

Today's Notes:

1. The New Austerity and the Discovery Investing Scoreboard

There's a new austerity creeping up on the world's citizens this AM. It is still difficult to see but it is becoming painfully visible. This "New Austerity" is one ramification of the "New Normal" posited by Pimco's Bill Gross in 2008ⁱ. It is mostly invisible today in the U.S. and Canada. Yet one country after another has been asked to bear a new austere lifestyle. These messages have not been vocalized in North America, yet. But a creeping austerity is being forced by the economic conditions here in the US and Canada.

Some time ago we advocated the notion of convergence of global lifestyles. This notion has been widely discussed in the academic literature. A confirmatory trend is indeed regression to a lower mean level of lifestyle in the developed world. It is one thing to pontificate on such a trend but quite something else to realize that one's quality of lifestyle, one's comfort level, is being reduced and reduced by government fiat. This upsets the "apple cart" in economies whose lifestyles have increased consistently for the past 6 decades. We have seen this dissatisfaction in Greece and New York, with the "Occupy Wall Street" efforts.

In Europe, particularly southern Europe, Churchill's soft underbelly, austerity has been demanded of people who have retired in their mid-50s and lived a post-war lifestyle far better than Kings and Queens of yore. Greek and Italian pensioners have felt the pain and are protesting, sometimes violently. It is fair to say that the protests have had a major effect on governments worldwide who are watching this "soft underbelly." Both the Greek and Italian governments have now fallen. France, Spain, Portugal and yes even the Brits are watching this spreading disaffection with government.

Canada's Eric Sprott said it best in a November 8th interview with James Turk. Referring to the new austerity and government's response Sprott said,

"A lot of promises are going to be broken by governments and by pension funds around the world."ⁱⁱ

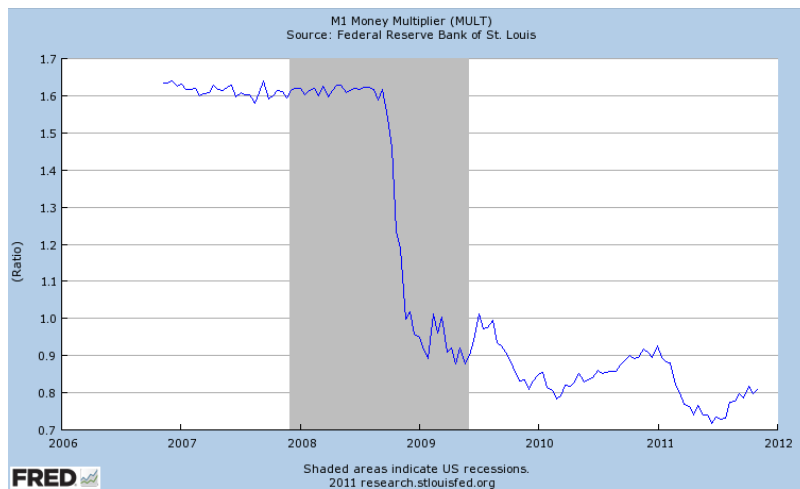
At the macro level we see very slow economic growth forecasts in both the U.S. and Canada – growth (3%?) too slow to put our unemployed back to work and too slow to provide good jobs. Many believe that such torpid growth rates will infect the developed world for several years.

Sprott comments that the problem of another "Lehman moment" looms large because government leaders world-wide do not have the will to clear the system of unserviceable credit – instead substituting new debt (presumably of much lower quality) for old debts that would otherwise default.

