



The Worst Is Yet to Come

This month, we bring you boats.

One boat is a sinking ship. The other is a life raft of sorts.

And we hope you'll take advantage of both ideas, even though one of them will require selling a stock short, something we know is difficult (and scary) for many individual investors. However, we are not responsible for the bear market in equities that began in 2007. We are only responsible for helping you survive and prosper in it. And as we've told you many times, this bear market requires you to sell short to survive.

Sadly, we don't think we've seen the worst of it yet.

Last week, the Federal Reserve began the process we'd been expecting since December 2008, in the early stages of this global financial crisis: The Fed is now actively and continuously monetizing large amounts of U.S. Treasury obligations on a permanent basis.

Between March 2009 and March 2010, the Federal Reserve increased the size of its assets by roughly \$2 trillion. It refused to disclose exactly what it bought, but claimed the purchases were a mix of triple-A mortgage securities and U.S. Treasury obligations. It said its actions were necessary to "save the financial system." We will never know exactly what was purchased, from whom, or at what price, as the Fed has refused all attempts at transparency. But the magnitude of the purchases was clear. They roughly doubled the size of the Federal Reserve's balance sheet.

These "emergency" measures are now being extended into an ongoing policy – one that will continue to be beyond the reach of Congress to audit. By rolling these maturing obligations into new U.S. Treasury debt, the Federal Reserve has abandoned its primary responsibility to safeguard the value of our currency. Instead, it is using its powers to facilitate the government's unprecedented peacetime deficit-spending binge. Rather than forcing our feckless politicians to balance the budget or face a creditor revolt, the Fed is providing the easy way out: monetizing our debt.

The consequences of these actions are uncertain – but very risky.

Printing money to buy Treasury bonds is a direct threat to our creditors, roughly half of whom are our foreign trading partners. They currently hold large quantities of our debts. Using the Fed's printing press to finance these obligations is nearly without precedent in the history of the United States. This is banana-republic finance, straight from the playbook of Robert Mugabe. Every American ought to be ashamed. And then, he ought to be furious that our leaders would allow the honor of our country to be stained by such measures.

More importantly, we had all better pray that our current bondholders will continue to accept our dollars as payment in exchange for things like oil and manufactured goods. One thing is certain: This strategy cannot go on forever. As the Fed continues to buy more and more Treasury debt, sooner or later, our foreign trading partners will balk.

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Editors: Braden Copeland
and Porter Stansberry

From where we sit, these actions are tantamount to throwing gasoline on a fire.

The world's financial system has more than enough to worry about... Italy will likely require a massive bailout in the next 12 to 18 months... At least one member state of the euro may default on its debts (probably Greece), potentially triggering another large banking crisis... One (or several) large multinational conglomerates may fail because of the inability to access additional credit at a reasonable price (GE)... China's booming economy could falter because of a real-estate collapse in its major cities.

Back in December 2008, we saw that the size of the financial sector bailouts and the direct involvement of the Federal Reserve would cause an enormous increase in the Fed's balance sheet. We knew that sooner or later the Fed would have to bail out the U.S. Treasury, too. As we told you then:

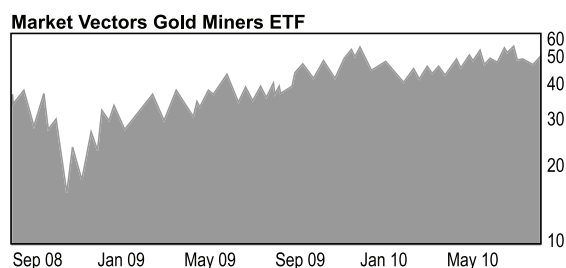
With a currency and a budget process totally untethered to any reality, nothing limits the amount of foolish spending Congress can (and will) authorize... Our government is the most powerful in the world. It controls the world's only reserve currency – meaning it is the only country in the world that can print money to cover all of its debts, bar none. And yet, for all of this power [it is] only a matter of time now before our creditors realize America's government is just as bankrupt as Iceland's. 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...

The huge inflation underway right now will be what I call "The End of America." I don't mean an end to our political union – I mean an end to the special role America has played in the global economy since World War II. The coming great inflation will destroy America's economic leadership. It will lead – eventually – to the return of settling international obligations in gold instead of paper dollars. And this will happen much faster than anyone expects. By the time Obama leaves office, you will not be able to exchange dollars for any sound currency in the world without permission from the U.S. government. The price of gold will be well over \$2,500 per ounce. Most importantly, commodities will no longer be priced in dollars either, but instead in the currencies of the leading producer. Americans haven't experienced anything like this since the Great Depression.

