

**Today's Notes:**

**1. Currencies**

**PLEASE CONSIDER ATTENDING PETER GRANDICH'S CONFERENCE THIS SATURDAY. I THINK IT WILL BE ONE A SUPERB EDUCATIONAL EXPERIENCE.**

**IF YOU ARE ANYWHERE ON THE EAST COAST THIS SATURDAY AUGUST 15<sup>TH</sup>. IT WILL BE WORTH YOUR DAY TO HEAR PETER GRANDICH, JAY TAYLOR, BOB MUNOZ, LOU SCATIGNA AND YOUR'S TRULY UPDATE ON THE CURRENT STATE OF AFFAIRS.**

**I WILL BE PRESENTING MY POST-CRISIS MODEL PORTFOLIO, COVERING POTNETIAL INVESTMENTS IN LITHIUM, RARE EARTHS, POTASH, WATER, URANIUM, COAL-TO-LIQUIDS AND BIOFUEL TECHNOLOGY, COPPER AND SILVER.**

**PLEASE SEE:** <http://grandich.agoracom.com/2009/07/the-one-conference-you-must-attend/>

## **1. CURRENCIES: STRANGE ETHER**

I do not usually look at short time series of data. It is **always** over longer time periods that trends and changes in trends (turning points) become evident. Fortunately we are not market timers here at DiscoveryInvesting.com. The valuation of discovery is independent of turning points and hence it is a longer term investment strategy – perhaps the most serious disadvantage of the discipline. It requires patience a commodity sadly lacking in most practitioners.

Today I want to make a point regarding what I believe is happening in the currency markets. The data below represent three trading days in the foreign exchange markets this week, Monday through Wednesday. This pattern has occurred (though not as definitively) weekly since October 6<sup>th</sup>.

This week the US \$ has been stronger each day. This must be slightly disconcerting to the dollar (US) bears. I receive numerous inquiries asking how this can be. In the short run, of course, anything can happen. As numerous commentators have suggested, the bearish dollar “boat” is overloaded and in danger of tipping. All this begs the question, why? How can the dollar strengthen against its fiat cousins when US budget deficits are rising and Treasury monetization is underway?

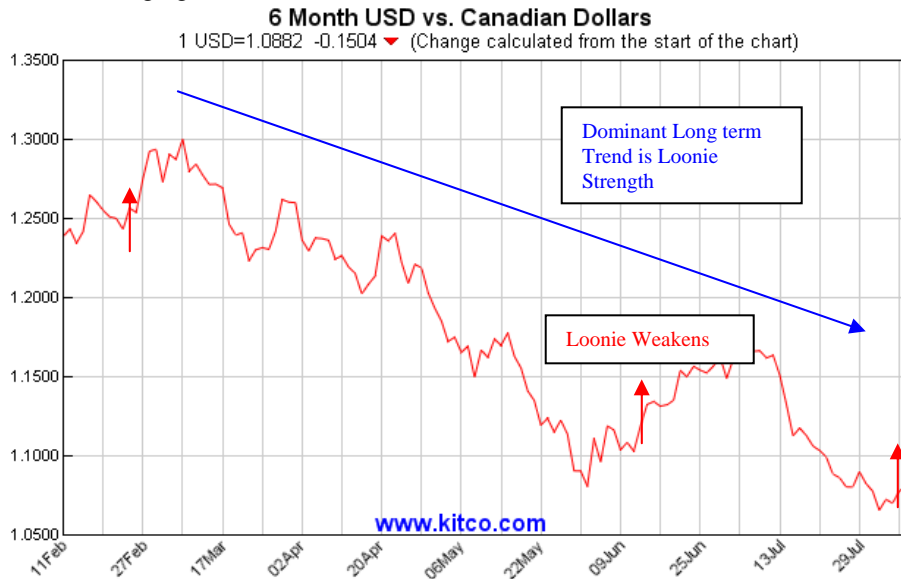
Some suggest that US dollar strength means the end of this terrible economic time in the US. It is much more likely that we are witnessing the ongoing, intermittent and long-lasting process of Yen and US dollar deleveraging. One observer remarked that it is impossible for the world to take Yen and Dollar debt for decades and expect to deliver in a few months. This deleveraging phenomenon is likely to be long term and keep a lid on real growth for some time. Yen and dollar carry trades have been so profitable for so long.

