



Time Is Running Out

What will have to happen before you'll say we're in a crisis right now?

We've been on the radio a few times in the last month. Producers are contacting us with interview requests because of our new promotional video, "The End of America."

Most of you have seen this video already. You know the core components of our argument: The debts assumed by the Western democracies will overwhelm their economies and lead to the end of our current dollar-denominated, global currency regime. This has profound implications for American's standard of living and our empire's role in the world.

Doing these interviews and taking call-in questions from people around the country reminds me of why we made the video: People suffer from a shocking lack of knowledge about the serious financial problems facing our country.

For example, the most popular question is: "When will the crisis begin?"

The question assumes we ought to ignore the collapse of the automakers, the complete destruction of America's investment banks, and the receivership of the world's largest mortgage firms (Fannie and Freddie) and the world's biggest insurance company (AIG)...

The question implies nothing unusual has taken place with housing prices... or in the markets for strategic commodities, like lithium, copper, oil, coal, and corn – all of which are absolutely soaring in the face of the moribund U.S. economy. The question assumes nothing is going on with the value of our dollar, despite silver trading near \$30 and gold trading close to \$1,500 – up 100% in only two years.

We respond with the question we asked at the outset of this month's letter: *What will have to happen before you'll say we're in a crisis right now?*

How high will gas prices have to get before your neighbors notice something is wrong? How high will gold have to get? Or silver? How many banks will have to go under? How high will unemployment have to rise? How many cities will have to go bankrupt?

Where's your threshold? How bad will things have to be before you begin to see what's really happening?

Inside This Issue

- The Crisis Is Here
- S&P Warn on U.S. Debt (from *France*)
- Municipal finance collapsing
- How to profit from the panic in 2011

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How We Know the Crisis Has Arrived

For us, the moment arrived five years ago. We noticed the dollar collapsing against both gold and the currencies of our trading partners. We could see the problems on the balance sheets of carmakers, investment banks, and Freddie and Fannie. We watched, aware of the risks, when investors bid up real estate prices, oil prices, gold prices... almost anything to get out of the dollar.

By late 2008, it all came to a head.

We expected the government to spend anything – and print as much as necessary – to forestall the collapse of our system. And so it did.

This is *certain* to continue and increase in velocity because this path is the only way for the people in Washington to maintain power. Their way – the path of massive inflation – won't work, but it will postpone the day of reckoning and give them plenty of time to get out of the way. They're counting on people like us to end up holding the bag – a bag full of worthless government bonds and paper dollars.

If you follow our advice, that won't happen to you. Still anytime you're following an investment strategy, you ought to ask reasonable questions about the strategy. So how do we know our strategy is right? How do we know it's working?

Let's look at our results.

Last November, Porter was invited to a private dinner in New York with the CEOs of some of the world's largest food companies. They warned him food prices were on the brink of soaring. We gave you a virtual transcript of the meeting and passed along the warning. Were we right?

Since we published that letter, the price of corn has shot up 24%. The price of wheat is up 21%. The price of soy is up 18%. And our recommendation to buy shares of Monsanto has kept pace, moving from \$59 to \$75 (27%).

Yes... this is only one example. It doesn't really prove anything. Maybe we just got lucky.

So let's look back over the current bull market. How have we done since the markets put in their bottom in the spring of 2009? Since March 1, 2009, we've recommended 32 positions in this letter. So far, we've made money on 20 of the recommendations and lost money on 12. We've been "right" 62.5% of the time, so far. Much more important, our gains have far surpassed our losses.

The average return across all our recommendations during the period (March 1, 2009-January 1, 2011) was 17.3%. Assuming you'd bought the S&P 500 at the same time and in the same amounts, your account would have gone up 10%.

Keep in mind, that's just the simple average. On an annualized basis, which implies reinvesting your winnings, you would have made 28.7% with our recommendations.

It's difficult to know which number is the best to use. The simple average definitely understates the actual performance because it reflects zero reinvestment. But the annualized number assumes all winnings are instantly reinvested precisely across the entire portfolio. That's unrealistic as well. That's why it's helpful to know how our actual subscribers' portfolios have performed.

One longtime subscriber we've gotten to know over the years set aside \$3 million to follow our recommendations exclusively. He's a former managing director of a major Wall Street firm. He would not invest \$3 million in our ideas unless he believed our strategy is right. In any case, his portfolio rose 27% in 2010 – almost exactly the same number our annualized track record suggests.

We doubt most of our subscribers recognize how good these returns are, across a large portfolio. Especially once you realize 10 out of our 32 recommendations in the period were short-sell recommendations. That is, almost 30% of our portfolio was actually *shorting* stocks during the biggest bull move in stocks since the Great Depression. That should have produced a big drag on returns. But we made money on our shorts. On average, we've made 4.3% during the period on our "short book."

That return might seem paltry, but our short book is primarily designed to be insurance – we'll only make a lot of money on those positions if the markets as a whole go down. Making a profit – even a small one – is a great result during a major bull market like we've had since March 2009.

These short positions also mean our portfolio experiences less volatility, as our short sells rise in value when the market falls. Think of it this way. Wouldn't it be nice if your insurance company paid you 4.3% on your policy each year, instead of you having to pay a premium?

We think our track record proves that our strategy is fundamentally correct. But we admit this is a rear-looking examination of our thesis. How can new subscribers judge the accuracy of our "End of America" forecast?

Seven Key Facts

We put together a few of the key facts. We are interested in hearing from you if you have any contravening information. We always want to understand the other side of the argument... but so far, we haven't learned anything that sways our opinion.

We would urge you to share these facts (and our “End of America” video presentation) with anyone you care about.

