



The Day the Dollar Dies

It is the world's single greatest trophy.

Cutting a 120-mile-long course, it is 79 feet deep and 673 feet wide. It took 10 years to build. The total construction cost is nearly impossible to calculate because the original construction depended on slave labor, and since then, hundreds of millions of dollars have been invested in improvements.

What's it worth?

We know the British paid 4 million pounds in 1875 for a 44% interest in the asset. That's roughly the equivalent of \$3 billion today. You could argue a fair market price today would equal around \$6 billion. But you'd be off by a wide margin. The Brits acquired their stake in a distressed sale.

We are talking about the Suez Canal. Its real value is nearly impossible to quantify.

Roughly 20,000 or so ships traverse the canal each year. They carry nearly 7.5% of the entire world's trade. More important, most of the oil imported by Europe travels through the canal. Without the canal, ships would have to travel an extra 2,700 miles around the Cape of Good Hope in South Africa.

The strategic importance of this waterway is immense. Its hypothetical replacement cost would run in the hundreds of billions of dollars. It is a completely irreplaceable, one-of-a-kind asset: *There's nowhere else you could construct a sea-to-sea canal connecting Europe and Asia.*

We'd wager most people don't know private investors from around the world – mostly from France – originally owned the Suez Canal. The company raised money in 1858 and began construction in 1859. The canal opened in November 1869. It ushered in a new, greatly expanded era of world trade and colonialism. Unfortunately, it ended up costing twice as much as its builders expected. When the canal was finished, Egypt owned 44% of the company that owned it.

Ownership of 44% of the canal allowed Egypt's rulers to live far beyond their means. They offered as collateral for any money they borrowed a large piece of one of the world's greatest assets. From 1867-1875, Egypt's foreign debts grew by 32,000%. Bankers were happy to lend against the future revenue of the canal. But... when those revenues didn't materialize fast enough... Egypt was forced to sell its stake in the canal for a bargain price to the British. It didn't stop there. A few years later, Egypt lost its sovereignty as Britain sent in its troops to protect the canal and collect taxes to pay back Egypt's bad debts.

This put Great Britain in control of all European trade with Asia. It also allowed it to establish and maintain huge colonies in India, Singapore, and China. The Suez Canal was the key to making Great Britain the wealthiest, most

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Editors: Porter Stansberry
and Braden Copeland

powerful empire in the world.

Just imagine the worldview of a British banker in 1910. The sun never set on your empire. You earned a percentage of a majority of the world's trade. Everywhere you went in the world – from Singapore to Central America – the business community not only spoke your language (literally), it also used your currency. This led to a nearly endless demand for your government's debt. Surely, you believed your economy was as strong as your invincible navy. But less than a decade later, Britain was nearly bankrupt...

Its currency, once the world's standard, began to collapse in the Great Depression. Investors around the world started buying gold instead of British consols (bonds). Britain was forced to abandon the gold standard in 1931. The cost of maintaining its foreign colonial outposts skyrocketed.

In Egypt, it had to cut back. In 1936, just prior to World War II, Britain signed a treaty with Egypt agreeing to share revenues from the canal and withdraw all troops from the country except those necessary to defend the canal. Those revenues, though, were paid in British pounds. With a weakening country backing them, those pounds continued to fall in value. This gave Egyptian nationalist politicians a pretext to break the treaty and seize the canal. In 1956, they finally did.

The British are now long gone. So... who protects the canal today, dear reader?

If you live in the U.S., you do. (Well, your taxes do, anyway.)

In 1979, Israel and Egypt signed the Camp David peace accords. According to the treaty, the U.N. was supposed to take over canal security. But the U.N. Security Council never approved the use of its troops (thanks to a Soviet veto). A multinational peace keeping force was organized. It contains a handful of troops from countries like Uruguay. The majority of the troops, of course, are U.S. soldiers.

And so, once again, the country running the Suez Canal seems to be going broke. History has a wonderfully ironic sense of humor, does it not?

Yes, from where we sit, with plenty of gold stored away and a portfolio well-positioned for the coming collapse of the U.S. dollar, we can appreciate the irony of history. We hope you're in the same position. For most Americans, we fear the next year will be a disaster.

The Beginning of the Panic

In the next six weeks, our country will enter a period without precedence in our experience.

On June 30, the Federal Reserve has pledged to cease buying U.S. Treasury bonds. This is the second time since the financial crisis it has intervened in the Treasury market in a major way. The program of buying new Treasury issues has been dubbed "quantitative easing II" (QE2).

We'd wager not one in 1,000 Americans has any idea (or at least any real understanding) of what has been going on in the market for U.S. Treasury bonds since the financial crisis. For the last nine months, the Fed has been printing up new dollars and buying huge amounts of newly issued debt from the U.S. Treasury – \$600 billion of bonds. And these purchases followed a \$1.75 trillion program of quantitative easing that ran from March 2009 to March 2010.

It is no exaggeration to say that a printing press has kept our economy going for the last two years. But what will happen when the printing stops?

Answering that question is the focus of this month's issue. While we honestly don't *know*, we're going to *speculate* that, in the short term, the U.S. dollar will rally and commodities will suffer a serious correction. We will see a dramatic slowdown in the rate of monetary inflation. People will think prices will stop going up. Economic activity will begin to decline. Fear will lead a lot of investors to "go to cash." That means buying short-term U.S. Treasury bonds because they're the most liquid, most frequently traded form of cash.

As this process unfolds, we expect to see another global panic. Especially if Bernanke's decision to stop the presses coincides with a Republican political gambit – refusing to raise the debt ceiling, which could cause a default on U.S. Treasury bonds.

Whether the debt ceiling is raised or not, it's only a matter of time before the Fed will have to turn on the presses again for reasons we detail below. And when "QE3" begins, it will send our creditors an unmistakable message: *You will never be repaid in anything other than massively devalued paper.*

That will be a horrible day for the value of our currency. It may even mean the end of the U.S. dollar as the world's reserve currency.

