



Peak Oil Is a Flat Lie

Peak oil my ass.

How many times have you heard someone claim, “We’re running out of oil”?

Experts have said for years U.S. oil production is doomed to collapse. Domestic oil production, they noted, peaked in the early 1970s. It had declined every single year since 1991. It would never come back, they said, because “all of the oil” had already been discovered.

I never believed a word of it. The core problem of the oil business has always been *too much oil*. Think about it. Would OPEC really have been organized to limit production if we were truly in danger of running out of the stuff? (OPEC, by the way, is just a knockoff of the original oil cartel, the West Texas Railroad Commission.) I knew it was only a matter of time before either technology or geology produced a new gusher.

What I didn’t know was by the time the peak oil nut-jobs had taken over the investment conference circuit (where I was forced to endure their hysterical presentations over and over again), the solution to declining U.S. oil production had already been discovered by a man named George Mitchell.

Unless you’re a petroleum engineer, you have probably never heard his name before. But he’ll go down in history as the greatest oilman since J.D. Rockefeller. Of course, at first, everyone thought he was plumb out of his mind...

It was 1981. George Mitchell was near financial ruin. Investors wouldn’t return his calls. Mitchell Energy employees were often paid late. Sometimes, they found themselves using rusty cattle fence wire to secure the steel on the platforms.

It shouldn’t have been this hard for Mitchell to make a living. Drillers all over Texas were getting rich producing natural gas from sand reservoirs that lay less than 5,000 feet below the surface. Punch a hole into one of these reservoirs

EDITOR’S NOTE: You might notice a small change in the masthead of this newsletter. For the last 11 years, I’ve written this newsletter, *Porter Stansberry’s Investment Advisory*, completely by myself. It has been my constant, monthly challenge to write a well-thought-out, thoroughly researched, entertaining, and profitable piece of investment research to you each month.

I am pleased to announce that going forward another person will share that responsibility with me – Braden Copeland. You might recognize the name. Braden was hired to pen our *Inside Strategist* newsletter. Since he took over, he has compiled a track record second to none in our business. His performance – both as analyst and writer – has been so impressive, we’ve decided to give him a much larger stage: our flagship publication.

As a result, this letter will now be called *The S&A Investment Advisory*. You should expect a tremendous increase in the quality and breadth of our coverage, but no change at all in the publication’s willingness to take on vested interests or to take unpopular stands. We will write what our research leads us to conclude and nothing else.

Regards,

Porter Stansberry

and the gas would come soaring out of the well.

Mitchell thought he had a better idea, though. He had friends drilling for oil – not gas – in Texas' Barnett Shale near Fort Worth. He'd heard their tales of the hated natural gas flows they'd hit in the hard, brick-like clay. When they struck those firebombs unprepared, their holes could become instant barbecue pits, cooking expensive equipment. To them, the gas was a nuisance. But Mitchell saw value in it...

The shale, though harder than the sand that lay above it, was still porous. It was also deeper, at least 8,000 feet underground. If Mitchell was right, the sand-hosted gas discoveries they'd been hitting for years were tiny outlets for a massive shale-hosted gasfield in the shale below. All he had to do was drill into the gigantic hardened clay slabs and coax the gas out, making him incredibly rich.

He sank his first drill into the Barnett shale in early 1981. He could hardly light a cigar with the gas he produced, but the geology of the core samples indicated a huge amount of natural gas was in the shale. He needed to find a way to break up the shale and get it flowing. And he needed to do this at the bottom of a seven-inch-wide hole he had drilled nearly two miles into the ground.

Mitchell considered his dilemma and talked to some of the oil guys about using water and sand to help crumble the shale. He decided to take a chance on it, and ordered more than 50,000 gallons of water and 75,000 pounds of sand out to the well. Then, he got a mixing truck, connected a high-pressure pump to it and the well head, and forced the sandy water into the hole...

Then, he waited. And waited. He was sure the liquid's force would break up the shale, creating outlets for the trapped gas to get to his well. Once the material cracked, the sand would prop the cracks open. The process is called hydraulic fracturing, or just "fracking." Mitchell was convinced it was the answer...

He got a few belches, pops, and gurgles out of the well. Nothing big ever came. He'd spent tens of thousands of dollars with nothing except a sandy mess to show for it. Most men would have given up. But there was something a bit different about George Mitchell. He never quit.

He tried foam nitrogen, CO₂, special gels... none of it worked.

As cheap as natural gas was throughout the 1980s, fracking costs were hardly justified. Mitchell's board members urged him to stop. He didn't. He knew those shales trapped huge amounts of gas. He was determined to get it out. There was nothing more to discuss.

One morning in the early 1990s, Mitchell had a revelation:

The brittle Barnett shale didn't stretch or bend under pressure. Once it was fractured, it stayed rubble and the openings would remain. That meant he had been using more sand than required to maintain the cracks for the gas to escape. If he used less sand, he could run his pumps faster and drive the water into the hole much harder, cracking-up more shale and leaving less-obstructed openings for gas flow.

Another idea immediately followed. He'd also make the water "slick," adding a chemical to help slam his sand/water concoction into the well with even greater force.

The new approach worked instantly, with spectacular results. The next time he fractured a well, he didn't need to measure anything to know he'd conquered the shale. The 40% increase in flow almost blew his derrick into pieces. The gas kept coming... Mitchell's wells went from producing very little natural gas to more than 1.4 million cubic feet per day.

News of Mitchell's hard-fought victory spread. Other drillers moved in, acquiring more well rights over the Barnett shale. They started drilling and fracking the same way. Well drilling in the Barnett shale expanded from 40 wells in 1993 to more than 200 in 1999.

Then, the real rush began...

No one's quite sure who began horizontal drilling Barnett. The technology, developed in the 1980s, when combined with Mitchell's specialized slick-water fracturing, was perfect for the conditions. Shale slabs extended for miles... sideways. A drill that could traverse the shale horizontally, allowing more of the reservoir material to be fractured, would be incredibly efficient.

Immediately, average well yields approached 2 million cubic feet per day, double what they were just 10 years earlier. Between 1999 and 2001, more than 100 of the horizontal contraptions were rigged. Five years later, 2,000 more were put in service – just in the Barnett shale. By 2007, Barnett wells alone were producing more than 1 *trillion* cubic feet of natural gas. And the Barnett is a small shale.