Here are the top seven factors we believe **MUST** lead to the end of the global U.S. dollar standard – what we call The End of America.

1) The price of gold has gone up for 10 years in a row.

We can't think of another market that's ever risen for 10 consecutive years. This is a historical anomaly, and it means something has gone badly wrong with the world's reserve currency (the U.S. dollar). Markets, if left to find their own equilibrium, will naturally fluctuate. Gold isn't fluctuating. Its steady move up proves something strange is happening to our money.

2) Our government's deficits are out of control. The government's annual deficits now routinely surpass \$1 trillion. The first \$1 trillion deficit came in 2008 – and the government explained it away as the consequence of the financial crisis. But we racked up another \$1 trillion deficit in 2009 and yet another in 2010. We'll have another in 2011 and so on. *Our national debt has doubled since 2005.* We've borrowed more money in the last five years than we had in the entire history of our government until then. This isn't sustainable.

3) The government cannot increase tax revenues enough to cover our spending or repay our debts – ever. Our annual deficits have become completely unlinked to taxes. Total federal income taxes and corporate taxes generate \$1.1 trillion a year in revenue, and we still ran a \$1.3 trillion federal deficit last year. So even if we increased tax revenues by 100%, we would still have fallen \$200 million short. *This is totally unsustainable.*

4) Special interest groups – particularly government unions – are looting our Treasury. Self-serving special interest groups have completely hijacked government spending. We now spend \$200 billion a year on federal pensions. We're spending another \$450 billion on welfare. This spending, combined with our defense spending (\$700 billion), exceeds total federal tax revenue and leaves nothing to pay the \$200 billion in interest on our debt, nothing to pay for actual government services (like roads), and nothing to pay towards the inevitable Social Security/Medicare shortfall. *Remember... most voters do not pay taxes. It's politically impossible to reform this interest group-based spending.* These people are robbing the Treasury. They will cause our currency and eventually our government itself to collapse.

5) We're printing money just like the banana republics we used to mock. To support the government's runaway spending, the Federal Reserve is now continuously buying government debt. This process was commonly called “monetizing the debt” or, more simply, “printing money.” The Fed creates new money to buy government bonds. This

kind of Ponzi financing destroyed every previous experiment with paper money. *If printing money were truly good for an economy, Zimbabwe would be the world's wealthiest country.* Perhaps even more worrisome than the practice itself is the leadership of the Fed, which has alternately defended this practice and then denied using it. If the Fed continues this practice, it will eventually cause a global run on the dollar that will destroy the value of our currency overnight.

6) We can't repay our debts. Total debt outstanding in the U.S. currently exceeds \$55 trillion. That's \$681,165 in debt per U.S. family. There is simply no way to repay (or even maintain) debt of this magnitude using the income of the average American family, which is slightly less than \$50,000 per family. Interest alone on these debts (based on a 5% rate) would total \$34,000 per family every year. Total debt in the U.S. economy is unsustainable and can't be financed without printing vast new sums of money.

7) Shockingly, new debt issuance in the U.S. is soaring, with the lowest-quality debtors borrowing record amounts. Despite all the evidence that the U.S. economy carries far too much debt, both public and private debt issuance soared to new record levels in 2010. Overall, more than \$3 trillion in new corporate debt was issued last year – the second record year in a row. And junk-bond issuance set a new, vastly higher record. In 2010, 509 speculative-grade corporate borrowers sold \$287 billion worth of new debt. That compares to the previous record (2009) of \$167 billion. Our economy has become so warped by its debt load, it cannot function without ever-larger amounts of debt. Anyone looking at these numbers must realize this is not safe and will not last long.

Why No One Else Is Issuing These Warnings

You may read these facts and ask, “Where are the ratings agencies? Why does a small newsletter based in Baltimore, Maryland seem to have the jump on everyone in Washington and most of the people in New York? Why aren't these facts in the newspaper? On the news at night? In magazines?”

The answer: Government spending now makes up more than 40% of our economy. No big business can afford to offend its best customer. And most also depend on the government for protection from competition, in the form of licenses or permits.

Take the ratings agencies. The SEC licenses them, and their business model depends on SEC regulations that require all new debt issues to be rated. The ratings agencies can't say anything bad about the government's finances because a sin-

gle act of Congress could put them out of business immediately. Listen to what Standard & Poor's said recently about the federal government's deficits and the risk the U.S. faces of losing its world reserve currency status:

The view of markets is that the U.S. will continue to benefit from the exorbitant privilege linked to the U.S. dollar... But that may change. We can't rule out changing the outlook... No triple-A rating is forever.

It's clearly a warning. But it's not specific. And it was issued from an S&P employee in France. Believe me, all of the debt analysts know how much trouble America is really in... but they're not going to say anything. It's a game of "see no evil; hear no evil; speak no evil."

Why? What's the point of everyone keeping his mouth shut?

The government believes the average American won't understand what's happening as the dollar collapses. When prices begin to explode higher (as they are already doing) the government will pin the blame on commodity producers, like oil companies or the big food conglomerates.

No one will notice or care that prices for these commodities are set on global markets and none of these companies has anything close to monopoly pricing power. But the crowd will not care. The crowd will believe anything on the nightly news. NBC, CBS, ABC, and Fox will all go along with the government's line – their broadcast licenses depend on it.

And so, the game will continue. The middle class will be wiped out. The poor will get vastly poorer. And the rich – the folks who own plenty of assets to protect themselves from inflation – will get vastly richer.

What could go wrong?

Well, what about our creditors? Sooner or later our creditors will notice what's really happening. They won't care what Brian Williams or Katie Couric says. And eventually one of our major creditors – China or Japan – will demand some kind of compensation for the decline in the value of the dollar. Or else.

