

**Today's Notes:**

1. **Housing and Cars: American Dream?**
2. **Ten Point Grid: Game Changers**

**1. HOUSING AND CARS**

April Fools! It was all a practical joke just to twig all those newly minted millionaires out there. Taxes will fall, jobs will proliferate and Jimmy and Sally can go to Harvard after all.

Mom and pop, relax.

Sorry it is April 1<sup>st</sup>. I joke! We start the morning with a discussion of the US housing sector. This sad story began with a little known contract known as a "sub-prime" mortgage. It was designed for people with poor credit and no down payments. It is not necessary to further define this contract. I am certain you have a good idea of the results of this "innovation."

Let's face it every Administration in Washington from President Carter forward wanted to put more Americans in homes. Even the most recent Congress refused to believe that there were any problems with Fannie Mae and Freddie Mac (the GSEs) that grew to mammoth size (50% of all \$14 trillion in US mortgages). They were key enablers of the sub prime and ALT-A paper machine by taking on all mortgage comers. Wall Street salivated and securitized.

Congressman Barney Frank was in denial in 2006 and 2007 when confronted with the potential for a GSE disaster. The commercial banks caught on early and by November 1999, during the Clinton Administration, Glass Steagall, the Depression era legislation that restricted commercial banks from leveraging up to 50 to 1, was repealed in the Senate (90-8) and in the House (362-57). Both Republicans and Democrats voted overwhelmingly for this claiming that by permitting banks to expand into investment banking and insurance (and accumulate massive leverage) consumers would save "\$18 billion a year" through economies of scale -- a figure that seems rather quaint as taxpayers now pony up trillions of dollars to rescue those same institutions.

President Obama's National Economic Council Chairman, Larry Summers, then President Clinton's Treasury Secretary said,

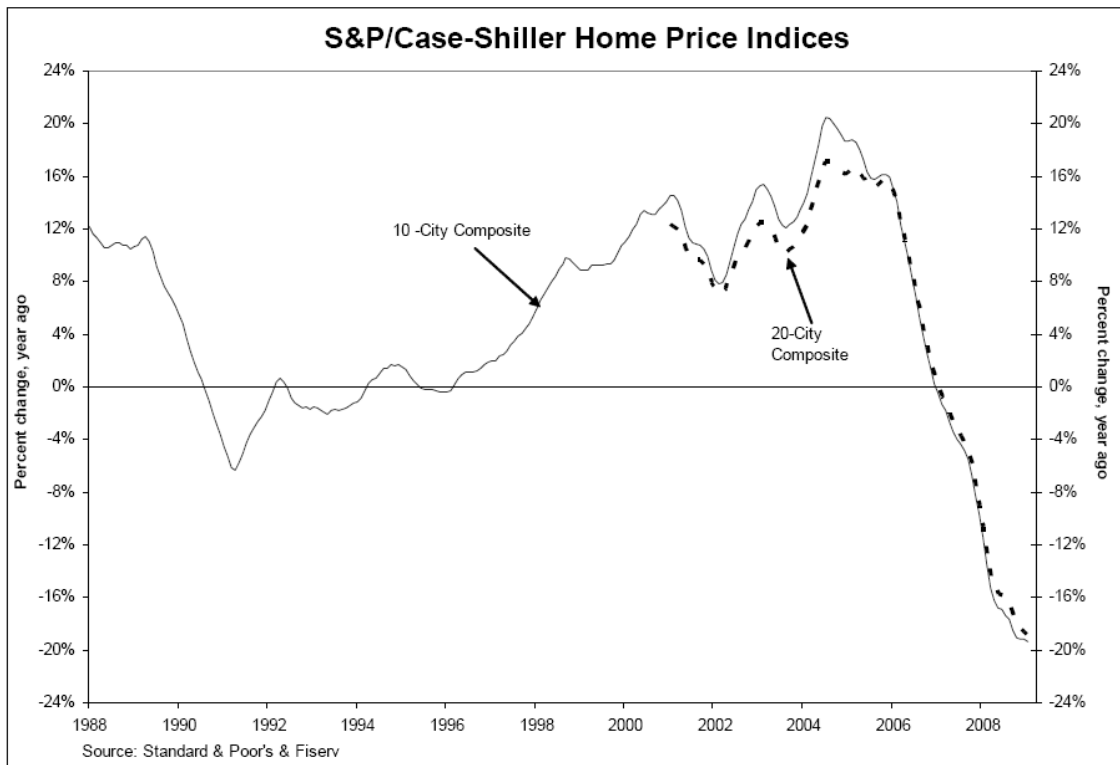
***"Today Congress voted to update the rules that have governed financial services since the Great Depression and replace them with a system for the 21st century. This historic legislation will better enable American companies to compete in the new economy."***