We urged you to buy gold bullion and gold producing stocks via the gold producers ETF – Market Vectors Gold Miners (GDX). Since then, the price of gold is up more than \$400 per ounce, or about 50%. GDX is up roughly 80%. Believe it or not, we still expect both of these investments to vastly outperform the stock market over the next two to three years, despite the gains we've already seen in these instruments.

The Fed's ongoing direct involvement in the U.S. Treasury market makes our prediction of a coming hyperinflation much more certain. We know this sets the stage for a credit crisis in the U.S., as sooner or later our trading partners will refuse to accept our currency as payment because they fear a massive devaluation of the dollar.

When will that happen? Your guess is as good as ours. But we have never believed that knowing *when* something would happen was important if you knew for certain that it *was* going to happen.



How can you protect your wealth from what is going to be an incredibly tumultuous and dangerous time in the world's financial markets?

The first thing you have to realize is this isn't a normal period of time. The world's largest debtor hasn't gone broke since the end of World War I. (That's also the last time the world used the gold standard to settle international accounts.) The second thing you must understand is, the U.S. dollar cannot continue to serve as the world's reserve currency because our government is bankrupt and using its currency to finance *generations* of deficit spending. While I don't know exactly how or when the current global system of finance will unravel, I promise you it will happen – and faster than anyone expects. This isn't a time to get rich (although, with foresight that might happen). This is a time to survive, to do your best to hold on to what you have.

Make sure you hold at least 10% of your net worth in gold coins. Keep them some place safe – not in your house or a bank. I prefer self-storage units – ideally in a foreign country. Don't tell anyone besides perhaps your spouse or your lawyer about your gold purchases. If you can, buy your gold in small lot amounts – less than \$10,000. And pay in cash. Use several different bullion dealers. There won't be any coherent record of your purchases and if you hold your bullion overseas, it will be nearly impossible for the government to seize your gold. Don't laugh. It happened before, in 1933. It could easily happen again.

Make sure you hold plenty of cash in reserve – at least enough to cover all of your expenses for one year. Why would you hold cash when you expect the U.S. dollar to be devalued? Because the path to devaluation will be very, very volatile. When Argentina's government went bankrupt in late 2001, the banks were closed for six weeks. No one could use their credit cards or their ATM cards. No one would accept checks, because they couldn't be cashed. So

even though the peso was devalued by 75%, it was still in desperately short supply for that initial six-week period.

Holding cash now is also a good idea because you will almost certainly have several great opportunities to buy high-quality equities in the midst of the crisis. Most people forget that during the Great Depression stocks bottomed on July 8, 1932, when the Dow closed at 41.22. That was roughly one month after Hoover hiked the top marginal income tax rates to 63% from 25% – perhaps the most ill-advised tax increase in American history. Even so, it was only the first in a long series of idiotic government policy blunders implemented over the next decade, which nearly destroyed our economy during the 1930s. FDR declared a bank holiday and confiscated gold in 1933. Then, he further hiked taxes in 1936, pushing the top marginal rate went to 63%. Not surprisingly, the country couldn't be taxed or regulated into prosperity – but that didn't bother FDR in the least. By the time War World II began, he was proposing that all income, from all sources, above \$250,000 should be given to the government to aid in the war effort. Thankfully that measure didn't become law, but the government did move the highest tax bracket all the way up to 94%.

I wouldn't be surprised to see our stock market react violently to the huge tax increases Congress will almost surely levy on us this fall. Even if Congress doesn't add any new taxes and merely lets the Bush tax cuts expire, the marginal rate on dividend income will soar from 15% to 39.6% and the estate tax will return at a 55% rate.

These tax increases make it more likely the U.S. will dip back into recession next year. If that happens, U.S. deficit spending could get immediately out of control, as tax receipts will fall more than expected. Companies, for example, will simply refuse to pay cash dividends, using tax-free share buybacks to return capital to shareholders. Likewise, many high net worth individuals will either delay being paid or simply forego working in order to avoid tax rates that, when combined with state income taxes and payroll taxes, will be in excess of 50%.

