

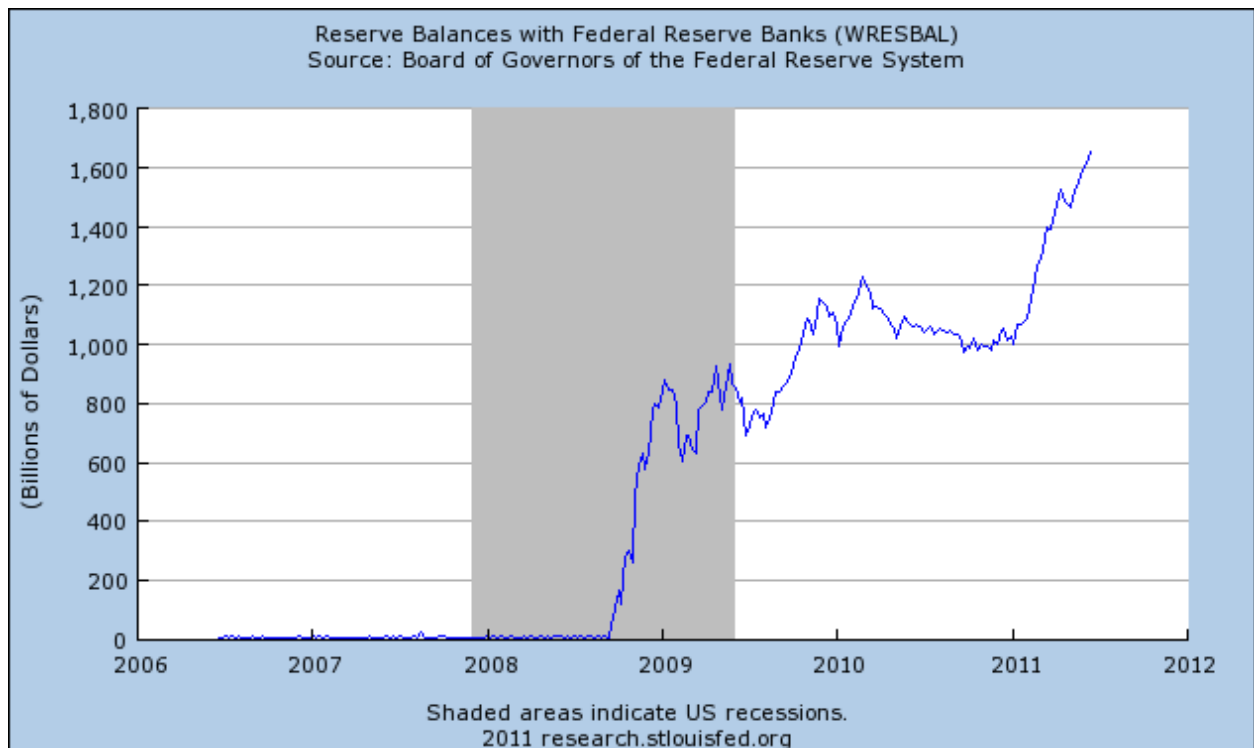
Today's Notes:

1. A Spoonful of Sugar

A Spoonful of Sugar

As I prepare for my upcoming July 18 presentation to the Fed, I try not to listen to the cable commentators. Even Bloomberg and Fox Business are unabashed cheer leaders for the stock market and the “all is well” Bernanke Rx. It has become very clear that the current treatment by Dr. B and the Congress is insufficient to get the US economic ball rolling again. No matter how hard they have pushed the economy uphill toward a positive tipping point, the economic ball has rolled back down for the past three years and quashed hopes every time – unemployment, housing, real wages, asset inflation, zombie consumers

American banks are stuffing the liquidity they receive from the printing presses back into the Fed to earn interest, perhaps part of the plan to keep rates low. The banks now have \$1.65 trillion as reserve balances with the Fed. In more normal times bank reserves amount to \$8 to \$10 billion. They are not lending and the money multiplier is at an all-time low.

