If deflationary forces persist and strengthen as they now seem to and the Fed cranks up its presses, we could see resurgence in equity prices – at least in the US. We think chances of this are 50/50. If so it will be an opportunity to take some cash off the table.

The economy is still moribund. The M1 money multiplier is .8 (should be 2.0 to 3.0) and velocity of money supply (relative to GDP) is falling. These are Great Depression levels and have been declining for three years. It is interesting that the St Louis Federal Reserve has not published any velocity numbers since March 31. These statistics should be published quarterly so we should have seen at least the second quarter numbers by now. I wonder why? Can anyone help me here? Deflation is in the air dear Discovery Investor.

Many of our discovery companies (both Incubator and Mature) have received a good punch in the gut. They are getting ridiculously cheap now. Go back to the Ten Point Grid and re-examine these companies. Those that you believe can sustain this downturn should be on the top of your list.

A Major Head And Shoulders Pattern Now Followed By Another In the SP500.

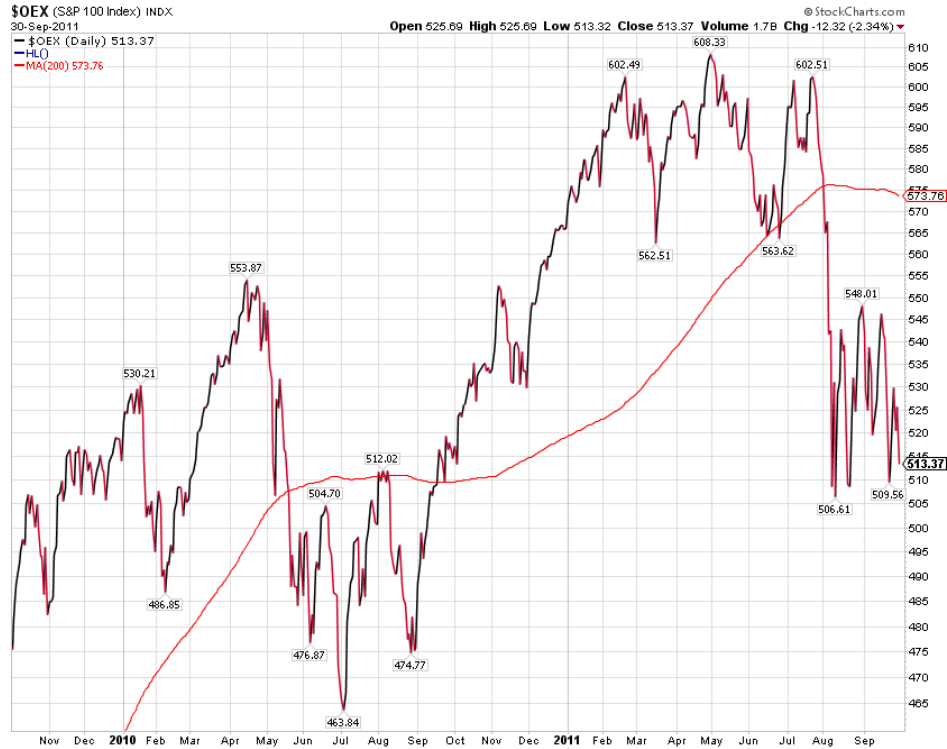


Table 1: Global Equity Performance 2011

		YTD	3RD QTR
Greece	ASE	-43.8%	-36.6%
Italy	MIB	-27.4%	-23.8%
Brazil	Bovespa	-25.7%	-17.5%
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Norway	OSEBX	-21.4%	-15.1%
Germany	DAX	-21.3%	-23.8%
Russia	MICEX	-20.3%	-17.2%
India	Sensex	-20.0%	-11.1%
India	Nifty	-19.7%	-9.3%
Europe	BE 500	-19.5%	-17.4%
US	Russell 2000	-19.4%	-22.4%
Taiwan	TWSE	-19.3%	-17.3%
Tel Aviv	TA 25	-18.7%	-12.3%
China	CSI 300	-18.6%	-15.3%

Singapore	STI	-17.3%	-14.4%		
Australia	ASX 200	-16.0%	-11.9%		
Colombia	IGBC	-15.3%	-8.2%		
Japan	Nikkei 225	-14.9%	-11.2%		
Swiss	SMI	-14.8%	-9.9%		
Britain	FTSE 100	-14.7%	-11.3%		
Spain	IBEX 35	-14.5%	-14.5%		
Turkey	ISE 100	-13.9%	-5.6%		
Korea	KOSPI	-13.7%	-15.7%		
Irish	ISEQ	-13.3%	-17.9%		
Canada	TSX	-13.2%	-12.6%		
Mexico	Bolsa	-13.0%	-8.4%		
Bangkok	SET	-11.9%	-15.4%		
US	S&P 500	-11.1%	-13.7%		
US	Nasdaq	-10.3%	-12.2%		
S Africa	TOP40	-8.5%	-7.6%		
US	Dow Jones	-6.5%	-11.3%		
New Zealand	NZX 50	0.5%	-2.8%	Average	-19% -16%

2. Some Recent Site Visits (Quaterra, Entre Gold, Revett and Terraco Gold)

Last week I visited the Entre Gold / Quaterra Resources progress at soon to be world class copper district in Yerington, Nevada. This copper district is on the radar of all the big copper producers. We think that ultimately there will be 50 to 60 billion pounds of copper discovered in the district. The work that Quaterra has completed on the MacArthur oxide deposit is truly impressive. I believe that Quaterra's MacArthur holds the key to the entire district because as a run-of-mine producer it will be in production sooner and with much lower capex.

I will report more fully on Quaterra's progress at Yerington tomorrow. Two weeks ago we visited Revett's Troy mine in Montana and Terraco's Almaden gold deposit in Idaho. Both have made significant progress. Revett is producing above 4,000 tons per day of the finest copper / silver concentrate and Almaden has the drills turning. Results should be out soon. More research to follow on these properties.

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