



The BIG Collapse in Bonds Is Here

I believe we are seeing the very early stages of a great monetary crisis that will, eventually, lead people (and then their politicians) to return to gold- and silver-backed currencies. – Porter Stansberry, May 4, 2006

Four years ago, starting in the May issue of this advisory, we began warning people that something was seriously wrong with our money – the mighty U.S. dollar.

The economy then was enjoying a furious bull market. Everything – literally everything – was going up.

Near the peak in February 2007, when we warned of an impending bear market, investors were no longer requiring a higher return for taking more risk – a so-called risk premium. Junk bonds were trading at nearly the same prices as triple-A credits. Garbage penny stocks were trading at blue-chip prices. Dividends had disappeared. So much money and credit had been created from thin air (subprime mortgages) and thrown into the market that prices had reached a point where, as careful analysts, we could find nothing safe to buy.

We were afraid of what would happen next. We knew the country would have to make a choice. Would we write down and write off the excesses of the greatest credit bubble in history? Would thousands of banks fail? Would millions of “investors” – fools, really – lose everything? Would the slate be wiped clean, allowing a recovery to occur?

Or would something far worse manifest?

Would politicians seeking power and wealth promise to bail out unwise corporations and reckless lenders? Would the full potential of our paper money system be revealed to the public? Would there be an all-out attempt to “paper over” the bad investments and debt-driven losses?

We always knew what would happen. Our democracy – the most powerful government in history – would surely choose to print. How did we know? Because that’s what governments do... all of them... especially democracies. Their ability to print money is always too powerful a temptation to resist – to paper over... to create money from thin air... to lie, cheat, and steal from the citizens via inflation.

We knew it would happen. We warned and warned it would happen.

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And now it's happening. We have proof.

Last month, some of the Fed's secrets were unearthed. Dozens of well-connected companies received billions in bailout money from the Fed – deals the central bank never disclosed to Congress or the press. Remember when the government promised it would only rescue companies that posed a “systematic risk” to the banking system? It was a lie. Harley Davidson got \$2.3 billion in Fed money. Caterpillar got almost a billion dollars. Even McDonald's got more than \$200 million. In all, the Fed printed up \$3.3 trillion and doled it out to what seems like every big company on the planet with a lobbyist in Washington, including dozens of foreign companies with almost no U.S. employees.

Since then, the prices of gold and silver have rocketed 150% higher. If you took our advice and began to hoard gold and silver bullion, you've probably protected your net worth from the worst of the collapse of 2008 – at the very least.

If you're new to the story – and new to this advisory – don't worry.

The curtain is about to come up on the real show. Politicians (and the press) have largely supported the Fed's decision because in their eyes printing the money was better than falling into a massive recession or possible depression. And that's certainly true – in the short run. In the long run, these decisions must lead to more printing and eventually the collapse of our currency.

The big move down in the U.S. bond market has only just begun.

In this month's issue, we will review where we stand right now along the path to national insolvency. We will also provide a full review of our existing portfolio and recommend our new favorite pick for 2011. As you'll see, shorting this stock is the best way to hedge your portfolio against losses in 2011.

Ignoring All of History's Most Valuable Lessons

There are few things about which history is unanimous. Land wars in Asia, for example... Always a bad idea.

Paper money falls into this category because it *always* fails and wipes out the people who depend on it.

Or as our friend Rick Rule likes to say, paper money's track record is unblemished by success. The return of paper

money to its intrinsic value (nothing) is guaranteed. All we need is time. (Politics certainly help move things along, too...)

We would not argue organizing a system of sound money based on paper receipts is impossible. We would merely point out that keeping such systems sound and reliable has proven elusive to this point in human history.

Paper money is like many other types of idealized virtue that humans cannot attain. It's simply beyond human nature to avoid perdition. Sin, as they say, is part of man.

Thus, we firmly believe you should only trust sin-proof monetary systems. And that is precisely why nature provides us with gold. It is timeless (it doesn't rust). It is easily divisible (it's a soft metal). It is substantial – among the heaviest of metals. It is cherished (gold isn't consumed). It is easily portable. Gold is nature's bearer bond – it is no one else's liability. Best of all, it has always held its value – for thousands of years an ounce of gold has purchased the rough equivalent of a finely tailored suit. And so it does today, too. The last suits I had made cost \$1,500 – just a bit more than an ounce of gold costs today.

Whether you share our appreciation of gold's charms or not, history is clear on this point: Every government that has used paper money has succumbed to a fatal level of borrowing. Rather than restructure these debts, paper money systems allow for the rapid expansion of the monetary base to facilitate paying off debts in devalued money. This is no different than stealing. And yet... that is what happens every time, resulting in a massive crisis and a breakdown of social norms.

It normally happens faster in democracies, where no strong interest group votes for living within the country's means and repaying its creditors in sound money. No, people *vote* for more spending and more debt. And they always expect someone else to pay. Case in point...