In a short ten years Mr. Summer's "***new economy***" has become very old indeed. At the same time New York's Senator Chuck Schumer opined,

***"If we don't pass this bill, we could find London or Frankfurt or years down the road Shanghai becoming the financial capital of the world. There are many reasons for this bill, but first and foremost is to ensure that U.S. financial firms remain competitive."***

Current Treasury Secretary Geithner was a high ranking treasury official under Mr. Summers at the time GS was repealed. In the final analysis if there is any finger pointing to be done, the finger must point at Washington – both Republicans and Democrats. The idyllic notion of 3 cars in every garage and a 3 car garage for every American was never sustainable – no matter how much our leaders at the time denied the growing, onrushing 30 year final catastrophe.

Here is yesterday's housing story from Case / Shiller. It is still a sad story though one commentator yesterday said, with a straight face, *“the rate of decline, of the rate of decline in housing prices may be slowing.”* No joke! The year-on-year average home price decline nationally now approaches 20% for both the 10 and 20 city indexes.



**Since the housing peak in July 2006 homeowners in Phoenix have witnessed an average housing price decline 48%. Asset values in the Sun Belt have been ravaged. S&P suggests that housing remains on the downtrend even if the downward price movement might be slowing. The Case Shiller S&P news release somberly noted,**

*“All 20 metro areas are reporting negative monthly and annual rates of change in average home prices. Seven metro areas and the 20-City Composite recorded a record monthly decline in January. In addition, seven metro areas (not always the same seven) reported declines in excess of 4% in the month of January alone. Phoenix led with a report of -5.5%. Every MSA has had at least five consecutive months of decline, dating back to September 2008. On a marginally positive note Cleveland, Los Angeles and Las Vegas are reporting a relative improvement in year-over-year returns, in terms of lesser rates of decline than last month's values. Furthermore, Las Vegas, along with five other metro areas, showed a marginal improvement in monthly returns, albeit still negative.*”

*The three worst performing cities, in terms of annual declines, continue to be from the Sunbelt, each reporting negative returns in excess of 30%. Phoenix was down 35.0% (YOY), Las Vegas declined 32.5% and San Francisco fell 32.4%. Dallas, Denver and Cleveland fared the best in terms of annual declines down 4.9%, 5.1% and 5.2%, respectively.”*

Professor Shiller said yesterday that another 20 to 30% decline through mid 2010 is not out of the question. The housing debacle is still a bedfellow at least through the end of January, when these results were recorded. **This means that the banking system cannot get much better. I really don't care if 30 year fixed mortgage rates are 4.58%.** Mom and pop are in a deflationary funk right now, waiting for lower prices. Bankers are in a mark-to-market bind. If they lend here and asset (not only housing) prices continue to fall more toxic paper will surely surface. This paper is no longer from sub prime mortgages but frequently from high quality mortgages. Defaults and bankruptcies are still high and on the rise.

This is absolutely a crisis of our own making. The 3 decade combination of Washington, Wall Street, London and yes, mom and pop in Kankakee now has a death wish. There can be no sustainable economic recovery till the banking system is able to perform its critical functions as envisioned in 1934 under Glass /Steagall (GS).

And what is the status of the American auto industry? Washington now runs that show. The team headed by a new Car Czar, Steve Rattner combined with Larry Summers (yes the same that praised the repeal of GS) and, of course, President Obama now makes industrial policy. This AM Bloomberg reported that President Obama sees a “pre packaged Chapter 11 bankruptcy” for GM and is prepared to let Chrysler “go.” This means liquidation and a fire sale of individual pieces of Chrysler. Will it be possible to revive this industry? Who will employ the tens of thousand brothers and sisters of the UAW? The major task now for the new administration, whether it acknowledges it or not, is to develop a “**new** industrial society.” Where is John Kenneth Galbraith when we need him? To hear Washington's plan the auto industry **must** now produce “green” cars, which in turn will produce “green” jobs. Green jobs are the highest priority in Washington these days. Stay tuned.