Few people fully understand how important fracking and horizontal drilling have become to the oil and gas business. In hardly a decade, an area once producing practically zero natural gas covered nearly 5% of America's needs. Estimates showed the shale had more than 27 trillion cubic feet of proven reserves. Combining Mitchell's slick-water fracturing and horizontal drilling, almost every well was a big producer.

These methods are unlocking huge new reservoirs – like the shale plays – and *changing the entire financial footing of the oil and gas business*. Today, we can identify the companies at the fulcrum of these changes, and the potential in them is immense. **Investors who act now on the gigantic shift occurring**

The New Direction

To understand horizontal drilling, you need to know the simple construction of a ground-drilling bit, the “drill string.” It consists of a series of joints connecting steel pipes; heavy cylinders to apply force on the bit; and the drill bit itself. This design allows a hole to be drilled deeper by simply adding more steel pipes to the length of the shaft. Counting the pipes used allows you to track hole depth to be tracked.

Here’s the key: The material used to make the pipe section is able to bend like a pole-vaulter’s pole. That means, as the drill bit is pointed away from vertical, the drill string can follow it through the curve. Drillers control the bit’s direction by installing directional tools, like short, nonrotating, curved sections of pipe between the bit and the first pipe on the string.

All of this was done manually once the drill bit reached the target vertical depth (the top of the shale slab) before new remote control and location technologies became available. Entire drill strings would be removed, measured, and tweaked with directional devices several times to get the bit pointed the right way.

Now, sophisticated “smart” drill-bit assemblies require few – if any – time-consuming removals – of the drill string. Instead, the driller steers the bit real-time from the platform, able to measure almost exactly where it is at all times and sending it exactly where he wants it.

Between the new technology of the drill-bit assemblies and the advanced drill string materials used today that allow for horizontal drilling, drillers are able to economically reach and produce massive reserves they never could before.

because of these technologies stand to make fortunes that will last generations.

How One Company Single-Handedly Revived U.S. Gas Production

Oil companies used to spend a fortune drilling vertical wells – many of which never found any oil. As a result, they had to spend a lot of time and money coming up with drilling plans that featured dozens of wells and lots of investors – all to reduce the risk of hitting of dry holes.

Today, because of extensive historical drilling and 3-D seismic technology, the location of the shale reservoirs aren’t in much doubt. And there are almost no more dry holes. Portfolio company **Petrohawk Energy (NYSE: HK)**, for example, has yet to drill a single dry hole in the new Eagle Ford shale play. This allows far

more capital to be spent on improving the engineering of the rigs, leading to better recovery rates. It also means while horizontal drilling is more expensive than vertical drilling, the cost per unit of energy produced is likely to fall, making it easier and cheaper for oil companies to replace and grow their proven reserves.

What about George Mitchell? In January 2002, he sold his wells, leases, and entire company to Devon Energy (DVN) for \$3.3 billion. Last year, realizing the significance of fracking and large shale-oil discoveries, Devon moved to sell its deepwater Gulf of Mexico properties and nearly all of its foreign production. Instead, Devon will devote nearly all of its capital to domestic onshore oil and gas production.

Devon’s success with Mitchell’s wells in the Barnett shale almost single-handedly reversed the decline in domestic natural gas production, beginning in 2003. And this year, for the first time since 1991, U.S. domestic oil production will increase, thanks largely to oil coming from the horizontal drilling in the Eagle Ford shale.

Last month, we gave you two ways to invest directly in the Eagle Ford play. This month, we want to pass along what we think might be the most sure-fire way to capture the largest profits that come from these discoveries.

It seems likely natural gas prices are going to be depressed for a long time. While oil companies and trusts (like San Juan Basin) can certainly be good investments, thanks to soaring production rates, we also think it makes sense to own what may be the single-largest consumer of natural gas in the United States...

This is a stock you’ll recognize. We’ve recommended it to you before in these pages. However, a recent large acquisition has positioned the company’s earnings to grow even more. It’s time to take a second look at **Calpine (NYSE: CPN)**.

The Fulcrum Security

In the few years since the wide adoption of horizontal drilling with slick-water fracking, U.S. oil and gas companies have discovered a staggering amount of natural gas.

In 2003, the U.S. had 192 *trillion* cubic feet of proven natural gas reserves. By 2008, the amount grew to 245 trillion, a *25% increase*.

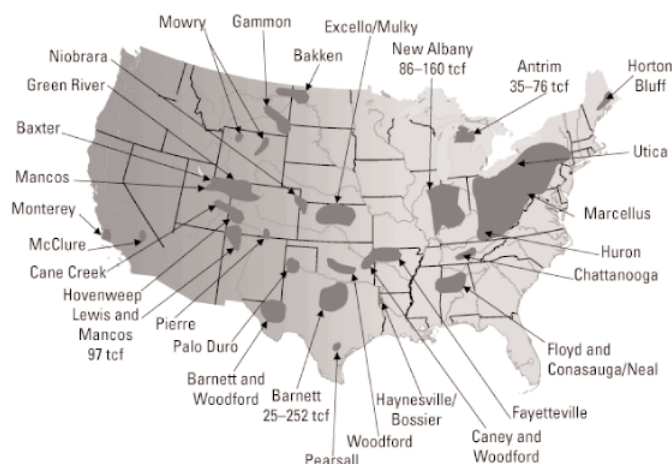
These amounts don’t include anything from the huge Eagle Ford Shale discovery. Eagle Ford is almost as big as the entire state of Indiana. Petrohawk Energy (NYSE: HK) drilled more than 35 wells there last year. On average, these wells yielded more than 8 million cubic feet of natural gas per day – *twice as much as the average in the Barnett Shale*.

Petrohawk expects its average well to yield a total of 5.5 bil-

lion cubic feet of gas over its useful life. At that rate, every 1,000 wells in Eagle Ford will yield 5.5 *trillion* cubic feet of gas. There are already 5,500 wells drilled in the Barnett Shale. And the Eagle Ford is much *bigger*. Recent estimates peg the Eagle Ford's gas reserves at 27 trillion cubic feet... and climbing – that's more than a 10% increase to all known U.S. reserves.

Then, there's the gigantic Marcellus Shale. Range Resources (RRC) began exploring and developing a corner of the shale in 2004. By the end of this year, the company expects to be capturing 200 million cubic feet of gas per day from it. Its target is to capture more than 1 billion cubic feet per day within five years. Drilling is just starting at Marcellus. Trillions more cubic feet of natural gas await...