The Greeks

Researching problems in the Greek economy is like reading a financial comic book. All the players are clowns.

For example, the national railroad has annual revenues of 100 million euros... against a wage bill of 400 million euros and another 300 million euros in expenses. The Ministry of Agriculture hired 270 people to digitize photographs of Greek public lands... with one digital camera.

In 2001, the Greek government borrowed \$1 billion

from Goldman Sachs to help try and balance the budget. The deal relinquished future receipts from the national lottery, national highway tolls, airport landing fees, and even funds granted to Greece in the future from the European Union.

The government was burning the family furniture to pay current expenses. And now, they're out of furniture. It's all been burnt.

In total, the Greek government owes 1.2 trillion euros. That's 250,000 euros for every adult.

Obviously, Greece cannot repay this money in sound currency. The only way out is for the Greeks to inflate the debt away – effectively stealing from their creditors with a printing press. That they haven't done so yet is only because they no longer have their own currency – the drachma. Instead, they are part of Europe's common currency, the euro. And Europe is making every effort to maintain the mirage of a united economy. Unfortunately, no such thing exists. It's merely a matter of time before the Greeks default.

The exact same thing is true about the United States – *except the numbers are even worse.*

The Western World Collapses

The Greeks may be the most notorious of the world's profligate nations, but they are not the real problem. The real problem is much larger and more complex.

The root of the problem isn't really governments... or banks. The real problem is simply a very bad idea – the State ought to sit in the center of society. Let us explain.

The last 100 years (since 1914) saw not only the end of the classic gold standard, but also the fantastic ascendancy of the nation-state.

These two trends are inherently and dangerously related.

Until World War I, the central government of the United States, for example, played a small role in the lives of its citizens. Its powers were strictly limited, as were its revenues. It was specifically barred from taxing citizens directly. It was a humble government that interacted with the individual states in the union, but didn't interact much with individual citizens.

The first signs of change came after the civil war. "Progressive" ideas began to emerge. Most of these ideas came from Germany, from philosophers like Karl Marx and Friedrich Engels. The core of these ideas was the State itself

was superior to its citizens. Therefore, the argument went, society ought to be organized to better accomplish the goals of the State.

Today, most Americans have no idea that the foundations of our modern State are based – nearly verbatim – on the demands of Karl Marx's *Communist Manifesto*.

In 1848, Marx threatened to organize a worker's revolution unless European governments:

1. Abolished property rights and applied all rents towards public purposes. [Modern corollary: Don't pay your property taxes, lose your house. So who really owns your house?]
2. Levied a heavy, progressive income tax to equalize wages. [Modern corollary: Combined federal and state marginal income and payroll taxes approach (or surpass) 50% in many U.S. states.]
3. Abolished all rights of inheritance. [Modern corollary: The estate tax.]
4. Confiscation of the property of all emigrants. [Modern corollary: The 2008 "Hero's Act" which forces people leaving the U.S. to pay the equivalent of their estate taxes on the global assets before they turn in their passports.]
5. Centralize access to credit in the hands of the State by means of a national bank and an exclusive monopoly. [Modern corollary: Fannie Mae and Freddie Mac, which make more than 90% of all of the mortgages in the U.S. and have dominated the market for mortgages for decades.]
6. Centralization of the means of communication and transport in the hands of the State. [Modern corollary: AT&T was a legal monopoly for decades. Amtrak is a ward of the states. The government owns all the roads. And the State controls all air traffic.]
7. Free education for all children in public schools. [Note the emphasis on public schools. Paying for education isn't enough. What counts is indoctrinating the kids in glorifying the State.]
8. A common agricultural policy to maximize the productivity of the land. [Modern corollary: Massive ethanol and agricultural subsidies.]

Imagine trying to explain to your neighbors that public education is a communist idea that's meant to indoctrinate

children. Imagine trying to convince them that the estate tax is a bad idea, or that progressive income taxes are the key to communism in America.

To most Americans, these aren't *bad* ideas at all. No one will believe you when you explain that these ideas make up the core values of communism. And no one believes these functions can be handled vastly more efficiently by a free market. And that's the real problem with these ideas: The bigger the governments get based on these mandates, the more inefficient and uncompetitive an economy becomes.

Even so, most people in democracies like these ideas for one simple reason: They hold the allure of getting something for nothing. They are the siren song of living at the expense of your neighbor.

These ideas became extremely popular over the last 100 years, all around the world. As a result, as democracy spread, so did these ideas. Politicians of each party and persuasion throughout the western world quickly adopted them as their own (and never mentioned Karl Marx).

As these ideas took hold, one big problem developed... How do you pay for them?

Progressive politicians believed they had the answer. They just took Marx's big innovation: A progressive income tax. Let the rich pay! It's a popular idea – but it never works because decisions to add more benefits don't take into account the expense of paying for them. It doesn't take long for the budget to get out of control. Or said another way, everyone can't live at the expense of his neighbor. His neighbor can't afford it... and he moves.