There is relative strength in Canadian housing but it is also beginning to wane. Canada has many fewer banks and hence less exposure to US sub prime and ALT-A mortgages. However, Canada now will sneeze more loudly when Washington catches a cold. Washington has pneumonia and is not getting better. Ottawa had better take note. The Canadian situation is less dire of course because the Canadian banking system is very much stronger not having been infected by the sub prime crisis. Nevertheless, as 95% of Alberta's gas drilling fleet is mothballed and 9,000 Chrysler employees, working mostly in Ontario join the bread lines, the Canadian economy will worsen. Weather in the Great White North will feel less like spring, more like the onset of winter.

Given massive de-regulation and accelerating missteps in the US for three decades, our leaders' politically motivated assumption that private home ownership is a right and not a privilege has come to grief. Since 1978 the Federal Reserve, Congress and EVERY Administration has touted the inalienable right of every American to own a home (or two) and a car (or three). Do you have any confidence in the current ability of the gang in

Washington to right the situation? The American guarantee had become Life, Liberty and a pursuit of cheap housing. Nassim Taleb's complained on Bloomberg this AM,

*“Why do I as a taxpayer have to subsidize those that failed?”*

April fools, all.

## 2. GAME CHANGERS

The most important aspect of Discovery Investing is ranking potential discovery candidates using the Ten Point Grid. I developed this technique over two decades while working on Wall Street and refined them subsequently while writing Morning Notes. I publish these below for your perusal. Because I now have several thousand more readers, and also because commodities have bottomed and cancer treatments, for example, are always Game Changers, I publish this Grid once more.

So here they are. Using the Grid is fairly simple. Rank each of the ten factors for each company. Add them up and find what you think are the highest ranking companies. This approach worked well during the commodity bull and is working well now. However now we have to emphasize different factors. This will be the topic of my tutorial at the Calgary Cambridge Symposium on Saturday April 4<sup>th</sup> and Sunday April 5<sup>th</sup>. If you have a contrarian bent, it is now time to be seeking those companies that will be resurrected even though the recovery may still be a year in the future. Here is the ten point grid.

- **Assets / IP / Technology** world class?
- Percent Project Ownership?
- **Potential, timeliness and immediacy? A GAME CHANGER?**
- **Management and Board** track record, ownership and insider buying?
- **Company Diversification:** Portfolio across several assets?
- **Cycle and Catalyst** identification?
- **Establish Positions in Contrarian** Assets. Black Swan?
- Financial **Soundness / Sustainability / Dilution mgmt? Balance sheet strength.**
- **Company's Stakeholder** relations?
- Investor **Behavior:** Patience and Courage?

In today's environment points 1, 3, 4 and 8 are most important in analyzing your picks. But I want to provide a tutorial focused on potential "Game Changers." Why Game Changers? because in today's market a cure for cancer, a stem cell treatment for ALS or a new, clean energy technology will be worth many billion dollars. You only need one of these to create great wealth and also to do some "good." In this respect Discovery Investing is a socially responsible approach to investing. Here are some of the names I may review in Calgary. These are not recommendations nor are they in order of priority though I own many of these companies:

1. Senesco Technologies (Cancer)
2. Melkior Resources (Gold)
3. Neuralstem (ALS)
4. Indicator Minerals (Diamonds)
5. Vadium (Computer Encryption)
6. Houston Lake (Gold)
7. DataMeg (recycling)
8. Avalon (Rare Earth and Lithium)
9. Hyperion (Nuclear)
10. Nu Coal (Coal to Gasoline)
11. Blue Earth (Recycling)
12. Quaterra (base and precious metals)
13. Terraco Gold (Gold and silver)
14. Midway Gold (Gold)
15. Commerce Resources (Tantalum)
16. Minco Silver and Gold

Not all these companies are public. I own Senesco Melkior, Terraco, Midway, Neuralstem, DataMeg, Quaterra and Houston Lake. The purpose is to tech a case study of this important aspect of Discovery Investing. It is no longer possible to throw darts at commodity stocks. As always, should you accept this assignment your job will be to select which 5 of these you think you must own? See you in Calgary!

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*Goldcorp, Senesco Technologies, DataMeg, Immtech International, Horseshoe Gold, Derek Oil and Gas, Terraco Gold, US Silver, Neuralstem, Piedmont Mining, MegaWest Energy, Valcent Products, CGX Energy, MacMillan Gold and Quaterra Resources. He has been awarded 250,000 options on Terraco Gold exercisable at C\$.50 for 5 years, for services as a financial advisor. In his role as advisor he has been awarded 75,000 options from Polymet which strike at C\$2.76. We cannot attest to nor certify the correctness of any information in this note. Please consult your financial advisor and perform your own due diligence before considering any companies mentioned in this informational bulletin.*