

Today's Notes:

1. A Sustainable US Energy Future
2. Europe Feels the Sting
3. Resource Nationalism (Submitted by Chris Berry)

1. A SUSTAINABLE U.S. ENERGY FUTURE

It is becoming obvious to even the most casual observers that alternative, "Green," energy is not price competitive. There are many issues that have cropped up as the world of Al Gore and John Brown rushed head long into alternative energy programs and then dropped unceremoniously off the cliff. For the most part, none of these "alternatives" have been tested and found to be economic in large scale deployment. It has been disappointing and injurious. Not because the millions of President Obama's "Green Jobs" have not materialized. Nor is it that the billions spent on "shovel ready" green projects were also a figment of the Administration's imagination.

Instead the build out of alternative energy technology is proving costly and deleterious to the environment on its own. It will not be economically effective in solving energy dependence or our economic problems for decades. In fact it will impose a horrendous tax on all citizens for decades.

For example each wind machine requires 5 tons of copper, half of which must be imported to the US. Another requirement is cobalt and the US imports 80% of its cobalt needs. Green energy will **NEVER** solve the world's carbon problems or ease the self imposed guilt trip the populous has been brainwashed to accept. Has it simply been a brilliant ploy for a government takeover of the energy space?

Throughout human history we have seen many such deceptions and articles of faith. Recent examples of human hubris stand out including the unsinkable Titanic, the US Space Shuttle proposed to be everyman's road to space, the Chunnel between Britain and France and President Nixon's 1971 proclamation that solving cancer would require money and an effort comparable to the US landing on the moon. More recently, of course, global warming and the notion that humans control climate have become the *bête noire*, the latest example of extreme hubris. Simply apply Western technology and capital and the problem will vanish. No so fast. Many think, with some justification, that the entire idea is a sham to contribute to world governance. In part the recent thrashing of President Obama's candidates in Virginia, New Jersey and Massachusetts repudiates this entire program. Mom and pop are losing confidence quickly in this government fiasco.

Last week President Obama admitted, for the first time, that nuclear must be part of the equation by upping the nuclear budget by \$18 billion to \$54 billion. Southern Company will build 2 new (third Generation) nukes to be operable by 2016. But to make a real impact we must mobilize in China-like fashion. To have a positive impact on greenhouse gases nuclear electricity generation would have to increase from its current 20% to 33% of the total. That would require another one hundred reactors. This is indeed a 30 year process.

I am not a nihilist, just a realist. I believe we must develop but also conserve our own resources. The Massachusetts Institute of Technology recently made an important point about another cleaner energy source, natural gas. In a recent research paper its Technology Review wrote,

“ ..the PGC pegs the future supply at 2,074 TCF. In other words, there is enough natural gas to supply the country (editor United States) for 90 years at current consumption rates. Even if we used natural gas to totally replace coal in generating electricity, domestic supplies would last for 50 years.”¹

We have put forward an **interim** energy plan that would extend for the next 30 years or more. Through tax-incented conservation, natural gas and nuclear energy programs, carbon emissions would be cut drastically, energy costs bounded, domestic jobs revived, energy independence increased and transition to a truly sustainable energy environment made available. Such an interim timeframe could make the transition to the next energy platform. It would be cleaner and cheaper than coal-fired carbon sequestration (CCS) and imported oil energy sources. CCS will indeed come on stream but, according to Energy Secretary Chu, it is still decades away.

Our plan advocates an interim move to gas fired utility plants, the build out of gas-to-diesel refining infrastructure along with offshore drilling, domestic shale gas development and an aggressive nuclear program. Let's face it we have just spent the better part of \$80 billion on an aborted jobs program that has produced little in the way of a jobs recovery. This amount would go a long way toward the nuclear build out to sustain 33% of our electricity needs. It is time to make serious and sensible decisions including a new and more secure electrical grid.

The cruel economic facts of the alternative energy are becoming more apparent every day. The U.S. has now identified enough domestic NG energy for 30 to 50 years of electricity and diesel production in the major shale deposits of Texas, Louisiana and Pennsylvania. There are large reservoirs of gas and oil offshore of Virginia and New Jersey. North Dakota and Saskatchewan contains the prolific Bakken oil deposits. Virginia, Texas, Wyoming, Utah and Arizona contain hundreds of millions of pounds of uranium. There is no need to remain energy dependent by importing our future uranium from Russia². Why pay Russian miners world prices for their uranium when the US mining industry is fully capable of labor supply? Senator Murkowski sums it up best last week when she noted that there are millions of pounds of uranium on the Arizona strip tied up in environmental folly. (See MN 3 below)

Such domestic energy initiatives would transition us into advanced and cleaner technologies with significant jobs and quality of life benefits. The U.S. nuclear industry alone needs a rebirth. After leading the world in the 1950s the US has surrendered her technological prominence in nuclear energy technology to China, France, Russia and Canada. There is one more thought here. It is about conservation. Every barrel of oil saved is a barrel we do not have to pay \$70 to \$80 to foreigners. Every barrel of oil for which we substitute diesel from natural gas is a barrel for which we do not have to sustain further deficits. Every domestic barrel of oil

¹ MIT Review, December 2009.