Congress will learn basic economics: The lower the tax rates, the higher the tax revenues when you're taxing people or corporations who can easily avoid paying. But as long as Congress attempts to use the tax code to equalize economic outcomes and "share the wealth," our country will be forced to rely on a printing press to pay its bills. This will have disastrous consequences for all of us, but especially for the middle class and the poor, who will be wiped out by the coming inflation.

It's sadly ironic. Poor people vote for socialist policies because they want something for nothing. They end up with something that's a lot worse than nothing. It reminds me of a lesson Bill Bonner (founder and president of Agora Inc.) taught me a long time ago: *People don't get what they expect. They get what they deserve.*

And that brings me to my final warning... which I admit might sound a little kooky. If you live in a major metropolitan

area, you have to be prepared for a severe social crisis.

Our offices are located in Baltimore and I have a home that's in the countryside, far outside of town. But for many years I lived in the city, including an apartment where I regularly heard automatic gunfire. I know how dangerous it can be and what type of people live there. In many respects, they are like savages. The criminal element has zero respect for human life and no concept of private property.

Obama has convinced many of the desperately poor that he can give them better lives, that he can give them free health care, free housing, a job, etc. At some point, Obama's people are going to realize that none of these things are going to happen. They won't just be disappointed, they will be mad. Now, imagine if on top of this, the value of the dollar collapses and suddenly their food stamps aren't going far enough. More than 40 million people get food stamps today. That's one out of every eight Americans. I'd bet 70%-80% of the inner city residents of Baltimore get food stamps, if not more. And then, imagine if there's any kind of problem or allegation of fraud in the next presidential election. Or what happens if, like Martin Luther King, President Obama is assassinated?

Obviously, I don't know that any of these things will happen... But I perceive our country is on the edge of a severe crisis. Who could have imagined that America would end up with a currency that's weaker than the ruble, with tax rates that are 400% higher than Russia's, and with more people on the dole than the Soviet Union had? At some point, historians are going to look back at this period in America's history and simply shake their heads. Is it paranoid to think our current system isn't going to hold together? I don't think so. And it's foolish not to have a back-up plan in mind if you live in a major urban area like Baltimore that's already a dangerous place. It wouldn't take much for Baltimore to boil over into an American Beirut.

So... assuming you've done these things... assuming you own gold bullion, gold stocks, and have plenty of cash on hand, what else can you do to make some money before the whole thing blows up? That's a hard question to answer. As we told you last month, we can't recall a more difficult period in our career.

Most of the time, what we do in these pages isn't all that hard and doesn't require much experience. We parse the financial world down from facts and figures into plain common sense. We know that common sense is anything but common. But from time to time, the correct action to take in the financial markets is often no more complex than answering the phone. When it rings, you pick it up.

Take the fall of 2008, after the failure of Lehman Brothers. The world's capital markets were in a blind panic. Various measures of fear – like the VIX index that measures the value of call and put option premiums – soared to levels that had never been seen before (and may never be seen again in our lifetimes).

You may recall a stock we wrote about, Starbucks (SBUX), was trading for less than \$10 – a price that assumed one of the world's leading sellers of the most addictive drug in the world (caffeine) would go bankrupt. Since those days, the company has produced more than \$3 billion in cash from operations – an amount of money that was roughly equal to the price of the entire company in the fall of 2008. Telling you to buy stocks at those kinds of moments is so easy to do, we feel slightly ashamed we get paid to do it.

Likewise, six months before the top of the stock market, in February 2007, we plainly described a financial mania whose magnitude might not recur for decades. Not only had real estate developers convinced the world that home prices could never fall, they built one of the largest cities in the world, from scratch, in the desert, with \$800 billion of borrowed money (Dubai.) As we wrote at the time in these pages:

I think we're close to an important top in equity prices...

Bullish sentiment is now pervasive. Stocks are rallying almost every day. Everything I follow has gotten too expensive to buy safely. And investors have begun to completely ignore risk... What we've seen in the market since the last bear run (2001-2002) is that almost everything has gone up. Value stocks, foreign stocks, commodity stocks, blue chips, hedge funds, insurance stocks, private-equity firms, technology, etc. Normally, you can find a sector that's been beat up for a few years. Not right now. This bull market has been the broadest four-year rally I've ever seen. Lots of investors think they're geniuses – especially the commodity guys. – Porter Stansberry, February 2007

My point is, there are times, like late in the big real estate boom or at the bottom of the 2008 financial crisis, when telling you what to do was easy because it was so obvious and clear. Unfortunately, that hasn't been true this year.

