

Today's Notes:

1. Yesterday
2. Quaterra – Molybdenum Joins the Portfolio

1. YESTERDAY

The American people have every reason to remain confident that the U.S. banking system is sound. The FDIC has made clear that of the nearly 8,500 insured banks and thrifts that comprise the U.S. banking system, 99 percent are well-capitalized. One thrift and four commercial banks have failed this year; during the 1980's Savings & Loan Crisis there were an average of 255 failures per year – the circumstances then are hardly comparable to today. Treasury Secretary Henry Paulson, July 22, 2008

Yesterday the equity markets caught fire late in the day. All throughout the day the major averages were “UNCHed” and then about 3 PM they soared. It was instantaneous, like the resurrection. “Now it begins?” Some called it a sea-change. While the transports soared and Wachovia (up 27%) gained north of 20%, commodities swooned. Wachovia wrote off an astounding \$8.6 billion and reduced its dividend to 5 cents to save \$700 million in capital. The balance sheet is still suspect.

There were only two events of import yesterday to explain this euphoric reaction. Treasury Secretary Paulson implored the US Congress to approve legislation on Fannie and Freddie in a speech at the New York Public Library. The motto chiseled on the side of the New York Library on 5th Ave. is,

“Above all things, truth beareth away the victory...” (The Apocrypha: 1 Esdras Ch. 3).

It was therefore an appropriate setting. Secretary Paulson made a point with which we cannot disagree, though many would. Fannie and Freddie must be saved by Congress, which will **ONLY** cost taxpayers \$25 billion according to Congressional quants. These lifeline matters may be voted on in a chastened, pressured and uncertain Congress in short order, perhaps today. This is now the bind that the world finds itself facing. For if the US housing decline is to be checked anytime soon, Fannie and Freddie must be stabilizers in the US housing market - buying mortgages. That much seems clear. Mr. Paulson and the Treasury understand and believe this. **The future dynamics of the housing market hold the keys to the kingdom as PIMCO Chief Investment Officer Bill Gross noted on Monday.**

Mr. Paulson also reiterated the mantra that a strong dollar was very important to the US. This time he probably meant what he said. He was followed by Philadelphia Fed President Charles Plosser who jawboned that interest rates must be increased *“sooner rather than later.”* These two events were signal events and the Wall Street analytical and trading crew took up the mantle. The dollar strengthened significantly against all currencies. At the same time gold, (but not copper) and oil prices fell. Oil is trading at the \$126 level this AM and gold has fallen \$45 in the space of less than 24 hours.

Traders are continuing to push the \$ higher and gold lower this AM. Before we get too giddy about this equity levitation, please sit back and reflect. This AM, Robert Doll, Vice Chairman and Director of Blackrock, said re the financials, “*buyer beware.*” He reiterated the trap that the Fed is in.

“We expect headline inflation rates to fall over the next few months, particularly if we are able to get some additional relief in energy prices (and we do believe oil prices are due for more of a correction). Against this backdrop, the Federal Reserve remains trapped to some degree. The central bank would no doubt like to focus its attention on inflation, but cannot take the risk of tightening monetary policy, because to do so would potentially cause additional financial turmoil.”

Bill Gross has suggested an interest rate increase would throw the economy into a 1930s style trauma. Wachovia wrote off everything but the kitchens sink under its new head Mr. Steel – or did they? That will depend, of course, on the fate of the housing industry. Neither Mr. Doll nor Mr. Gross believes it is possible for the Fed to raise rates in 2008 to “energize” the strong dollar. Yesterday discourses, therefore, were all talk. They worked beautifully. Traders bought them and they became self-fulfilling. Naked shorts are still scrambling to cover (find stock) and oil is, quite mercifully, finding a lower level. For the Fed good news, gold, its worst enemy relative to growing inflationary expectations, is also lower. But please remember that in 6 years gold has soared from \$240 to \$935 – a compound annualized growth rate of 25%. Contrast that gain with Wachovia over the past 3 years.