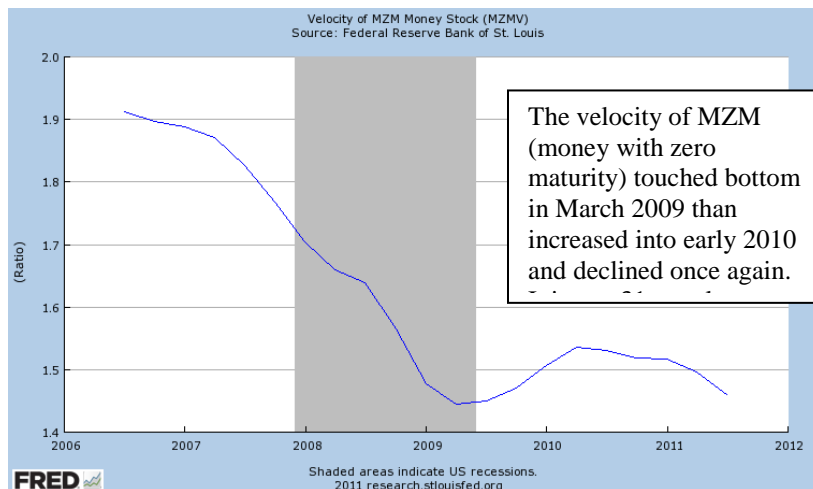
We see a great reluctance of the banks to lend, preferring instead to stash their newly printed U.S. dollars with the Federal Reserve to earn a risk-free 25 basis points (instead of the fractional banking system which multiplies the money supply into the economy). In addition

the velocity of money in the economy is falling. This means that the economy is slowing. Nothing matters much more than the velocity of money and the money multiplier. Our level of well-being is almost totally dependent upon healthy fractional banking and an economy in which the velocity of money (number of times the money supply turns relative to GDP) continues to function. Combined with the money multiplier it paints a dark picture for recovery as you can see below in the United States.

The M1 money multiplier has fallen steadily from 3.2 to .8 over the past three decades. Money supply strategies, at least in the US, appear less than stimulative. It is clear that by July 2008 the rout was on and a new economic tempo and reset was underway. This data is reminiscent of the money multiplier in Great Depression – the “pushing on a Keynesian string” trap. That trap has held us for the past 49 months.



The velocity of money data in the US does not comfort either. It continues to fall. Data is through July 2011. As you can see the recovery, at least in terms of increased velocity of the money supply, has been short-lived. In the US money velocity (M2M) touched 2.5 times in 1980 and has declined with every recession since. It sits at a 31 year low point today.

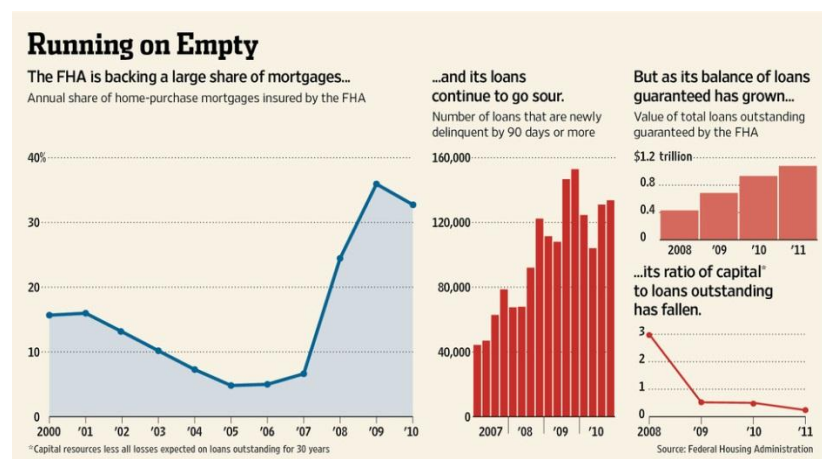


We have often noted that one of the characteristics PIMCO’s New Normal paradigm is that the recovery, according to El Erian, will progress into a “major national and global realignment.”

This represents the convergence of lifestyles. This structural realignment will affect every aspect of our lives – in short a realignment of our lifestyles as measured by our quality of life quotient.

Our solons in Washington and Ottawa persist in planning for cyclical recovery. But after three and a half years of well above average unemployment and falling home prices mom and pop are beginning to understand that recession or not, something much longer and more severe is at hand.

Two days ago a government report forecast a 50% chance that the FHA would require a bailout. Without the FHA guaranteeing home mortgages in the past three years US housing prices would have fallen much further. However with 7% foreclosures last year FHA's cash reserves have fallen by \$2.1 billion from \$4.7 billion (45%). Another 9% decrease in house prices in 2012 and the Treasury (taxpayer) will be on the hook for \$13 billion to fund the FHA.