The markets have rallied in spite of what we've seen as tremendous risks to the sovereign debt markets in Europe, risks that haven't disappeared or been dealt with yet.

Inflation has seemed to decline, despite a Federal Reserve that's doing its best to debauch the U.S. dollar at every turn. And the U.S. economy, until recently, has seemed largely immune to what we perceive to be the Damocles' sword of next year's soaring tax rates.

To say our crystal ball is cloudy is an understatement. Rarely in our careers have the risks to equity investors seemed so large. And yet... until recently, the stock market seemed oblivious to them all. Nevertheless, you don't pay us to equivocate. We remain bearish on the world's markets as a whole and urge you to exercise extreme caution in your investments. Now is a time to maintain your trailing stops, raise cash, and wait for the next moment of

panic. It is probably not far off.

But we have a new idea this month that will allow you to hedge some of your market exposure. Plus, we have a counter-cyclical trade that's only available during severe bear markets.

We'll start (not surprisingly) with a new short sell recommendation. As we see the American dream evaporating before our eyes, we're going to short the archetypal American dream stock.

The Slow Boat to Bankruptcy

Few things are more quintessentially American than the **Brunswick Corporation (NYSE: BC)**.

It's the world's largest manufacturer of outboard engines. It also makes dozens of brands of pleasure boats: high-speed bass fishing boats, Hatteras Yachts, Boston Whaler offshore fishing boats, etc. It also makes top-quality exercise machines under the Hammer Strength and Life Fitness brands. If you work out in a gym, you've probably seen this equipment. Finally, of course, it owns Brunswick bowling alleys and makes bowling balls and billiard tables. In short, Brunswick makes the kind of stuff baby boomers who gorged on debt and real estate wanted to buy. That's the same stuff that they're trying desperately to sell now, either to prevent a foreclosure on their McMansion or to simply pay the rent at their new two-bedroom apartment.

The impact on Brunswick was massive. For Brunswick, the credit crisis of 2008 wasn't *like* the great depression, it was the *greater* depression.

Sales peaked in 2007 at \$5.6 billion. In 2009, sales were \$2.7 billion, a decline of 51%. Not many businesses can survive when sales drop that much, that quickly... especially not when they've got a heavy debt load (almost \$1 billion) and huge fixed costs, like big manufacturing plants and pension obligations. The company's profit margins have been decimated. Return on equity was 6% in 2007. Last year, it was *minus* 80%.

The company is doing everything it can to stay afloat, including firing almost half its employees, cutting R&D and capital spending, and reducing total selling, general and administration expenses by 24%. Even so, in 2009, the company only made \$125 million in cash from operations, which didn't come close to covering the \$172 million in restructuring and impairment expenses or even the \$157 million in annual depreciation expenses. Also, all of the \$125 million it made came from a reduction in inventory... It actually lost money making boats.

The company has three obvious problems, none of which it will likely overcome and all of which could be fatal.

First and foremost, its main products are expensive luxury recreational items that everyone can do without. No one has to buy a boat, a motor, or a pool table to get by. Likewise, these are the first

things most people will return to the bank or sell when finances are strained. As a result, the prices for used boats, motors, and pool tables have all plunged since the beginning of the financial crisis.

I have personal perspective. I purchased a new offshore fishing boat in the fall of 2009. The dealer was literally begging me to buy it, as he had no “bids” on any of his new inventory and was facing bankruptcy because he couldn’t make the interest payments on his store’s line of credit. I was able to buy a brand new boat, completely outfitted with electronics and tackle for about 50% of the original retail price. In short, I bought a new boat for the same price as a five-year-old one, because the market was flooded with boats for resale. Judging by the number of for-sale signs at the marina, this situation hasn’t changed.

Most boat buyers also need access to credit to finance their purchase. And you’ll never guess who finances most of Brunswick’s boats... GE Capital. As a reader of this newsletter, you’re undoubtedly aware that GE Capital is facing enormous losses across its entire consumer financing portfolio and has significantly tightened credit on boat buyers and boat dealers.

The lack of sales and credit means boat dealers aren’t ordering new boats. Production fell by 65% in 2009, from the already reduced levels of 2008. And there’s a further financial risk. In many cases, Brunswick has to guarantee its dealers inventories: If the boats don’t sell, Brunswick has to buy the boats back.