Take a look at this map of the major shale discoveries in the U.S. (Eagle Ford's not shown. *It's that new.*) Those who say America is the Saudi Arabia of natural gas may not be giving the U.S. enough credit.



With the supply and reserves the country has now developed, the U.S. Department of Energy estimates it already has enough natural gas to satisfy its needs for the next 90 years. And reserves are going to keep growing over the coming decades as these shale discoveries get developed. Few realize the U.S. is sitting on an ocean of onshore oil and gas.

You can forget wind and solar. Natural gas will be so cheap these alternative technologies simply won't have a chance.

Right now, almost half of the power we consume comes from coal. But because natural gas is so much cleaner (and will soon be so much cheaper), we believe the power sector will undergo a massive conversion from coal-fired power plants to natural gas-based plants. In fact, those conversions are underway right now. The amount of energy gas-fired power plants poured onto the grid increased from 16% to more than 21% between 2000 and 2008.

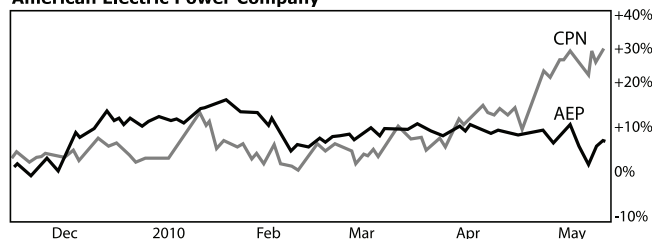
As you probably know from our March 2009 recommendation of the company, Calpine is the giant in the unregulated power industry. Calpine's customers include utilities, industry, agriculture, and municipalities. The company operates in Texas, California, the Southeast, and the Northeast. With its 79 power plants in 16 states, Calpine produces more power than any other wholesale provider, all from natural gas.

The company's average plant is less than eight years old. On the other hand, almost half of the legacy, coal-burning plants in the U.S. (there are more than 600) are beyond their useful lives. If Calpine secures just 5% of the replacement opportunity, the size of its current business would double. We're confident it will grab far more than 5% of the market over the next two years.

The business is simple: Calpine generates the bulk of its revenue purchasing natural gas, burning it in its power plants, and then selling electricity to its customers. The business is also already growing thanks to cheap natural gas. During 2009, when overall power demand was down in the U.S., Calpine's power production increased by 3%. Much of this came from coal-to-gas switching as gas prices fell and coal prices remained relatively constant. The ever-increasing supply of natural gas from the shales will keep natural gas prices low.

For coal-fired providers, the competitive pressure will only increase. That's why we've recommended selling short shares of **American Electric Power (NYSE: AEP)**. Over the last six months, the market has definitely begun to value these two business models quite differently, with Calpine's stock outperforming AEP's by a wide margin. (See the chart, below.)

American Electric Power Company



Calpine is simply in the best position to take advantage of the coming flood of cheap natural gas and new proposed legislation that will heavily tax coal-burning plants. Just look at what Calpine's CEO says of its recent deal to acquire \$1.65 billion of new power plants and convert them to natural gas:

These sites have historically been primarily fired with coal. We do not intend to operate these power plants utilizing coal as a fuel source. The plants are capable of running primarily on natural gas, and it is our plan to operate them as such from day one.

We see Calpine as being a “fulcrum security.” It lies right in the middle of two enormous economic forces: The abundance of natural gas and the never-ending demand for electricity. Calpine is the way our economy will convert the tremendous abundance of natural gas coming from our shale resources into something tangible and useful. No other company in America stands to gain so much from shale gas as Calpine. We think it’s a must-own.

Before buying the stock though, we have to answer...

One Final, All-Important Question

Is Calpine cheap enough?

Right now, Calpine’s market cap (444 million shares outstanding multiplied by the current stock price of \$13.50) is \$6 billion. That means the company’s shares are trading for 10.7 times free cash flow from the prior four quarters. Given Calpine’s expanding fleet of power plants and the likely growth in profitability thanks to the low price of natural gas, we think this is a cheap price to pay, both in absolute terms and in comparison to its peers. Calpine’s cash-flow multiple is slightly lower than the average we calculated looking at 15 similar businesses (including Mirant, Entergy, Unisource, and PPL Corporation).

At less than \$15, we think we’re getting the stock at greater than a 30% discount. While this isn’t nearly as cheap as the last time we recommended it (it was trading at \$5 then), we still think it’s an excellent long-term investment. It’s a great business trading at a reasonable price.

Calpine’s fundamentals of coal obsolescence, ever-increasing power demands, and exploding natural gas supplies are incredibly strong.

Action to take: Buy Calpine (NYSE: CPN) up to \$15 and use a 25% trailing stop.

Gold: The World’s Best Credit Default Swap

What a spectacle...

In an utter and complete repudiation of its founding principles, the European Union’s central bank (ECB) has decided to copy the U.S. Federal Reserve’s 2008/2009 strategy of “papering over” Europe’s massive debt problems. The ECB will provide nearly unlimited credit to Europe’s sovereign borrowers, while also buying troubled assets from Europe’s largest banks.

Before we talk about the details of the plan and what we think they mean for the world’s financial markets, let’s review what we call “the most important chart in the world.”

You should be very familiar with this chart by now, as we’ve

been publishing it nearly every month in this letter and even more frequently in the daily *SC&A Digest*. It shows the value of U.S. government long bonds (represented by the ETF symbol “TLT”), the price of gold (represented by the ETF symbol “GLD”), and the price of silver (represented by the ETF “SLV”).

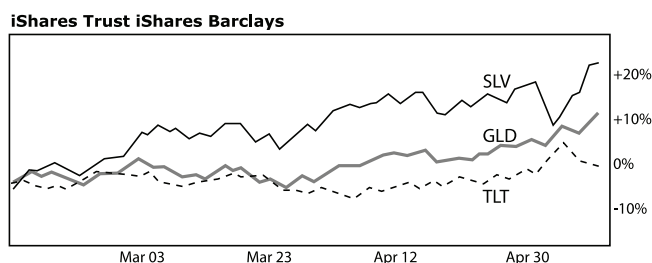
This is the battle for monetary supremacy... The market is arguing over a fundamental question: What is money? Dollars? Gold? Or silver?

For more than 60 years, the U.S. dollar has unquestionably been the world’s safest, most liquid form of money – its reserve currency. During times of economic trouble, investors rush to buy U.S. bonds as a safe haven, causing their value to rise sharply.