The Taxpayer? Yes, this again is the creeping, almost invisible hand of the new austerity. Two factors sure to be felt are more bailouts and inflation. Both are insidious destroyers of our before and after-tax wealth. Inflation of the currency has always been our desired way out and entitlements, such as housing in the US (a chicken in every pot), is much too big to fail. Inflating debt away may not work now that Minsky's Ponzi units are everywhere being expanded.

Europe is beginning to see significant ramifications of the new normal. The austerity stipulations to Greece have made that country ungovernable. We expect to see a similar but much larger unhappiness in Italy. In both countries the populace now believes that their governments are working against them. Greeks and Italians are clamoring with protests that are becoming increasingly violent. The Wall Street Journal recently remarked, "Now the dominoes will move west" in an article titled,

"New Austerity Incites a Bitterness the Postwar Generation Did Without."ⁱⁱⁱ

But the new austerity is not limited to a southern European experience. British young people are unhappy and demonstrating. In the past two years the Tea Party organized here in the US. People understand that our Congress is deadlocked and that government will not, or cannot,

agree on a solution to the mounting debt problem. The US, saddled with an ultra-liberal press, has become an entitlement economy. Any perturbation in that entitlement mentality will surely cause a serious reaction. We are just beginning to see that happen today. The WSJ article notes, ***“In the final analysis what will have brought down these dominoes will have been a global debt market allowed to fester. This debt load has already pushed the cost of borrowing beyond affordable levels. These markets in turn make the bad habit of living beyond one’s means simply too expensive.”***

Europe’s hubris in leavening the quality of life across its many cultures now stands stark naked and exposed. In many ways the US is next. In the new austerity you will have to fend for yourself.

How Do You Plan to Handle the New Austerity?

As part of your response to this eventuality you must consider discovery as a cornerstone discipline in your portfolio management and wealth creation strategy. As discussed above there will now be a reset, a realignment. With that, expedited discovery in many areas of science will be required. As Asia and the Emerging world begin to consume, even at lower growth rates than today, and as the current credit cycle is cleared and restarted, discoveries in natural resources, bio technology, healthcare, materials science, alternative energy, cancer research and immune related diseases and high technology (to name of few of my interests) will be necessary and they will come on stream quickly. We are already witnessing high temperature magnets from new rare earth applications, graphite as a replacement for silver in thermal printing application (solar cells), and manganese in new battery technology. These discoveries are creating wealth.

More to the point, gold and silver discovery is likely to become more valuable as the volatile fiat currency markets continue to inflate away value. To counter the insidious taxes known and unknown, you will have to look for significant wealth creating opportunities. Discoveries, particularly in these areas and in the North American locale, will be priced at a premium. Here’s another example. Converting Algae to bio-diesel is beginning to look possible from an economic perspective. There are a number of discovery companies that exist in the bio-fuel space. Discoveries promise cheaper energy; better environmental remediation and help to sustain QOL, albeit lower than today.