I think these reversals are very positive outcomes, at least in the short run. Longer term I listened with interest to Marc Faber's interview this AM. Speaking on Bloomberg TV, he said we that the global synchronous boom in the past few years has been *"unprecedented in history"* and that the bust to follow will also be *"unprecedented in history."*

Without the proper functioning of the credit markets, the global economy is in trouble. Without a bottom to housing (prices, defaults and therefore foreclosures) the write-offs will continue and credit markets will continue to be very difficult. Perhaps Mr. Paulson does speak the truth and perhaps it "shall beareth away the victory." Fannie and Freddie as more active mortgage market participants may hold the key.

With the Congressional infusion of \$25 billion or more into the GSEs, a interest rate stalemate at the Fed and the necessity for significant money creation, the \$ faces very strong headwinds. No dear D. I., while I would like to see oil lower and expect it to fall, the food the two fine gentleman fed the trading market yesterday was just what they were looking for.

2. QUATERRA: MOLYBDENUM

Yesterday Quaterra Resources reported the acquisition of the Cave Peak moly deposit in West Texas (about 100 miles east of El Paso). There are three pipes within a few hundred meters of proximity in the 524 acres that the company obtained.



The Quaterra release indicates that beginning in 1965 and through 1980 Union Carbide and several other companies drilled and examined the largest pipe. 26 holes including 40,000 feet were drilled in that pipe. On hole, B-30, they intersected 645 feet (200+ meters) from the surface of .58% molybdenum. .6% moly is equal to 12 pounds Mo per ton of ore. Moly sells for \$33.00 today because it is critical to the steel (4% to 7% moly) used in coal and nuclear fired power plants as well as oil pipelines and other high strength applications (Middle East water de-salination). This makes the in-situ value of ore in this one location (not the entire pipe) worth over \$300 per ton. Union Carbide estimated between 18.3 and 19.6 million tons of ore at .22 to .18% in 1970. These are historic and not 43-101 estimates but Union Carbide was probably a good proxy for the indicated and inferred based on this small number (26) of drill holes. In 1970 Moly was selling for \$4 per pound.

Using their estimates the pipe (not including the other two known pipes) would contain approximately 90 million pounds of molybdenum. 40% of the ore is oxidized (to a depth of 1,000 feet) and I am told that the deposit is open at depth. In addition to moly there are apparently tungsten, silver, niobium (steel catalyst) and base metals. But the real upside is the fact that one hole was drilled in the second pipe and intersected the "halo" of base metals including silver. Management of Quaterra believes that this could indicate a second moly ore body. Quaterra will proceed to map and drill these targets and I suspect that the historical resource outlined by Union Carbide could be expanded considerably.

Once again we see the strategy of Quaterra working for the shareholder. At Cave Peak, the team has acquired for a very small \$ value a historical resource of moly with significant drill indicated ore. This is value-creation at its best. I am not certain the market heard this announcement yesterday. Maybe it was pre-occupied. Perhaps it will take time for the bad news overhang in the economy to dissipate and allow value realization here (and in many other Discovery Companies). Once again the company has chosen carefully and the infrastructure (road access) and locale are excellent for mining opportunities.

But the company continues to be opportunistic and build a very valuable portfolio of advanced stage properties across a number of metals. However they are not only acquiring valuable properties but also experiencing significant drill successes. For example they are drilling their third blind pipe target (having made two significant new discoveries) for uranium on the Arizona Strip. They are drilling out a copper resource at MacArthur. I expect to see drill results from their Mexican silver and gold properties this year. I also expect they will produce two 43-101s by year end on the uranium and copper resources. The team is executing its strategy well. The chart for Quaterra shows that it has held up very well in difficult markets over this year.

The next stage for this company could be to unveil to its shareholders its strategy for monetization of some or all of its assets. Stay tuned.

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