We Can't Borrow Forever... and We Can't Stop

On May 11, the U.S. Treasury updated the public on our federal government's finances. So far this fiscal year (which began October 1, 2010), the feds have borrowed nearly \$1 trillion. April marked the 31st consecutive month of deficit spending at the federal level. It did not matter that tax receipts have rebounded substantially – growth in spending on social pro-

grams has far outpaced the increase in revenues.

In total, President Obama's economic mandarins now forecast the fiscal year 2011 deficit will come in at \$1.6 trillion.

To put this figure in perspective for you, when Ronald Reagan took office, the **entire national debt totaled less than \$1 trillion**. Even as late as 2002, the national debt was only \$6 trillion. Obama's administration will almost surely borrow more than \$6 trillion in only his first term. *In four years, Obama will double our entire national debt from its pre-financial crisis levels.*

This has never happened in peacetime.

Keep in mind, this is the same president who, after taking office in 2009, held a widely publicized Fiscal Responsibility Summit and pledged to "halve the deficit we inherited" by 2013.

The budget deficit in Bush's last year in office (the 2008-09 calendar year) was \$1.2 trillion – due largely to the Wall Street bailout and Iraq war.

Today, both of these major sources of spending have largely disappeared. The government is selling assets acquired during the financial crisis. That generates revenue. Yet rather than decreasing the deficit, Obama has allowed it to grow by 33% annually.

This same man, while a U.S. senator, called 2006 efforts to raise the debt ceiling "a sign of leadership failure." He voted against raising the debt ceiling to \$9 trillion, proclaiming, "Americans deserve better." Obama noted, accurately in our view, these mounting federal debts were "shifting the burden of bad choices onto the backs of our children and grandchildren."

We hope history will hold Obama accountable for his actions. We're not holding our breath. Federal, state, and local government spending now makes up about 45% of the U.S. economy. Hardly any major business in America doesn't count on the government for a significant amount of its earnings. While we used to call this kind of system "socialism," today the popular term is "crony capitalism."

Whatever you call it, it leads to collapse.

Another worrisome sign? A record number of people (almost 70 million) now depends on the U.S. government for their daily housing, food, and – most of all – health care...

Today, 45% of American households receive some form of direct government payments. And 132.5 million people pay no federal taxes whatsoever – a record number of people who neither paid federal income taxes in 2010 nor were claimed as a dependent by another taxpayer.

Tallying up all these numbers, you discover something quite amazing. A tiny number of Americans pays for the well-

being of nearly a majority. While half of the population may pay something in taxes, only the top 10% – people earning more than \$113,000 – pay a substantive amount. These few citizens pay 70% of all the income taxes collected.

Benefits funded this way are unsustainable. According to a recent study published in the *Wall Street Journal*, the average couple that retires at age 66 on Social Security and Medicare will receive \$1 million in benefits. On average, they and their employers paid \$500,000 into the system.

The federal government is taking an excessive amount of money from its few high earners – a wealthy minority – and redistributing inefficiently to pay for services the country can't realistically afford...

Individuals, of course, are not the only beneficiaries. Entire industries gush cash thanks to the generosity of the federal treasury – mortgage REITs, defense companies, and most of the health care complex.

The system is so broken, not even the already lopsided system is enough. Not even close. Every week we hear more demands for the "rich" to pay their "fair share." The political reasons for spending are so powerful, until the government can take it from there, they will continue to borrow it from somewhere else.

We don't believe Americans are intrinsically superior to the Egyptians of the 1870s or the British of the 1910s. Surely, many people in those societies recognized the approaching financial disaster. Any American with the ability to balance a checkbook can discern the serious nature of this financial situation, and the politics that explain its origins. Yet the borrowing and spending continue to accelerate. In the battle between political expediency and financial probity, the lust for power will always win.

Thus have all of Suez's masters destroyed themselves. Thus shall we be destroyed.

A Hard Reality

Rather than face these unpleasant facts and consider where they are leading us, most people continue to think, "It can't happen here, this is America."

Meanwhile, our country has been depending on a printing press to make our economic system work. When is the last time that happened in America? (Hint: the Civil War.)

How many other things most people didn't think would ever happen in America have happened recently? What about the collapse of our investment banks, the bankruptcy of

General Motors, the liquidation of Fannie Mae and Freddie Mac, the failure of AIG, hundreds of banks being seized, millions of homes in foreclosure, real unemployment rates close to 20%. We could go on.

As we frequently point out to our critics, the question isn't when this crisis will begin – it started in 2008. The question is, when will it end and how bad will it get before it does?

We believe every American ought to be ashamed, outraged, and furious that the most powerful political union in history proceeded down the path of these bankrupting policies. But most of all, you ought to be afraid of where these policies have led us.

Don't forget: In about six weeks, the Federal Reserve will stop buying Treasury bonds.

That's the first time since March 2009 our economy will stand on its own two feet. And we expect... just like a child riding a bike without training wheels for the first time... it will crash.

We are not alone.

Bill Gross, manager of the world's largest bond fund, has put 4% of his fund *short* U.S. Treasury bonds. Just consider that for a minute: *The most powerful fixed-income manager in the world (not just in America) is selling the U.S. Treasury short.*

The University of Texas endowment fund recently took physical delivery of \$1 billion gold bars. That's an enormous bet that the U.S. monetary system falls apart, from some of the wealthiest and best-informed investors in the world.

Finally, in what we believe is the ultimate death knell for the U.S. dollar, *our trading partners are moving out of the dollar and into gold.* Mexico, for example, one of our most important trading partners, just purchased almost 100 tons of gold.

All around the world, more and more central banks are selling dollars and buying gold. They're doing so because they can plainly see America's credit has become unreliable and the value of the dollar is likely to decline. If you think you might be trading in something other than U.S. dollars in the future, then you might not want to be holding U.S. dollars. You might want to be holding that currency. And if you can't hold that currency (like you can't hold the Chinese yuan), you might consider holding gold.