More serious, the flaw in communism is obvious. *Communism doesn't account for the fact people expect to control the fruits of their labor.* People don't like their assets being stolen and their wages being heavily taxed by a government that regulates their businesses and sends their children off to war. Incrementally, people stop working. Wealthy people flee... or hide their incomes. Tax revenues fail to meet projections. Deficits grow. Deficit spending soars. And debts mount.

That's where paper money comes in. Paper money isn't only good for financing a war. It's also perfect for closing the gap between what an economy ought to produce and its paltry real production when it has been beaten into submission by communist ideas. I like to explain it this way...

The central truth of economics is scarcity. There can never

be enough of anything to satisfy everyone. The central truth of politics is patronage: promising to give everything to everyone. Paper money is the bridge between economics and politics.

The unpaid debts of an entire generation of people in western countries are coming due. The so-called "baby boomers" grew up in a world dominated by Marxism and Keynesian economics. These are bad ideas. They are destined to collapse.

And the collapse is here.

The Global Debt Bubble Is Bursting

The International Monetary Fund estimates the 20 largest industrial nations (known as the G20) are on course to see total government debt exceed 100% of GDP within three years.

Sovereign debt of this magnitude has NEVER been repaid with sound money.

And none of these governments are making any real attempt to repay these debts. Instead, in most of these countries, annual deficits will surpass 10% of GDP and rise substantially over the next decade.

Sovereign creditors can now see plainly that the existing monetary system is doomed.

Debts of this size simply cannot be financed, let alone repaid. The first step in this great unraveling is underway – the collapse of the euro.

In March 2010, Porter wrote:

Like dominoes, the highly indebted economies of Europe are going to topple. Greece was first. But plenty more problems are coming. Italy has no way to meet its obligations. Nor do Portugal or Spain...

Events over the past two weeks in Greece should give you plenty of warning governments all over the world have too much debt.

What will the U.S. do when a major European financial institution fails? If the resulting contagion causes one of America's major banks to fail, what will the U.S. government do?

The answer, my friends, is simple: It will print, print, print, and print. Here's the important fact to remember...

The United States is the only government in the world that

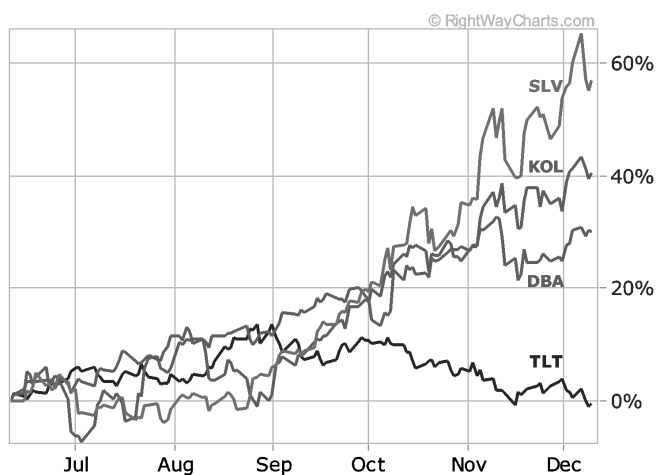
can actually afford to underwrite the world's banking system. That's not because we have any real savings, it's only because we control the world's reserve currency. It's a paper standard, which means we can always print more of it.

The U.S. announced exactly that last month... setting up an enormous \$1 trillion bailout fund for the euro via the IMF and beginning a new round of quantitative easing – this time \$600 billion of new dollar reserves will be injected into the U.S. Treasury market.

Despite the enormous buying of Treasuries by the Fed, long-term Treasury bond rates have soared on these announcements. Investors have begun to flee the U.S. dollar into all other forms of savings:

- Coal and oil are trading at two-year highs.
- Corn, soybeans, wheat, cotton, and sugar are trading at multiyear highs
- Gold and copper are trading at record highs.
- Silver is trading at a 30-year high.
- Even long-depressed natural gas is now rallying.

Take a look at this chart going back six months...



What you see here is the credit of the United States, represented by the value of a 20-year Treasury bond (TLT) versus the major alternatives to money: energy as represented by coal (KOL), agriculture (DBA), and hard money as represented by silver (SLV).

This picture sums up the arguments and warnings we've been giving for years. We are not going to have a crisis. We are in a crisis right now. U.S. credit is now in permanent decline, while the value of the main alternatives to the dollar – energy, food, and real money – are soaring.

The market is giving you a warning. Inflation is here.

We are in the midst of a monetary crisis. The facts are undeniable.

What's the single best way to protect yourself?

At the beginning of 2010, Porter made a simple prediction:

Rates on 10-year government bonds have nearly doubled since last year. I expect this trend toward higher rates (lower bond prices) to continue – for a long, long time. This trend – toward higher interest rates in the United States – is the single most important trend in finance. The great bull market in paper money, central banking, and the faith and credit of the United States is over. After all, our leaders have no faith. And we have no credit.

