

# MAEDEL'S

## EQUITY MARKET ANALYST

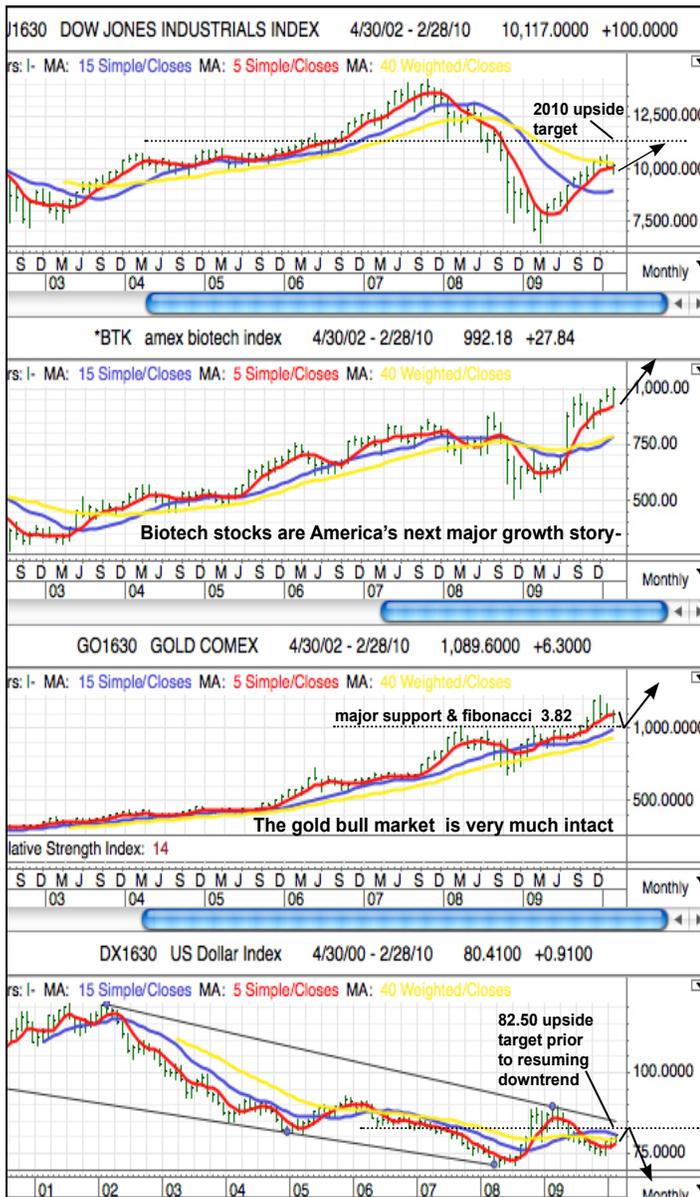
March 2010

## The Forgotten Bull Markets



Editor: Neil Maedel  
Uncompromising analysis  
exclusive advice beginning 1987.

In the last issue we described how the developed world's leaders walked a razor's edge: on one side a demographic implosion and deflationary collapse looms. On the other an inflationary spiral, exploding debt service costs and sovereign default threatens. In this issue we focus on what has gone hand in hand with every crisis in the past century: opportunity.



### Crude calculations

- Gold's correction is nearly complete and is setting up for a major move in its multi-year bull market.
- US equities should begin moving higher but will under perform emerging markets. Biotech stocks are the clear leaders.
- Dollar rally is nearly complete expect a resumption of its down trend.
- OECD economic growth to slow by Q3 necessitating further government and central bank support

### This Month's Star Houston American Energy

Houston Energy came to Maedel's via an associate who was among the **InterOil Corp. team** which I had written research (recommending a buy) previously. Last year IOC drilled the highest flowing gas well in history. While HUSA may not be about to drill any record wells it has even more compelling explosive growth potential. Its principal area of operation is Columbia's Lianos basin where it has over 895,000 gross acres with more than 100 drilling prospects and produces a net of 1300 barrels per day. Royalties vary from 8% to 20% depending on the size of the field and corporate taxes are 33%.

**This Month's Star**  
**Houston American Energy**  
**HUSA \$12**

Last January 4th we added **Houston American Energy** to our portfolio at \$6.50 a share. We had followed the company for more than a year after having met its founder and chief executive officer, **John F. Terwilliger** and one of its directors Lee Tawes.

What interested us was the company's strategic position in Columbia. Specifically its 25% interest (South Korean **SK Energy Co.** owns the balance) in an exploration block called CPO4, which is adjacent to a recently announced major discovery by Columbia-based **Petrominerales**.

The block is only 2.4 miles away from Petrominerales Candelilla discovery and a 2D seismic program is understood to have identified over 100 leads on CPO4 generating a recoverable potential of 1 to

4 billion barrels (25% to HUSA). The Petrominerales discovery has revealed a major new exploration trend most of which is on HUSA's gross 345,000 acres (25% net to Houston). A follow up 3D seismic program by HUSA is currently underway and at least 40 locations are expected.

The flow rates reported at Petrominerales Candelilla 1 and -2 wells at its recently discovered Candelilla structure were 12,400 b/d and 15,800 barrels per day of light 43 gravity oil with a less than 1% water cut. This gives them a pay back of a few weeks.

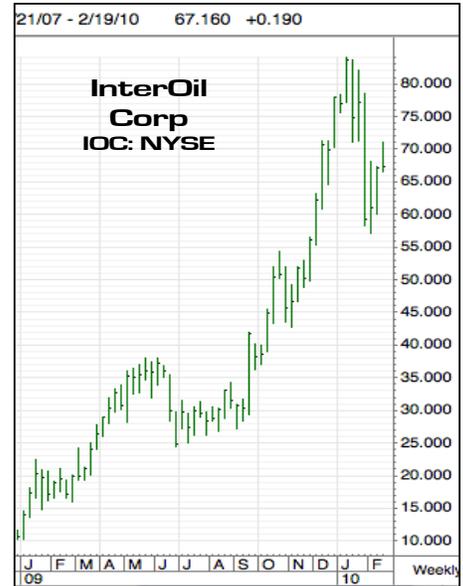
Houston has 31 million shares outstanding thus a single well of Candelilla 1's size would produce cash flow of around \$2 per share.

The discovery is along the same fault system which goes through HUSA's acreage and potentially Candelilla's structure

appears to extend onto HUSA's acreage according to 2D. The trend's fields consist of a series of reservoirs trapped by a series of faults and vary in size from 1 - 10 wells. Mapping by HUSA indicates its block is updip from Corcel field which is currently 18,000 Bbl/d from 8 wells.

It was only early January that the tone of its trading, technical break out made buying its shares compelling. We are of the same school as uber-trader **Michael Marcus** and thus HUSA clearly fulfilled the best trade criteria: in that it had the fundamentals, technicals and market tone clearly going for it - its bullish tone was demonstrated when the company's shares traded up to sideways con-

trary to the S&P 500's correction. (The soon to be named **Pan American Goldfields** (Mexico Minerals: MXOM \$0.51) also fulfills the Marcus rule of fundamentals, technicals and tone as its shares rose from the low \$0.40s to a high of \$0.58 during the S&P 500 correction and similar to HUSA we think its only a matter of time before its shares trade higher - more on it later.) In HUSA's case we are holding our position as Houston shares look set to move even higher.