Two Secrets About U.S. Finances You Won't Read Anywhere Else

Most people misunderstand two things about the U.S. financial situation...

First, the U.S. government's official debt burden might not

yet have reached the "red line" of imminent default. But our entire economy's enormous debt burden makes it nearly certain we will default on our federal debt and many of our private debts, too.

The U.S. is the world's largest debtor. **As a whole, Americans owe a total of nearly \$56 trillion dollars (almost 400% of GDP).** That's federal, state, municipal, corporate, and private (mortgages and student loans) debts. The debt service on our total obligation is \$3.6 trillion a year. It's hard to put that number into context because it's so large. Think about it this way – It's roughly the same amount of money as the federal government's entire budget.

To the extent our debts fueled past consumption (homes, cars, credit cards, health care, etc.), they are unlikely to spur future economic growth. That's not to mention a considerable portion of these payments belongs to foreign investors, folks who are typically more interested in building their next factory in Bangladesh than in Bangor.

When you combine this "debt tax" – aka interest – with the size of our actual tax burden (about \$4.4 trillion when you combine federal taxes with state and local taxes), you can see pretty clearly why our economy is struggling.

We're spending half our annual GDP on taxes and interest.

Imagine if you had to spend half of your family's income on taxes and interest. How would you rate your credit risk? What's the likelihood of default in that scenario?

More important, given our current federal deficits and the looming entitlement crisis we face (total unfunded future liabilities in excess of \$100 trillion)... How is it possible to expect Americans will be able to afford to pay more taxes? What would happen to our budget if interest rates rise because of inflation, which seems inevitable?

We don't think many Americans – even sophisticated investors – have considered these numbers. Our foreign creditors will realize they have no chance of being repaid in sound money. Americans simply cannot afford debt service, never mind principal repayment. There are signs they already recognize this...

Mainstream economists have long scoffed at the possibility that our foreign creditors might stop funding our existing debts at an interest rate we can afford. When you pose the question about our poor credit, they tell you our trading partners can do nothing about the dollar. If they want to sell goods to Americans, they have to accept our dollars. As Nixon's Treasury Secretary John Connally said, "It's our dollar, but it's their problem."

For years, that was true. But it's changing. Increasingly, U.S.

trading partners are taking our dollars, but instead of recycling them back into Treasury bonds, they're buying gold and strategic commodities, like oil and copper and steel. That's why prices for these commodities have soared. That's obvious to most folks. What isn't so obvious is what it means for the bond market...

For the last nine months, the Federal Reserve has been purchasing 70% of all the debt issued by the U.S. Treasury. What happens when the Fed stops buying? With 70% less demand for Treasuries, we expect prices to fall. Benchmark interest rates will rise. Bill Gross agrees, which is why he's shorting Treasuries. Higher benchmark interest rates – perhaps sharply higher should cause the U.S. dollar to strengthen against foreign currencies (like the Euro) and against commodities. It should also cause most U.S. stocks to fall.

The Dynamics of a Bond Market Collapse

How much could rates rise?

Over the long term, the average real rate of interest on U.S. sovereign debt has been around 2% a year. The latest Producer Price Index (which we believe is more reliable than the Consumer Price Index) shows price inflation is currently 6.8% annually. Add the 2% real return we believe investors expect, and you get 10-year Treasury bonds yielding 8.8%. Currently, those bonds yield only about 3.25%.

This implies a huge collapse of bond prices – a collapse of more than 50%. A collapse of that magnitude would completely wipe out the stock market. It would be a massacre.

No one is expecting any of this. Everyone believes something like this could never happen. Yet this rise in interest rates would only carry us to the *average* return bond investors have earned over the last several decades. It doesn't even consider the kind of panic selling that would ensue.

In truth, rates might go considerably higher than this for one fundamental reason. If the bond market crashes, investors would begin doubting America's ability to *finance* its debts, never mind trying to repay them. As rates rise, the cost of maintaining our debts would grow substantially – perhaps doubling.

Keep in mind, the U.S. Treasury currently pays only 1.4% annually to borrow \$14 trillion. Yes, 10-year Treasuries currently yield around 3.25%. But because the Treasury has issued so much more *short-term* debt than long-term debt, U.S. borrowing costs are lower.

No, all of our debts wouldn't "reset" to higher rates overnight. But the losses in the bond market, the losses in the stock market, and the resulting decline in business activity

would cause a lot of our creditors to worry about our ability to afford higher interest payments.

Think about it this way. By the end of 2012, our national debt will likely exceed \$17 trillion. Let's assume our average interest increases to 4.4% – half the rate we believe investors will eventually demand. That works out to an annual interest expense of almost \$750 billion. That's more than we spend on defense or Social Security. Interest expenses would leave the government spending almost 25¢ of every dollar on interest payments.

Does that sound wise or reasonable to you? Given these expenses, some of our creditors would become reluctant to "roll" our debt into the future by offering new loans. This could cause a serious problem for the U.S. Treasury. This is how the dollar dies.

Gambling on Short-Term Financing

Portugal's government recently suffered a debt default. The country required a bailout by the European Central Bank (ECB) because it had too much short-term debt coming due and not enough lenders were willing to extend these loans at affordable rates. Lots of economists criticized Portugal's borrowing strategy because much of its debts were short-term.

Apparently, these folks haven't bothered looking at the U.S. Treasury's debt maturity curve. We have. The numbers are so shocking, we expect most of our subscribers simply won't believe us. You can read all of the numbers for yourself, if you'd like. Bureau of the Public Debt includes all the numbers in its Financial Audit (which you can read on its website: (http://www.treasurydirect.gov/govt/reports/pd/feddebt/feddebt_ann2010.pdf).