If you had done nothing this year but bought real money (gold) and shorted U.S. Treasury bonds, you would be sitting on a significant profit. Gold is up about 25% in the last year. TLT (Treasury bonds) are flat. (See the chart below.)



This trade is the most pure expression of what we believe is inevitable.

Note how for most of the year U.S. bonds (TLT) kept pace with gold. That's because the Fed was continuing to recycle maturing bonds back into Treasuries. But... when the Fed announced \$600 billion in additional quantitative easing in October, the bullish trend in bonds was broken. Bonds started going down. Gold, meanwhile, kept rising.

I believe this is the moment we've been expecting, when even massive government buying of bonds (with newly printed paper) can't stop the selling of our foreign creditors, who are fleeing to gold, silver, energy, agriculture, and strategic metals.

The credit of the U.S., which backs every bankrupt gov-

ernment in the western world, must soon collapse. Our ongoing debts and deficits cannot be financed in sound money – they're too big. Thus, the Fed is turning on the printing presses, and they will be running for a long time.

There is no alternative.

The Time to Act Is NOW

It's critical you orient your investments so you're long real money and real assets and short bad credits – starting with the U.S. government.

You can add various forms of energy and agriculture to the long side of your portfolio. You can short multiple forms of bad credit. But the gist of the strategy is simple: *Buy the things people need – food, energy, and money. Sell things that are vastly encumbered – especially the stocks of corporations that are deeply in debt.*

As interest rates rise, deeply indebted companies will find it impossible to refinance. (This month's recommendation is a company too indebted to survive.)

As you look through your portfolio, the first thing you ought to consider adding is silver. Silver is the best hedge against paper money for one simple reason: When it's not used as money, there's very little demand for it. When it is used as money, there's a tremendous demand for it.

You see this by looking at the so-called silver ratio, which is simply how many ounces of silver it takes to buy one ounce of gold. Historically, when silver was used as money, the ratio was around 15 to 1. But for most of the last 100 years, silver has been demonetized. During this period the silver ratio soared to as much as 100 to 1.

Today, silver is trading for a little less than \$30. Gold is a little more than \$1,300. Therefore, the silver ratio is roughly 43 to 1. As this monetary crisis deepens, people will come to value silver as money once again. The silver ratio will fall. Imagine, even if the price of gold doesn't go up at all, if demand for silver continues to increase because of monetary problems, silver would hit \$86 an ounce, just to return to its historic value relative to gold.

I expect gold will continue to move higher too... much higher. If you wanted to put the U.S. dollar on a 10% gold-reserve standard, the price of gold would have to reach nearly \$10,000 an ounce to back all the outstanding money of zero maturity. Assuming gold reaches this price, the price of silver at its full monetary value would be around \$650 an ounce.

I know these prices seem ludicrous today... but those numbers are real.

Remember, we're a long way from the end of this crisis. Most people don't even own any gold or silver yet. Many people, including our economic leaders, continue to deny a massive inflation is underway.

Our Best Bet for a Sure Thing

As longtime readers know, one of the real specialties of this advisory is short-sell recommendations. Not many newsletter writers offer short-sell recommendations. And we're proud to say even fewer have as good a track record in the category as we do.

Don't panic if you've never sold a stock short. Allow me to suggest you call a broker and ask him to walk you through the process. It's just like buying a stock, except you're going to borrow shares and sell them first. Thus, you'll make money if the price of the shares goes down. If you're nervous about shorting, try it once with a few shares. Put \$100 into a short trade and see how it works. Soon you'll find it's no big deal at all – no different than buying a stock.

There are big advantages to keeping a "short book" – a part of your portfolio that's short. In the first place, let's face it – most companies don't pan out. Very few companies are still operating 20 years after they go public. If you're unwilling to short stocks, you're going to miss at least half the opportunities available to you.

But another reason you should keep a short book is to give your portfolio a hedge against a general decline (or flat market.). This year, we've made several short recommendations. Our average return on these recommendations is more than 17%. And that's despite the overall rise in the markets. But what if there had been a serious break in stock prices? What if the market had fallen 10% or 20% this year? If so, these short recommendations would have been up 50% or more and these gains would have given us a wide buffer against losses in other areas of our portfolio.

We know, regardless of what we write, many people will simply refuse to short stocks. If you're one of these people, you should get out of stocks. To stay in the market, you must at least consider shorting a stock.

In a monetary crisis, some stocks – the most elite blue-chip stocks – will serve as a refuge for savings. But most stocks will collapse. A broad portfolio of stocks is unlikely to

do well over the next two to three years. Inflation and bond yields are going to move much higher. That will take a huge toll on the stock market. And most stocks will fall.

If you're planning to stay with stocks of any kind, you must hedge your longs with short positions. That's what we did this year, and we ended up making more on our shorts than our longs. We suspect that will be true for several years – especially outside of investments tied to inflation, like energy, agriculture, and precious metals.