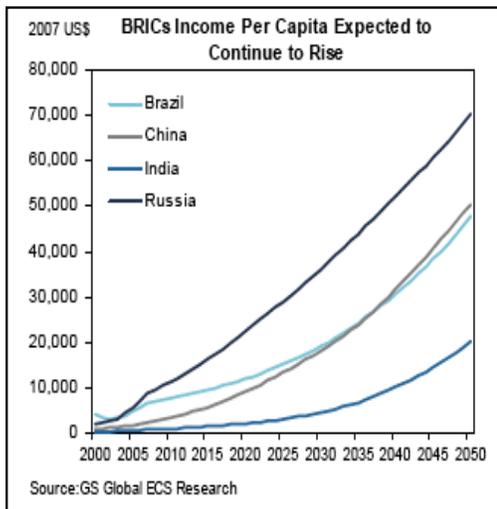
# The Forgotten Bull Markets metals + biotechnology

In our inaugural quarterly, *The bubble that broke the world*, we outlined how in the developed world demographic trends, combined with an explosive rise in debt had reached a tipping point where western governments and central banks were likely to gravitate towards solutions (government rescue packages and quantitative

In the short term there continues to be a lot of opportunity as **Houston American Energy** and **BNK Petroleum** illustrate (see page 1 and 7).

Notably, though in terms of growth, the developed world may be stagnating, the outlook for many commodities remains very positive as countries like Brazil, China, and India experience exceptionally strong growth.

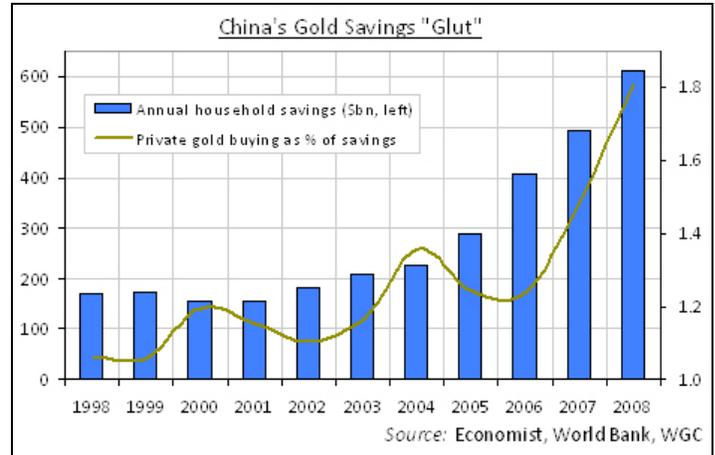
**Bill Gross** of **PIMCO** the world's largest bond fund recently described America's likely sluggish outlook in a



easing) which risked provoking stagflation, similar to what occurred during the 1970s.

Critically, because of the time lag between QE and explosive government spending, accelerating inflation is unlikely to occur until 2011-2012. If inflation does accelerate then the profitability of our metals and energy investments is likely to be spectacular.

thought provoking essay called *The New Normal*. If the eminent Mr. Gross is correct and Japanese-like economic stagnation is what the West experiences rather than a period of stagflation while its population ages and economy de-leverages



the question for investors is, what would the impact be on our original investment theme: a continued gold bull market?

**Its all about the East**  
We expect the metals and energy bull markets to continue in spite of sluggish developed world growth. Principally because countries like China and India (and Thailand where the *Maedel's* editor lives)

are booming. There is no de leveraging needed in these countries and built up savings are massive and retail sales growth exceeding 15% is considered normal. The chart from a **Goldman Sachs** research paper shows their take on the BRIC's likely growth in per capita income. According to GS by this year, "*the BRICs will contribute almost half of global consumption growth. In particular,*

**Exhibit 6: Per capita consumption of key commodities by major countries (2008)**

	Oil (barrel per day)	Aluminium (kg)	Copper (kg)	Nickel (kg)
USA	0.064	18.6	6.4	0.4
Japan	0.038	17.6	9.3	1.5
South Korea	0.047	19.9	17.5	1.5
Mainland China	0.006	9.4	3.9	0.2

Sources: "Global Commodity Markets", 2009, World Bank; Hang Seng Bank.



*China will contribute almost 30% of global consumption growth, more than the G3 and almost double that of the US."*

Consider that China and India have 37% of the world's population compared to America's and that its per capita remains a fraction compared to developed countries. Consider that most of its families already have paid for their homes. That's correct: because they inherited them. The houses they lived in prior to the advent of free markets they were allowed to keep. This real estate has been upgraded and renovated but it represents decades of defacto savings. Now add in an average household where the only child with two doting grandparents and two parents ensuring they get everything they need to be successful productive adults. This is the reality on a giant scale.

The impact of continued growth in the developing world will underpin energy and metals prices for years to come. **Fortis Metals** recently noted in a research report that:

*"It is astonishing that, in what is generally agreed to be the worst post-1945 recession,*

*no copper producer or mine has been forced out of business as a consequence of insupportably low metal prices."*

And this is the crux of the matter. The financial crisis has merely delayed the growing shortage of metals and the next energy crisis. How bad could it get? **BHP Billiton** the world's largest mining company warns that there could be a shortfall of 10 Mt of copper by 2020. *Consider that world production is currently only 15 Mt. compared to the mining giant's prediction of a 10 Mt shortage.*

Gold's correction looks nearly complete. Our instinct is that it is a natural substitute for an appalling series of currency choices (most with their own looming default and inflation potential) and that gold is also a consumer driven growth story. The yellow metal **Rupert Robinson**, chief executive of **Schroders Private Bank**, agrees and recently advised:

*"As the global economy wrestles with the threat of deflation on the one hand and the prospect of higher inflation on the other, investors need an investment that will work in both*

*scenarios: gold bullion or gold stocks are an answer."*

In China it is government policy to encourage the purchase of gold by its citizens. Gold has been a store of value there for 5,000 years and buying gold remains among the first impulses of its emerging middle class. According to **GFMS**, gold consumption has risen six fold in US-Dollar terms over the past decade making China the worlds largest consumer and over 31% (GFMS) of the global jewelry market.

Reflecting increased spending power, Chinese private gold purchases of jewelry have increased from just over 1% to more than 1.8% of annual household savings in the past decade. If Chinese personal gold consumption growth continues to at least match GDP growth (instead of exceeding it as it has over the past decade), then the prediction by gold giant **Barrick's** Chairman Aaron Regent that *"There is a strong case to be made that we are already at 'peak gold'"* becomes even more bullish.

But China's government also has a strategy regarding gold accumulation as **Nidhi**

**Nath Srinivas** of **India's Economic Times** reports:

*"Since 2003, Beijing has been buying most of the gold excavated and refined locally. It was a perfect strategy. No one in the international market became the wiser and the bill was paid in yuans.*

*Today, China has more than 1,000 tonnes in its official vaults, up 75% in six years. Its gold reserves are now the fifth-largest among national central banks after the US, Germany, France and Italy. This insurance helped mandarins in Beijing sleep easier at night.*

*But the public still had no such hedge. So, Beijing has begun actively encouraging people to invest up to 5% of their income in gold and silver. The biddable Chinese have diligently followed this advice. Full-year 2009 private demand in mainland China could outstrip India by a fifth."*

In December **Ji Xiaonan** Chairman of the Supervisory Committee overseeing large state-owned enterprises was quoted in the **China Youth Daily** newspaper advised that:

*"China should increase the amount of gold it*

holds in reserves to reduce potential losses from a depreciating dollar. Adding that China should increase its gold reserves to 6,000 metric tons within three-to-five years and possibly to 10,000 tons in eight to 10 years."

While the Chinese continue to add to their gold holdings the metal's mini-correction has caused a healthy negativity to descend on the gold market. The **Mark Hulbert** index of bullish short term gold timer newsletters has plunged from 60% to 18% in the past month while **Jake Bernstein's** DSI bullish percent fell to 13%.