Now... besides the obvious risk of being in the luxury boat business when few Americans are going to buy a new boat... Brunswick faces some significant financial risks, namely its large debt burden and its huge pension obligations.

Let’s start with pensions. The global financial meltdown didn’t only wipe out demand for new boats, it also decimated Brunswick’s pension plan, which fell from fully funded to only 60% funded. Fully funding the plan today would require Brunswick to pay \$418 million.

Then, there’s the long-term debt, which currently totals \$865 million. Over the next five years, Brunswick must spend \$734 million in interest to service this debt (it is a triple-C rated “junk” credit), plus another \$163 million on long-term lease payments.

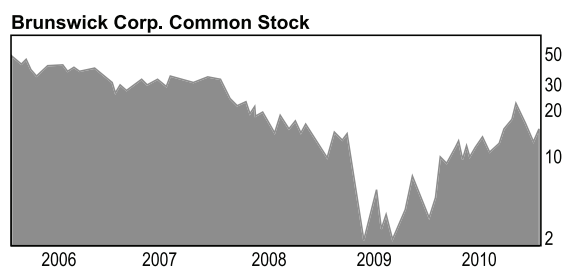
Let’s assume sales and profits can return to 2007 levels (which seems hard to imagine with half the employees gone). The company made \$136 million that year in earnings before interest, taxes, depreciation, and amortization (EBITDA). It needs to make \$179 million each year to service its debts and pay its leases – and that assumes it can return to 2007 levels of profitability. Meanwhile, its most recent quarterly report shows it is only making about \$120 million per year in EBITDA.

The big problem in situations like this is, while Brunswick struggles, it won’t be able to afford the investments it needs in marketing, research and development, and new plant and equipment

to improve and sell new products. As its financial situation becomes more precarious every day, it will be forced to spend more on interest and fees to its lenders. It’s a downward spiral that’s hard to stop. The best chance of avoiding a complete liquidation is to sell assets and pay down debts. But that would leave the company with fewer and fewer assets, which can trigger debt covenant defaults and simply make it harder to earn a profit going forward.

We certainly hope Brunswick can find a way to salvage its best brands and survive in some form. The company does have enough cash on hand today (more than \$600 million) to ensure that bankruptcy isn’t a near-term possibility. Nevertheless, we don’t think paying more than \$1 billion for the company today makes any sense because we doubt it can earn more than its interest expenses. In fact, we believe the common equity of the company is likely to be rendered worthless if we’re right about more economic problems in 2011. In short, Brunswick simply doesn’t have much room for error. Looking ahead to higher taxes and enormous macroeconomic disruptions we doubt it can survive.

We recommend you sell short shares of Brunswick Corporation (NYSE: BC). Use a 25% trailing stop loss.



Boats that Won’t Go Bankrupt

While we’re bearish on recreational boating in the U.S., there’s another kind of boating that we’re very bullish on for the future: dry bulk shipping.

These are the boats that move grain and coal around the world. Why are we bullish?

We believe China’s economy is on the way to becoming the world’s largest and richest. This is a big trend that will take decades to develop. The world’s current problems are merely a hiccup compared to this megatrend. And as China develops and grows richer, it will begin importing more and more raw materials. For example, last June, China received its first large shipment in corn in over a decade. After having enough of its own for years, the country suddenly ordered five shiploads, 1.2 million tons... all of it from the U.S.

Then there’s coal. Not only do the Chinese use it for electricity (more than 70% of the country is powered by it), but they also must have special metallurgical coal to make steel. The same is

true in India. Combined with China, they are driving 80% of the global demand for coal.

By the end of 2010, total seaborne coal shipments are expected to reach 1 billion tons, 75% for power plants and 25% for steel production. At the end of 2007, the total was 820 million tons. *During the recession, shipments continued to rise roughly 6% per year.* By 2014, total shipments are expected to surpass 1.2 billion tons.

Pick your commodity, and you'll find shipping demands for it are now increasing. Meanwhile, the market for shipping rates (and shipping stocks) is depressed. The Baltic Dry Index is down nearly 80% from its peak in 2008. Many experts think shipping rates (and shipping stocks) will stay depressed because of what they believe is excess capacity in dry bulk ships. We disagree.