So if you're looking for a good stock to short, both to earn a profit and hedge against future stock market volatility, what should you look for? We target three kinds of short-sale candidates: companies with obsolete products, companies with far more debt than they can repay, and companies we suspect are involved in a fraud. In short, you've got: frauds, the obsolete, and deadbeats.

The best, of course, is a fraud. But they are rare and difficult to uncover.

The next best is a deadbeat business. Once you know a company cannot afford to repay its debts, you know the equity value of that business is going to zero. In these cases, shorting stocks is much safer than buying them. Making a profit on these kinds of shorts is almost a mathematical certainty – as was the case with our short recommendations of General Motors (which owed more than \$400 billion) and Fannie and Freddie (which owed trillions).

That's what we'd like you to consider this month. A company we're confident cannot repay its debts. When this company completed a major merger in mid-2009, Egan Jones, the only major independent credit-rating agency, wrote the deal was like "tying two drunks together to walk in a straight line."

The company today is called **PulteGroup (NYSE: PHM)**. Following its merger with Centex, PulteGroup became the largest homebuilder in the United States. It offers cheaply constructed homes on tiny lots in mostly bad locations. In all, PulteGroup offers homes in 842 future slums... er... we mean... communities.

These communities have and will continue to have big problems for several obvious reasons. First, the most important factor in any real estate deal is location. In general, U.S. homebuilders bought too much low-quality land between 2002 and 2006 – in terrible locations. Pulte and Centex were no exceptions. Second, PulteGroup constructs these homes as cheaply as possible, which means they will cost more to

maintain in the future, making their resale value much lower than people expect.

These guys specialize in cheap houses and bad locations... what could go wrong? Well... if you sell these poorly constructed homes in bad locations to tens of thousands of people who can't actually afford to pay for them, you've got a giant problem on your hands. No one wants to live in a neighborhood plagued by mortgage fraud, empty homes, and deteriorating common areas. That's exactly what's happened to many of PulteGroup's communities.

While all of the above is true, it might not spell doom for the company as much as it does for the customers of the company. But PulteGroup also committed the one sin from which homebuilders usually cannot recover: It bought far, far too much land at the peak of the bubble in 2005 and 2006. Now, it can't afford to pay the interest on these real-estate purchases. Nor can it sell the land because prices have fallen so much. The resulting write-offs would put the company in violation of its loan covenants. Ironically, PulteGroup finds itself in the same position as many of the poor fools who bought its homes: It can't sell, it can't move, and it can't refinance. The only thing left to do is default. And that's what's going to happen.

Consider these numbers, taken straight from the firm's most recent quarterly report:

We are required to not exceed a debt to tangible capital ratio as well as to meet a tangible net worth covenant each quarter. At June 30, 2010, our debt to tangible capital ratio (as defined in the Credit Facility) was 51.0% (compared with the requirement not to exceed 60.0%) while our tangible net worth (as defined in the Credit Facility) cushion was \$893.2 million.

Thus, at the end of the second quarter of this year, the company was a mere \$893.2 million away from defaulting on a key loan covenant.

Now wait a minute... you might say... that's a lot of money. Why does reading that note make you feel that the company is in imminent danger of filing for bankruptcy?

Consider this, taken from the same quarterly report:

An additional source of liquidity during the six months ended June 30, 2010 was the receipt of federal tax refunds aggregating \$881.6 million primarily as a result of the carryback of taxable losses provided for under the Worker, Homeownership, and Business Assistance Act of 2009.

In other words, without one of the most absurdly generous federal bailouts of all time, the company would have long since violated its loan covenants. Meanwhile, the number of homes in foreclosure continues to grow. Demand for new homes continues to fall. And prices for real estate continue to decline.

Our bet is Congress won't give PulteGroup another \$881.6 million handout. And we doubt the company will be able to earn enough money to pay the interest on its debts. Next year, the interest will total \$222 million. It will also have to repay or refinance \$397 million in debt coming due. That's a total of more than \$600 million. In 2012, it will have to repay or refinance \$986 million in debt while paying another \$204 million in interest. Altogether, PulteGroup has to come up with \$1.6 billion just to manage its debt load. That's roughly twice the amount it currently holds as a cushion against a covenant default. And it is vastly more money than the company can earn selling houses.

To put these risks in the proper perspective for you, consider the government again went all-out on behalf of the homebuilders and homebuyers in 2010, extending various tax-credits through the end of September in an economically moronic attempt to forestall the inevitable. (These kinds of temporary incentives only serve to greatly reduce future demand for new homes.)

The good news for PulteGroup was, thanks to the government support and the company's massive cost cutting since its merger with Centex, it made money selling homes in the second quarter of 2010 for the first time since 2006. It sold a little more than \$1 billion worth of houses and land. Those homes cost \$952 million to build. That's a profit of roughly \$50 million.

So... you may be thinking, "Well, if that holds up or grows a bit, making \$200 million in interest payments next year might be doable."