And that’s what happened – briefly – during the Greek crisis last month. But then, something changed. As soon as the ECB announced its big bailout and established a swap line with the U.S. Treasury (more about this below), investors realized there’s no real difference between the U.S. dollar and the euro. They’re simply different names for the same thing: paper money. And investors understand the value of paper money may finally collapse under the weight of these massive sovereign debts.

What did investors buy when they sold the U.S. dollar in this crisis? Where did they run? As you can see, they bought gold... and to an increasing degree, silver. We believe this preference for metallic money will continue to strengthen as the financial problems of the U.S. Treasury begin to mount.

If you ignore this trend, you will be financially destroyed over the next several years. If you act now to protect yourself and your family, it will be the greatest single investment decision of your life.



Now... let’s look more closely at what the Europeans have done to stave off the collapse of the European Union...

To maintain a veneer of legality, the European Central Bank (ECB) will create an off-balance-sheet entity to “borrow” roughly \$1 trillion from itself, the U.S. Federal Reserve, and the IMF. Europe’s member states agreed to guarantee these debts, which the ECB claims will be “riskless” because they’re simply loans between central banks.

As we’ve explained in the past, at the root of every paper

currency arrangement – whether John Law’s Royal Bank or John Maynard Keynes’ Bretton Woods agreement – lays a simple scheme to grant credit where none is due. In this case, the scheme is designed to give credit to bankrupt governments in the European Union, via guarantees from those *same* bankrupt governments and additional credit from the U.S. Treasury, which is itself a troubled creditor at best.

In short, the ECB is going to print up lots of euros and give them to the least creditworthy states and the worst bankers in Europe.

The politicians apparently believe this massive infusion of new money and credit will “jumpstart” the European economy, which will then produce enough tax revenue and banking profits to finance these new debts. Don’t laugh...

Meanwhile, to insure this action doesn’t result in a collapse of the euro currency, the Federal Reserve has agreed to open a “swap” line, which will allow the ECB to fund as much of these news “loans” with dollars as is necessary to prevent a run on their currency.

Will this work? At the risk of dramatic future inflation, will creditors really be willing to accept devalued euros, which offer investors almost nothing in interest payments? We don’t think there’s a chance in hell. But perhaps we should ask someone who’s been there... hell, we mean... just to make sure.

No one alive knows as much about bailing out the world’s banks and deadbeat sovereign borrowers as Montagu Collet Norman. Unfortunately, he’s dead. He was governor of the Bank of England from 1920 until 1944. He took England off of the gold standard in 1931, in response to a string of bank failures throughout Europe following the collapse of Kreditanstalt in Austria. It was the beginning of the Great Depression. He had close personal ties to the two other senior central bankers of the era, Ben Strong at the U.S. Federal Reserve and Hjalmar Schacht at Germany’s Reichsbank.

Years later, just before his death, Montagu Norman reviewed the body of his life’s work.

*As I look back, it now seems that, with all of the thoughts and work and good intentions, which we provided, we achieved absolutely nothing... nothing that I did, and very little that old Ben [Strong] did, internationally produced any good effect – or indeed any effect at all except that we collected money from a lot of poor devils and gave it over to the four winds. – Montagu Norman in *Lords of Finance* by Liaquat Ahamed*

The reason paper money systems always fail is because they provide no practical limit to credit. New currency reserves can always be printed. Bad debts – credit defaults – can be “papered over” rather than restructured. The stability of paper money sys-

tems seems like a virtue. The ability to simply manufacture money – without a deposit or true asset as collateral – is the ultimate financial sinecure. As long as confidence in the system remains, the amount of credit that can be manufactured seems limitless.

Unfortunately, this always leads to more debt. At some point, the whole system simply collapses. The debts become so large, they create an untenable economic imbalance, overwhelming the real economy. And when the credit bubble finally bursts, it doesn’t destroy just one or two banks’ house of cards. It wipes out the entire system, which is linked together by the currency itself.

You might recall as early as late 2008, we warned the U.S. had embarked on a massive inflation – the creation of money – designed to save our banking system (TARP, etc.). We believed this marked the beginning of the end for the U.S. dollar paper standard. And the imbalances in our economy had become so large they had warped the real economy: Americans no longer made anything or saved anything (no deposits and no *true* assets to back up the money). They’d come to believe they could grow wealthy merely by trading houses with one another, effectively manufacturing money. It was an enormous delusion, bringing about the largest accumulation of debt in human history, a debt bomb enabled by the first truly global paper currency – backed by nothing at all. Here is what we wrote then...

We are past the liquidity crisis. The forced selling has come to an end. We are now beginning the solvency crisis... With a currency and a budget process totally untethered to any reality, nothing limits the amount of foolish spending Congress can (and will) authorize... We are witnessing the end of the paper-dollar standard. Like every experiment with paper money in history, our paper dollar will be destroyed in an all-out attempt to paper over deficit spending, bad investments, and war debts. – PSIA, December 2008

We told you the best way to protect yourself from the reckless and unlimited money printing was to buy gold: “Buy as much gold bullion as you can reasonably afford.” And because gold shares were crushed in the bear market of 2008, we specifically told you not only to buy gold, but to buy gold stocks: “There has literally never been a better time in history to buy gold stocks.”

When we first warned you about the coming deluge of government debt and money, the price of gold stood at a bit more than \$700. And the ETF of gold-mining stocks recommended were trading at a little less than \$30.

Today, as you surely know, gold trades for more than \$1,200 and the mining ETF sits at more than \$50 per share. At one point this week following the ECB’s announcement, the gold mining ETF shot up almost 10% in two trading days.

While some pullback is surely to come following such a sharp rally, these big moves in gold and gold stocks are not unsustainable. More and more people are beginning to realize gold is the only stable currency left. The paper currencies of *all* of the sovereign issuers are not only troubled, they are all ultimately backed by the U.S. Treasury.

We believe our prediction and advice to buy gold is the most important thing we've ever written.

We don't think this merely because the price of gold and gold stocks have shot up. We think this because *the underlying fundamentals have deteriorated in exactly the way we predicted.*

Before the bailouts began in late 2008, total U.S. government debt held by the public stood at around \$5 trillion. Today, total U.S. government debt held by the public stands at almost \$10 trillion. *It has doubled in less than two years.* The rate of new debt issuance is still completely out of control. This April, the U.S. government's deficit totaled more than \$80 billion. This marks the 19th month in a row the U.S. government has run a monthly deficit. That's the longest string of monthly deficits ever.