Feel free to read all 35 pages... Or focus on just this piece of data. It's all you really need to know: *61% of all the marketable Treasury debt held by the public will mature within four years.* Thus, over the next four years, the U.S. Treasury must either repay or refinance more than \$1 trillion in existing debt each year – not to mention additional deficit spending of at least \$1.5 trillion. **For us to avoid a default, the U.S. Treasury may have to borrow or refinance as much as \$10 trillion in the next four years.**

That would double the amount of U.S. Treasury bonds currently trading in the world's markets.

Think about that for a minute. Then, consider the decades-low yields in the Treasury market today, which would surely rise to accommodate this enormous increase in supply.

Now, try to arrive at any sort of scenario that ends well for today's U.S. Treasury bond market investors. We can't... We

don't know exactly what the end game will look like or exactly when the bond market will crash. But we know it is coming. We know it can't be avoided. And we know many investors will suffer catastrophic losses.

Given these risks, the Federal Reserve cannot allow the Treasury's borrowing costs to increase. It cannot allow the dollar to strengthen. It cannot allow the stock market to fall, or business activity to slow...

That's why we are 100% certain the Fed's promise to stop printing money and buying Treasury bonds on June 30 is a lie.

Even though we know Bernanke will have to turn back on the printing presses sooner or later, we have no doubt the market will react strongly to the presses' temporary stop. Expect big moves – falling commodities, a rising dollar, and even falling stock prices.

We have been warning our readers since the spring of 2010 that the stock market was no longer broadly attractive. Since then, valuations have only gotten more extreme. A big correction is overdue. We will likely get that correction this summer. We've been very patient, waiting for the better entry point for stocks that will come as a result. And again this month, we will keep most of our "powder" dry. In fact, we're even going to close out several long-held positions. It's time to raise cash and be ready to take advantage in the aftermath of a new, mini-crisis this summer and fall.

But first, we have one new recommendation this month. It may surprise you...

Who Owes You Nothing?

Seventeen countries have no way out.

The European Monetary Union began on January 1, 1999. Others joined a few years later. Estonia just joined in 2010.

Until 2008, the arrangement generally worked. For much of the decade, the euro's value held steady relative to the U.S. dollar. In 1999, one euro cost \$1.18. In the fall of 2008, one euro traded for \$1.60. The euro gained an average of 4% per year during the period. But when the credit crisis hit and the global economy entered recession, the situation turned nasty...

So from July to November 2008 the euro plummeted as the crisis struck. From its peak of \$1.60, the euro lost nearly 25% of its value against the dollar in three months, bottoming at \$1.23. Panicked investors fled the euro for the traditional safety of the U.S. dollar.

As our old friend and mentor Doug Casey is fond of saying, the U.S. dollar may be a worthless piece of paper – nothing more than the obligation of a bankrupt government. A "we owe you nothing" note. But the euro is worse. It's a worthless piece of paper from a toothless bureaucracy in Belgium. It's a "who owes you nothing?"

When a crisis hits, nobody wants to hold a "who owes you nothing?" asset. We recommend holding gold in these situations. Gold is a "nobody owes you anything" asset. It's the only widely accepted financial asset that is no one else's liability. But most global banks continue to trade dollars, not gold, because that's what other banks deal in...

In March 2009, Fed Chairman Ben Bernanke rewarded the world's investors for their dollar preference with the perfidy of a printing press. Bernanke began to print dollars, and the world began to flee the dollar. Within six months, the euro was trading at \$1.50.

There was a widespread belief the ECB wouldn't engage in the Fed's kind of blatantly inflationary policies. France and Germany both suffered hyperinflationary periods in the 1900s. Their populations fear inflation more than a slowing economy.

But the ECB had no choice but to follow Bernanke's lead...

The first big problem was Greece.

On December 9, 2009, credit-rating agency Fitch Ratings downgraded Greek debt. After its review, the agency determined Greece could not hit its target budget deficit of 9.1% of GDP for 2010. (Down from 12.7% in 2009, this target was still three times what European Union rules allowed.)

This downgrade led to the discovery of even worse conditions. Over the next few months, the country's deficit numbers were exposed as bunk. In April, Greece's 2009 deficit was estimated to be closer to 14% of GDP. Revised 2010 estimates were closer to 14% as well, a far cry from the 9% the Greek government had forecast for 2010 just months earlier.

The Greek government had been playing financial games for years...

Investigators discovered in the beginning of 2010 that Greece had paid hundreds of millions of dollars in fees to experts at Goldman Sachs to help it hide much of its borrowing. The country also took advantage of the cheap interest rates received from being part of the euro since 2002. By the end of 2009, Greece had racked up an estimated 300 billion euros in debt, more than 125% of GDP. For perspective, the monstrous U.S. debt load is a bit more than 90% of GDP.

With this in the open, Greece's creditors – mostly governments, including the ECB and the large European commercial banks – began to find themselves in investors' and regulators' crosshairs. With such a debt load and deficits, wise investors wondered if Greece could ever repay its debts. If the loans soured, these banks' solvency would become suspect. The entire Eurozone structure would be questioned. What seemed like a sound path for the euro countries in the 1990s was proving to be a sinister trap.

Why is this a trap? Why is there no way out? None of the euro countries is the master of its own currency. Despite managing very different economies, all 17 countries are inextricably linked by the euro.

By the end of April 2010, the Greek government had to come clean. At the end of May, 11.4 billion euros in debt were coming due. For the entire year, Greece had 54 billion euros in debt to repay. It also had a budget deficit to cover. On April 23, the Greek government and the ECB agreed on a 110 billion-euro bailout. Was Greece saved? So it said...

The International Monetary Fund and European Union member countries agreed on another 750 billion-euro bailout fund. This would be available to control any problems that might arise in Ireland, Portugal, Spain, or Italy. Of course, as we pointed out at the time, about half of this bailout money was supposed to come from the same peripheral countries whose Treasuries can't pay their own domestic debts. The fund itself seemed implausible to us.