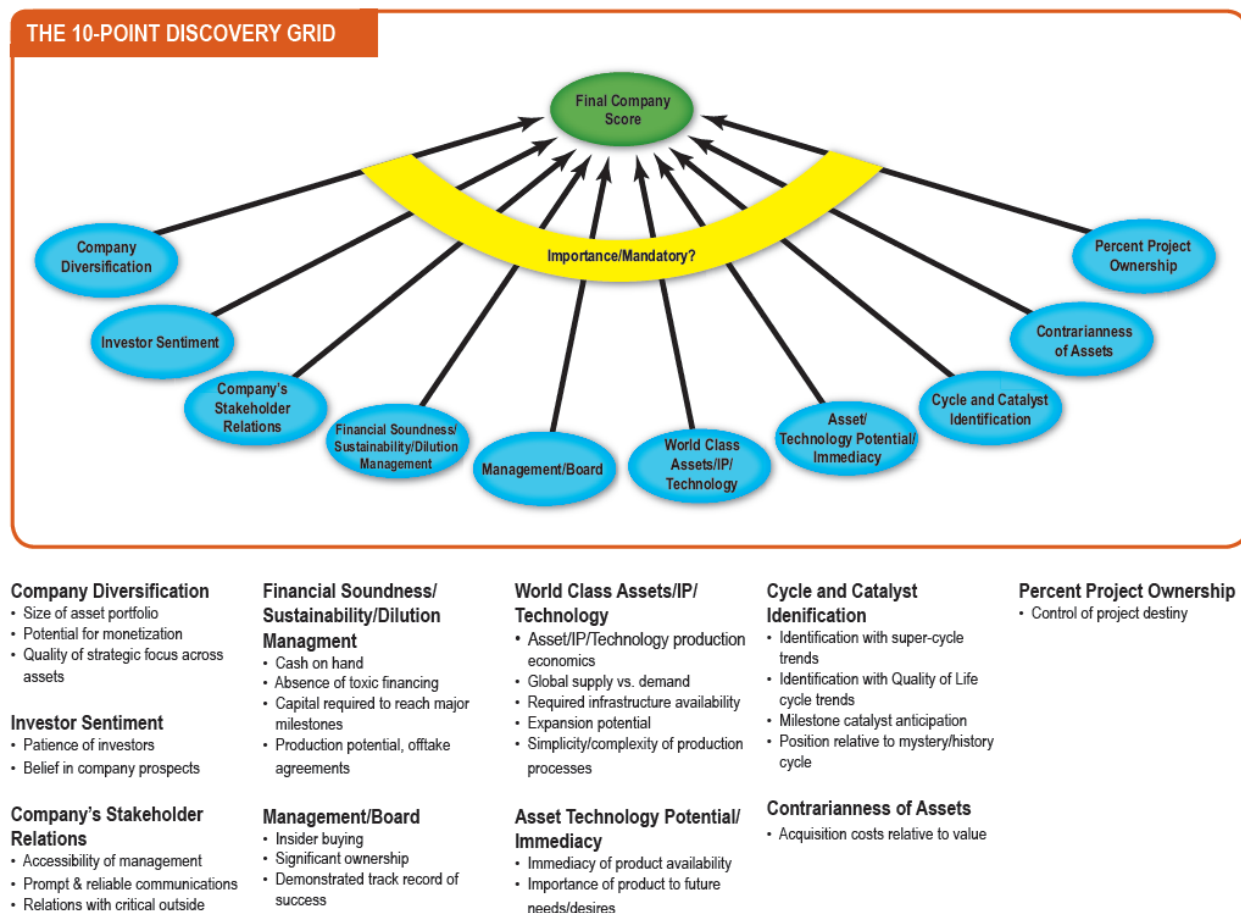
To keep up with these you will have to embrace discovery investing in the areas in which you have a real interest. Discovery Investing can pay off in a very big way – but it is also very risky. We will be providing the Discovery Investing Scoreboard as a tool to help you in your due diligence process in all these areas.

This analytical system is based on 10 factors that I developed over the past decade. In many respects the goal is to eliminate mistakes and let the good discovery companies prosper. We think these factors cover most of the critical aspects of analysis for discovery companies whether incubator, mature or legacy companies. I include a graph of the ten factors below and also a You-Tube introduction to our product.

We will formerly introduce the Discovery Investing Scoreboard in January (23rd) at the Cambridge House symposium in Vancouver. In the meantime we will be seeking individuals

with an interest in utilizing the software to rank companies of interest as we create a global Crowd Data base of discovery opportunities. See the You Tube video and DiS Ten Point grid below.

<http://youtu.be/Uo0FjTmkMP8>



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ⁱ Pimco's Bill gross coined the concept and phrase, "the New Normal," in March 2009. It predicts a post-financial-crisis world of lower investment returns, slower economic growth and higher odds of another out-of-the-blue financial shock. In short, a world in which the range of financial outcomes — and risk — is much wider than normal. His sidekick Mohamed El Erian says, **"The basic premise (of the new normal) is that we are in the midst of a major national and global realignment. The main catalyst was the financial crisis of 2008, but the underlying factors have been there for a while. The question is: What does the world look like post-realignment? The world is on a bumpy journey to a new destination and the New Normal"**

ⁱⁱ See James Turk Interview with Eric Sprott at the Munich Gold Show November 8, 2011.

ⁱⁱⁱ Wall Street Journal, **New Austerity Incites a Bitterness the Postwar Generation Did Without** November 13, 2011.