We are encouraged by gold's relatively minor price correction which has occurred in the face of a major dollar rally and an increasingly negative investing public and calculate that on a technical basis it is at or near its lows. Critically both fundamentally and technically

gold's historic bull market remains in force.

**BioTechnology, the next great bull market?**

By 2015 45% of all Americans will be over 50 years old. And that tsunami of aging baby boomers in Europe and America is at the root of much of the Western world's fiscal mess because as these boomers retire the savings pool available becomes smaller and tax revenues shrink just as housing prices, a principal store of savings for too many, fall. Making matters worse the cost of medical care and pensions mushrooms. According to the Social Security Administration's Office of the Chief Actuary America's social security as measured by the combined OASDI (Old-Age Survivors and Disability Insurance) "Trust" Funds posted a \$5.858 billion primary (cash, non-"interest") deficit for November,

*continued on page 5*



**Points to Ponder**

**Bill Gross** who runs Pimco, the world's largest bond fund commenting on the winding down of the US multi-trillion dollar stimulus programs:

"We definitely need another stimulus program because the effects of the first will be wearing off in the next 3 to 6 months and we'll be back to 2% growth which isn't enough to generate jobs."

According to Bloomberg the US Fed and Government agencies have "lent spent or guaranteed \$8.2 trillion to lift the economy from the worst recession since the great depression".

**Peter Warburton**, the author of *Debt & Delusion*, which predicted the global collapse, comments on the last decade and what is likely to happen during the next:

"Sadly, most of it was illusion, based on increased economic leverage and an accompanying erosion of the national saving rate. The surprise was the length of time it took for the reckless over-expansion of credit to blow up economic performance and the breathtaking audacity of the leading central banks in prolonging the flight from economic reason. In the coming decade, the key surprise will be the return of a high single-digits global inflation rate and the sickening realization that we have to fight this dragon all over again."

Comparing recent real estate derived financial instruments to those which were created prior to the Great Depression, a study by **William Goetzmann** and **Frank Newman** for the Bureau of Economic research concludes:

By nearly every measure real estate securities were as toxic in the 1930s as they are now... The study details how a real estate securitization boom preceded the bubble and bust in the 1925 - 1935 era and concludes: "The breakdown in the value of real estate securities as collateral assets preceded the crash of 1929".

**Edward Chancellor** the author of *Devil Take the Hindmost: A History of Financial Speculation*, and who is a member of asset management giant GMO LLC's asset allocation team cautions:

"Keynesian economists do not focus on inflationary expectations or on the money supply. Instead, they point to the dramatic collapse of demand in the glob-

*continued on page 5*

the worst monthly performance since monthly records began in 1987".

This is just the beginning and it is an approaching tidal wave. Of America's 72 million families, 34 million are baby boomers. But while they play havoc with government budgets and pension plans, this avalanche of boomers is creating a major opportunity in the form of a growth industry that deals with age related diseases and other challenges associated with growing old.

It is occurring just as Ray Kurzweil's *Singularity*: the logarithmic growth of scientific knowledge, is becoming a reality. Mr. Kurtzweil who is best known for predicting the internet revolution, theorizes that a combination of three important technologies, genetics, nanotechnology, and robotics (including artificial intelligence) will underpin this ongoing human revolution.

This next great technological wave will create many fortunes for a corresponding flood of investors. But we must always keep in mind, the more great advances and the more money that is made, the larger the subsequent bubble will be. It's human nature.

During the 1990s when I authored *Mae-del's MiniCap Analyst* we were at the forefront of the mining boom and bubble, and thus fortunate to have recommended, when they were pennies a share, stocks such as the late great **Adolph Lundin's Argentina Gold** or **David Lowell's Arequipa Resources** both which rose a thousands of percent. In that mining boom and during the subsequent bubble, tripling our money in a few months seemed, well, ordinary.

One company I recommended, **Ken Shannon's Corriente Resources** (it was just bought by Tongling Nonferrous Metals Group Holdings Co. and China Railway Construction Corporation for \$8.60 per share) had not even drilled, even so Corriente's shares rocketed from \$0.80 to \$20. No wonder I get nostalgic.

Part of the reason the bubble developed was that in response to geoscientific advances, commodity pricing and the opening of new areas to explore a series of fantastic discoveries had been made. They included Voisey's Bay (Nickel) Eskay Creek (gold) Ekati (diamonds) Arequipa (gold) Escondida (copper).

*continued on page 6*

**Points to Ponder**

*al economy as a sign that deflationary forces will be around for a long while. Goldman Sachs estimates the current "output gap" to be about 8 per cent of global GDP. Inflation will not pick up until this spare capacity has shrunk, according to Goldman.*

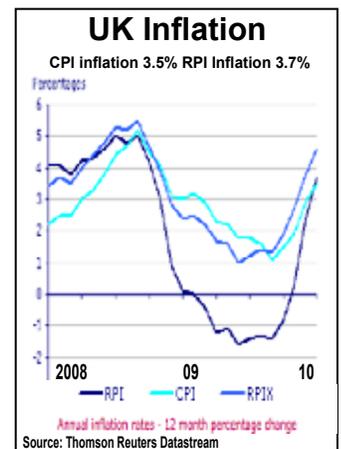
*This argument should be viewed sceptically. There are times when inflation and economic activity move in the opposite direction. For instance, periods of rising inflation and unemployment are relatively common during emerging market crises. The US witnessed something similar during the stagflation of the 1970s. Leading indicators suggest the US economy is set to decline sharply in the first quarter. The last time these indicators were so dire occurred in 1974. Yet there was no deflation in that year. Rather the inflation rate climbed to 12 per cent."*

*Societe Generale analyst Dylan Grice writes in Popular Delusions about the potential for a Japanese debt crisis:*

*"Japan's government borrows from Japanese households and has done for decades. But Japanese households are retiring, and traditionally retirees run down their savings. So who will fund Japan's future deficits, which are already within the range identified by inflationc historian Peter Bernholz as hyperinflation 'red flags'? Twenty years ago, who could predict long-term JGB yields below 1%? Who sees uncontrolled inflation as the primary risk facing Japan today?"*

*Lord Maynard Keynes on avoiding recessions (bubble creation?) with low interest rates:*

*"The right remedy for the trade cycle is not to be found in abolishing booms and thus keep us permanently in a semi-slump; but in abolishing slumps and thus keeping us permanently in a quasi-boom."*



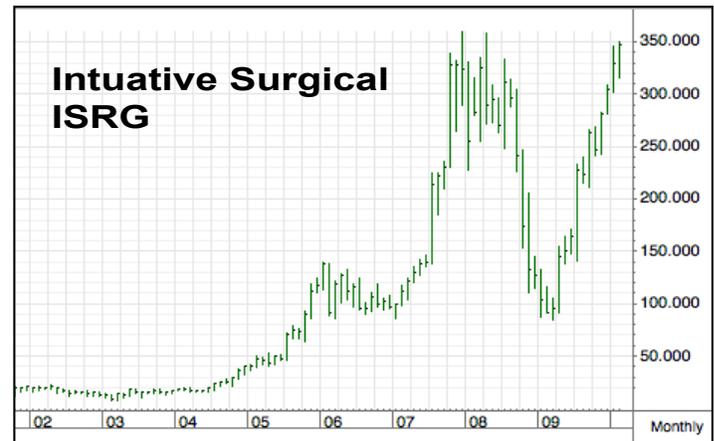
Among the leaders of the boom was David Lowell who authored with Dr. John Guilbert a seminal report outlining the Lowell-Guilbert model for copper porphyry ore deposits. They went on to discover the **Escondida mine**, the world's largest copper deposit. David was also credited with the discovery of the giant **Kalamazoo** copper deposit and the **Dizon** in the Philippines. So when he showed me his first public company Arequipa Resources, I was quickly a believer. Arequipa rose from \$0.60 to \$32 where Barrick bought it.