On November 28, 2010, Ireland received an 85 billion-euro bailout after months of denying it needed one. The problems stemmed from a real estate bust, much like the one in the U.S. The Irish banks' assets evaporated, and without additional capital, they were going broke. Depositors, fearing the worst, had been withdrawing money by the billions.

Of course, the Irish government was guilty of profligate spending, too. Its national debt exceeded 90% of GDP, and its budget deficit in 2009 totaled more than 14% of GDP. To receive the bailout, the Irish government agreed to a four-year plan to raise taxes and slash \$20 billion from its spending, including a cut in welfare payments. Now, the Irish budget deficit is forecast to be 10% in 2011 and 8.6% in 2012. It doesn't appear \$5 billion per year is nearly enough.

Up next... the Portuguese. They too had been denying their debt and deficit troubles. Like Greece and Ireland, the government overborrowed and overspent as its economy grew in the years leading up to the 2008 recession. In 2008, the country's external debt (money borrowed in foreign currency)

ballooned from \$272 billion to \$460 billion, nearly a 70% increase. Its overall debt was more than 70% of GDP by the end of 2009. The budget deficit was 9.3% of GDP in 2009 and 9.1% in 2010. The situation was unsustainable.

Finally, on May 4, Portugal was bailed out. In exchange for a cash infusion of 78 billion euros over the next three years, Portugal has to decrease its budget deficit to 5.9% of GDP in 2011, 4.5% in 2012, and 3% in 2013.

Two days later, Greece suddenly re-entered the fray. News leaked that Greece was discussing leaving the euro. It roiled the markets, and the euro plummeted from \$1.48 to less than \$1.44 over the weekend.

Greek bonds now trade with yields greater than 20%, implying an imminent threat of default.

Europe has two possible courses of action... either will destroy the euro... while making us a nice profit.

Either Way, the Euro Will Crater

The first course of action is for the ECB to buckle and give Greece another bailout. (Greece is looking for 30 billion euros.)

If that happens, we will see the euro slide again. The reason is simple. A bailout means money-printing. That devalues a currency. It also reminds investors the strength of the currency they are holding is only as good as the strength of the economy behind it.

The ECB isn't doing so well. Greece is back for round two. Ireland and Portugal are suffering. This time, the euro may slide even further than \$1.20. If Spain goes, look out below. As we've explained before, the euro bailout fund is nothing by empty promises from bankrupt countries. The only way to bail out Europe is to pull a "Bernanke" – print, baby, print.

Regardless of how the situation is handled, it won't solve Greece's problems. Greece has a solvency problem... not a liquidity problem it can fix with a few extra euros. The country is essentially bankrupt. You know about its debt and deficit quandary, but...

What's really hitting it in the mouth is its "business" keeps losing sales. The economy, heavily dependent on tourism and overseas shipping, is shrinking. Tourists are no longer going to Greece. The reports of how depressed most of the people are don't play well. The people who aren't depressed are angry and given to striking and rioting. Greece is not a place anyone wants to visit. The Greece-based shippers are losing business to competitors elsewhere, many of them based in Asia where

growth is heating up.

Greece's economy shrank 2% in 2009 and 4% in 2010. In 2011, it is forecast to shrivel another 3%. Greece is on its way out of business. Who wants to lend money to a country going bankrupt? The Germans are tired of it. The Finns are raising hell, too. Without their votes, Greece isn't getting any ECB money... All 17 euro countries have to agree to a bailout.

This brings us to the second course of action: Greece leaves the euro. *This is really the only ultimate course of action.* It gives Greece one huge new advantage: It allows it to have its own currency that can be valued by the markets according to its specific economic conditions and managed by its own central bank.

Otherwise, Greece is left in a trap – along with the other 16 euro members – where currency adjustments are painful and made by political consensus among those whose interests and situations are completely alien. Greece is an economic disaster, Germany a juggernaut.

To see how having an independent currency can help, look at what happened in Hungary... a member of the European Union on the periphery that maintains its own currency and is similar to Greece – heavily export dependent without much domestic demand to drive economic growth.

Between 2000 and 2008, the forint (Hungary's currency) traded in a relatively tight range: one euro to 240-260 forint. The Hungarian economy was humming along. Its European consumers were consuming.

Then the recession came. Fast.

In October 2008, Hungary received an emergency loan of 20 billion euros from the IMF, the World Bank, and the European Union. The forint went to 260 from 230 in 60 days.

By the end of 2008, Hungary's economy contracted at its fastest pace since 1990. The economy withered by 2.5% over the prior year. Estimates were the economy would shrink

another 5% in 2009. Hungary's industrial sector contracted 10.7%. Its largest customers, the euro countries, cut their purchases. By mid-2009, the forint had hit almost 320 per euro, losing close to 50% of its purchasing power in one year.

Eventually the process stopped, and the Hungarian economy began to hobble along, despite talk of a default last summer. (You may remember our June 2010 issue: "Hungary Matters.") The new government raised the possibility publicly. It reported total debts of 90% of GDP.

But Hungary did not default. Instead, the new government revised its budget deficit from 4.5% to 7% of GDP. Not good, but not the end of the world, either. Its imports and exports were roughly in balance, showing the country wasn't buying more than it was selling.

Hungary is serious. To help pay some bills, the government passed a retroactive 98% tax on the outrageous public-service severance payments made between 2005 and 2009. The Constitutional Court annulled the law, but it shows the Hungarian government is committed to getting back at the old bureaucrats who had their hands in the cookie jar when times were good.

By the end of 2010, the forint strengthened to 275 per euro. This year it has strengthened back to 265, following news budget deficits are declining... forecast to be less than 3% in 2011.

Also helping matters in Hungary... after falling 6% in 2009, GDP growth was 0.8% in 2010 and is forecast to reach 2.5% in 2011. In an export-driven economy, the weak forint helped this turnaround by making exports cheaper.