There aren't any ships sitting around anymore... and there haven't been for months. That is, unless you count the full ones floating for weeks outside of the world's overcongested ports. Shipping companies estimate more than 10% of the world's fleet is floating at any given time, effectively decreasing the total amount of shipping transit days available. Then, you have the capacity problems at the repair yards. There aren't enough of them. Of course, when a ship needs work, it's not used. Right now, ships wait an average of 20 days to get service. This limits shipping availability too. Finally, more than 2,000 of the world's 6,000 dry bulk ships are more than 25 years old. Eventually, these older, slower, less-efficient hulks will have to be scrapped. This will offset a lot of the new shipbuilding.

So is there really a lot of spare capacity? Consider **Eagle Bulk Shipping (Nasdaq: EGLE)**.

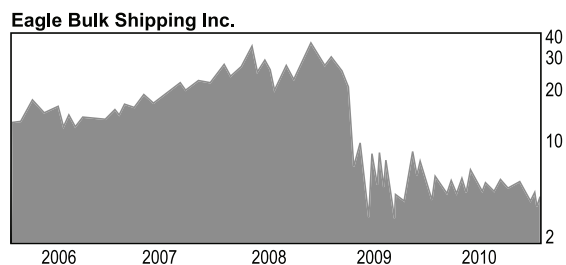
During the second quarter, 99.9% of its fleet capacity was booked. Of the company's 36 existing ships, 17 of them are on charters that end this year. That gives Eagle the benefit of stable revenues for half of its fleet with the flexibility to book the rest at higher prices as shipping rates climb.

It's an envious position because new bookings are not in doubt... Of Eagle's 11 new ships coming online during 2010, only one has less than a three-year charter. Of the 10 chartered ships, six have been chartered under arrangements that give Eagle some upside on higher future shipping rates. The company has the best of both worlds... guaranteed minimum revenue for its fleet and the ability to profit from rate hikes.

Furthermore, Eagle's ships are modern and efficient, with an average age of less than five years. All of the ships are of the versatile Supramax type. They are small enough to traverse the Panama Canal, but substantial enough to carry coal, iron ore, and heavy grains. All of them also have onboard loading cranes, mitigating the need for shore-based cranes in the crowded ports. This helps keep the ships on the water, making money instead of floating and waiting.

These fleet characteristics and the profitable charter book show up in the company's operating cash flow. The company has generat-

ed positive cash flow every quarter since it went public in 2005.



But we don't want to overstate our case. Shipping is a tough, low-margin business. It is not the kind of business where you want to be an owner all the time. Almost every penny Eagle makes gets spent building new ships. This earn-and-build "treadmill" will never end, making the industry a poor one for long-term investors. On the other hand, the 2008 downturn obliterated global dry bulk shipping stocks... and unlike just about every other kind of equity in the world, they never bounced back. Meanwhile, Eagle's sales continued to grow, year after year.

The uncertainty about the future of the world's economy means you can buy Eagle Bulk Shipping today for about 90% less than it would have cost you in the spring of 2008. At the same time its sales have improved, its fleet has grown. We think the worst economic outlook has already been "priced in" to the stock – **it's actually trading for less than half its \$10.35 per share book value.**

And unlike Brunswick, even in the depths of the crisis, it always earned much more than enough to pay the interest on its debts. Interest coverage in 2009 was 2.3 times.

We don't know exactly when the shipping cycle will turn up. It could begin at any time, as China's economy continues to grow. Or it could be postponed for another year or two, as the world's financial problems continue to hold back growth. But we do know this: It is unlikely Eagle Dry Bulk Shipping will get materially cheaper in terms of price to book value, as it is well run company with valuable assets (ships) that can easily be sold to manage debt loads.

Think of it this way: Today, you could buy the whole company for \$300 million, then sell \$1 billion worth of boats and pay off all of its debts (\$988 million). You'd still have \$600 million in assets left. At its current price, you could double your money simply by liquidating the company.

It may be counterintuitive, but the only time to buy a shipping company is when you can buy it at a distressed price like this. While we don't want to own the stock for the long term, we believe it is safe to buy at current prices – regardless of the economic outlook. And as conditions improve we should be able to sell these shares for book value or better within two years. Assuming you buy shares for less than \$5 (where they trade now), that should deliver better than 100% capital gains.