If you're not out of the dollar by then, it will be difficult for you to maintain your wealth. The dollar will collapse almost overnight.

This will happen.

Today, no one believes it could. But our government and private debtors have no other way out. There's simply far too much debt to be financed. It must be inflated away.

We know most of you simply can't believe this forecast.

You can't imagine America could suffer the fate of a banana republic. You will look at our numbers. Then look again. You'll re-read our list four or five times. You might even double-check our numbers. (They're right.) But still... you'll tell yourself, *something will change. In a few years, these numbers won't look so bad.* Or perhaps you'll simply think, *"These numbers are so bad and they foretell of such bad times that I simply don't want to think about them."*

People often struggle to imagine their lives changing in a profound way. So as a prelude to what's going to happen to the country as a whole... to help you prepare emotionally for what's going to happen... we give you the municipal financial crisis.

How to Make a Windfall Profit When America Goes Broke

All across the country, state and local governments have run up the same kind of enormous debts as the feds.

According to a study from the Pew Center on the States, state and local governments will need at least another \$1 trillion to meet their obligations over the next few years. Total outstanding state and local debt is currently \$3 trillion. It's unlikely the states can borrow the money they need or raise it in new taxes. Widespread defaults are imminent. Why?

The states can't print money. Their financial problems can't be "kicked down the street" or monetized. These debts will explode in a crisis this year.

Yes, we know... Everything that can be done to prevent an outright default will be done. Numbers will be fudged. Insurance companies will begin to pay debt service rather than allow a muni bond to actually default. But eventually... some politician somewhere will say, "We're not going to pay." And they will default.

What happens next? No one knows.

If the default stands, the entire muni bond market will shut down. Investors have long assumed muni bonds would never default. They have an implied triple-A rating based on the assumption that state governments would always bail out any issuer who went into default. They would do so to avoid a statewide downgrade that would make borrowing more expensive for all of the municipalities in the state.

If there's a big default (and we believe there will be dozens in 2011), states like California, New Jersey, Illinois, and New York may simply be unable to bailout the issue because of their own budget problems. Default may become the logical political choice.

To understand why, you should know a little of the

history of...

How the State Governments Went Broke

Two profound changes in the nature of state government went mostly unnoticed in the early 1970s.

The first is simple to understand: States gained the power to levy *progressive* income taxes.

In 1973, the Supreme Court voted nine to zero (*Lehnhausen v. Lake Shore Auto Parts*) that the equal protection clause of the 14th Amendment doesn't apply to state governments when it comes to taxes. Said another way, the Supreme Court took away one of our civil rights in favor of state-level tax authorities. Doing so allowed the states to begin progressive taxation of incomes. Politicians could finally get people to vote for higher taxes, because the majority wouldn't have to pay them – only the “rich.”

I can't think of a modern Supreme Court decision that so flagrantly abuses the Constitution. But judge for yourself. Here's what the 14th Amendment says:

No State shall make or enforce any law, which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

This seems clear: Every citizen of every state should be treated equally under the law. How then is it constitutional for Maryland to tax a millionaire's income at 8%, while anyone who makes less than \$1 million a year only pays 5%? It seems pretty obvious millionaires in Maryland are not getting the equal protection of the law.

Here's what the Court said in its unanimous decision:

The Equal Protection Clause does not mean that a State may not draw lines that treat one class of individuals or entities differently from the others...

What?!? Preventing state governments from treating groups of people differently was the express purpose of the 14th Amendment!

Interestingly, the Court's decision also made it clear that while individuals had no right to equal protection, the states had better not tread on the federal government's turf. No mention of the citizen's rights is made – except to be explicitly denied...

... the States, in the exercise of their taxing power, are subject to the requirements of the Equal Protection Clause of the Fourteenth Amendment. But that clause imposes no

iron rule of equality... The State may impose different specific taxes upon different trades and professions and may vary the rate of excise upon various products. It is not required to resort to close distinctions or to maintain a precise, scientific uniformity with reference to composition, use or value...

With this decision, almost every state in America soon established progressive income tax rates. As the revenues grew, so did the debts. The size of government swelled to new highs.

Unions Invade City Hall

Simultaneously, an interesting new trend appeared in the national labor force – unions for government workers.

These two changes – progressive state income taxes and unionizing state employees – are inherently related.

First came the unions (as you'll see). And as their demands sent the cost of governing soaring, progressive taxation became the only politically feasible way of closing the states' newly expanding budget deficits.

In this way, the unions got what they'd always sought – a path directly into the wallets of the upper class. In almost every year since 1973, union membership in industrial trades has fallen... while union membership in government work has grown. In 2009, this massive transition hit a new milestone. Public-sector union members (7.9 million) now outnumber private-sector union members (7.4 million).

Unions exist to get their members the greatest benefits for the least amount of effort. They are particularly effective at that in the public sector, which isn't subject to the market discipline of private industry. And for workers with the impetus to be lazy, government jobs have a natural appeal... government employers have little incentive to fire unproductive employees. They can simply hire more to get the work done.

It's also important to note these new government union members are white-collar employees who graduated college, have a clearer sense of their “rights,” and are skillful at asserting them. They aren't uneducated blue-collar laborers, who are more vulnerable to being exploited.

Today an amazing 39% of all state government workers belong to a union.

If you want to chart the decline of American prosperity, just follow the unions. They wiped out the auto industry, starting in the 1960s. And as that fell apart around them, they moved into the only real growth business left in America: government. That's when the foundations for what we face today were laid.

The existence of public-sector unions allows government workers to not only dictate the terms of their employment, but also to elect their own bosses. That's why from 1989 until 2004, the American Federation of State, County and Municipal Employees (AFSCME) was the largest single donor to federal political campaigns in the country. More than 98% of their donations went to Democratic candidates.