The sales of these former penny stocks meant that thousands of investors were soon awash with speculative money looking to do it again. The point was that as new technology combined with the opening of new areas there were many other discoveries which in turn produced a subsequent wave of optimistic and cash-rich investors.

The ingredients for a bubble were in place and it was finally pricked with the revelation that **Bre-X Minerals** at \$286 a share, was a massive fraud. Truly a Bernie Madoff moment for the Canadian min-

ing industry. And it has never been the same since. In the biotech space events are developing just as mining success stories did in the early '90s. A wave of small companies are becoming giant success stories and an increasing number of speculators are being cashed out and looking for the next biotech winner. The numbers in reality dwarf what occurred in the Canadian mining industry. For example, three years ago **AstraZeneca** bought **MedImmune** for \$15.2 billion and last year **Johnson and Johnson** bought **Cougar Biotechnology** for \$1 billion cash. **Mederex** quadrupled in a matter of months just prior to its takeover by **Bristol Meyers Squibb** last summer and a year ago **Roche** paid \$43.7 billion for **Genetech**. In 2006 Merck & Co put RNAi on the map with its purchase of **Sirna Therapeutics** in a \$1.1 billion deal.

Viewed over the past decade major success stories are even more common. Take **Intuitive Surgical** it traded as low as \$6 in 2001 last week it closed at an all time high of \$346. **Celgene** which traded as low as \$2.80 in 2002 is at \$60 now. Not bad considering most in-



vestors refer to the last 10 years as the lost decade. Too many consider themselves lucky if they managed to avoid going broke. What will happen when they continue to see fortunes made in biotech?

The point is the biotech sector has all the fundamental ingredients required for a major bull market and like all historic bull markets. Its story and momentum is building.

In 2003 I penned together with analyst Conrad Weiss, *The Forgotten Bull Market* series which first predicted a major gas, and later, oil bull market and energy crisis. Almost every energy company we recommended at least doubled and some rose as much as 1000% - carried by a wave of increasingly robust economics and enamoured investors.

Today the Biotech sector has the same tone, and the same technical and fundamental characteristics as energy stocks in 2003.

Take the Amex Biotech index. It has moved from new high to new high even while the major markets have been correcting and even though Greece and the rest of the PIGS looked to be imploding and taking the Euro with them. How many other market sectors are that strong? Certainly I am impressed with gold's resilience but really, biotech were the stars.

A quiet revolution has been underway for some time and as it becomes increasingly apparent to the public this bull market will accelerate. Stay tuned we will be adding biotech stocks to our portfolio at [www.maedels.co.uk](http://www.maedels.co.uk). crude in the near future.

# Gold Rush

Mexican gold producer **Mexoro Minerals** (OTC MXOM \$0.51) marches to its own drummer as it's shares traded at new highs despite the gold and gold sector correction, marking a bullish divergence which is confirmed by its rising On Balance Volume and RSI (see below). The chart pattern Mexoro has been developed is known as a "scaloping" or "rounding" bottom and it appears to be in the midst of breaking out to the upside. Rounding bottoms are generally very reliable and thus great investment opportunities when you can find them. The 1948 classic **Technical Analysis of Stock Trends by Edwards and Magee** notes:

*"Rounding bottoms occur most often in low-priced stocks in an extended, flat bottom form which usually takes months to complete... these patterns, when they occur*

*after an extensive decline, are of outstanding importance, for they nearly always denote a change in Primary trend and an extensive advance yet to come".*

Maedel's previously have outlined the bullish fundamental case for Mexoro Minerals. We are quite familiar with it as we advised them in their reorganization last year and continue to consult for the company which is in the midst of changing its name to Pan American Goldfields

Simply put Mexoro is growing its gold production dramatically at its Cieneguita Mine while it advances two other "high impact projects.

The company is in the midst of a drilling program at its Sahyuacan project better known for containing the Santa Teresa mine workings, formerly one of the highest grade producers in Mexico's Chihuahua state.

Like most mines in the state, its operations ceased at the start of the Mexican revolution around 1910. The original miners simply followed high grade gold veins that were visible to the naked eye to develop underground workings and they produced millions of ounces doing it.

Critically in those days if you could not see it, you did not mine it, meaning a breathtaking amount of gold remains around many of these historic producers at grades that are wildly economic using the latest technology and gold price.

The Sahyuacan's high grade mine workings have lain fallow since the revolution, that is until Mexoro acquired the property.

Because the gold grades required to make an economic discovery in Chihuahua are a very small fraction of the grades mined previously, a gold rush was triggered when the government opened the area up for foreign investment.

Since the area was opened up roughly 10 years ago, gold production has leapt from zero to more than 2 million ounces in 2010

Mexoro is a very good example of what is happening. Its first

stab at drilling next to an old producer was at the company's Cieneguita which is now the company's principal growth story. So far they are mining a 1.2 million ounce resource an amount which is expected to be increased substantially.

The initial-growth is anticipated from ramping up their gold production from this year's 1000 tpd at 3 grams gold per ton (roughly 30,000 ounces at a cash cost of around US\$350) to over 100,000 ounces.

It does not seem too much of a stretch to expect the Sahyuacan to be come their second mine, an event that should dramatically add to the company's share price as it evolves.

Mexoro's chairman Mario Ayub was the president of the Mexican Miners Association and has discovered and put into production 8 mines in the area. Importantly he says he has several additional Cieneguita-Sahyuacan-like plums in mind for the company.

Analyst Victor Gonçalves who pens the *Equities and Economics Report* recently described Mexoro as "very very undervalued" we agree and note that it is one story that just keeps getting better.



**BNK Petroleum**  
TSX: BKX \$2.00

Insider buying is what originally alerted us to BNK Petroleum at \$1.30, specifically continued purchases of the company's shares by its Chairman Ford Nicholson and President & CEO Wolf Regener throughout November and December 2009. Upon our analysis it quickly became evident that the company had a compelling story that was confirmed by its technical picture and trading tone. BNK is a spin off of the US assets from

Albania-based Bankers Petroleum and it has the same very high level of operating expertise. Its main US asset is its average 50% interests in acreage covering the Tishomingo gas field in Oklahoma. Considerable upside exists from a proposed increase in drilling density and development of other shale plays within the acreage.

The company's European activities are what however, has got investors' attention. Shale gas has become a major source of production in the US that used to be dominated by scrappy independents but is increasingly being taken over by super-majors such as ExxonMobil. The same

potential for shale plays is considered to exist in Europe. Tim Cejka, Exxon's head of global exploration, said in the WSJ that "the company has been bullish on shale-gas exploration since 2003". XOM is already very much involved in Eastern Europe notably Poland, Hungary and Germany's lower Saxony.

Beginning 2008 BNK evaluated more than 18 basins in Europe and chose to focus on Poland where a very low cost per acre, a 1% royalty, 18% corporate tax rate and a \$9 per mcf price of gas added up to very compelling economic potential. The company has since acquired 2.1 million acres in the Baltic Basin.

Three of its concessions, the Slawno, Slupsk and Starogard covering 720,000 acres has been farmed out to its neighbor Conoco Phillips and the first well is expected to be drilled later this year. In a WSJ article Larry Archibald, Conoco's vice president of exploration, was questioned about its first farm in into the area with Lane Energy BNK's neighbor.