Buy Eagle Bulk Shipping (Nasdaq: EGLE) up to \$5 per

share. Don't pay a penny more. Also keep in mind this is a small company with lighter daily trading volume. Take your time building your position. Also, you must be aware that this will be a very volatile stock. Above \$5 you should expect to see its share price bounce around a lot. Don't let that bother you. Set a stop loss at \$4.00. Don't sell unless it goes below \$4 or until it gets over \$10.

Regards,



Porter Stansberry & Braden Copeland
August 12, 2010

Portfolio Review

It's time to close our position on the **Financial Select Sector SPDR Fund (NYSE: XLF)**. We've had the position open for exactly a year now. It has gone nowhere. More importantly, it's not likely to go anywhere over the next year either... except perhaps down.

The Federal Reserve's decision to keep stimulating the Treasury market is going to weigh on bank earnings. It will keep long-term interest rates down and the spread tight. The "spread" is the difference between short-term rates (what banks pay to borrow) and long-term rates (what banks make for lending). The tighter it is, the less money banks make.

Advanced Micro Devices (NYSE: AMD), our short recommendation from last month, isn't going to even get close to the \$10 "short above" price we set. We clearly gave the shares too much benefit of the doubt. They've tumbled from more than \$8 to less than \$7. They now sit near \$6.50. However, we don't want to sell short down at that price. The upside is too limited. Instead, we want to catch AMD on a fleeting attempt to climb. We're moving our "short above" price to \$8. **If AMD closes at more than \$8, sell the shares short the next day.**

Also from the short book... Keep an eye on our short sales of obsolete hard-drive makers **Seagate Technology (Nasdaq: STX)** and **Western Digital Corporation (NYSE: WDC)**. The nearly 50% gains we have made on these are exceptional. And 50% also happens to be the magic number when you're short. After that, since the most a short position can ever make is 100%, you're entering the land of diminishing returns. It doesn't make sense to stay there. *The day after AMD or STX closes, earning us at least a 50% gain, we're buying to cover.*

On the long side of things, if you're interested in getting your hands on a blue-chip dividend payer in our portfolio, make sure to pick up some shares of health care giant **Johnson & Johnson (NYSE: JNJ)**. The stock is yielding nearly 3.5% (the most it has in a decade except for the depths of 2009) and is extremely cheap.

Looking at the price of the stock either in terms of its (1)

book value, (2) EBITDA, or (3) cash flow, it's sitting within 20% of five-year lows. From such a depressed level, there's not much downside left. *JNJ is a fantastic buy here if you don't already have it in your portfolio.* We've moved JNJ to a "1" on our risk scale, indicating the least amount of risk.

Our blue-chip chocolate empire, **Hershey (NYSE: HSY)**, is also getting cheap. It's not trading at the same depressed levels as JNJ but it's certainly attractive. We've moved the risk scale for Hershey from a "3" to a "2." **If you don't own Hershey, it's a buy.**

A Word Regarding My Co-Editor

By Porter Stansberry

I don't think I did a very good job introducing Braden Copeland to you a few months back, when he suddenly joined me on the masthead of our flagship publication.

It was a difficult decision for me to ask Braden to join me on this letter... which was my sole responsibility for nearly 11 years. It's not easy to share something you've been invested in for so long. However, Braden is an extraordinary person, whose life seems like something from a Tom Wolfe novel... We'll be generous and call his background "eclectic."

Since graduating from one of America's elite universities (Duke '94), he's made a living in the racing business and racing stock cars professionally. (I'm pretty sure he is the only Duke grad to grace NASCAR's oval rings.) He also pursued a career with even lower odds of success: He managed and invested in a start-up band, personally providing the capital for its first major studio album. The band is now a huge success. It's won a Grammy and sold millions of copies of its debut, making it a multi-platinum blockbuster. Also along the way, not happy with doing anything easy, he became a large-scale real estate developer.

Braden did all of these things before turning 40.

I picked him for the job because his training as a mechanical engineer and his real life experiences in several different businesses make him an excellent securities analyst. He "sees" companies the same way I do and can go through the numbers just as quickly (and probably more accurately). Having him onboard has greatly increased the quality of the work and has challenged me to come up with better and more thoroughly researched ideas. I hope you've noticed and appreciated the difference he has made to our letter.

Finally, we are both deeply grateful for your continuing interest in our work and the trust you extend to us through your subscription. We'll continue to work hard to earn your respect (and your renewal).