It's fascinating to us to understand this history. Unions drove American manufacturing out of business by making unit labor costs wholly uncompetitive on the global market. In the private sector, the market responded by sending factories (and their jobs) overseas to places like Mexico or even the southern U.S., where labor unions were not welcome. This market discipline limited the power of the unions – even though it came at a high cost. Just spend a few days in Detroit, and you'll see what we mean.

The unions responded by getting involved in a strictly monopoly business where none of the unit labor costs would matter for a long time – the government. And they've been wildly successful. The average annual income of federal employees is more than \$100,000.

But the union's impact is most keenly felt today on the state and local levels. The unit labor costs – particularly medical care and pensions – are driving cities and states out of business. Taxes can no longer be raised without people actively fleeing states – as is happening now in places like New York, California, New Jersey, and Maryland.

The states and their union employees have reached the inevitable endgame. The numbers in many states are mind numbing. Illinois' pension liability now exceeds \$100 billion. Roughly half is unfunded. In California, the pension liability is \$50 billion. Another 10 states have unfunded pension liabilities in excess of \$10 billion. Pew estimates when retiree health care benefits are included, the total unfunded liabilities of the state governments currently exceed \$1 trillion.

Who will pay these bills? No one. The governments will default, just like every other union employer eventually does. We know this is inevitable. Taxes cannot be raised enough to close the deficits at the state and local level, never mind actually repaying any of these bonds.

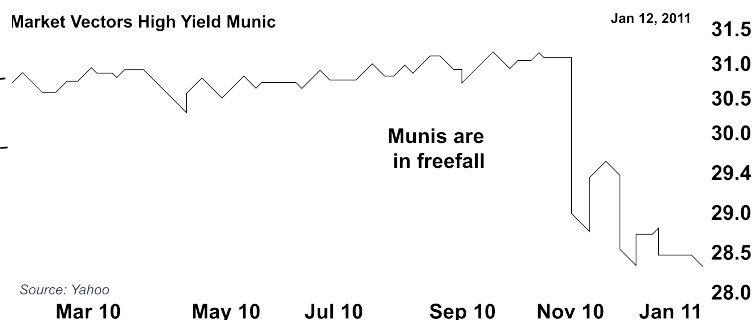
The only question left is, what will the federal government do? Judging by its past actions, we're confident that some kind of a bailout scheme will be organized. In fact, at a low enough price, muni bonds will be a great speculation. But we are nowhere near that point yet.

We are far from the only analysts who see the handwriting on the wall for muni bonds. Legendary investor Warren Buffett has refused to write insurance on muni bonds since

2009. He says, "There will be a terrible problem and then the question becomes will the federal government help... It's a bet on how the federal government will act over time."

But Buffett agrees with us that the feds will almost surely come to the rescue with their printing press. "It would be hard in the end for the federal government to turn away a state having extreme financial difficulty when they've gone to General Motors and other entities and saved them. I don't know how you would tell a state you're going to stiff-arm them with all the bailouts of corporations."

The easiest and most direct way to profit from the coming collapse of municipal finance is simply to short the bonds of the lowest-quality municipal issuers. One ETF in particular should be on your radar: the Market Vectors High-Yield Muni ETF (NYSE: HYD). Look at the following chart of the ETF. As you can see, it is collapsing. More than 30% of its holdings are rated below "B" – which is deep into junk status. Most of the other bonds it owns are triple B, double B, or B. Most of these bonds will be downgraded at some point this year. And many of them will default.



While shorting HYD is a high-probability trade, it's not the best way to capture profits as the municipal-debt market implodes. While HYD is going to be a disaster for investors, it does pay a handsome dividend – at least for now. It currently yields almost 6%. If you short this ETF, you will have to cover those dividend payments. That will reduce your profit and give you a heavier-than-necessary carrying cost.

Instead, we suggest shorting the last municipal-bond insurer standing – **Assured Guaranty (NYSE: AGO)**. All the other companies in this space have either gone out of business or stopped writing new insurance because the risks have become too large. When knowledgeable insurers like Warren Buffett completely step away from a market... you're wise to follow. But that's not what Assured has done. Instead it has written 98% of the municipal policies for the last year. It even boasts in its annual report it has no real competition. Look out below...

This isn't the first time Assured has made a catastrophic

underwriting mistake. The firm also wrote insurance on many of the bad subprime mortgage securities that went south in 2007, taking huge losses (more than \$400 million) on those policies. Since that time, the firm's earnings have appeared to soar... because it's the only insurer still willing to underwrite municipal bonds. Meanwhile, it still has huge exposure to additional real estate losses, as its exposure to real estate securities remains near \$30 billion.

The company's next debacle will be in its municipal business. The company currently insures more than \$400 billion (yes, *billion*) worth of municipal debt, including more than \$40 billion rated triple-B or lower. The ratings agencies are likely to downgrade all this debt this year. That would result in Assured having to post larger and larger amounts of collateral for these policies – triggering a “run on the bank” where its credit rating would be downgraded, forcing it to post still more collateral. The liquidity demands could easily (and quickly) force the company to file for bankruptcy, wiping out its equity investors.

Another high-risk area where the company has exposure is the insurance of municipal utilities, transportation, health care, and housing bonds. Unlike general obligation bonds, the entities issuing these bonds do not have the power to tax, but instead must fund their debt service from revenues. Many of these entities would not be able to fund their debt service without support from the local municipality, which may withdraw support in the event of a funding crisis. In total, roughly 30% of Assured's municipal portfolio is made up of these bonds – more than \$125 billion in exposure.