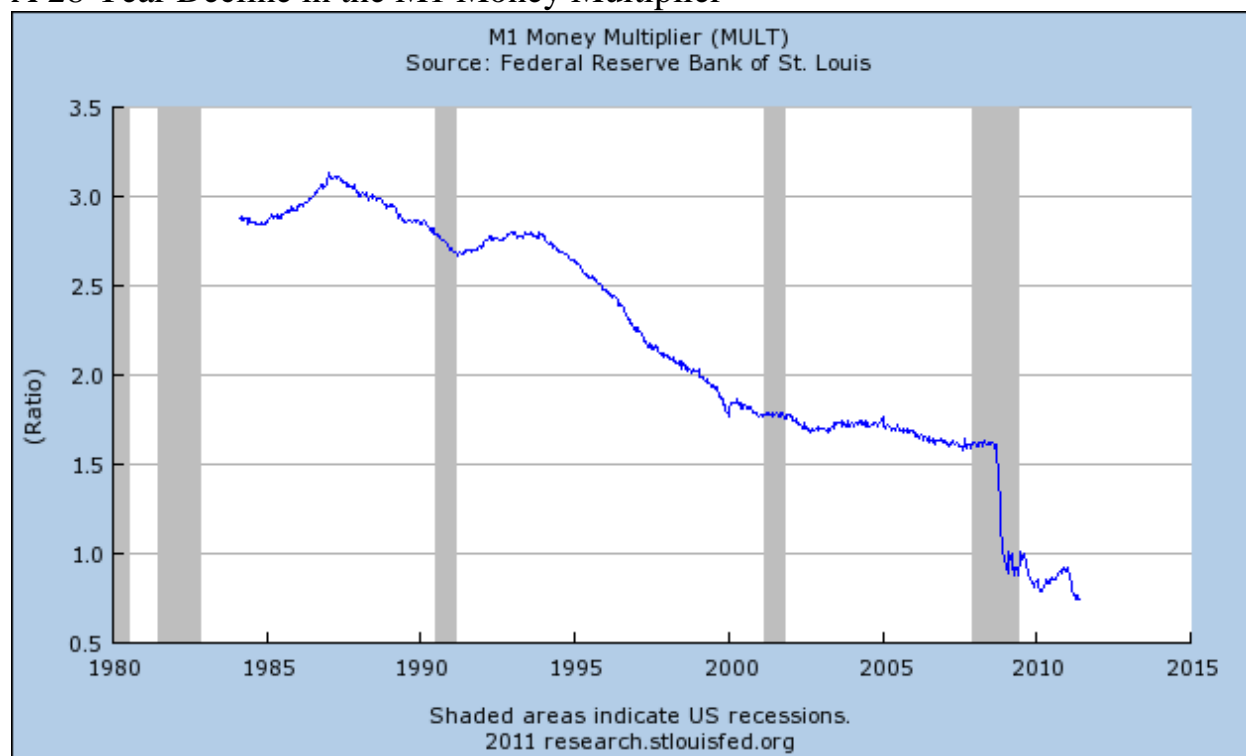


Within the next 10 days the much vaunted QE II manipulation of Treasury rates will cease. The Fed has been issuing and repurchasing its debt concurrently in an effort to keep rates down. In many ways this pogrom was a giant \$600 billion Ponzi scheme. It appears to have worked – thus far.

(Nota Bene: Only the government, through the Federal Reserve, is allowed to run a Ponzi scheme, others may go to jail for 700 years).

Another deadline is looming on the horizon. At some point, on or before August 2, Congress and the president must decide to raise the debt ceiling. This, of course, is necessary to avoid a sovereign default (missing an interest payment on \$14 trillion of US debt for example). The world will be watching as Congress decides on the polarizing issues of budget cuts versus taxation or simply increasing our indebtedness.