Investment Advisory Model Portfolio

Prices as of August 12, 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>
Johnson & Johnson	JNJ	7/6/06	\$60.52	\$58.52	\$7.13	Blue-chip health	Buy	8%	1
Exelon	EXC	10/9/02	\$21.47	\$41.25	\$13.10	Nuclear power	Buy	153%	1
Annaly	NLY	11/6/08	\$13.64	\$17.75	\$4.37	Gov. port. repair	Buy below \$17.50	62%	1
Intel	INTC	7/16/10	\$21.51	\$19.45	\$0.16	Blue-chip tech	Buy	-9%	2
Weyerhaeuser	WY	7/16/10	—	\$16.46		Timber REIT	Buy below \$13.53	—	2
Prospect Capital	PSEC	6/24/10	\$10.08	\$9.47	\$0.20	High-yield lender	Buy below \$10.08	-4%	2
Hershey	HSY	12/6/07	\$40.55	\$46.04	\$3.02	Chocolate empire	Hold (Long)	21%	2
SVB Financial^^	SIVB	6/29/10	\$41.42	\$40.48		Warrant banker	Buy below \$42.50	-2%	3
<u>The “Next Boom”</u>									
Financial ETF^	XLF	8/13/09	\$14.33	\$14.11	\$0.17	Fed manipulation	SELL	0%	2
Calpine	CPN	5/13/10	\$13.93	\$12.51		Nat gas power	Buy below \$15	-10%	2
SM Energy**	SM	4/13/10	\$37.73	\$36.68	\$0.05	Eagle Ford	Buy	-3%	2
Eagle Bulk Shipping	EGLE	8/12/10	NEW	\$4.72		Super-cheap ships	Buy below \$5	NEW	3
San Juan Basin	SJT	1/7/10	\$18.34	\$24.10	\$1.06	Safe natural gas play	Hold (Long)	37%	4
Silver	SLV	10/13/09	\$17.48	\$17.69		Money crisis	Hold (Long)	1%	4
ConocoPhillips	COP	4/2/09	\$41.45	\$55.35	\$3.04	Cheap oil	Hold (Long)	41%	4
Gold Miners ETF	GDX	12/11/08	\$28.02	\$50.31	\$0.11	End of America	Hold (Long)	80%	5
<u>Victims</u>									
Brunswick	BC	8/12/10	NEW	\$15.01		Sinking boat maker	Short above \$15	NEW	5
Adv. Micro Devices	AMD	7/15/10	\$7.41	\$6.57		Intel’s punching bag	Short above \$8	-11%	5
iShares Italy ETF^^	EWI	6/10/10	\$15.79	\$15.73		Europe crumbles	Short	0%	5
Barnes & Noble	BKS	5/13/10	\$20.01	\$15.06	\$0.25	Obsolete bookstores	Hold (Short)	23%	5
Gannett	GCI	3/11/10	\$16.29	\$12.78	\$0.04	Obsolete newspaper	Hold (Short)	21%	5
Western Digital	WDC	2/18/10	\$43.40	\$24.24		Obsolete tech	Hold (Short)	44%	5
Seagate	STX	2/18/10	\$20.73	\$10.99		Obsolete tech	Hold (Short)	47%	5
General Electric	GE	11/19/09	\$15.76	\$15.49	\$0.30	Overleveraged	Short	0%	5
Am. Electric Power	AEP	7/24/09	\$30.53	\$35.35	\$2.07	King of coal	Hold (Short)	-23%	5
Current Portfolio Avg:	23.3%								
S&P 500 Portfolio Avg	2.5%*								
* This is the average return you would have earned so far had you opened positions on the S&P 500 Index instead of the Investment Advisory recommendation at the time the recommendation was made. ** Name changed from St. Mary Land & Exploration to SM Energy Co. on 5/27/2010 ^ Recent price and gain reflect stop-out date. ^^ See “Special Reports” section of the website for further information. Investment Advisory’s Model Portfolio does not represent any actual investment result. Our reference price represents the price of our recommended securities at the time we wrote the recommendation. Our sell 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. Please note: Our investment philosophy requires limiting risk through the use of trailing stop losses. Unless otherwise noted, all recommendations use a 25% TRAILING 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. Our risk label is based on current share price and one-year business outlook. 1 = the lowest possible risk. 10 = the highest possible risk.									

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