He described the area as flat, easy to reach and any natural gas produced can go into the European Union market, which has good

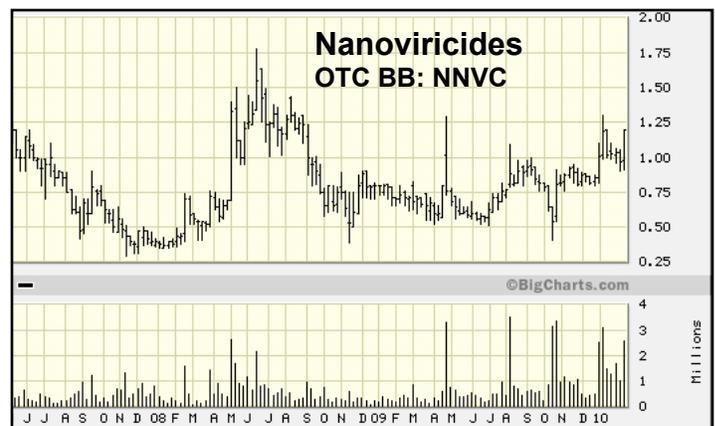
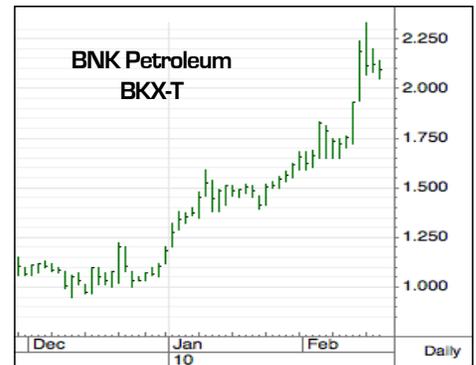
demand. "What's not to like about this type of play?"

BNK's real upside comes from its Polish high risk exploration while we view its underpinning production and growth in the US as a foundation it is not the story. Given the inherent risks it faces we are hedging our bets and selling 50% at \$2.00 thus lowering our cost per share to \$0.30.

**The Next Penicillin? Nanoviricides OTC BB NNVC \$1.30**

To infect a human cell viruses attach themselves to healthy cells via an outer membrane which recognizes the target human cell. Nanoviricides is developing a broad spectrum antiviral drug whose basic design is to render inert various targeted

viruses by interfering with the normal process by which a virus attaches to the outside of a health cell and then infects the cell. Its strategy is to create a molecule with bespoke proteins which can be designed to target a specific or broad range of viruses. The targeted viruses mistake the molecule/protein combination for a healthy cell which they then fuse to. Once fused the normal infection process is stopped as the viruses outer membrane breaks down and nucleocapsid exits the cell. The applications are enormous basically



everything from ebola to swine flu (its initial focus is herpes, HIV and influenza). Like what penicillin was to bacterial infections

Nanoviricides drug promises to be to be to viruses such as influenza, aids and herpes. Because it acts before the virus gets into a health cell patients treated won't get sick and animal trials show no toxicity or resistance developing.

Last August, in vitro showed a 99.99% reduction in herpes viral loads in vitro. Animal trials on the company's HIVcide in Israel in 2008 "have shown that animals treated with its lead anti-HIV drug candidate, HIVCide-I, demonstrated a substantially greater reduction in viral load -- number of infectious virus particles per milliliter of blood -- when compared to the animals given the anti-HIV "combo cocktail" in a preliminary animal study. An important objective of anti-HIV treatment is to minimize the viral load. According to Viricides' president Anil R. Diwan, PhD.

*"We now know that HIV-Cide-I was clearly superior to the triple drug combo cocktail in all parameters we observed,"*

Because the molecule is small enough delivery introduction of the drug can be via nasal sprays, bronchial inhalers, intramuscular and intravenous injections. Its application as an antidote in biological warfare is also being tested by the US military. The core molecule called a nano-micelle remains constant while the proteins on its surface are changed to target specific viruses.

Nanoviricides' most recent development was the signing a R&D agreement with Dr. Eva Harris a Professor of Infectious Diseases at UC Berkeley, to evaluate (en vivo and vitro) the effectiveness of nanoviricides against the viruses which cause dengue fever.

Dr. Harris is considered the worlds fore-

most authority in Dengue fever and received the **McArthur "Genius" Award** in 1997. In 2001, Dr. Harris was named a Pew Scholar for her work on dengue pathogenesis and was selected as a Global Leader for Tomorrow by the **World Economic Forum**. As the company states

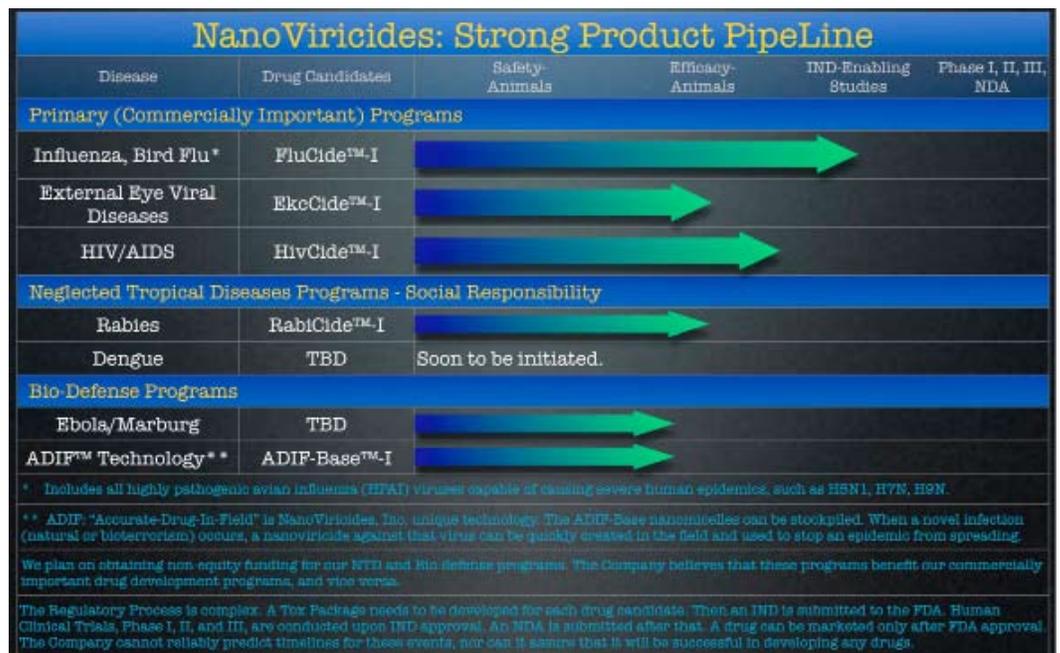
*"There are no approved vaccines for the prevention of dengue, nor drugs for treatment of dengue virus infection".*

And the market size for an effective treatment is expected to compare to Hepatitis C virus treatment which **Roche and Schering-Plough** expects to exceed \$7 billion annually in the next 3 years. Dengue is particularly dangerous because rather than developing an immunity

the antibodies produced by the immune system can lead to increased severity of the second dengue infection

In the news release the company stated

*"Using computer modeling, the Company has developed a library of small chemical ligands that bind to dengue virus envelope proteins. Using these ligands, a number of candidate nanoviricides that are capable of attacking the dengue virus have been developed. The Company believes that these nanoviricide drug candidates mimic the natural, common attachment function by which the four different dengue virus serotypes bind to the body's host cells".*



That's it. Nanoviricides appears to be on its way to developing a blockbuster drug platform of biblical proportions. The risk is that some how a, to date unknown, competing technology is developed sooner and works better. Or that while animal testing has been highly positive the subsequent human trials for Nanoviricides turn out to be a flop.