Maybe. But the numbers we gave you were gross figures. We didn't include the corporate overhead, which was \$416 million in one quarter. We also didn't include the costs of various land value writedowns/options losses, which totaled \$672 million.

The company didn't actually make \$50 million. It lost nearly a billion dollars... in one quarter.

To be fair to PulteGroup, many of these charges were noncash or had been reserved earlier. So if you look at its operations on a cash basis, it only lost \$20 million in the

quarter, not counting the government's tax-refund largesse, which will not continue. Add these losses to the company's \$11 million in capital expenditures, and you find a company that's staring at \$1.6 billion in debt repayments over the next 24 months while it's losing a considerable amount of money on its operations each quarter – more than \$30 million.

The company has two significant assets on its balance sheet. Cash stands at \$2.6 billion, though much of it is pledged as collateral for loans, as we described earlier. (The company's defacto cash cushion is roughly \$800 million.) It owns nearly \$5 billion worth of homes and land, which, at auction would probably fetch 50¢ on the dollar. So... let's say the company's assets in liquidation are worth around \$3.3 billion. Measured against these assets you'll find \$6.7 billion in debt.

That's not a situation which would produce a quick and easy, low-cost refi. Just like PulteGroup's homebuyers, the corporate subprime lending racket has been mostly shut down.

Our guess? You'll see the corporate version of a foreclosure within 12 months.

The stock is volatile and has been moving straight down for a number of weeks. We'd recommend waiting to sell short at prices above \$8. There's no particular logic for that price, as we firmly believe the proper value of the company's stock is \$0.00. But there's no reason to expose yourself to a bad entry price when the recent momentum in the shares has been a firm rebound.

If we miss our entry point, don't worry. One of the real joys of shorting stocks is you're never too late, unless the shares stop trading: The downside (or upside when you're short) from here is always 100%.

Corn and Coal

On the long side of our book, we are buying assets that will thrive during an inflationary period. As we've explained, that means energy, agriculture, and precious metals.

We're currently recommending buying **Monsanto** (NYSE: MON), the seed company. You can find the full story in the November issue.

Right now, corn and soybean prices are rallying on the back of surging worldwide demand. Monsanto's genetically modified seeds hold the secret to satisfying it. We see shares surging 20%-50% over the next year alone. **Monsanto is a**

buy up to \$65.

Our other major inflation trade is U.S.-based coal miner **Arch Coal (NYSE: ACI)**. The price of coal is rising thanks to limited supply, the weakening dollar, and increasing global demand... particularly from China where 70% of the power is provided from burning coal and the government is building two coal plants every month. The price of coal is up 17% in the last three months. Arch Coal's profits and the price of its stock will race higher with it. We're already up 25% in two months. **Buy Arch Coal up to \$33.**

The Eagle Ford Story

Earlier this year, we broke the story on the Eagle Ford shale discovery in south Texas. We predicted it would become one of the largest oil and natural gas finds in the U.S. in the last 50 years. It is happening. Recently, you may have seen it in the news. On November 15, Chinese oil giant CNOOC (CEO) and U.S.-based energy behemoth Chesapeake Energy announced a \$1 billion deal to explore 60,000 acres in the Eagle Ford. In June, India-based Reliance Industries agreed to a \$1.15 billion deal with Pioneer Natural Resources (PXD). The two firms will be exploring 212,000 acres in the find.

You can read more of our report on the Eagle Ford Shale in the April issue. We recommended two stocks: **Petrohawk (NYSE: HK)** and **SM Energy (NYSE: SM)**. We were right, but we were early. During the market's summer swoon we stopped out. We followed our trailing stop rule and recommend subscribers sell. Following a sell rule is a critical part of any investing strategy. We have found a 25% trailing stop works best over time. (See sidebar.)

So even though our first foray into the Eagle Ford wasn't successful, we plan to return to the story. We still like the fundamentals of SM Energy in particular.

Our Current China Trade (Expect many, many more...)

While America buckles under its debts, weakening dollar, and inflation, we're predicting China's economy is on the way to becoming the world's largest and richest. This trend will take years, even decades, to develop. It has a strong start, though. *The Chinese government already has more than \$2 trillion in savings and is hoarding gold.*

Our current pick for investing in the Chinese megatrend

Our 25% Trailing Stop Strategy

Before you buy a stock, you must know when you are going to sell. This is the only way to make sure you will get rid of an investment that may turn into a large loss while letting a good one run higher. Having a strategy when to sell is one way successful investors outperform the market.

The strategy we use – the 25% trailing stop – is simple. And it works. You sell a stock once it declines 25% off its highest close since you've owned it. For example, if you buy a stock at \$10 and it rises to \$20, you sell if it closes at less than \$15. Period.