Among the bonds insured in this part of the portfolio are the Harrisburg, Pennsylvania incinerator bonds currently in default and unlikely to ever be repaid. Assured is making the interest payments on these notes to avoid paying out the creditors in full. We believe these bonds are only the first of many to technically default... and we find it hard to imagine a company in a worse financial position.

Assured sits on more than \$400 billion of potential municipal bond liabilities and another \$138 billion of potential structure financial liabilities (stuff like mortgage bonds). Reserves against future losses currently stand at \$12 billion. The company has another \$10 billion or so in cash. To be generous, let's call it \$25 billion in claim-paying ability. We wouldn't be surprised to see the company spend this entire sum in the next 12-18 months, solely on one category of claim: the nongeneral obligation municipal bond.

One thing is for certain... **We wouldn't own this stock at any price.** And if you're not ever going to be a buyer, it usually makes sense to be a seller. We recommend short selling shares of Assured Guaranty (NYSE: AGO) when they

trade for more than \$18.

Keep in mind, when you sell a stock short, your upside is limited to 100%. (If the shares go to zero, you'll make a 100% profit. You can't make more than that because the stock can't go to less than zero.)

Thus, speculators who are comfortable trading options may want to consider buying puts on this stock. That kind of advice goes beyond the purposes of this advisory. But to anticipate future questions we thought we'd mention if you want more “bang” for your risk equity, buying puts here might be a good idea.

We are adamant about shorting stocks.

We know some of you remain unconvinced. You believe it isn't necessary to short a stock to have long-term investing success.

Really? Imagine how much better your portfolio would have fared in 2008 if you held just one short position before the market cratered. Next time the market crashes, we hope you won't have to “imagine.”

Meantime, if you're a non-shorter (or even if you love shorting), we have discovered a unique long situation this month you must not miss...

The “Hot Money” Is Moving

You'll be unsurprised to know the roughly \$1.8 trillion the federal government pumped into the economy in 2009 and 2010 is doing virtually no good for the United States.

Look no further than U.S. gross domestic product (GDP). Our GDP growth has stalled near 3%. (Think of the U.S. as a gigantic business. GDP is how much the business is producing.) Three percent growth for a business isn't very exciting. (Europe is even worse... and has been for years. France has grown, on average, less than 2% a year since 1979.)

Are you excited about looking for investments where people are giving up and growth is a paltry 3%? We doubt it.

On the other hand, are you ready to invest where employment is growing and the economies are expanding with GDP growth better than 8%? We are. Enter Asia...

India's GDP growth rate is 8.9% a year. Singapore's GDP is growing at a 12.5% annual clip. Taiwan's and China's annual GDP growth rates are approaching 10%.

The Asian employment situation is also robust. In China, unemployment is less than 5%. The average unemployment rate for the major countries throughout Asia is hovering near 5%. The worst unemployment rates are in India

and Indonesia, 7.4%. But the situations there are improving.

Yes, you should take government economic reports (even those coming out of the U.S.) with a dose of skepticism. But they are all we have and they are useful, generally. And the general message here is undeniable: Significant future growth is coming from Asia. That's why the "hot money" is flooding Latin America and Asia.

Why's it called "hot money"? You've undoubtedly experienced – perhaps first as a child – the phenomenon of making money and having to buy something with it immediately. It happens to all of us. It also happens *on a much larger scale* to big corporations, banks, institutional investors, investment funds, etc. When they have cash, they put it to work earning a return – *as fast as they can*.

Right now, they have cash. More cash is sitting on corporate balance sheets than ever. The world's 1,000 largest companies (including banks, technology companies, industrial firms, etc.) have nearly \$2.9 trillion in cash. Some of this will be saved. Most of it will be invested.

Where did it come from? Much of it came from the U.S. and other countries' stimulus plans. Government efforts to reflate the world's economies *mainly served to inflate big institutional balance sheets*. Now, it's burning a hole in money managers' collective pockets.

Where's it going? It's not going to the United States. The hot money is rushing overseas where people are working (making money) and GDP growth is strong.

Wal-Mart (NYSE: WMT) is developing stores in Africa for the first time. It's also opening stores in India. General Motors continues to increase capacity in China. The auto company now sells more cars there than in the U.S. (2.35 million vs. 2.2 million in 2010). Citigroup now has more than 700 branches across Asia and plans to open 300 more in the next three to four years. Since 2008, Asian profits have been the largest contributor to Citi's international operations.

And then there's commercial aviation, one of the worst businesses on the planet. Yet, as we'll show you, the industry is exploding in Asia. And we're going to show you a specialized company where an investment today could double in one or two years.

The Commercial Aviation Explosion Few See Coming...

In 2009, Asian passenger traffic surpassed North American passenger traffic for the first time.

While 662 million passengers took to the air in North America, 665 million flew in Asia. The International Air

Transport Association projects that number will grow by another 54% by 2014, when more than 1 billion Asians will take to the skies.

Already, nine of the 20 busiest airports in the world in terms of passenger traffic are located in Asia. Beijing Capital International Airport (BCIA) is projected to be the second busiest in the world once the numbers are totaled for 2010 (behind only Atlanta's Hartsfield-Jackson). This is a leap from the eighth slot just two years ago. BCIA can handle 78 million passengers per year. In 2010, the airport is on track to handle 73 million. By 2012, the number is projected to surpass 90 million passengers. Beijing is rushing to build a second gigantic airport by the end of 2015.

This growth really isn't surprising. Look at it this way... Asia has about 10 times as many people as North America. But in 2009, the passenger counts for both regions were almost identical. If the air passenger-to-population ratio in Asia approached *half* of what it is in North America, the Asian market would be five times larger than it is today... 500% growth. About 3 billion air passengers would be scooting around Asia over the course of a year... five times as many as in North America today. Over 20 years, that would mean double-digit growth... for an entire industry. It may seem insane, but we haven't met an analyst yet who can get his brain around the true growth potential in Asia.