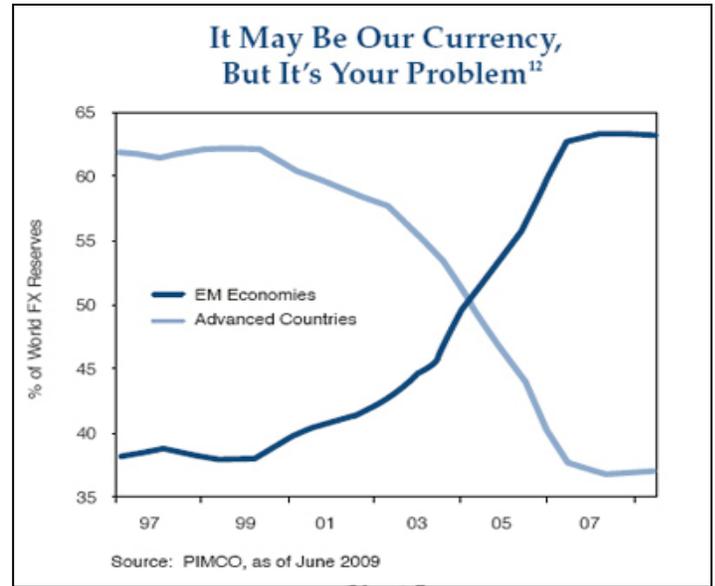
To give readers a picture of where Nanoviricides is in terms of development see the chart from the company's web site ([www.nanoviricides.com](http://www.nanoviricides.com)), on the previous page. We are adding it to our portfolio.

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## The eye of the hurricane

An avalanche of sub prime mortgage defaults precipitated the last world financial crisis. Since then the developed world's economies have staged a tepid recovery, mostly as a result of stimulus programs, central bank quantitative easing (creating money and using it to buy government debt) and the ending of the first wave of the residential real estate collapse. As the chart below shows another wave is about to hit just as QE and stimulus programs are ending and the FED is talking tough about deficit spending.

The million dollar question is how will developed countries' central banks and governments

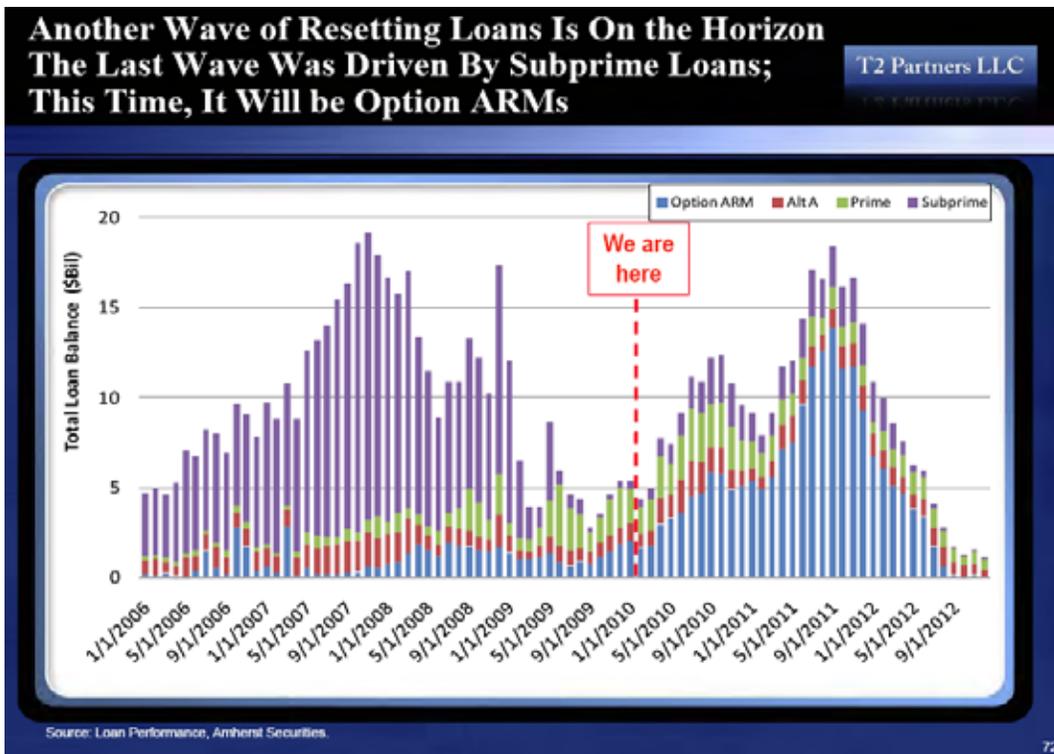


react when the next wave hits? Their choice is simple but hard. The first is to allow an Austrian style deflationary collapse so that unsound investments are liquidated. The second is to continue their Keynesian demand management strategy as

long as emerging market countries (China, Brazil etc.) finally stop buying their debt. The chart above shows how EM countries' FX reserves have reversed from their miniscule holdings at the time of the Asian collapse in the late 1990s, to where it is the advanced countries with miniscule FX reserves and giant borrowing needs.

The first choice, an Austrian style unwinding, would be political suicide for the Obama administration. But more Keynesian spending risks extreme currency volatility as investors react to deteriorating government balance sheets, central bank quantitative easing and potentially accelerating inflation.

As bad, the White House may do nothing, and thus allow America's structural deficits to continue growing dramatically, interest rates to rise,

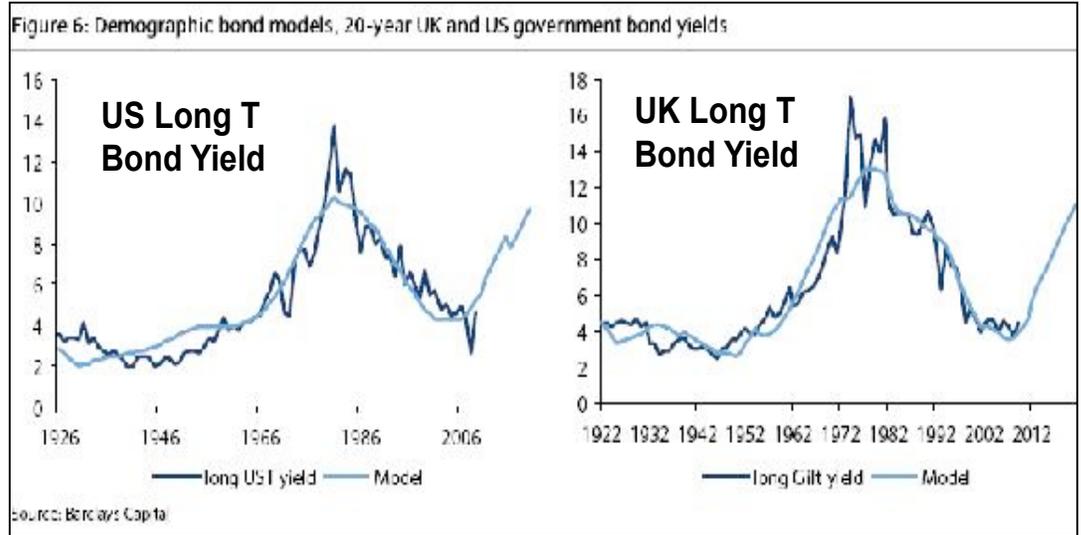


along with inflation and possibly their dollar collapse. The country's economic imbalances would then be solved by 1970s style stagflation: a dollar decline which allows it to slowly export its way out of the crisis, just as accelerating inflation reduces the impact of its record public and private debt. Economist Paul Krugman recently warned that doing nothing is exactly what is happening:

*"Instead of fraying under the strain of imperial overstretch, we're paralyzed by procedure. Instead of re-enacting the decline and fall of Rome, we're re-enacting the dissolution of 18th-century Poland... The truth is that given the state of American politics, the way the Senate works is no longer consistent with a functioning government."*

**Talking tough**

The short term strength in the US economy has allowed both President Obama and Fed Chairman Bernanke to talk about ending their respective stimulus and quantitative easing policies. But as the next wave of US home foreclosures hit this summer and America's economy swoons, their focus is likely to switch to implementing another round of rescue packages, quantitative easing and selling treasury bonds. The result will be a plunging US dollar.