Moody's now warns it may downgrade the U.S. Treasury's debt

as soon as 2013 because interest payments on our national debt alone could surpass 20% of federal revenue by then. That leaves only 80¢ of every dollar in tax receipts to pay for Medicare, Social Security, defense, etc., which we already can't afford (hence the 19 straight months of deficits).

We'll keep hammering away at these issues *because all of these problems are going to get a lot worse.* We can only hope you are taking these warnings seriously.

As we see things today, the ECB's actions prove all of my concerns about the future of our paper money system are valid. Not only is the ECB prepared to print as much new money as necessary to protect its banks and sovereign borrowers, the Federal Reserve is backing the plan. How will these systems survive if the U.S. is downgraded?

We believe investors will continue to seek safety in gold (and silver), pushing prices higher at a faster and faster pace until they see a serious and credible effort to bring the U.S. deficit under control. But that won't happen. OBAMA! is on the verge of losing control of both the U.S. House of Representatives and the Senate. His ability to raise taxes will probably disappear. Even so, there has never been – nor will

Duped by the Soviets

When thinking about the likely fate of our global paper currency standard, consider this little-known piece of historical trivia: Both of the main architects of the world's current currency system believed it would eventually lead to revolution and the destruction of the current social order. Maynard Keynes, who advocated paper money in the United Kingdom, wrote:

By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose. – *The Economic Consequences of the Peace*, Maynard Keynes

After the British abandoned the gold standard in 1931, Keynes wrote:

The abolition of the rich will be rather a comfort and serve them right anyhow... I reflect with a good deal of satisfaction that because our rulers are as incompetent as they are mad and wicked, one particular era of a particular kind of civilization is very nearly over. – Maynard Keynes in *Lords of Finance* by Liaquat Ahamed

In the United States, the main architect of the 1944 Bretton Woods agreement, which placed the U.S. dollar at the center of international finance, was Harry Dexter White, the assistant secretary of international affairs at the U.S. Treasury. After Bretton Woods, White secured a place for himself at the center of the new monetary framework – he was the first executive director of the International Monetary Fund (IMF), which was created to implement the new global currency scheme.

Unfortunately, White was an active Soviet agent. He'd been spying for the Russians since the late 1930s. Among his other betrayals, White gave the Soviet Union copies of the plates used to print money in American-occupied Germany – money that could be exchanged for U.S. dollars. This allowed the Soviets to steal billions from us in 1946.

So... if you've ever wondered why, at the end of World War II, when we held the vast majority of the world's gold bullion, we'd implement a global *paper* currency regime, now you know. It was what the Soviet Union wanted. The Soviets were confident they could counterfeit any paper we printed. How many members of Congress today know an active Soviet agent designed the world's monetary system expressly so the Russians could counterfeit the world's reserve currency?

there ever be – any real political support for drastically reducing the size of the federal government.

As a result, the U.S. dollar will collapse. It's no longer a prediction. It is a certainty. Few people believe me yet, but more and more people have begun to consider our repeated warning: *The U.S. dollar will lose its standing as the world's reserve currency.*

This will happen far sooner than anyone can imagine. And the destruction of our currency will wipe out most of the middle class in the United States and lead to a huge decline in our standard of living.

The Best Way to Protect Yourself

When this crisis hits, it will be worse than you can imagine. No one will be able to understand why the value of their savings or wages was destroyed. It will be a dangerous period. But you have a simple way to protect yourself and your family: Buy gold bullion. Put it someplace safe – perhaps even outside the United States.

Many investors have trouble buying gold because it is notoriously hard to value. Unlike a bond, it provides no yield to measure against other productive assets. Unlike a stock, it doesn't have a dividend yield or an earnings multiple. We submit that you ought to think of gold as insurance, as a credit default swap on U.S. Treasury bonds. If you look at the price in this way, gold still seems pretty cheap.

As you've probably read, credit default swaps are contracts bond traders made with each other to pass along the risks of owning any kind of credit instrument. These contracts allow investment banks to spread the risk of defaults on corporate debts, residential mortgages, and credit card receivables, among other things. Essentially, they are insurance. For a relatively small amount of premium, you can buy principal protection on just about any kind of investment-grade credit you want, including on sovereign states like Greece or even on the U.S. government.

Credit default swaps were a big part of the financial crisis in 2008. When subprime mortgages blew up, they wiped out

all of the big pools of mortgages, or CDOs, hidden inside. Most of these CDOs had credit default protection written on them, resulting in huge losses for insurance companies like AIG and MBIA.

We see gold as being the ultimate credit default swap because the U.S. government will never actually default on its debts. It will merely print as much money as it needs to pay them. The appearance of a "default" in the U.S. will actually be the price of gold going much, much higher.

The U.S. Treasury typically sells bonds in \$10,000 denominations. With gold at \$1,200 per ounce, that's about eight ounces of gold right now. Which would you rather have? A \$10,000 piece of paper paying 4% backed by worthless dollars, or \$10,000 worth of solid gold that in a few years could be worth \$50,000... or priceless...

Buy the golden credit default swap. At \$1,200 per ounce right now, it's a small price to pay against a nearly guaranteed future event, especially considering that your gold will never expire.

We continue to urge you – **Buy as much gold bullion as you can reasonably afford and store it someplace safe.**

Adding to Our 'Obsolescence Book'

We've insisted on a "hedged" portfolio this year. For every new long position we recommended, we've also added a new short. We realize most individual investors will not sell stocks short. But we've warned you repeatedly, if you do not, you shouldn't be in stocks at all right now. The risks to the dollar and to the world's monetary system are simply too severe. The sudden 10% collapses in stock prices we saw two weeks ago is a warning about what can happen to equity prices when the world is unsure about the future value of the U.S. dollar.

If you've never shorted stocks before, we encourage you to simply try it with a small position. It's not difficult. Just call your broker, make sure your account is qualified (it must be a margin account), and make an actual trade – it's the only way to learn. If you want, short just a single share of stock so that you can see for yourself – and, more important, *feel* – there's really no difference in volatility or risk. Consider your costs a tuition expense. You might even profit a little...

Remember, whether you're long or short, you should use a stop loss. Shorting stocks shouldn't be any riskier than buying them. But you should also know, the odds are against you when you short stocks – especially during periods of rampant inflation.