Asian airlines are leading the way in terms of profits, too. During 2010, the commercial aviation industry is forecast to earn \$15 billion. More than half of it – \$7.7 billion – is expected to come from Asian airlines. U.S.-based airlines will come in second, generating an estimated \$5.1 billion. With the Asian airlines making money, they'll be able to buy new airplanes to satisfy the surge in demand that's coming.

Investors are already starting to take note. The top three airlines in terms of market capitalization are all in Asia. Air China has a market cap of more than \$20 billion. Singapore Airlines' market cap is \$14 billion. The market cap of Hong Kong's Cathay Pacific totals \$12 billion. China Southern's market cap is \$11 billion. Investors are bidding up shares in anticipation of the surge in future profits.

Airlines are not the right way to play it, though. An airline is a horrible, low-margin business. In 2010, worldwide airlines are projected to generate \$565 billion in revenues. The profit forecast is just \$15 billion. That's a profit margin of just 2.7%. That's thin for any business. For one that requires ongoing borrowing, it's a bankruptcy waiting to happen. Why an investment advisor would recommend buying airline stocks, we really have no idea. You have a much better way to take advantage of this gigantic growth opportunity...

Perhaps the way to invest is through either Boeing or

Airbus. These two companies together control the commercial-aircraft construction industry. As airlines need more planes, these companies will surely see sales increase. (It is interesting to note that, while these two will continue to dominate for the next few years, a third force is coming. Surprise... it's coming out of China. The Commercial Aircraft Corporation of China, or Comac, aims to begin delivering its own commercial jet, the C919, in 2016. The company took an order for the first 100 just months ago.)

Boeing and Airbus are not pure commercial-aviation investments. Some of each company's revenues also come from government defense and space program spending. Those two areas could be a drag on the companies as a whole. We want a more direct angle to take advantage of the surge coming...

We have one. It's a commercial-aviation supplier, one where nearly 70% of the revenues come from sales to companies including Boeing, Airbus, and major aircraft engine makers Rolls Royce, GE, and Pratt & Whitney. And it's one of two companies that dominate its industry (the other is in Russia).

If shares of this specialized company return to the levels where they were trading in 2006 and 2007 – when Boeing was building more than 1,000 planes per year – we'll be sitting on a 100% gain. With the demand this company already started to see for its products during the third quarter, we may well see much more than a double before it's all over...

The Ultimate Way to Play the Exploding Commercial Aviation Industry (with a \$46.4 Million 'Confirmation')

Harold Simmons is among the most obscure multibillionaires in the U.S.

Few have heard of him, yet he's worth \$5 billion. He closely controls a network of U.S.-based industrial companies that operate worldwide.

Simmons made his first fortune in 1973 when he sold 100 drug stores to Eckerd Corporation for more than \$50 million. He started that business buying a single drug store with \$5,000 of his own money and \$95,000 of debt. After that, he bought and sold businesses – including a nearly 20% stake in Lockheed – amassing billions.

We covered Harold Simmons and one of his companies in the past: **Valhi (NYSE: VHI)**, a public holding company he controls. The Valhi story is complicated, but principally, it invests in Simmons' other industrial companies. Subscribers gained 136% investing in Valhi.

This time we have our eyes on a much simpler Simmons company – **Titanium Metals (NYSE: TIE)**. Known in the

industry as "TIMET," the company produces raw titanium and milled and fabricated products. It is one of the world's leading titanium producers. The other, Vsmopo-Avisma, is based in Russia. In 2008, the most recent full year for which data is available, both companies reported more than \$1.2 billion in titanium sales. Essentially, they split the market.

In the last 30 years, titanium's use in commercial aviation has surged. Now more than 50% of the world's titanium is consumed by the industry.

As with most commercial aviation advances, the material's major (top secret) debut came with a defense project. It has its beginnings in the 1960s – the SR-71 Blackbird spy plane designed by the "Skunk Works" division of Lockheed.

The airplane was built – including the skin – completely of titanium and composite material (mostly carbon fiber). The split was 85% titanium and 15% composite. Using titanium made the aircraft able to withstand the heat caused by the friction of flying faster than three times the speed of sound (well over 2,200 mph) at an altitude of 80,000 ft. This is four times faster than the average commercial jet flies, twice as high, and more than twice as *hot*. When the SR-71 landed, its exterior temperature would often exceed 550° F. Most aluminum alloys start to melt at more than 250° F. Using aluminum – the material used for all other aircraft at the time – was not an option.

Aluminum is also weaker than titanium. A titanium skeleton that is smaller than an aluminum one is able to carry far more weight... and the skeleton itself will be much lighter. It's like seeing an ant carry a breadcrumb 100 times its weight.

The ability to carry extreme weight was critical for the SR-71. The plane was essentially a flying gas tank with a pilot, camera, and two engines attached. To get to 80,000 feet and stay there, the SR-71 used 12,000 gallons (84,000 lbs.) in a 90-minute flight. A Boeing 777 uses 75% less – 3,000 gallons (21,000 lbs) in a 90-minute flight. An aluminum frame able to carry the SR-71 fuel load would have made the airplane practically the size of a skyscraper... and it would have melted.

Finally, titanium alloys are not corrosive. Aluminum alloys react, corrode, and weaken over time when they come into contact with most composite materials. This is a problem because carbon fiber is increasingly replacing fiberglass and plastic in aircraft in order to save weight (pound for pound carbon fiber is much stronger than plastic and fiberglass, so less can be used for the same purposes – floor and wall panels, bulkheads, etc.). So titanium is being used instead of aluminum in more areas of an aircraft. It is even being used to make the nuts and bolts to hold components together.