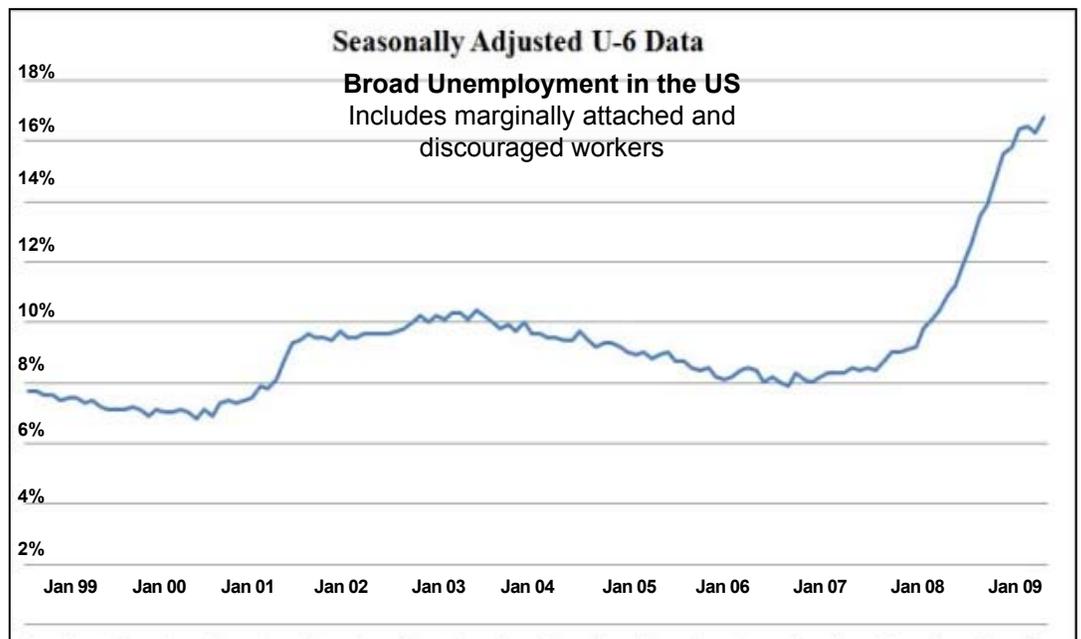


Montreal based **Bank Credit Analyst** says that ending the Bush tax cuts, temporary tax reductions and stimulus as Obama currently plans (and Bernanke is campaigning for) would "represent a fiscal drag of about 2.5% of GDP" - political suicide for law makers in Washington given that the tepid economic recovery is decelerating and the only significant

growth as of late has been in home foreclosures and unemployment.

The rest of the developed world is struggling with varying versions of the same crisis. Too much private and public debt, mushrooming social costs and shrinking populations which in turn reduce tax revenues, while further increasing deficits and borrowing needs.

Work by **Ed Yardeni** on of the America's most respected researchers sums up the US version of the crisis succinctly: between 1999 and 2009 federal outlays for social security and medicare rose 78% the GDP rose 48%, the working age population rose 29 million or 22%, new jobs rose by 0%, but the number of new retirees rose by 38.4 million or



17.9%. In short: swelling unemployment benefits, welfare, medicare and pension costs, shrinking government income.

The **Organization for Economic Cooperation and Development** estimates government deficit-prompted borrowing by developed countries will total a record \$16 trillion in 2010, a 25% or \$4 trillion increase from 2008. Not only does this borrowing threaten to crowd out private investment and borrowing but it also translates to more money being spent by governments on interest - a big risk considering that interest rates have nowhere to go but up from their historically low levels.

Currently Japan spends the most of its fiscal budget on interest: an eye-popping 22.4% ,making it particularly vulnerable to any interest cost increases. In comparison America's interest costs totalled 5.4% of its federal budget, but worryingly 40% of its borrowing has maturities of one year or less and nearly a third is foreign held. Recall what happened in the late 1990s. Asian currencies collapsed when short term borrowing and low FX reserves left those economies vulnerable to capital flight which is exactly what happened. This time the opposite is true. Consider the defi-

cit increasing effect of rising interest rates. Short term US Treasuries currently yield 1.2%. If they yielded a more historically normal 4% with a corresponding increase in long dated securities, America's interest costs would double: a perfect storm of contagion would result as its debt is downgraded thus increasing their interest costs even more.

**Against the tide: rising interest rates to threaten the recovery**

Critically there is strong evidence that without QE interest rates could begin rising immediately. Demographic bond models employed by **Barclays Capital** have tracked the interest rate cycle in the UK and US with uncanny accuracy over the past century and they now indicate a major upswing in interest costs is at hand

(see chart). As would be expected many investors have little interest in government debt at current interest rates.

Last month's aborted bond auction by Greece is only the latest of bond market failures. Economic powerhouse Germany, suffered two failed bond auctions last year when not enough investor interest materialized. A UK auction also flopped following which The Bank of England began quantitative easing.

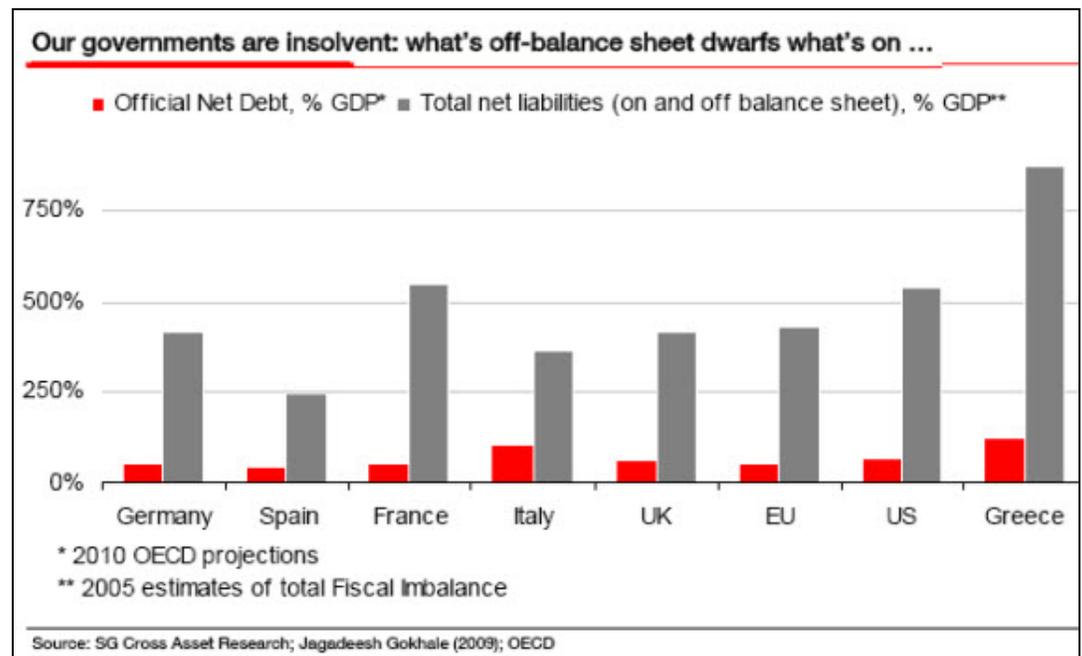
Adding to costs is the increase in sovereign risks. **Japan** whose reliance on domestic investors is looking increasingly tenuous recently had its debt outlook downgraded to negative by **Standard & Poors** as its government increased its deficit spending plans. Standard & Poor's also downgraded the **United**

**Kingdom's** outlook from stable to "negative" - the first time since it started analyzing its public finances in 1978. And early February **Moody's Investor Service** warned that America's Triple AAA credit rating could be at risk "*should its economic revival not develop into a full-blown recovery*".

