Today's Notes:

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1. THE BAD NEWS BEAR

BECAUSE THE HOLY GHOST OVER THE BENT WORLD BROODS WITH WARM BREAST AND WITH AH! BRIGHT WINGS."
GERARD MANLY HOPKINS

The world, as Hopkins tells us, is indeed "bent." It behooves us to take another look at the global economic playing field. Meredith Whitney the financial analyst and bad news bear from Oppenheimer suggests that credit availability may be halved by new proposed legislation. Two months ago she intoned,

"The best-case scenario is that financial firms take the pain quickly and purge assets from their balance sheets. That could bring (ed.: financial) stock valuations down by as much as 50%, which would be enough so that you could legitimately buy long-term positions,""

This AM she said that **securitization has dried up** and this could throw a $2 trillion liquidity crisis at the US consumer. She pointed out that prior to 1995 the securitization-to loan-on-the-books ratio was .9. Since 2000 that ratio has increased to 7. The new lending regulatory environment proposed on May 19 (Fed, OTS, NCUA) will change that. Therefore banks must re-capitalize their balance sheets quickly. This is the warning that Clinton Treasury Chief Larry Summers, and a dozen others have made. Citibank, for example, has already raised $22 billion in new capital. Now the cost of credit card securitization will increase along with lending rates.

The 600% securitization to loan ratio mentioned above means that the debt and equity markets sopped up this securitized paper. At the time the banks breathed a sigh of relief but investors are now left holding the bag. You remember the US consumer don't you? Mom and pop comprise the most potent economic force in the world for global growth. It now appears with all the forces arrayed against the banks and the lending industry (particularly new regulation) that the global credit squeeze will increase. The long and short of the issue is that the US has been living on increasingly easy debt for years. That will be over according to Whitney. If so our standard of living, (that discretionary new boat, car, vacation, Broadway musical, etc.) must decline. The City of New York estimates this AM that employment in the city's banking sector will shrink by 7.1% (33,300 jobs) in 2007-2008.

Mom and pop, fed by pandering Congressional Reps such as Maxine Waters and Debbie Wassermann Schulz, are misled and confused. Rep. Waters threatened oil execs, in testimony on Friday, with nationalization of the oil industry. Rep. Debbie Wassermann Schulz also scolded Big Oil execs. She said, ***"I'm a mom of three young children who filled up her minivan the other day for $68 … Sixty-eight dollars — that's real money. Maybe that's not real money to the five people (editor: Big Oil execs) sitting here because $68 is like a nickel to you, based on the income you all earn."***

But Rep. Schulz should also be aware that cheap gasoline is not an American birthright. Perhaps she should downsize her minivan? $7 per gallon gasoline is most definitely in the cards, as I have often forecast in past Morning Notes. The problem is that Ms. Schulz's $68 is not ***"real money"*** because it can be produced "***at essentially no cost."*** Gold and other commodities are morphing into a "third" type of currency, as my friend Dennis Gartman would likely agree. For our legislators to misunderstand the nature of our money creation and the related commodity market dynamics is criminal. Can anyone educate these people? Ms. Waters' suggestion of nationalization of big oil would be a disaster. No one, not even Senator McCain, wants to drill the politically sensitive ANWAR. No one has any sense or guts to solve the problem. It is all political pandering. It is threatening our security and lifestyle. Be appraised.

The credit crunch is an issue that Dr. Bernanke did not recognize when he made his now famous 2002 deflation speech. At the time he laid the foundation for his deflation fight,

"But the U.S. government has a technology, called a printing press (or, today, its electronic equivalent), that allows it to produce as many U.S. dollars as it wishes at essentially no cost."

Everywhere today, there is shrinking credit availability, de-leveraging and credit liquidation. The Fed's rate cuts, new lending facilities, bailout of Bear Stearns and increased money supply have not lessened the severity of the credit crunch one iota. This tightening will now become extreme. Credit cards are next on tap. **Much tougher lending requirements are in store.** Car loans are also being squeezed. This had impacted GM and Ford's sales and business planning significantly.

At 9 AM today we will see the new March Case-Shiller housing price numbers. They are expected to accelerate downwards. Bad news could bring higher quality ALT-A mortgages into play. As housing prices continue to fall, more mortgagees, even those with the better paper, will be “upside-down.” This will create the next wave of bank write-offs and security losses. In short credit market liquidity is likely to worsen. Can Washington move expeditiously to save imminent foreclosures as George Soros suggests?

To top off this seamy situation, Dr. Greenspan suggested that a recession is dead ahead though he thinks not a deep one. One wonders what he really sees in his crystal ball? He also noted that, ***“it was too soon to tell whether the worst of the financial crisis was over, as this would depend on what happened to house prices.”***

I remain on the sidelines with the exception of my Discovery portfolio. Hard assets are now relatively rare and increasingly costly to find and produce. If they are morphing into pseudo-money, their discovery will be extraordinarily valuable. This is my current fishing pond. There are numerous values in these waters today.

When I see the real estate markets stabilize, our capital markets will be poised for a rebound. Unfortunately, that may require several years of debt liquidation, overhang and financial system recapitalization. A cardinal rule of Discovery Investing is to acquire “significant positions.” A “significant position” is defined to be large enough to make a positive economic difference in your lifestyle. Hopkins suggests that the world is “bent,” the Holy Ghost ***“broods with warm breast and Ah! Bright Wings.”*** Take heart!

2. THE COMMODITY SQUEEZE IS REAL

Last week I wrote on the latest “villain” in the commodity “bubble.” This AM it appears to be Big Oil’s executives. Congress, of course, takes no responsibility for the perilous energy situation in which we find ourselves. Perhaps we should throw out all Washington’s lawmakers. You must agree that the energy buck stops in Washington.