With the use of titanium, corrosion concerns are minimized making general airframe inspections much less intense. (i.e. costly X-rays and airplane skin removals are less frequent). This reduces operating costs for the airlines significantly.

The weight reduction that comes with using titanium alloys saves even more. On a 737, a weight savings of just 700 pounds can save nearly \$20 per hour. This may not seem like much until you multiply it over the course of a year and the number of total flight hours. For a business where profit margins are less than 3% and bankruptcy is the rule, this becomes real money.

Titanium is more expensive to process, produce, and mill than aluminum. Depending on the alloy, using titanium can cost anywhere from two to 10 times as much as using aluminum. Historically, to keep the cost of aircraft down, its use has been limited in the commercial sector. With the fuel and maintenance cost savings being proven now, that is changing...

Back in 1982, Boeing started the process. Its engineers were the first to design a meaningful amount of titanium into an aircraft. The 757 design contained 6% titanium, a little more than six metric tons. The trend began...

TIMET estimates the newest generation of Boeing 737s that went into service 15 years later had more than 18 metric tons of titanium. The plane is half the size of a 757. TIMET also estimates the newest 747s use 76 metric tons of titanium and the 787, when it hits the market, will use the most of all. Its design incorporates 15% titanium, by weight, using 116 metric tons. The trend is the same for the planes at Airbus, though the percentages are slightly less.

Few trends are more obvious. Commercial aircraft will continue to use more titanium in their designs in the future. The fuel and maintenance savings story for the airlines is just too compelling.

All this means much more business for TIMET, a company that generates nearly 70% of its revenue from sales of titanium products to the commercial aviation industry. It has already started...

In the third quarter of 2010, TIMET earned \$21.5 million, up from just \$1.1 million in the third quarter of 2009. Revenues were up nearly 16%. As more of TIMET's production capacity is required to satisfy the surging commercial aviation demand coming, the company's profits will continue to climb. The share price will move higher right along with them. Look at what happened with TIMET shares as commercial-aircraft titanium orders surged in 2006. Thanks to the demand coming out of Asia, we may well see the same action again...

Investing opportunities don't get much simpler... or better. We have big investors awash with hot money. We have an

exploding, capital-intensive industry – aviation. We have found one of two companies in the world capable of making critical components for the aircraft and engines needed in the industry. We have an established, long-term trend where more and more of this company's products are being used as aircraft designs are modified to decrease weight and improve efficiency...

And that brings us back to Harold Simmons. You see, not only is Simmons chairman of this company and not only do we know he is a shrewd entrepreneur... we know Simmons bought \$46.4 million worth of TIMET stock *just within the last 45 days*. He paid an average price of \$17.07 for his shares. Even though Simmons is worth \$5 billion, this is not a token buy.

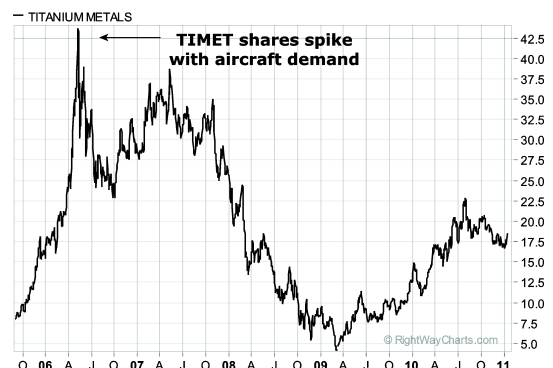
Our experience tells us Simmons (who tried to buy Lockheed in the 1980s) sees the strong growth coming for TIMET's business. After all, he knows aviation, how to gauge the growth coming out of Asia, and how significant titanium is for the commercial aircraft that will be required.

He also must know his stock isn't getting any cheaper. He also saw what happened with TIMET shares when commercial airplane building really gets going like it did into 2006 and 2007. They screamed from \$10 to near \$40.

At the end of 2005, the market cap of TIMET was \$2 billion (share price, \$15.80, times the number of shares then outstanding, 129 million). Cash flow from operations was \$73 million. TIMET stock buyers were paying 27 times cash flow for shares. That's pretty rich...

Eighteen months later, TIMET's cash flows from operations ballooned nearly 60%, to \$116 million. The stock price more than doubled sending the market cap to \$5.2 billion. Investors were paying 44 times cash flow for the privilege to own TIMET.

Today, investors are paying less than \$19 for shares of TIMET. They are getting the shares for 19 times cash flow. This is still pricey, but it's a much better deal than 27 times. The current market cap of the company is \$3.4 billion. Cash flow over the last 12 months totaled \$183 million. If that surges 60% within the next 18 months (and given what's coming out of Asia, 60% may be conservative), operating



cash flow will grow to \$292 million. TIMET's operating cash flow in 2009 was \$209 million. None of this is a stretch...

Apply a cash flow multiple of 30 to \$292 million (less than the 44 investors paid back in 2007) and TIMET's market cap vaults to \$8.76 billion. With 180 million shares outstanding, that equates to a stock price of \$48.70. Pay less than \$20 today for TIMET and you'll double your money.

We imagine Simmons is seeing the same sort of potential for another climb... and then some. Given what we've researched about this situation, we're looking for the same.

Action to take: Buy Titanium Metals Corporation (NYSE: TIE) up to \$20.

Portfolio Review

Last month's recommendation – to short **Pulte Group (NYSE: PHM)** when it trades for more than \$8 – was triggered when shares of the debt-laden homebuilder closed at \$8.23 on January 6. *If you haven't shorted Pulte yet, you must... and prepare for a profitable ride south.*

Wal-Mart (NYSE: WMT) announced plans to open more stores in Brazil this year than in 2010, when it opened 50. The global retailer's story is unfolding just as we predicted in our September 2010 issue.