While not the entire solution, the Hungarian experience shows an independent currency is one way to manage excess debts – particularly in an export-driven economy. Managing the economy this way is more politically acceptable because most people don't understand inflation.

The other way, of course, is default. That leads to vastly lower prices, which may cause Greece to lose 20%-30% of GDP. That's the only other way of regaining a competitive advantage again in the euro region. Unfortunately, while most people are blissfully ignorant of the impact of inflation, they are extremely sensitive to losing their jobs or taking a pay cut.

Faced with the alternative of a massive depression and prices falling 30%, we think most Greeks will opt to leave the euro. In the long run, this will relegate Greece to second-rate country status for at least the next decade. But all the mob (the voters) care about is tomorrow.

However it goes, whether Greece leaves now or later, the



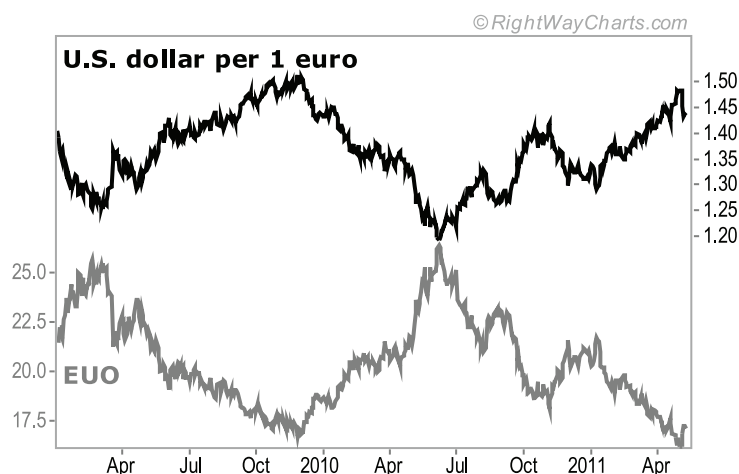
conclusion is inevitable. The euro's value will slide into oblivion. The euro is finished.

Our vehicle for this trade is the **ProShares UltraShort Euro (NYSE: EUO)**.

This is an exchange-traded fund (ETF) that trades just like a stock. It is also "leveraged," designed to move twice as much as its underlying index. It's also what's known as an "inverse" fund. That means EUO not only moves twice as much as the euro moves against the U.S. dollar, but *it moves in the opposite direction*. As the euro weakens, the dollar will rise roughly twice as much.

We're not usually fans of leveraged ETFs. They have some bad habits. The financial engineering that goes into them means the price movement can vary from the action of the underlying index over time.

But this is a special case. Take a look at the nearby chart... When the U.S. dollar/euro exchange rate reaches an extreme, EUO hits the exact opposite extreme. This is as it should be. The performance over time is solid. That's why we're comfortable using this proxy to short the euro... and get leverage.



You'll also notice we are just coming off of an extreme now. **Our timing on this trade is ideal.**

How to Trade EUO

First, buy shares of EUO and set your mental stop at \$15. **If shares close at less than \$15... get out.** EUO has never traded for less than \$15. If it does, that will be our alert something has changed and we need to cut our losses.

Once shares close at more than \$20, we'll raise our stop to \$18. At that point, we would sell on a close of less than \$18.

From there, once we close above \$22, we'll raise our stop to \$20. We'll do the same with \$24, raising the stop to \$22.

Finally, once we get to \$26, we'll go to \$25, trailing in dollar increments from there on. (A close above \$27 would move the stop to \$26, etc.) Any close below the current stop will lead us to sell, and that will be the end of the trade.

Why are we using such a system for this trade? **We are looking for a powerful move all the way to \$26 – and perhaps higher.** A \$2-per-share reversal off any of these steps would indicate we are not getting it. We will take our money and get out.

MAKE THIS TRADE. We're on the right side of the move, and we're limiting our risk. That way, if something strange happens, we'll lose very little. Yet if we get to \$26, we'll have a gain of 33%.

Action to take: Buy the ProShares Ultrashort Euro fund (NYSE: EUO) at the market. Set a mental stop of \$15. Once shares rise above \$20, we'll adjust our stop to \$18.

What Are Our Indicators Telling Us?

Checking in with our three *Stansberry's Investment Advisory* indicators this month, we turn our attention first to the *SIA Spread Signal*. (For a full explanation of our indicators, refer to our March 2011 issue.)

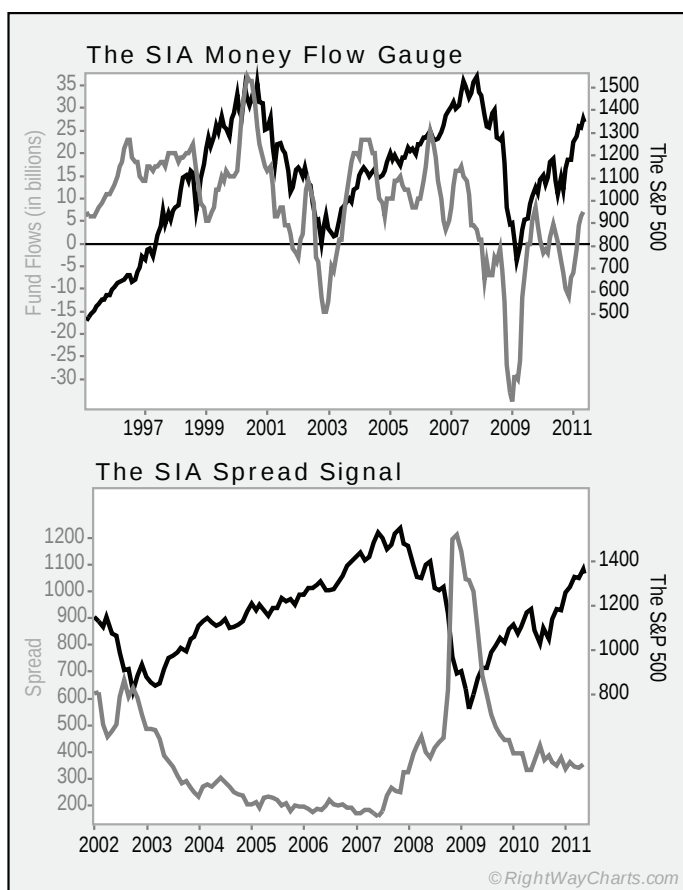
The *SIA Spread Signal* shows how corporate bond buyers feel about the global economy. Bond buyers are one of the most insightful groups of investors there is. It is important to know if they are bullish or bearish.