The bête noire last week was, of course, institutional investors such as CALPERS, Harris Bank, etc. They are, ironically, trying to guarantee that sufficient pension returns will be maintained by shifting asset allocations to the commodity / discovery sector. The problem is two-fold. First the futures markets may be too lax in their position limits and margin requirements. This was a problem that Chris Tibbs and I highlighted in 1995 in the nascent Chinese Treasury markets. Second, and more important, there has been so little investment in the commodity and more generally Disovery sector that there is little commodity market capitalization created in the equity market. One only has to see performance of the Morgan Stanley Commodity equity index to see the effect. The index has doubled in the last two years for a compound annual rate of 40% plus, well above inflation. The index is composed of 30 large cap companies all of which are Legacy companies in terms of my Discovery Investing philosophy.

It is, therefore, interesting to note that Washington is only now becoming aware of the rise in commodity prices when these equity prices have now gone bid for the past three years. Perhaps the price of gasoline was the catalyst for this recognition.

Nevertheless there are more profound problems south of the border. President Calderon is begging, this AM, for revolutionary changes in Mexico's energy policy.

His plea comes on the heels of declining production from Mexico's oil fields. Lest we forget, Mexico with Canada and Venezuela is one of America's largest oil suppliers.

A recent government study by the Mexican government showed a decrease in proven reserves from 20.1 billion barrels equivalent in 2002 to 14.7 billion in 2007. Mexico relies on oil production to supply 40% of its governmental income. But left wing politicians have rejected any increased foreign technical assistance to the industry. Consequently Mexican oil production is floundering. Pemex for example reported a production decline from 3.18 million barrels per day (M BPD) in April 2007 to 2.77 m BPD in last month – a 13% decline in the past year. Production at Mexico's largest field, Cantarell, declined 24% last year. There is a clear supply squeeze underway in Mexico. At the same time energy demand from China continues to increase. T he China situation cannot be cast in the light of potential slower growth because current growth is endemic to hundred's of million of people experiencing a new quality of life. Cars purchases are just one example. Experiencing these new lifestyles will be denied only at great risk.

Last week my friend Chris Tibbs, formerly of Citibank, suggested the book, ***Bad Money*** by Kevin Phillips. This is a must read. To site just three examples from it, he focuses on the academic affection for Efficient Market Theory and how that conned Wall Street into misestimating risk. He notes that inflation statistics we are ‘fed’ by the Fed and Congress are vastly understated. Mr. Phillips also discusses peak oil and 6 independent studies in 2007 that support assertions that global oil production peaked in 2005 or will soon peak. He also notes the lack of understanding in Congress of new world events that have overtaken the US economy. A second book worth a read is Peter Schiff’s, ***Crash Proof.*** The author acknowledges global problems and suggests protective investment positions.

3. NAMES THAT KEEP ON GIVING

I normally do not write on a company that does not have a press release recently out. I always try to make definitive statements about the company. Today, and in the future, I will occasionally write a thumbnail review of a few of the Incubator and Mature discovery stocks that have languished since October (at popular request):

Norwood: Up 300% on news that they may have a significant petroleum discovery in Nicaragua. Mystery / history shift coming? Put on the Discovery radar screen, once again.

Polymet: Up 40%, since bottoming in March (19^{th}), on expectations of approvals from Minnesota DNR for the company’s mining permits and new reduced cost estimates.

MegaWest Energy: Steaming in Missouri on its heavy oil field. Expectations for 1,000 barrels per day by year end. I am a buyer of MegaWest on weakness. At $65 per barrel oil net back about $17.

Piedmont Mining: Announced acquisition of option on a new property. Stock is cheap at $.17. I am holding my position pending information on the new property and financing.

Aura Silver: drilling in Mexico on high grade silver potential. New CEO in place and I await drill results. I will hold for drill visibility.

Terraco Gold: Active in acquisition and drilling programs on Middlegate and Moonlight properties. The drill is turning for Terraco Gold. I will be a buyer on weakness below $.30.

Birch Mountain: Visited company management twice in November and April. New marketing momentum under COO Joel Jarding could pay off. I am holding position awaiting more visibility on further orders. Orders will be critical for the company.

Derek Oil and Gas: Given a price of oil over $100 per barrel and the proximity of the company to a refiner, I **hold** Derek while DRK management raises money and plans to bring in additional steam generating capability. Stock seems cheap at this level.

Dejour Enterprises: Up 50 % since February on good discovery potential and its discoveries in Alberta and BC natural gas. Natural gas is significantly stronger and should move higher. Dejour seems to be breaking out.

Kenrich Eskay: The Company with some of the most prominent massive sulphide experts in the world (Paul McGuigan) has acquired significant new land positions in and around the Eskay Rift geology which produced the Eskay Creek mine. Last year the nearby Eskay Creek mine produced 68,000 ounces of gold. KRE stock is cheap at $.28 with an expanded property position in elephant country and a team of top geologists.

Terrapinn will hold its Latin American Mining Congress

On June 17th through the 19th, Terrapinn will hold its Latin American Mining Congress 2008 in Miami. There will be many institutional investors in attendance. I will chairing two sessions. I invite you to attend. Other notables attending will be John Embry, Frank Holmes, Ari levy and several mining and governmental officials from Mexico, Colombia and other Latin American countries. This will be a chance to ascertain the true pulse of the global mining industry. Please go to the web to see the highlights of this conference:

www.terrapinn.com/2008/latmining

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