It's difficult to make money shorting stocks when the market as a whole is soaring. Be prepared to take some losses

Published by Stansberry & Associates Investment Research



Braden Copeland, Editor
Porter Stansberry, Editor
Brian Hunt, Editor in Chief
Cadie Palmer, Graphic Designer

Visit our website at: www.stansberryresearch.com

1217 St. Paul Street, Baltimore, MD 21202 888-261-2693

LEGAL DISCLAIMER: This work is based on SEC filings, current events, interviews, corporate press releases and what we've learned as financial journalists. It may contain errors and you shouldn't make any investment decision based solely on what you read here. It's your money and your responsibility. Stansberry and Associates Investment Research expressly forbids its writers from having a financial interest in any security they recommend to our subscribers. And all Stansberry & Associates Investment Research (and affiliated companies) employees and agents must wait 24 hours after an initial trade recommendation is published on the Internet, or 72 hours after a direct mail publication is sent, before acting on that recommendation.

on our short positions.

Why would we be shorting stocks if we expect the market to go up, costing us money? It's simple. Insurance costs money. *Our short book is our insurance against a huge, sudden fall in stock prices.* Assuming we're right about at least one or two of these stocks, the profits we can make in some should make up for the small losses we're likely to take in others. The result, ideally, will be a slightly profitable short book. We could end up getting our portfolio insurance for free.

As you know from our earlier discussions of shorting stocks, we prefer to target three types of situations: frauds, deeply indebted stocks, and companies whose business model has become obsolete. Right now, more than half our short portfolio is in the obsolescence camp: newspapers, hard drives, coal-fired power plants, and first-generation solar power.

Obsolescence shorts are tough to get right because it's difficult to know *when* they will "roll over." Hard-drive makers, for example, are producing record earnings at the moment because they still enjoy a massive price advantage over the next generation of digital storage technology.

But if you look at the share price closely, you'll see drive makers are underperforming the market. And they enjoyed a big rally immediately after releasing strong earnings in late April. Then, they resumed falling. This is classic obsolescence market action and exactly what we'd expect to see from our hard-drive stocks right now.

Our next obsolescence trade is related to the new Apple iPad and Amazon's revolutionary book reader, the Kindle.

We have been Kindle users since they were released. And we've been completely addicted to the device since Day One. If you've never used a Kindle, there are three things you ought to know...

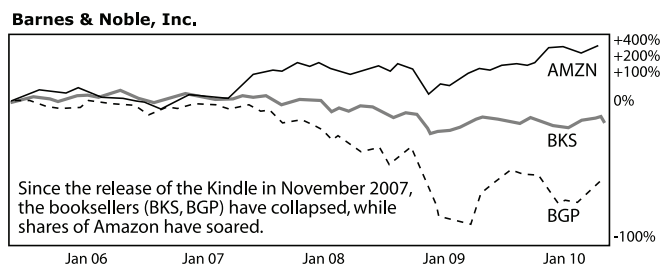
First, unlike the iPad, it isn't 'backlit.' That is, you have to turn a light on to read it. This means your eyes don't get tired the way they do when you're trying to read from a computer screen. Using a Kindle is actually more comfortable and easier than reading a real book, because you can read a Kindle with only one hand. You can also do all kinds of other things you can't do with a book, like adjust the font size, look up words, and save excerpts of text with the click of a button.

But far more important is the device's second key feature: instant access. When you want a book now, you simply pick up your Kindle and hit a button. The book is purchased, wirelessly, from your Amazon account and you have total access to it in less than 60 seconds. No more going to the bookstore. No more waiting for a new book to arrive. For bookworms like us, this is a dream come true.

Finally, the last key feature is the licensing system Amazon created. When you buy a book on the Kindle, you actually buy a license to your copy, which Amazon keeps for you on its website. If you lose your Kindle, you won't lose your books. With a Kindle that stores around 200 books, you can have just about any book you need with you, wherever you go.

Kindle has had a huge impact on the book publishing business – mostly by dropping the perceived value of a hard cover book. Why pay \$25 or \$35 for a new edition hardback book when you can get the same material for only \$9.99, instantly?

You can see the impact most directly by looking at the share price of the two largest U.S. sellers of hardback books. The Kindle came out in November 2007. Since then, Barnes and Noble's share price has declined by more than 50%. Borders is nearly bankrupt already. Amazon's stock, on the other hand, is up 300%.



There is no doubt these trends are going to continue. More and more people are reading books and magazines electronically. Worse, the best buyers of books are the most likely to switch to Amazon's Kindle reader or Apple's new iPad. And since the Kindle and iPad are fighting for market share, the price of books themselves has plummeted – especially for hardback titles. The price war will devastate **Barnes & Noble (NYSE: BNS)**.

Selling books has always been a low-margin business. Barnes & Noble lives on a razor-thin 3% operating margin. It simply cannot afford a decrease in top-line revenue. And there's no doubt that will happen this year. Despite the launch of Barnes and Noble's e-book reader (the Nook), the company's sales would have declined in the first quarter except for a huge acquisition (B&N College).

Unfortunately for Barnes and Noble shareholders, the company's website and its e-book business aren't nearly big enough to replace the continuing same-store sales (roughly 5% per quarter) figures at its bookstores, which make up the vast majority of its business. Quarterly revenues at the bookstores are more than \$1 billion, while quarterly online sales are less than \$250 million.

Shorting Barnes & Noble is, in our view, a one-way bet. There's no way it can compete against instant, costless, digital distribution of books over a wireless network. Nor can it compete on a technological basis with either Amazon or Apple. Bookstores are finished. And so is Barnes and Noble.

We recommend you sell short the shares of Barnes & Noble (NYSE: BKS). Use a 25% trailing stop loss.

Good investing,



Porter Stansberry and Braden Copeland
May 14, 2010

Portfolio Review

When Porter first recommended shares of the U.S.-based nuclear power generator **Exelon (NYSE: EXC)**, the markets were in a tailspin.

It was October 9, 2002. The S&P 500 Index had crashed 26% in four months, remaining depressed 50% below its 1999 peak. Porter wrote, "Almost everywhere I went, fear, loathing and outright panic were in the air." Then, he explained it was the perfect time to buy certain stocks – stocks that had "the means to survive an extended downturn."

One was Exelon. The company's solid balance sheet, technological leadership, and proven business model made it a good choice. It would have been better if it was cheaper, but it was cheap enough... and as cheap as it would likely get. Porter got it right. Exelon remains in the portfolio today...