A 28 Year Decline in the M1 Money Multiplier



Finally the Greek situation is a microcosm of the developed world's half century debt binge. Greece only needs a Euro loan of \$170 billion to meet its debt obligations. The country has to find cuts of a mere \$70 billion – that's a few percent of what the American economy requires in cuts, taxes or debt relief. In the next very few weeks Greece's dilemma will be a real test of the ability of the world's central bankers and financial institutions to decide if debt deleveraging in this relatively small country will be the event that arbitrates how successful the

world's developed countries are in restoring sound economic growth, reduced debt loads and jobs. Will the Greek people agree on the new and tougher austerity package proposed by France and Germany? Will American citizens agree to similar spending constraints in this economy proposed perhaps by our lenders? All three events are "on tap." They can no longer be put off. Seminal and gut-wrenching decisions are now required. The events are interconnected with the future health of the world's largest economies.

China operates in another orbit today connected to these issues but with its own internal concerns and a significant bank account. On June 20 the FT noted that China is actively diversifying away from its US \$1.7 trillion dollar exposure. China's US exposure is 60% to 70% of China's total, still expanding foreign exchange bank account of \$3.04 trillion.

"It certainly appears that China's finally following through on its policy to diversify its foreign reserve holdings away from the US dollar," said Stephen Green, Standard Chartered Bank's chief China economist.

China is buying gold, silver and yes, even downgraded European sovereign debt in its diversification program. What do these actions tell you about the longer term potential of the US dollar and gold?

Can our Central bankers really step away from Quantitative Easing? In the face of these issues, none of which appear to have easy resolutions, world economic growth is faltering while stock markets, under relentless liquidity and asset inflation, move skyward to the cheers of the MSNBC, CNBC and FOX commentators. To this bull market mania how can revered experts such as Richard Russell still bow to the wisdom of the stock market??? Perhaps it is different this time.

The outcome of each of these three near term decisions will have a dramatic impact on the stock markets. I have oft been accused as a pessimist but that cannot be true. Discovery investors must, by definition, be eternal optimists. Nevertheless one cannot ignore the serious and very difficult decisions that are upon our leaders. One cannot also deny that putting these decisions off in the frantic hope that they will lessen in importance will likely make them much tougher.

Today Federal Reserve Chairman will speak at 2 Pm on these issues. We expect him to speak with customary confidence and hubris on the success of his plans. By the way the Fed did save the banking system in 2008 / 2009 during the credit crisis. However has it been saved for a fate worse than it might have experienced? It is

unfortunately obvious that “a spoonful of sugar does not make the medicine go down.”

Tonight President Obama will speak on his view of the situation. We shall be undoubtedly better informed by tomorrow morning. Examine the following chart. Know what it represents?



It represents the deflationary experience of Japan’s Nikkei share index from 1989 (with a few minor periods of minimal growth) through May 2011. Japan followed the same proscription that the US embarked upon in 2008. Extend maturities, print money, save institutions too big to fail for fear of failing, apply sugar. It has not worked very well. We worry it will not work in the situation the world now faces. Where are we? In the short run:

- 1) I think share prices, in general must come under significant pressure.
- 2) Commodities except for gold and silver, in the short run will experience serious headwinds.
- 3) Raising money for the Junior discovery companies may become challenging.
- 4) The US dollar will strengthen.
- 5) In the event of an unforeseen catastrophe we may have a serious liquidation similar to July 2008 through March 2009.

My view – raise some cash, be prepared to take positions as share prices decline. In the Incubator and Mature discovery sector we have already experienced severe pullbacks from their peaks in many companies during the past 3 months such as

Galway (-33%), Midway Gold (-22%), Talison Lithium (-21%), Revett Minerals (-23%) and Quaterra Resources (-25%).

I am confident, in the longer term, these companies can become excellent discovery wealth creators.

This AM I note that Grande Portage / Quaterra JV are drilling on the Herbert Glacier near Juno, Alaska. Please stay tuned for results as this program has significant discovery potential.

Saturday I shall travel to Guyana to visit the properties of GMV, Sacre Coeur and Sandspring. GMV has two drills turning as we speak on their gold properties in Guyana. I will be travelling with a Chinese and American group and meeting officials in that South American country. I will report next week.

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