

Today's Notes:

- 1. The Deflation Vortex**
- 2. Yerington: Domestic Copper Supply**

1. The Deflation Vortex

Canada's National Post says it well this AM.

“More than three years after the financial crisis struck, the economy remains stuck in a consumer debt trap.”

The bottom line is, has always been, that the end of a credit crisis and the beginning of a new credit cycle cannot occur until all the debts have been repaid or forgiven.

The Edge Of Chaos, is an out of print book but worth a read. In it author Bernice Cohen holds the simple prescription for the solution. She says “all debts must be settled.” Such a process can be drawn out and painful or quick and painful.

But our leaders, on both sides of the aisle, have abrogated the duty to solve the world's massive debt problem. I am not claiming this will be an easy task. Because politics is involved in the decision of debt resolution and as a society we our addicted to debt, any painless solution is unlikely.

Yesterday a money manager asked me whether this situation (Yesterday I outlined the recent global equity market collapse since mid-July is comparable to the 2008 crisis. It is not at all similar. Because of the still precarious nature of the banks (see chart below), a result of the inability to settle increasingly worthless real estate liabilities the debt problem lingers and festers. All this is compounded by the fact that nobody in Washington will talk about this borrower / lender conundrum. In the end both the borrower and lender must take a voluntary haircut one way or another.

If not, this torpid situation will drag on for months or years. Jobs programs and unemployment extension may ease the pain but until the overhead of underwater borrowers is resolved the economy, at best, will remain in neutral and unemployment will persist. The longer all these patchwork rescue packages are proffered, the greater the risk of contagion and a serious economic collapse. Europe is the latest example where French and German banks have been drawn into the expanding vortex.

This AM Korean equities have fallen 3.6% the Hong Market is off 3.2% and equity Futures in the US are lower - again.

One case in point is the situation in Greece. Yesterday Greece has announced they cannot make their current payment to the European banking sector. Europe's response is to postpone the payment- pushing it down the road in hopes that somehow another rescue package can be put in place. Greece is expected to implement further austerity measures – not a recipe for recovery and perhaps not a good recipe for debt resolution.

The following chart that really concerns me, more than the velocity of money or the money multiplier (both headed lower). It is a chart of the US bank index . Since mid-July it has declined from 48 to 33, a decline of 33%.

Yet we have not heard a word from our leaders on the obviously precarious state of the US banks. The equity market is sending a message –a 33% decline in the banking sector is highly significant reflects the debt situation in which they are all entwined. Since February's peak it has declined 42%.

FEAR ANYONE?



Is Morgan Stanley the Next Lehman?



The National Post correctly notes:

“We’ve put this off for too long,” said L. Randall Wray, a professor of economics at the University of Missouri-Kansas City. “We need debt relief and jobs and until we get these two things, I think recovery is impossible.”

This is the most poignant statement. Debt relief ultimately will be had through debt deflation – one way or another. It can be chaotic, as Cohen suggests in her book, or it can be engineered by our leaders.

We pointed out yesterday that US consumer debt is about \$13 trillion today. This well above historical norms and the debt levels (debt to GDP) of Germany, France, Spain and Greece. Such debt borne ominously by a US population with 22 million underemployed threatens to drag the economy along the bottom for years – at best.

Bernice Cohen suggests from history how this credit cycle will end. Her example is drawn from the Great Depression.

“In the melancholy reckoning that followed, the banks realized that many of the loans they had so willingly provided would never be repaid. Consumers realized they were hugely over-borrowed. A swinging debt deflation took hold.

This is a credit vortex; the underlying value of an asset such as a house, land or financial security, had fallen faster than the value of the associated loan. Once a debt deflation sets in it is incredibly hard to dislodge. ... In a severe debt deflation sales of good and services fall away, there are serious shortages of cash and profit margins are squeezed ”

Are we about to fall into a debt deflation vortex? There is no doubt we will reach such an unstoppable crisis if we continue to put off the voluntary debt reconciliation. This AM oil (-3.2%), gold and copper are all in decline deepening our deflationary concerns.

2. Yerington: Domestic Copper Supply

As I mentioned in yesterday's Morning Note I have been on the road visiting companies in the past month. Last week I spent two days with the Management teams of Quaterra Resources (QMM AMEX) and Entre Gold (EGI AMEX). These two companies own a significant portion of the Yerington District. My take away from the visit is that the Yerington District is a huge world class copper district. After touring both Quaterra's properties and those of Entre Gold it appears that this district may hold 30 to 60 billion pounds of copper.

There are three known porphyry deposits including Quaterra's Yerington mine see below, Quaterra's Bear deposit and Entre Gold's Anne Mason. We toured all three deposits.

The Yerington Pit With 97 Million Tons Of Copper Resource Remaining



Historically Anaconda carried the Yerington mine as 97 million tons of .365% copper. Quaterra has three drills running on the Yerington Pit and it is likely that the Yerington pit resource will be upgrade to a 43-101 status and it should increase in size.

More important for the entire Yerington District is the progress that Quaterra has made on its MacArthur open pit acid leachable deposit. This is an oxide copper / chalcocite deposit that outcrop. Quaterra has been focused on this for years. I now understand why.

The company has released recent drill results that indicate a much larger extent to the MacArthur deposit and also a higher grade to the resource. MacArthur's enriched copper is oxidized in part and outcrops over the area. This is ideal for an open pit operation. We are awaiting the Preliminary Economic Assessment which should occur in the first quarter of 2012.

I visited Yerington when the company first acquired MacArthur in 2006. The progress since is amazing. I estimate that the size of MacArthur (the original pit mined by Anaconda and Arimetco) has increased by 4 or 5 times (my estimate) from the drilling program Quaterra has executed. This last QMM release showed grades significantly higher.

My realization as I visited Yerington last week?

Whoever controls the MacArthur controls the Yerington district. MacArthur has been and will be a run-of-mine producer where the ore may not need to be crushed. When Anaconda needed more run-of-mine ore it ran a bulldozer (two pushes) over the surface at MacArthur and uncovered green copper rocks, oxides and chalcocite.

MacArthur will be put more quickly into production and will be more economic with much less capital expense than any of the known porphyry deposits - with the exception of Quaterra's partially mined Yerington pit. At the Yerington pit about 300 meters of water can be removed and supplied to local agriculture and the approximate 100 million tons of ore can be mined directly with no overburden removal.

We came away impressed by both companies in the district. Lyon County Nevada has the highest unemployment in Nevada and Nevada has the highest unemployment in the US at 13.1%. There is superior infrastructure. It consists of rail and road access, human capital, willing local officials, cheap gas fired electricity nearby, and perhaps most important the vision of Quaterra management to clean up the mess left by the previous operators. Yerington is indeed elephant country for copper porphyry hunters.

From a historical and 43-101 perspective Quaterra's property holds about 7 billion pounds – once again not all these resources are NI 43-101. We think they will be by the end of Q1 2012. However the drill programs currently in place may increase this resource and raise it to 43-101 level.

Obviously all companies are under massive pressures mentioned in the Morning Note above. Quaterra announced yesterday that 93% of the warrants were exercised providing \$6.77 million to the company. Both stocks, Quaterra and Entre Gold have declined by 67% and 65% respectively since the beginning of the year and particularly recently due to these increasing global deflationary pressures. Under the circumstances of a very superior asset portfolio including Yerington's owned assets, Quaterra is an excellent value stock and a deep contrarian play at present.



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