### **CANADA**

What about the Canadian dollar, affectionately known as the Loonie? We are bullish on all things Canadian. Yet this week the Loonie has fallen – significantly as you can see. Longer term, in the 6 months, the Loonie has appreciated significantly from C\$1.30 to C\$1.09 to the US dollar. This week Loonies have been sold and the price of gold in Canada has risen from C\$1025.97 to C\$1041.59.

<a href="#">Canadian Dollar</a>	-0.52%	08/10-12:40	1.0870	0.9200	1025.97	-7.15	▼	-0.69%
<a href="#">Canadian Dollar</a>	-1.20%	08/11-09:39	1.1016	0.9078	1039.75	+10.47	▲	+1.02%
<a href="#">Canadian Dollar</a>	-0.24%	08/12-04:55	1.1046	0.9053	1041.59	-0.08	▼	-0.01%

While the dominant trend is a stronger Canadian currency we see three periods where the Loonie has weakened. This week is one of them. The Industrial provinces (Ontario and Quebec) are worried of course. The commodity provinces (Saskatchewan, Alberta and BC) are in ascendance. Longer term we expect the Loonie to strengthen to below par. Short term while deflation retains its icy hold in the US and debt deleveraging obtains the Loonie will weaken.



**JAPAN**

Much of this Morning Note is predicated on the action of the Japanese currency, the Yen. As you can see this week a notable pattern exists. The Yen has strengthened with respects to the US dollar. This is almost always a sure sign that global debt de leveraging is occurring; The Yen carry trade is being reversed. A stronger Yen is universally a bad omen for Japan’s export economy. Since Japan is the world’s second largest economy (soon to be displaced) Yen strength bodes ill for the global recovery. Over the past 6 months the Yen also has strengthened against the US currency. The moves in the Yen are quite large.

<a href="#">Japanese Yen</a>	+0.64%	08/10-12: 40	96.9500	0.0103	91511.11	-1707.27	-1.83%
<a href="#">Japanese Yen</a>	+0.79%	08/11-09: 40	96.3750	0.0104	90968.36	-891.95 ▼	-0.97%
<a href="#">Japanese Yen</a>	+0.34%	08/12-04: 55	95.6850	0.0105	90230.96	-527.30 ▼	-0.58%

**RUSSIA**

And now we examine our old friend the Ruble. There is not much good news. Russia’s GDP is falling like a stone (down 10.9% annualized in the second quarter). Demography, falling birth rates, lack of infrastructure and health concerns make Russia’s economy, longer term, and a non player.

Russian men die on average 15 years earlier than North American men, women 13 years sooner than their North American counterparts (**how important is changing quality of life in the geopolitical machinations of our world?**) The ruble has clearly made a top and will now find room to fall back toward 36 to the dollar. The world is clearly buying dollars and selling rubles.

<a href="#">Russian Ruble</a>	-0.63%	08/10-12: 31	31.8586	0.0314	30071.33	-174.72 ▼	-0.58%
<a href="#">Russian Ruble</a>	-1.25%	08/11-09: 30	32.2550	0.0310	30445.49	+322.93 ▲	+1.07%
<a href="#">Russian Ruble</a>	-1.42%	08/12-04: 50	32.6904	0.0306	30827.05	+356.34 ▲	+1.17%