Throughout Asia and Latin America the company is building more and more stores. Within a few short years we forecast half the company's revenues will be coming from outside the U.S. Wal-Mart is the major emerging-market story no one sees... yet. When they do, shares will surge. *If you haven't already, buy Wal-Mart before the herd figures it out and comes rushing in...*

Eagle Bulk Shipping (Nasdaq: EGLE) shares are trading for half book value. That means stock buyers are paying 50¢ on the dollar for its fleet of world-class ships. The company's vessels deliver coal, grain, iron ore, and other bulk cargos throughout the world. Demand for these goods is only increasing, which means demand for Eagle's services will, too. In the coming quarters, this will cause Eagle's revenues to climb. When they do, the share price will follow. Companies with increasing revenues don't trade for half of book value for very long. Count on it. Eagle shares could easily double within 12 months. Buy Eagle Bulk Shipping up to \$5.25.

Good investing,



Porter Stansberry and Braden Copeland

P.S. If you're a new subscriber or if you've been with us for a long time, thank you. Knowing you're out there inspires us to do our very best.

Here are a few things you'll find of interest on the website. To get access, simply go to www.stansberryresearch.com and enter your login and password in the boxes at the top right. Your unique login and password are at the bottom of the e-mail you received with this issue. Once you're logged in:

1) If you're a new subscriber or you missed it, read last month's issue. It includes a thorough recap of the current portfolio. You can find it by clicking on the blue words "Stansberry's Investment Advisory" in the left-hand column, under "Your Subscriptions." Once you've done that, a list will open (also on the left, near where you just clicked). Click on "Monthly Issues." On the Monthly Issues screen that opens, find the December 2010 issue, "The BIG Collapse in Bonds is Here" and give it a read. (You may have to click on the year "2010" at the top to find the list of 2010 issues.)

2) Take a look at our issue, "The Seven Real Secrets of the World's Best Investors." It's from September 2009. You'll navigate to it by clicking on 2009 at the top of the Monthly Issues screen. If you're new to investing or just new to us, this will give you some insight into how we look at stocks. We share with you some ideas you might not have read or heard anywhere else... kind of like "End of America."

3) Feedback. Over on the left where the "Monthly Issues" appeared, you'll find another link in the list: Feedback. That's what you click if you want to send us a comment. We can't respond to all of them, but we do read all of them. If we respond, you'll find it in the *SeA Digest*, which you receive by e-mail for free each weekday evening around 6 p.m. Eastern time because you are now a Stansberry & Associates subscriber.

Stansberry's Investment Advisory Model Portfolio

Prices as of January 13, 2011

<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	\$54.79	\$0.30	Global blue-chip	Buy	6.13%	1
Johnson & Johnson	JNJ	7/6/06	\$60.52	\$62.91	\$8.21	Blue-chip health	Buy	17.51%	1
Exelon	EXC	10/9/02	\$21.47	\$42.37	\$13.62	Nuclear power	Buy	160.78%	1
Annaly	NLY	11/6/08	\$13.64	\$17.65	\$5.69	Gov. port. repair	Buy below \$15.25	71.11%	1
Intel	INTC	7/16/10	\$21.51	\$21.29	\$0.32	Blue-chip tech	Buy	0.44%	2
Prospect Capital	PSEC	6/24/10	\$10.03	\$11.53	\$0.70	Warrant banker	Buy below \$10.08	21.97%	2
Hershey	HSY	12/6/07	\$40.55	\$49.81	\$3.66	Chocolate empire	Hold (Long)	31.86%	2
SVB Financial^^	SIVB	6/29/10	\$41.42	\$54.69		Warrant banker	Buy below \$42.50	32.04%	3
<u>The "Next Boom"</u>									
Titanium Metals	TIE	1/14/10	NEW	\$18.40		Surging aircraft orders	Buy below \$20	NEW	2
Calpine	CPN	5/13/10	\$13.93	\$14.28		Nat gas power	Buy below \$15	2.51%	2
ConocoPhillips	COP	4/2/09	\$41.45	\$67.26	\$3.59	Cheap oil	Hold (Long)	70.93%	2
Monsanto	MON	11/18/10	\$59.63	\$74.78	\$0.28	Exploding food prices	Buy below \$65	25.88%	3
Arch Coal	ACI	10/8/10	\$26.00	\$35.46	\$0.10	Coming coal boom	Buy below \$33	36.77%	3
Eagle Bulk Shipping	EGLE	8/12/10	\$4.72	\$4.95		Super-cheap ships	Buy below \$5.25	4.87%	3
San Juan Basin	SJT	1/7/10	\$18.34	\$24.73	\$1.68	Safe natural gas play	Hold (Long)	44.00%	4
Silver	SLV	10/13/09	\$17.48	\$28.00		Money crisis	Hold (Long)	60.18%	4
Gold Miners ETF	GDX	12/11/08	\$28.02	\$56.05	\$0.51	End of America	Hold (Long)	101.86%	5
<u>Victims</u>									
Assured Guaranty	AGO	1/14/10	NEW	\$19.00		Muni bond implosion	Short above \$18	NEW	5
Pulte Group	PHM	12/10/10	\$8.23	\$8.35		Buckling homebuilder	Short above \$8	-1.46%	5
Barnes & Noble	BKS	5/13/10	\$20.01	\$16.63	\$0.75	Obsolete bookstores	Hold (Short)	13.14%	5

Current Portfolio Avg: 38.92%

* This is the return since reference date, including dividends.

^^ 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.