Last week Fed Chairman Bernanke warned Congress that the US could soon face a debt crisis like the one in Greece and declared that the central Bank would not help legislators by printing money to pay for ballooning federal debt.

How Congress and the Fed will react when faced with the prospect of renewed deflation is the poignant question.

New York based **Economic Cycle Research Institute**, one of the industry's most ac-



curate economic forecasters says its yearly growth gauge has continued to slide, bolstering expectations that economic growth will ease by mid-year. Approaching like a freight train is a second wave of commercial and residential foreclosures set to arrive this summer (see chart page 10). The housing sector accounted for roughly half of US economic growth and more than half of the private sector jobs created in the five years preceding the crash. Consequently a resumption of America's real estate crash will not help their economy.

**David A. Rosenberg** the Chief Economist & Strategist at **Gluskin Sheff** says that is exactly what is about to happen:

*“With over 9 million housing units either vacant for sale, in foreclosed inventory or occupied and listed actively, together with a competing record 11% nationwide rental vacancy rate, it's only a matter of time when home*

*prices succumb to what is still a glaring excess supply backdrop. New household formation is down just over 800,000 at an annual rate so what we are talking about here is 5 year's worth of underlying demand just to cut the total inventory backlog by half”.*

And while Mr. Rosenberg worries about the future the present doesn't look so good either. In January US builders sold 1,000 houses per day compared to foreclosures of 4300 per day and notices of default totalling 5100 per day, just as the number of securitized prime jumbo mortgages at least 60 days late reached 9.6% in January up from 9.2% the previous month and the 32nd straight increase for serious delinquencies according to Fitch Ratings.

Meanwhile 702 US banks are on the FDIC's watch list - Triple the number in 2008, and bank lending has fallen the most since 1943.

In a move that does not immediately effect government deficit spending but whose implications are dramatic, the Obama administration announced support for the real estate market on Christmas eve. They did this by establishing an unlimited credit line to **Fannie Mae** and **Freddie Mac** that would exist until 2012 the year of the next presidential election.

Freddie Mac Chief Executive **Charles Halde- man** warns that a “potential large wave of foreclosures” may sweep the nation. The government is getting increasingly panicky by the prospect of a renewed downturn. Last week the White House was reported to be considering a law that would prevent banks from foreclosing on defaulted homeowners unless they had been screened and rejected by the **Federal Home Affordable Modification Program (HAMP)**.

But the slowdown is not limited to America. Spain, Greece, France, the UK, Germany and almost all of the G20 save Canada and Australia all face the same debt crisis - too much private and public debt, mushrooming social costs and a shrinking population which in turn reduces revenues.

The result is that government borrowing needs continue to rocket.

**Sovereign borrowing to reach \$16 Trillion**

The **Organization for Economic Cooperation and Development** estimates that in 2010 \$16 trillion will need to be raised mostly by developed countries- up \$4 trillion from 2008. That is more than the GDP of America the world's largest economy and its principally the world's developing countries that are in the incredible position of lending money to the developed.

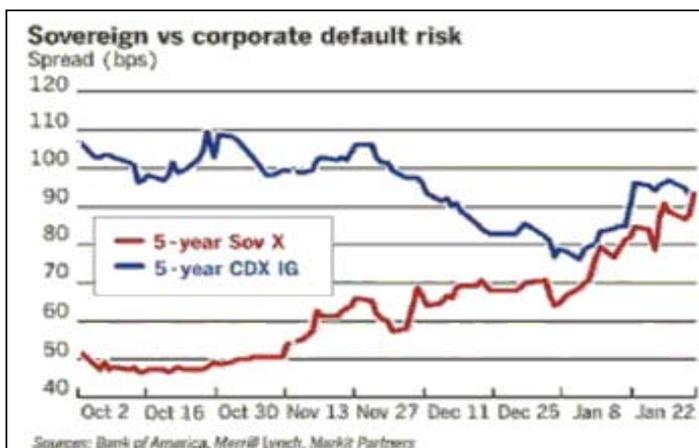
An **International Monetary Fund** study of the expansionary plans of the leading G20 countries calculates that government debt will rise from around 80 per cent of GDP in 2008 to 118 per cent of GDP in 2014. Incredibly it assumes discretionary tightening will occur next year, otherwise the debt will be much higher.

But how will all this borrowing be possible without causing interest rates to rise and in turn reduce growth and add further to government costs?

It seems logical that the choices for the near term are quantitative easing or higher interest rates.

**Race to the Bottom Riverfront Investment Group**

forecast a *major spike in defaults lasting many years* just prior to the advent of the sub-prime collapse. As the crisis was beginning they memorably warned that *“the calming reassurances from the CEO's are not con-*



sistant with the actions of their organizations". More recently they concluded:

**"America's only exit from the current crisis is a lower dollar".**

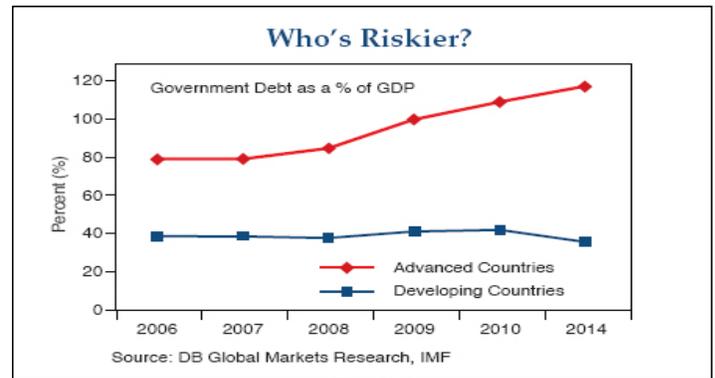
It is evident that America's real estate sector remains in critical condition, consumer confidence is in a death spiral and bank lending for mortgages, consumer credit and business lending is imploding as demonstrated by the latest 14 per cent (annualized) decline.

Under these circumstances the Obama administration is unlikely to make reducing the deficit a priority and will welcome a lower dollar. At the same time by this summer Congress will likely be faced with a worsening economy just as mid-term Senate elections approach

consequently they too will be happy to approve another stimulus program.

The other developed economies will not be helped by US dollar declines and increased export competitiveness. Their balance sheets will also deteriorate creating an environment of extreme currency volatility.

A recent declaration by George Papakonstantinou Greece's finance minister is an indication of a new anti-trade trend: *Foreign deposits held by Greek residents must be repatriated and will be taxed at a 5% rate and if not repatriated they would be taxed at an 8% rate every six months.* Cooperation between governments to catch tax cheaters no matter how unfair taxes may be are increasing to include even Switzerland and Liechten-



stein. America taxes its citizens even when they live abroad. Levying extra taxes on savings held in foreign accounts will be easy to rationalize by an increasing desperate developed world.

The US dollar looks to be the next to decline but that does not mean it will be the last as a race to the bottom between the developed world's currencies is well under way. Critically as demonstrated in the 1930s and 1970s (and by bullion's recent strength despite the



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