² The US now imports about 95% of its uranium needs from foreign sources including decommissioned nuclear warheads from Russia

we produce provides a similar benefit to US citizens. What does Washington not understand about this dynamic?

Water is a much large problem whose availability has been repeatedly assumed. Water is a critical resource in many alternative technologies, and water is becoming scarce. I will write more on the role that this precious resource will play - later.

2. EUROPE: THE ROAD TO SERFDOM

Last week the FT reported that Europe is feeling the sting of the world's enthrallment with green, unsustainable and alternative energy solutions³. All seem less real today. It is labeled Europe's folly. Disillusionment is on the rise in the Old World as well as in North America. It is not the sovereign debt time bombs waiting to detonate or defuse the new Union (no one is sure which). It is instead that Europeans are now feeling the sting of alternative energy taxation. Cost overruns are endemic with these mega projects because they have not yet been built to scale. The FT suggests that this is "technology that just does not work as advertised"

"As Europe turns to wind farms and the like for a growing share of its energy supplies, the daunting scale of investment required threatens unpalatable rises in the cost to consumers."

For example Europe plans to spend \$160 billion by the end of decade on wind turbines. Based on two historic commitments: European leaders pledged to cut greenhouse gas emissions by 20 % from 1990 levels and to raise to 20 % the share of the EU's energy derived from renewable sources - both by 2020. Historic they may have been but it is clear that something very bad, yet fully predictable, happened to the economics (and hence taxpayers) when the plans moved from "boutique to industrial scale." When energy becomes grossly more expensive the quality of life decreases because, as the FT article correctly points out, discretionary income is diverted to pay for energy. In Britain electricity costs are expected to increase 60%.

Contrary to the new natural gas discoveries in the US, European companies will have to install \$1.4 trillion in new energy infrastructure to meet Europe's goals – why? To cut greenhouse gas emissions, a goal which half the scientific community considers fallacious. Billions of dollars must be invested in a time of very high debt to GDP ratios. This is likely to be impossible.

Says the FT article ***"replacing obsolete infrastructure is costly enough (\$1.4 trillion US), but if you do it with emissions reductions and then put a renewable objective on top, it is incredibly expensive."*** This is the result of the climate hysteria in the 1990's. Climate hysteria is also part of the reason that Americans elected President Obama. It seemed so simple at the time. Europe's commitment to renewables is clearly unsustainable.

"To call it fiscal stimulus is false advertising. This is re-engineering our economy."

The strain of such grandiose and untried European development will create a giant sucking sound, the vacuuming of all available private capital. And what about a prolonged slowing growth in Europe due to higher energy costs? This could become a self reinforcing spiral. More expensive energy is a tax that will lower family QOL and slow regional economic growth. Slower growth will cause these

³ *The Power Bill Arrives*, The Financial Times, February 3, 2010.

alternative energy megaprojects to lose money affecting investor wealth and government loan guarantees. All this based on a questionable hypotheses that carbon is the problem and that humans can control it. Today the shortage of credit, capital and the recession have cut such spending, sharply putting the EU behind their self imposed targets. The private sector in Europe cannot provide the requisite investment. Et voilà, government crowds out economic projects.

Spain, Germany, Britain, France and Italy need to spend \$80 billion / year for the rest of the decade. They spent only \$64 billion last year. The UK wind industry alone will be a net absorber of capital for the next 10 to 15 years investing every penny it makes for that period. By 2016 British electricity costs are forecast to increase by 60% under current plans for alternative energy. This increases to 10% of personal household income –the stark reality of our dalliance with mythical carbon issues. Methinks there is more to the CO₂ issue than cleaning the air.

Is this the dirty little secret? If so it is a secret that is becoming known in the US. In order to raise huge amounts of capital for such fragile projects, governments must control of the projects. If Western governments cannot control their debt accumulation how can they effectively run the energy sector of the economy?

Has anyone in Washington or Brussels read, “*The Road To Serfdom*”? Have you?

3. RESOURCE NATIONALISM (CHRISTOPHER A. BERRY, MBA)

Last week various news outlets, including The Globe and Mail, The Financial Times, and The New York Times, picked up a story concerning the CIC (China Investment Corp. is China’s sovereign wealth fund) and its increasing holdings of U.S. and Canadian equities. As the CIC is considered an institutional investor under U.S. law⁴, it must file form 13-F and disclose holdings in the name of transparency. This is how this information came to light.

The CIC was founded in 2007 capitalized with US \$200 billion. It has since grown to US \$300 billion and another injection of capital is due in 2010. The mission of the fund is to make long-term investments that maximize risk-adjusted financial returns for the benefit of its shareholder.⁵ Sounds just like any hedge fund or mutual fund except this is a government sponsored entity.