**CHINA**

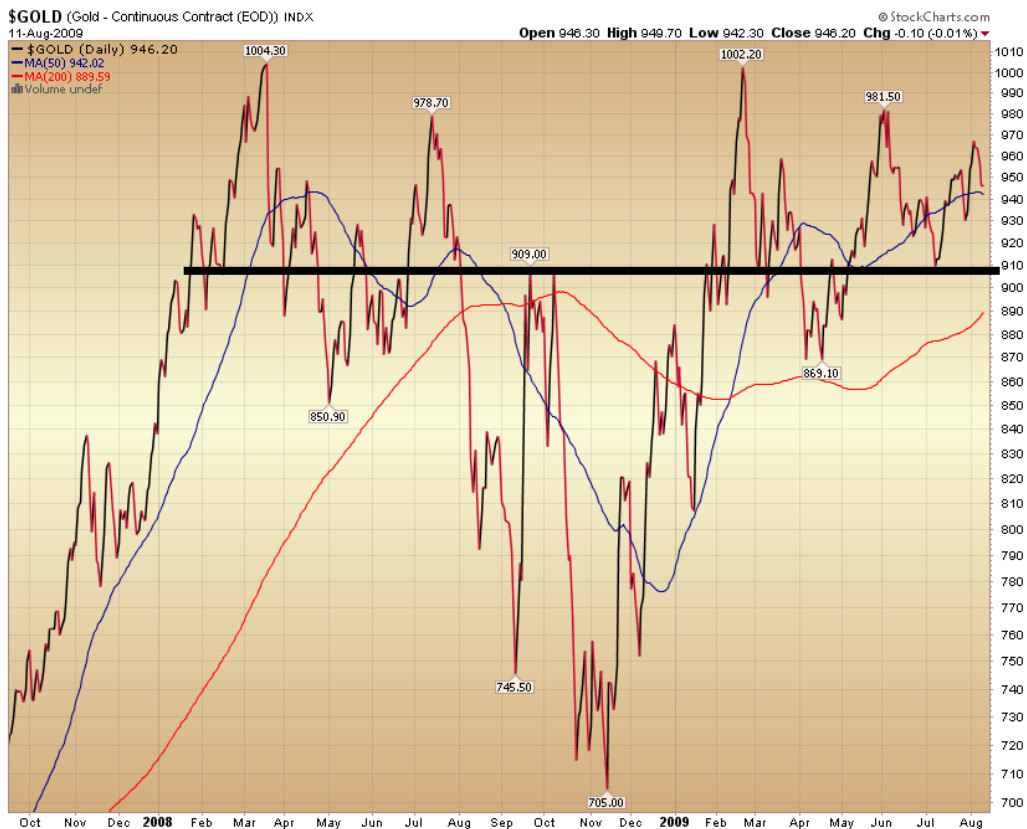
China’s Yuan, on the other hand, is clearly being pegged at 6.82 Yuan to the dollar. This also has geopolitical ramifications. China bluntly told the US (July 27 and 28) that significant dollar devaluation is out of the question if China is to continue to support the US Treasury and Agency markets. China holds

\$801.5 billion in US Treasuries and \$740 billion of US Agency securities. You can imagine what might happen to bond yields if China decides to step aside. More important, perhaps, is that fact that the stated goal of the Congress and Administration is to issue \$2 trillion of debt in 2009 and another \$1.4 trillion in 2010 for the grab bag of goodies to restore the American economy. China understands this and does not want her US\$1.5 trillion holdings to be devalued. This places enormous constraints on the American president. There are fewer degrees of freedom for President Obama today. He can raise taxes, lower spending or devalue the dollar to handle these tremendous debt loads, reduce the deficit and keep China happy. Raising taxes is deadly to his political and economic ambitions. He seems intent on increasing spending. There are not many ways out. Today, no one in Washington is suggesting that China should allow her currency to float higher today as they did so forcefully in 2005. The ball is now in China's court – the outcome for the US dollar very, very uncertain. A stronger dollar overall suits China very nicely.

<a href="#">Chinese Yuan</a>	-0.04%	08/10-12:05	6.8295	0.1464	6446.37	-76.06	▼	-1.17%
<a href="#">Chinese Yuan</a>	-0.04%	08/11-05:31	6.8323	0.1464	6449.01	-8.97	▼	-0.14%
<a href="#">Chinese Yuan</a>	+0.02%	08/12-04:53	6.8307	0.1464	6441.35	-17.22	▼	-0.27%

Gold and silver, on the other hand, are going nowhere (neither up nor down) for 6 months. Silver has been stronger than gold.

What does this signal? We think it presages deflationary forces that follow asset contraction and wealth destruction. Gold does not seem to be signaling inflation or even nascent inflationary expectations. Hand in hand with these periodic but consistent US dollar upticks we believe that deflationary forces still hold sway in the world. It is becoming clear that there is much deleveraging in force.



Monday I wrote on the strengths of the commodity markets. This commodity strength (copper for example) is not consistent with observed short term US dollar strength. Clearly the BRIC's use of trade surpluses has had an impact on commodity prices. We also believe that the commodity liquidation was overdone on the downside and we are witnessing a necessary regression to the

mean. Goldman sees commodity strength in 2010 we think such sustainable strength might be a year or two later.

In the meantime the Loonie must strengthen to par and beyond with its Yankee cousin despite periods of weakness which will in the short run impact commodity prices to the downside. These shall be buying opportunities in the Canadian markets.

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