In the chart on the following page, you will see the spread signal (the gray line) ticked higher last month as the S&P 500 Index (the black line) flattened. Recall... a higher move in the Spread Signal indicates the widening of the overall interest rate spread in the basket of emerging-market corporate industrial bonds we watch.

This move up in the SIA Spread Signal is a bearish signal for stocks. It tells us corporate bond buyers are demanding bigger interest payments. They're seeing more risk in the markets. *When more risk is seen entering the market, investors start paying less for stocks. Stocks fall.*

This signal is consistent with what we view happening in Europe. A growing crisis in Europe will lead to more economic risk throughout the world. If the crisis gets bad, stocks will nosedive.

We are keeping a close eye on the *SIA Spread Signal*. We will update you on its status again next month. Another move higher would be ominous. **When the signal moves higher in two consecutive months, a meaningful fall in stock prices follows.**



Next up, we review our *SIA* Money Flow Gauge. This is important just after points of extreme selling. Those are points where the gray line on the chart reaches a major low below the horizontal line and reverses sharply higher. When this occurs, the S&P 500 Index (the black line) rallies higher. Right now, the *SIA* Money Flow Gauge is not giving us a signal.

Finally, we have the *SIA* Black List. This is our list of stocks trading for more than 10 times sales with a greater than \$10 billion market cap. This is a crazy price for a stock investor to pay for the stock of *any* business. When that list of business grows to 12 or higher, investors have lost touch with reality.

This month, we added two new members to the list and lost three. Joining the list are Vertex Pharmaceuticals (VRTX) and Check Point Software Technologies (CHKP). Falling from the list are Continental Resources (CLR), Cairn Energy (CRNCY), and Intuitive Surgical (ISRG). There are 13 total members on the list. Investors have lost their minds. **The *SIA* Black List is giving us a bearish signal.**

Portfolio Review

It's time to take some risk off our portfolio... that means selling out of several positions.

Specifically, it means getting out of finance. We're selling three long-held and greatly admired businesses – **Annaly Capital Management** (NYSE: NLY), **Prospect Capital** (Nasdaq: PSEC), and **SVB Financial Group** (Nasdaq: SIVB).

Yes, we're selling our virtual bank Annaly. Currently, 12 mortgage REIT IPOs are in Wall Street's pipeline. A huge amount of capital is heading for the same carry trade that Annaly makes – borrowing money at low rates and investing it for longer durations in principal-guaranteed mortgages. We don't know how much capital the Treasury-backed, mortgage-bond carry trade can handle. We don't want to find out the hard way.

Letting go of so much yield isn't easy. But remember

THE *SIA* Black List

<u>COMPANY</u>	<u>SYMBOL</u>	<u>MARKET CAP</u>	<u>PRICE-TO-SALES</u>
Tencent Holdings	TCTZF	\$50 Billion	16.22
Baidu	BIDU	\$50 Billion	35.6
VMWare	VMW	\$39 Billion	12.6
American Tower	AMT	\$21 Billion	10.1
Public Storage	PSA	\$21 Billion	11.9
Tullow Oil	TUWOY	\$20 Billion	18.0
Salesforce	CRM	\$18 Billion	10.4
Power Assets	HGKGY	\$14 Billion	10.9
ARM Holdings	ARMH	\$13 Billion	19.2
Vertex Pharmaceuticals	VRTX	\$12 Billion	59.7
China Merchants Holdings	CMHHY	\$11 Billion	14.8
Check Point Software	CHKP	\$11 Billion	10.1
AvalonBay Communities	AVB	\$11 Billion	11.8
Total:	13		

this... Wall Street eventually turns every great financial idea into a farce. What comes next is always a tragedy. A decade ago, the men who created Annaly had a great idea. Now the 100 or so employees at Annaly earn \$400 million per quarter, without taking a shred of risk. It's a financial farce. It's simply too good to be true for long. And as a mountain of capital begins to chase exactly the same trade, we're certain it will turn into a tragedy. It is time to step aside. Let's let other investors learn this lesson the hard way. Sell NLY. We're booking a 77% gain.

We're also selling our other financial positions because we no longer trust the U.S. bond market, as we explained in this issue. Without Bernanke promising to underwrite the huge wave of new Treasury issuance, we have no certainty whatsoever about the future of short-term interest rates in the U.S. or even the U.S. credit rating. A rise in short-term rates or a downgrade in the U.S. sovereign credit rating would be deadly to these financial stocks. Selling now, we made 29% on PSEC and 44% on SIVB.

We expect Bernanke will have to restart the printing presses. So don't be surprised to see us re-enter these positions in a few months. We're selling now to hopefully avoid the coming rush out of financial stocks.

We are also exiting our **Market Vectors Gold Miner ETF position (NYSE: GDX)**. The huge rise in energy prices will hurt these companies' earnings and they are no longer cheap compared to bullion itself. Once again, we may re-establish this position at some point in the future – hopefully after a broad selloff in these shares.