If that same stock only rises to \$12 and then declines to \$9, you sell it... even at a loss. It's difficult to take that loss (you want to believe it will come back). But trust us, this is the only way to be sure that investment doesn't take you with it if it goes into the toilet.

is **Eagle Bulk Shipping (Nasdaq: EGLE)**. Eagle is a dry bulk carrier, operating ships that move grain and coal around the world. As the Chinese economy continues to develop and the country grows richer, raw materials imports will surge.

For example, last June, China received its first large shipment of corn in more than a decade. After having enough of its own for years, the country suddenly ordered five shiploads, 1.2 million tons... all from the U.S.

Then, there's coal. Not only does China need coal, so does India. These two countries alone are driving 80% of the global demand for coal, a significant amount of which the countries must import.

Total seaborne coal shipments for 2010 are expected to reach 1 billion tons. At the end of 2007, they totaled 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. **Buy Eagle Bulk Shipping (Nasdaq: EGLE) up to \$5.25.**

The Yield Generators

We're also cashing in on a few select, high-yielding financial stocks: **Prospect Capital (Nasdaq: PSEC)** and

Annaly Capital Management (NYSE: NLY).

Prospect Capital is a business development company (BDC). BDCs are specially qualified U.S.-based companies that raise money by selling stock. Then they use the money, combined with no more than an equal amount of debt (BDC rules limit them to a debt-equity-ratio of 1:1) to make loans to small, private companies at high interest rates. As long as they distribute 90% of their taxable income as a dividend (and follow other rules), BDCs don't have to pay income tax.

Right now, Prospect shareholders are earning a 12% cash-dividend yield as management borrows low and lends high to specialized businesses. It's a good business and a solid income stream.

But is it time to buy Prospect? You should buy Prospect whenever shares trade for less than book value per share (assets minus liabilities divided by the number of shares outstanding). This means you're putting *less* cash into buying the company's assets than the company had to when it bought them. Getting shares cheap like this gives you a margin of safety... and a great deal. Prospect's reported book value per share last quarter was \$10.24. Prospect is currently trading near \$10. **Buy Prospect** and collect some solid income.

Owning shares of Annaly is almost like having a license to steal from the U.S. government. Annaly borrows money at cheap U.S. interest rates (in the low single digits) and uses it to buy U.S. guaranteed mortgage-backed paper.

This may sound alarming since mortgage trouble led to the credit crisis of 2008 and the recession. It's not. Remember, the U.S. government is bailing out everything. These guarantees will be honored. After all, the government simply has to print money to do it.

So how much does your license to steal pay you? Annaly's current dividend yield is 15%. However, right now is not the time to buy. Like Prospect, you want to buy shares of Annaly when they trade for less than book value. Book value of Annaly as of the last quarter was \$15.16. Shares are trading near \$18, a 20% premium. We'll hold off on buying Annaly until we can get in for at least book value... hopefully even cheaper.

You can learn more about Prospect and Annaly in the June issue.

Super-Cheap Blue-Chips You Must Own

Speaking of cheap, we found two blue-chip value stocks this year that were extremely good buys and recommended them to subscribers: **Wal-Mart (NYSE: WMT)** and **Intel (Nasdaq: INTC)**. In our July 2010 issue, we wrote:

We begin with a conclusion you might find surprising: Only rarely in history have the world's largest and best corporations been for sale at lower prices. Furthermore, buying blue-chip stocks at these super-low valuations has always led to outstanding returns. In short, despite the risks, high-quality stocks are amazingly cheap. And you're probably foolish if you don't at least start to buy.

In particular, we showed subscribers how cheap Intel, Coca-Cola and Wal-Mart stock had become. At the time, the Dow Jones Industrial Average was clearly marking a bottom. Look at what it has done since...



At the time, we recommended semi-conductor giant Intel.

Two months later, in the September issue, we recommended shares of Wal-Mart. Snore. Actually, Wal-Mart is one of the best-kept secrets in the stock market. No one realizes it is the king of all emerging-market stocks. After reading our research on the company, we are sure you'll see why this is one of the best single stocks you can have in your portfolio.

Both Intel and Wal-Mart are buy-them-and-forget-about-them stocks. "What?" you ask. "Haven't you told us 'buy and hold' is for morons? What about this trailing stop loss thing?" You are right. We will track our trailing stops. Our bet is, though, Wal-Mart and Intel will never trigger them. You see, we're getting these companies for super-cheap. They're also so mature that, absent a major market correction, a 25% swoon is not likely. **Buy Intel and Wal-Mart... now.**

Prepare to Take Advantage of the Victims

Now... in addition to our new PulteGroup recommendation, we have one open short sell recommendation, **Barnes & Noble (NYSE: BKS)**. The story is simple...

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.

You can find more details about Barnes and Noble in the May issue. Even given the recent news of a possible merger with Borders (BGP), the business is barely holding on. Merger or not, nothing will change the fact that more and more Americans are now buying their books in digital format, rendering obsolete the massive physical locations of Borders and Barnes and Noble.