There are several interesting developments to consider about this disclosure. First, countless wells of ink have been spilled writing on the fact that the Chinese Government has focused much of its investing on US Treasury and agency mortgage debt. Based on the CIC’s filing with the SEC⁶, we know that the fund holds US \$9.6 billion of U.S. and Canadian listed companies. Not a large amount when you consider the total AUM of the fund is \$300 billion and the Chinese Government still hoards US \$2.4 trillion in forex reserves. However, her investment will almost certainly increase as the CIC continues to diversify its holdings away from US Treasury and Agency mortgage debt. This is a trend every U.S. and Canadian

⁴ The Securities and Exchange Commission mandates that any investment fund holding over \$100 million in US-listed holdings must publicly submit this info via a 13-F filing.

⁵ Here’s the link to the CIC’s website: <http://www.china-inv.cn/cicen/index.html>

⁶ Here is the link to the filing:

<http://www.sec.gov/Archives/edgar/data/1468702/000095012310009135/0000950123-10-009135.txt>

investor must be aware of. My goal is to inform you, rather than alarm you about investing trends growing around the globe today. Many in the U.S. do not realize how much paper money is being printed indiscriminately or how much debt is being issued in Washington. Obviously Chinese authorities do.

China's interest? Through the CIC she has made investments in U.S. and Canadian technology stalwarts such as Apple and Research In Motion, as well as banks and insurance companies such as Citigroup and AIG. To be fair, the fund only owned 30,000 shares of AAPL (out of 907 million AAPL shares outstanding) at the end of 2009. Nevertheless this is an example of diversification of its U.S. dollar exposure. In fact, many of the equity investments the fund has made amount to less than 1% of the total holdings of the fund. This does not include some of the negotiated holdings such as Morgan Stanley and Blackrock, where management sought out CIC investment to shore up their respective capital bases.

What strikes me as most significant here is that the biggest investments CIC has made are companies focused in the commodity sector. It should come as no surprise to regular Morning Notes readers about the focus we place on the commodity space and how the race is on for these assets. By combing through the 13-F, some of the notable investments are as follows:

COMPANY	COUNTRY	INVESTMENT
Vale SA	Brazil	\$652 million
Freeport McMoRan	USA	\$4.7 million
SPDR Gold Trust	USA	\$155 million
ArcelorMittal	India/Europe	\$9.1 million
Teck	Canada	\$3.5 billion
Kinross	Canada	\$4.6 million
Potash Corp.	Canada	\$5.4 million

I've highlighted a few of the investments above as they stand out in my mind. In July 2009, the CIC invested US \$1.5 billion in Teck Resources (TSE: TCK.B). The investment is now worth US \$3.5 billion – a nice 133% return!

Kinross (TSE: K) represents what appears to be the CIC's largest single exposure to a gold mining company. Finally, Potash Corp. (TSE and NYSE: POT) is an investment I find particularly interesting. Potash, of course, is used as fertilizer to increase crop yields and nutrient values. We're hearing word of water shortages in China and with more and more Chinese eating meat-based diets, access to potash producers is a necessity as potash also increases water retention in the soil.

So what are we to make of all this? First, the investments of the CIC in our respective capital markets are different from other foreign investments we've seen in the past. This isn't the Japanese buying Pebble Beach or Rockefeller Center – these are targeted investments aimed and procuring returns from commodities for the CIC shareholders – the Chinese citizenry. We've also written in the past on Chinese investments in the Canadian Oil Sands and in the Raglan Nickel Belt in Northern Quebec (Jilin Jien, Goldbrook and

Canadian Royalties). These investments offer a window into China's view of the best places to invest in the US and Canadian economies to achieve superior returns.

Moreover the world is now awash in resource nationalism. The current global crisis and debt deleveraging notwithstanding, the emerging economies of the world are well aware that they must carefully husband and develop their own natural resources as well as covet those of other countries. It is ironic, perhaps perverse, that in the United States our government is enacting legislation that makes US citizens more dependent on foreign natural resources. Senator Lisa Murkowski (R Alaska) recently noted this on the floor of the US Senate.

“Of course, we also need to make sure America is producing the raw materials used to generate nuclear energy. Here, again, the Administration took a step backward last year by withdrawing roughly 1 million acres of uranium-rich lands in Arizona. As a result, our nation has lost access to some of its highest-grade uranium reserves. We should know by now that following the same path for nuclear energy that we’ve been following for oil won’t work, and it won’t improve our energy security. It risks trading our dependence on foreign oil for a similarly devastating dependence on foreign uranium. 7”

We laud Senator Murkowski for her persistent and prescient educational efforts of her peers. Virginia has a world class deposit of 119 million pounds of uranium as does Arizona in its breccia pipe field north of the Grand Canyon – to which she refers.

Given increasingly strained relations with foreigners in the quest for their natural resources and the high US unemployment rate, the winds of US domestic natural resource development are blowing and with them a possible return to resource nationalism in the US. US citizens will realize some day that Canada is already moving aggressively to court non US capital providers in her natural resource spaces. There are few alternatives.

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⁷ Speech delivered February 11, 2010 on the floor of the US Senate.

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