Reviewing the portfolio table at the end of this month's issue, note **ConocoPhillips (NYSE: COP)**. We first recommended shares of the oil company in April 2009. The stock was trading for \$41.45. Since then, including dividends, we're up 82.8%. We're chugging along and earning \$0.66 per share each quarter. On our initial investment, this is a 6.4% annual yield about twice the 10-year U.S. treasury pays. (We've enjoyed some handsome capital appreciation on top of that.)

Given the state of the United States' fiscal situation and the U.S. government's abuse of its currency, given a choice between Treasury bonds and ConocoPhillips shares, we'd pick ConocoPhillips. Buy shares today and you'll earn 3.25%. If Conoco continues to raise (or keeps stable) its dividend, your yield will be even higher in a few years. With the rising price of oil, you'll earn some handsome capital appreciation, too.

While your brain's chewing on that, consider picking up some shares of **BP (NYSE: BP)**, too. It's a similar situation. The current yield is 3.8%. In addition, you may recall from our February issue we explained why the BP dividend is almost cer-

tain to double in three years. In 10 years, don't you think you'll be doing better than investors buying 10-year U.S. Treasuries today? It's almost guaranteed.

In other news... Unless you were down in your bunker hiding with your real gold and silver this past month, you know silver saw a major run higher followed by a painful selloff.

Even though our position on gold and silver remains bullish, this bloodletting stopped us out of both the **iShares Silver Trust ETF (NYSE: SLV)** and **Silver Wheaton (NYSE: SLW)**. We must follow our rule with these positions and sell. We closed SLV for a 90% gain. We closed SLW for a 10% loss. We may re-enter SLV or Silver Wheaton at some point later this year.

However, we don't recommend attempting to trade your physical silver or gold. As we've written before, the real story about silver and gold is they are your long-term stores of value. They are your crisis insurance. They are your "End of America" fund. They are not for trading. They are not for speculation. They are not investments. They are savings. Buy gold and silver over time and forget them. Hope you never need them.

We continue to recommend holding physical bullion with at least 10% of your portfolio's assets. And we remind you that if you're not willing to sell at least some stocks short (to hedge against a big selloff in the stock market), you shouldn't be in stocks at all. In that case, we'd recommend a 100%-hedged cash position – 50% short-term Treasuries (SHY) and 50% gold bullion (GLD). Yes, it seems contradictory to recommend short-term Treasuries when we believe the dollar is going to crash and take the Treasury bond market with it. But that's why you pair the position with gold bullion. This will have the effect of reducing the volatility of your gold positions by 50%, while offering you plenty of protection against inflation or a collapse in bonds.

Finally, we stopped out of our short on **Assured Guaranty (NYSE: AGO)** last month. **Buy to cover the bond insurer if you have not already.** We are booking a 5.9% gain on this one.

Good investing,



Porter Stansberry and Braden Copeland
May 13, 2011

Stansberry's Investment Advisory Model Portfolio

Prices as of May 12, 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	\$55.72	\$1.03	Global blue-chip	Buy	9.33%	1
Johnson & Johnson	JNJ	7/6/06	\$60.52	\$67.19	\$8.75	Blue-chip health	Buy	25.47%	1
Exelon	EXC	10/9/02	\$21.47	\$42.00	\$14.67	Nuclear power	Buy	163.95%	1
Annaly^	NLY	11/6/08	\$13.64	\$17.82	\$6.31	Gov. port. repair	SELL	76.91%	1
Prospect Capital^	PSEC	6/24/10	\$10.03	\$11.87	\$1.11	Warrant banker	SELL	29.40%	2
Hershey	HSY	12/6/07	\$40.55	\$57.57	\$4.01	Chocolate empire	Hold (Long)	51.85%	2
SVB Financial^	SIVB	6/29/10	\$41.42	\$59.61		Warrant banker	SELL	43.92%	3
<u>The "Next Boom"</u>									
POSCO	PKX	4/7/11	—	\$107.07		Asian steel	Buy below \$100	—	2
ConocoPhillips	COP	4/2/09	\$41.45	\$71.52	\$4.25	Cheap oil	Hold (Long)	82.80%	2
Calpine	CPN	5/13/10	\$13.93	\$16.32		Nat gas power	Buy below \$15	17.16%	2
BP	BP	2/11/11	\$45.93	\$43.58	\$0.42	BIG oil	Buy below \$50	-4.20%	3
Titanium Metals	TIE	1/14/11	\$18.40	\$19.44		Surging aircraft orders	Buy below \$20	5.65%	3
Silver Wheaton^	SLW	12/1/10	\$37.90	\$33.96	\$0.03	Secret silver	STOPPED OUT	-10.32%	3
Monsanto	MON	11/18/10	\$59.63	\$64.01	\$0.56	Exploding food prices	Buy below \$65	8.28%	3
Arch Coal	ACI	10/8/10	\$26.00	\$30.18	\$0.20	Coming coal boom	Buy below \$33	16.85%	3
San Juan Basin	SJT	1/7/10	\$18.34	\$23.54	\$2.08	Safe natural gas play	Hold (Long)	39.71%	4
Silver^	SLV	10/13/09	\$17.48	\$33.32		Money crisis	STOPPED OUT	90.62%	4
Gold Miners ETF^	GDX	12/11/08	\$28.02	\$54.65	\$0.51	End of America	SELL	96.87%	5
<u>Victims</u>									
ProShares UltraShort Euro	EUO	5/13/11	NEW	\$17.55		End of the Euro	Buy	NEW	5
iShares US Bond Fund	TLT	2/11/11	\$88.19	\$94.23	\$1.08	Runaway inflation	Short	-8.08%	5
Assured Guaranty^	AGO	1/14/11	\$19.00	\$17.83	\$0.05	Muni bond implosion	STOPPED OUT	5.92%	5
Pulte Group	PHM	1/16/10	\$8.23	\$7.66		Buckling homebuilder	Short above \$8	6.93%	5

Current Portfolio Avg: 37.45%

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

^ Recent price and return reflect closing 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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