For the last six months, we have also been shorting the European debt crisis through the **iShares MSCI Italy Index Fund (NYSE: EWI)**. We recommended this short in June based on the country's horrible financial situation. Here is what we wrote in the issue:

Italy's public debt totals 1.7 trillion euro – seven times the size of Greece. Italy is the world's third-largest sovereign borrower. It cannot be bailed out – it is simply too big. Meanwhile, it cannot possibly hope to pay back its debts as long as it remains in the euro. In fact, Italy has been in recession almost since the day it adopted the euro: Its economy has grown by a total of 0.54% over the last decade. The total public debt to GDP will soon surpass 120%. At that point, it will become progressively more difficult for Italy to extend its foreign debts because all of the foreign creditors will know these debts will never be repaid. A default and

devaluation will be the only way to restart Italy's economy.

However, given the fact that the European Union Commission and the International Monetary Fund (majority-backed by the U.S. government) have demonstrated they are willing to print money to bail-out anything, we are sure Italy will be rescued. The power of the EU/IMF cash fire hose cannot be ignored. And the U.S. and Europe have now demonstrated twice they will use it. Buy to cover EWI. We're booking a 3% loss on the trade.

One more note on our short positions... When the market closed on December 6, we were stopped out of our short on **Gannett (NYSE: GCI)**. We booked a 7% gain on the position. **If you have not bought to cover Gannett, do so.** We will probably short the company again in the future, as the future of its newspaper (the USA Today) is bleak.

Good investing,



Porter Stansberry and Braden Copeland

P.S. We spent a bit more time than usual reviewing our core positions and explaining some of our basic philosophies because we're aware that early December brought us lots of new readers on the back of our new End of America video warning. We welcome all of our new subscribers. Thanks for your business. We'll do our very best to exceed your expectations.

Stansberry's Investment Advisory Model Portfolio

Prices as of December 9, 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>Return*</u>	<u>RISK</u>
Wal-Mart	WMT	9/9/10	\$51.91	\$54.34	\$0.30	Global blue-chip	Buy	5.26%	1
Annaly	NLY	11/6/08	\$13.64	\$17.93	\$5.05	Gov. port. repair	Buy below \$15.25	68.48%	1
Johnson & Johnson	JNJ	7/6/06	\$60.52	\$62.06	\$8.21	Blue-chip health	Buy	16.10%	1
Exelon	EXC	10/9/02	\$21.47	\$39.61	\$13.62	Nuclear power	Buy	147.93%	1
Intel	INTC	7/16/10	\$21.51	\$21.81	\$0.32	Blue-chip tech	Buy	2.86%	2
Prospect Capital	PSEC	6/24/10	\$10.03	\$10.17	\$0.60	Warrant banker	Buy below \$10.08	7.41%	2
Hershey	HSY	12/6/07	\$40.55	\$47.08	\$3.66	Chocolate empire	Hold (Long)	25.13%	2
SVB Financial^^	SIVB	6/29/10	\$41.42	\$50.70		Warrant banker	Buy below \$42.50	22.40%	3
<u>The "Next Boom"</u>									
Calpine	CPN	5/13/10	\$13.93	\$12.78		Nat gas power	Buy below \$15	-8.26%	2
ConocoPhillips	COP	4/2/09	\$41.45	\$64.67	\$3.59	Cheap oil	Hold (Long)	64.68%	2
Monsanto	MON	11/18/10	\$59.63	\$61.00		Exploding food prices	Buy below \$65	2.30%	3
Arch Coal	ACI	10/8/10	\$26.00	\$31.53	\$0.10	Coming coal boom	Buy below \$33	21.65%	3
Eagle Bulk Shipping	EGLE	8/12/10	\$4.72	\$5.05		Super-cheap ships	Buy below \$5.25	6.99%	3
San Juan Basin	SJT	1/7/10	\$18.34	\$24.51	\$1.57	Safe natural gas play	Hold (Long)	42.21%	4
Silver	SLV	10/13/09	\$17.48	\$28.03		Money crisis	Hold (Long)	60.35%	4
Gold Miners ETF	GDX	12/11/08	\$28.02	\$61.43	\$0.11	End of America	Hold (Long)	119.63%	5
<u>Victims</u>									
Pulte Group	PHM	12/10/10	NEW	\$6.96		Buckling homebuilder	Short above \$8	NEW	5
iShares Italy ETF	EWI	7/15/10	\$15.79	\$16.43		Europe crumbles	Buy to cover	-4.05%	5
Barnes & Noble	BKS	5/13/10	\$20.01	\$15.19	\$0.75	Obsolete bookstores	Hold (Short)	20.34%	5
Gannett^	GCI	3/11/10	\$16.29	\$14.95	\$12	Obsolete newspaper	Buy to cover	7.49%	5
Current Portfolio Avg: 33.10%									
* This is the return since reference date, including dividends. ^ Recent price and gain reflect stop-out date. ^^ See "Special Reports" section of the website for further information. Stansberry's 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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