Since the original recommendation, shares have ballooned from \$21.50 (adjusted from \$43 for the two-for-one stock split in May 2004) to near \$43. *In addition, shareholders have cashed in on \$12.295 in dividends.* Subscribers who shirked their fear, taking the safe Exelon recommendation, have gained more than 150% so far... on a utility stock.

As for when Exelon pays its next 52.5¢ dividend in August? The annualized yield based on the October 2002 purchase price will be a staggering 10%.

Take a look at this chart to the right showing Exelon's dividend track record and its yield back to 2002 (the total of the previous 12-months' dividends is on the left axis – gray, annual yield is on the right axis – black).

The dividend line is climbing up and to the right the entire way. Even during 2008-09, when some of the biggest were slashing their payouts (GE, Altria, and Pfizer among

them), Exelon held its dividend firm. Thanks to management's vigilance, shares are yielding even more today than back in the panicked times of Porter's recommendation in 2002.

With the yield as high as it has been in the company's history, Exelon appears to still be an excellent safe, high-yield place to put some money to work.

If you're among the fortunate who've owned the stock for a while, there is one question: Is the dividend sustainable? If it is, you should keep holding Exelon. Few investors are good – or patient – enough to *ever* have strong, high single-digit dividend yielders in their portfolio.

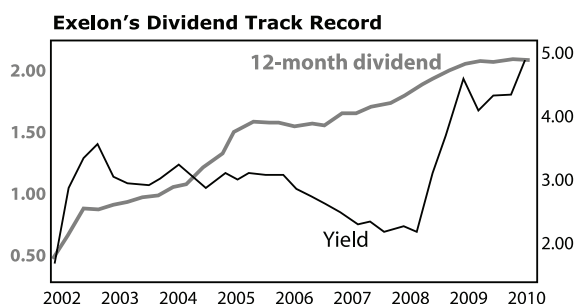
If you don't own the stock today, there is a second question: What are Exelon's growth prospects that might drive the dividend and share price higher?

First, let's see if the company can afford to sustain its dividend. Over the last four quarters, Exelon generated \$2.6 billion in free cash flow. The company spent \$1.4 billion of that – or 54% – paying dividends. For every \$2 Exelon makes, it's paying just over \$1 in dividends.

This amount, while healthy, still leaves the company with plenty of cash for savings, to pay off debt or continue to grow. At the end of the most recent quarter, Exelon's cash and highly liquid assets had grown to \$5 billion against \$4.9 billion in current liabilities. For a stable, profitable business that continues to generate cash, the balance sheet is in fine shape.

As for Exelon's growth prospects, a utility typically relies on increasing customer demand and acquisitions for growth. These don't often grow quickly. For Exelon, it's different – especially now...

Thanks to the separate movements at both the Environmental Protection Agency (EPA) and Congress to limit the use of coal-fired power, a chief competitor to Exelon's nuclear-based power, demand for Exelon's electricity is about to increase significantly. Certainly, natural gas providers like Calpine will compete with Exelon, too. With 48% of the market still tied up in coal, though, there is plenty of demand to go around.



As power companies burning coal are faced with the choice to spend money cleaning up their facilities or pay fines, many will likely choose to simply punt and shut their plants down. The ones that don't will have to increase what they charge their customers, making it difficult to compete with providers fueling power plants from other sources. For the coal-burners, the outlook is bleak.

This is not a "what if" situation, either. Wednesday, Senators Joseph Lieberman and John Kerry introduced legislation to restrict so-called greenhouse gas emissions. Coal plants are among the biggest offenders. Their goal is to get a bill passed that is a compromise with the "cap and trade" legislation passed in the house last year.

If the legislation stalls, the EPA is waiting. Just this past Thursday, the EPA finalized regulations to restrict greenhouse emissions anyway.

The great coal squeeze is coming... Exelon shareholders are in the ideal position to benefit.

If you own Exelon (NYSE: EXC), we recommend holding your shares and continuing to collect the fat dividend. If you don't own shares, we recommend adding them to your portfolio.

This month, we're also looking at another big dividend payer: telecom giant **Verizon Communications (NYSE: VZ)**.

Porter originally covered the company on February 3, 2006. At the time, shares were trading for \$31.54. The dividend yield was 5%. Today, the stock trades for less than \$29 and yields 6.5%. Four years have passed, and we're essentially where we started.

Shares did march higher after Porter's original recommendation, cresting a little more than \$45 in late 2007 for a 50% gain. The growth story he outlined was taking shape.

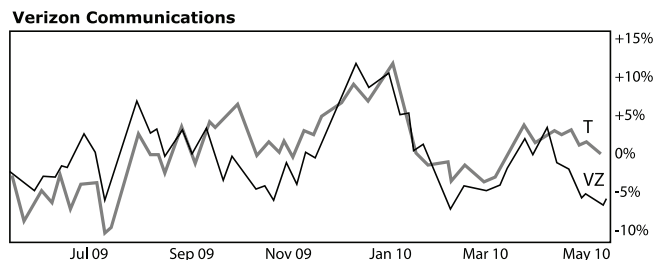
Then, shares started to sell off as the rate of wireline-subscriber loss surprised analysts. After that, the general market decline that ran through 2008 and into 2009 took over. Since bottoming at \$25 in October of 2008, the stock has bracketed \$30.

With this rise and fall now in the rearview mirror, is there anything that will boost shares significantly higher again? Perhaps. The fiber-to-home catalyst Porter mentioned in 2006 may still unfold, but it's not the potential difference-maker it once was. Verizon is a weaker story today. We're skeptical, though. The reason is fierce competition.

Verizon's primary business is providing wireline and wireless voice and data services. AT&T does the same thing. As much as both companies would like you to believe otherwise

with their talk of network quality, speed, and coverage, there is little difference in what they offer, what they charge, and what it costs them to do it – regardless of who might get the next super-hot handset.

Simply take a look at the performance of both stocks over the last year. This sort of correlation is typically reserved for boring, no-growth areas like the utility industry where little differentiates what the companies do. To see this in technology is rare – unless it's a utility dressed up like a tech stock (Verizon is the black line, AT&T is the gray one).



The correlation goes beyond just the stock price movement. Both firms pay almost the same dividend, near 6%. They're not just battling for subscribers, they're battling to make shareholders happy, too.

