

Today's Notes:

- 1. Flawed Theories**
- 2. Revett Minerals Agrees With Quaterra Resources**

1. FLAWED THEORIES

Most analysts tend to focus on the energy equation. Access to cheap energy sources is critical for an economy to prosper. "Cheap" is at least as important as "clean" when it comes to energy. I want to discuss the recent ClimateGate scam that seems to have been discovered through an examination of IPCC emails on a university (East Anglia) computer in England. Here the ultimate nature of the global warming research case is exposed.

This type of collusion occurred in academe in the Economics discipline in the 1960s through the 1990s. Here the idea was so simplistic¹. There was to be one risk measurement for financial assets. It was called beta. Beta was estimated from historical price data and explained all the systematic risk of equities that was important. The "model" was a simple linear (straight line) model with one risk parameter based on the inherent rationality of the markets. Hundreds of tenure decisions were awarded based on thousands of papers defending the CAPM and EMH written for peer reviewed journals such as the Journal of Finance. The research and the models proved inaccurate – all of them. Today the finance community is left in tatters trying to price, even define, risk appropriately. None of today's 1980s quant models works appropriately.

Here's the litany of wrecked approaches: CAPM, OPM, VaR, and the APT². Even Myron Gordon's venerable dividend discount model may not work in the short run. Now, it seems, our government will have much to say about that. They will apparently tax most, if not all, transaction in the capital markets. This is what happens when a system fails as badly as our credit and capital markets did in 2008 and 2009 based on misestimated risk. Big Government, run mostly by lawyers, comes into the fray to "fix" the problem. Once again, as the behavioral psychologists have maintained, human decision making seems much too complex for a simple quantitative model to describe the reality of risk and reward in financial assets effectively.

We now come to what we have always expected and written about often. Some of the smartest people have upbraided me for claiming that Anthropogenic Global Warming (global warming caused by man not God) was not the cause of a threat to our existence. I have claimed that there is as much peer reviewed research to show that AGW does not exist. But world opinion has been hijacked by fear. World leaders are headed to Copenhagen shortly to tax everyone's use of carbon into oblivion and increase the costs of energy

¹ My late mentor, Professor Robert Vandell, said that before computers researchers used elastic bands to group plotted data points and discern the slope (beta) of the risk / return line. He claimed that Sharpe's early work on the variance covariance matrix assumed off diagonal variances were zero. This was a result of the fact that in the 1960's computers were not powerful enough to invert the entire matrix. So assuming away off diagonal elements by diversification and the invention of a single systematic risk factor was a convenience.

² Capital Asset Pricing Model (CAPM) , Arbitrage pricing Model (APT) , Value at Risk approach (VaR), Option Pricing model (OPM).

dramatically. One leading AGW scientist, Phil Jones, was quoted as saying in these infamous emails,

“Just completed Mike's Nature trick of adding in the real temps to each series for the last 20 years (i.e., from 1981 onwards) and from 1961 for Keith's to hide the decline.”

The plethora of emails emanating from that British University is amazing. In some ways it reminds me of an old technique that more than a few assistant professors of Finance used – called data mining. Much academic work that showed the existence of a low P/E effect was rejected based on biases in the financial data. Survivor bias, where bankrupt companies are not adequately handled, was one such bias. Everyone knew that low P/E stocks tended to provide higher returns over time. But nobody in academe would dare admit (or publish) the truth because the results went against the prevailing theory which held in the Economics community that investors were ultimately rational. Trillions of dollars were allocated by pension funds, mutual funds and trusts based on the beta risk and alpha potential. In most cases these were more than flawed – in most cases probably useless.

So here we have “tricks” being played to “hide the temperature decline.” That’s enough for me. The end result in this case is not about a bunch of portfolio managers allocating money; it is instead about the collusion of governments to take control of the energy sector, a very large part, of the global economy. For example 51% of US electricity comes from coal fired utilities which would be taxed based on their carbon use. Today it is not simply a question of whether God or man controls our climatic destiny, it is a question of deceit, fraudulent research and a misplaced desire to raise taxes on energy and inadvertently suppress growth and prosperity in every country in the world.

This type of biased thinking is not new. When a researcher wants a particular outcome research can be skewed, data can be interpreted or suppressed to assure the outcome. Economics, the dismal science, practiced this for four decades through 2000 with a defense of the Efficient Market Hypothesis. Galileo and Copernicus met a similar fate. Now we have a last chance to re examine the facts in global warming – conveniently renamed “Climate Change.” It is clear that our government wants to run both health care and energy and thus reduce our ability to make intelligent and individual choices and hence prosper.

Given a dismal government track record in the past we must reject this effort.

2. REVETT MINERALS AND QUATERRA TEAM UP

Revett Minerals (RVMIF) and Quaterra Resources (QMM NYSE AMEX) announced this AM that they have signed a Memo of Understanding to explore the potential for a joint effort at exploring and developing the Rock Creek deposit in Montana and other North American properties. This MOU has the potential to create value for shareholders in both companies. Currently Revett Minerals employs 180 employees profitably mining the Troy deposit (silver and copper) in northwestern Montana. We expect the company to move to its C-Bed (11 million tons, 1.6 ounces silver, .55% copper / ton at Troy) next year where the grades and tonnage will improve generating significant free cash flow generation from the Troy mining operation by the fourth quarter 2010.

Rock Creek (20 miles south of Troy) is a world class deposit consisting of 230 million ounces of silver and 2 billion pounds of copper. The deposit is fully permitted by the state of Montana though the environmental lobby has blocked its development for several years. Development of Rock Creek will employ 300 new people and higher grade (.7% copper). There is significant additional exploration potential at both Troy and Rock Creek. The Governor of Montana fully supports Revett's development of Rock Creek.

Quaterra's CEO, Dr. Thomas Patton, said ***"Revett's operating experience and world-class Rock Creek deposit, in combination with Quaterra's exploration focus and portfolio of early-stage projects, present an opportunity to unlock value for both companies,"***

Said John Shanahan, President and CEO of Revett:

"We are delighted with our strategic alliance with Quaterra as we believe that our skill sets complement each other and will allow us to fully realize the potential of each company's assets."

On the other side of the ledger Revett's operating experience is now exposed to Quaterra's Nieves (30 million ounces of silver in Zacatecas) and MacArthur (QMM's Nevada oxide copper resource). The synergy of this combination could create significant value for both sides. The combination of the exploration expertise and property pipeline of Quaterra with the operating expertise of Revett Minerals under CEO John Shanahan makes for a unique opportunity for value creation. This agreement is, at present, a memo of understanding. But it is a very positive step for both companies. The Quaterra news release stated,

"The MOU may provide Quaterra with the opportunity to gain a foothold into Revett's production and development stage silver-copper holdings in the U.S. Revett's objective is to gain exposure to Quaterra's pipeline of precious and base metal exploration projects in North America, including the MacArthur/Yerington copper project in Nevada, the Nieves silver property in Zacatecas, Mexico, and the Americas-Mirasol gold/silver property in Durango, Mexico."

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