On the other hand, a 6% dividend for Verizon, what is effectively a big, safe utility *seems* a perfectly good "no risk" investment...

However, unlike Exelon, Verizon is actually burning through its cash reserves and borrowing money to maintain its dividend (perhaps to keep up with AT&T). Over the last year, the company spent \$1.40 paying dividends for every \$1 in free cash flow. Yes... *Verizon is deficit spending...* a recipe for disaster. (By the way, AT&T is not deficit spending, using only 77¢ of each \$1 to pay its dividend.) **Action to take: SELL Verizon (NYSE: VZ).**

Finally, we stopped out of our **First Solar (Nasdaq: FSLR)** short position on April 14 when shares closed at \$132.60, above our stop price of \$128.71. If you have not already closed out your First Solar position, make sure to do so. For the portfolio, we'll use the April 14 closing price and record an 8% gain.

Investment Advisory Model Portfolio

Prices as of May 13, 2010

<u>“No-Risk”</u>	<u>Symbol</u>	<u>Ref. Date</u>	<u>Ref. Price</u>	<u>Recent</u>	<u>Div.</u>	<u>Description</u>	<u>Action</u>	<u>P/L</u>	<u>RISK</u>
Hershey	HSY	Dec-07	\$40.55	\$47.56	\$2.70	Chocolate empire	Buy	24%	1
Verizon	VZ	Feb-06	\$31.54	\$28.69	\$9.34	Blue-chip telecom	SELL	21%	3
Annaly	NLY	Nov-08	\$13.64	\$15.96	\$3.69	Gov. port. repair	Buy	44%	3
Exelon	EXC	Oct-02	\$21.50	\$42.07	\$12.57	Nuclear power	Buy	154%	3
<u>The “Next Boom”</u>									
Calpine	CPN	May-10	NEW	\$13.93		Nat gas power	Buy	NEW	2
Petrohawk Energy	HK	Apr-10	\$23.18	\$20.13		Eagle Ford	Buy	-12%	2
St. Mary Land	SM	Apr-10	\$37.73	\$44.10		Eagle Ford	Buy	17%	2
Financial ETF	XLF	Aug-09	\$14.33	\$15.76	\$0.10	Fed manipulation	Buy	11%	2
Freeport-McMoRan	FCS	Nov-09	\$84.72	\$71.71	\$0.30	Inflation hedge	Buy	-15%	3
Silver	SLV	Oct-09	\$17.48	\$18.99		Money crisis	Buy	9%	3
ConocoPhillips	COP	Apr-09	\$42.36	\$56.94	\$1.94	Cheap oil	Buy	39%	3
Visa	V	Jun-09	\$66.50	\$85.73	\$0.48	Global money	Hold	30%	3
San Juan Basin	SJT	Jan-10	\$18.34	\$23.95	\$0.59	Safe natural gas play	Hold	34%	4
Gold Miners ETF	GDX	Dec-08	\$28.02	\$52.66	\$0.11	End of America	Hold	88%	5
<u>Forever</u>									
Johnson & Johnson	JNJ	Jul-06	\$60.52	\$64.67	\$6.59	Blue-chip health	Buy	18%	2
<u>Victims</u>									
iShares US Bond	TLT	Jan-09	\$114.30	\$93.26	\$4.28	End of America	Short	15%	5
Am. Electric Power	AEP	Apr-09	\$30.53	\$33.30	\$1.65	King of coal	Short	-14%	5
First Solar	FSLR	Jul-09	\$144.00	\$132.60		Expensive solar	Stopped Out	8%	5
General Electric	GE	Nov-09	\$15.76	\$18.05	\$0.20	Overleveraged	Short	-16%	5
Western Digital	WDC	Feb-10	\$43.40	\$39.68		Obsolete tech	Short	9%	5
Seagate Technology	STX	Feb-10	\$20.73	\$18.53		Obsolete tech	Short	11%	5
Gannett	GCI	Mar-10	\$16.29	\$16.44		Obsolete newspaper	Short	1%	5
Current Average	22.9%								
S&P 500 2010	2.7%								
Please note: our investment philosophy limits risk through the use of stop losses and trailing stop losses. Unless otherwise noted below, all “Next Boom” recommendations use a 25% TRAILING STOP LOSS; “No-Risk” recommendations use a 25% STOP LOSS; and all “Forever” recommendations carry no stop loss. NEVER ENTER YOUR STOPS INTO THE MARKET. KEEP SUCH INFORMATION PRIVATE. How to use a trailing stop: A stop loss is a predetermined price at which you will sell a stock in case it declines. A "trailing stop" is a stop loss that "trails" a stock as it rises. For example, let's say you set a 25% trailing stop on a stock you purchase for \$10. If the stock rises to \$20, you would move your trailing stop to \$15 (\$5 is 25% of \$20, \$20 - \$5 is \$15). Only use closing prices, and never enter your stop into the market. For more information, see our frequently asked questions at www.stansberryresearch.com/secure/faq.asp. Model Portfolio does not represent any actual investment result. Our reference price represents only the price of our recommended securities at the time we wrote the recommendation. Our sell or “stopped out” price represents the closing price at the time a reasonable reader would have had the opportunity to sell – typically the day after such a recommendation is given. Our risk label is based mainly on current share price and the nature of the business. 1 = the lowest possible risk. 10 = the highest possible risk.									

Stansberry & Associates Investment Research is committed to providing our readers with the very best in independent financial analysis. Our subscribers are our highest priority and we welcome any comments or suggestions that you might have. Please e-mail us your feedback: feedback@stansberryresearch.com. This e-mail is for editorial feedback only. It is not for customer service. For customer service questions, please use the following e-mail address: info@stansberrycustomerservice.com. We look forward to your feedback and questions. However, the law prohibits us from giving individual and personal investment advice. We are unable to respond to emails and phone calls requesting that type of information.

Copyright 2010 Stansberry & Associates Investment Research. All Rights Reserved. Protected by copyright laws of the United States and international treaties. This newsletter, e-letter, or promotional material may only be used pursuant to the subscription agreement and any reproduction, copying, or redistribution (electronic or otherwise, including on the world wide web) , in whole or in part, is strictly prohibited without the express written permission of Stansberry & Associates Investment Research, LLC. 1217 Saint Paul Street, Baltimore MD 21202.

Any brokers mentioned herein constitute a partial list of available brokers and is for your information only. S&A does not recommend or endorse any brokers, dealers or investment advisors.