



The Energy of the 21st Century

Please read this letter.

When you're finished, please read it again.

Please think carefully about the things I've written here. Look into the claims I'm making. This letter contains one of the biggest and most economically certain ideas I've ever come across. It details the largest opportunity for wealth creation I've discovered since the late 1990s, when I documented the emergence of JDS Uniphase's erbium-pump lasers. That technology led to ubiquitous bandwidth and the commercialization of the Internet – and made JDS Uniphase one of the best recommendations of my career, returning subscribers roughly 600% on their investments.

Let me say this as succinctly as I can...

Despite the enormous financial problems facing our country (and Western society in general), the ideas in this letter will make some people vastly wealthy. I'm not talking about increasing your portfolio performance by a few percentage points. I'm talking about people making modest investments and walking away in five years with homes in Monaco and Aspen.

I can say this with great confidence because it has already begun to happen. A friend who began to introduce these ideas to me in 2009 recently saw his main investment partnership bought out by Statoil for more than \$1 billion. It was the biggest payday of his career. (It was the biggest payday of just about anybody's career...)

This – and a handful of other events I'll detail in this letter – leave me convinced this issue will be one of the two or three most important I will ever write. So no matter what you think about what you've seen from us so far – good or bad – please take special note of this month's issue. Whether you agree with me or not, don't ignore these ideas.

They will change the world over the next decade.

For almost the last 100 years, the relatively low price and high quality of crude oil has led it to dominate the market for energy. And since roughly the end of World War II, the world's best and cheapest supplies of

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Editor: Porter Stansberry

crude oil came from the Middle East. The oilfields of Saudi Arabia and a few surrounding areas were astoundingly prolific. They could deliver a potent form of energy for the lowest total cost to almost any market in the world.

A key contributing factor to the dominance of crude oil is that it's easy and cheap to transport. (Remember this idea... It will be important later.)

The abundance of crude oil, its high energy density, the ease of transport around the world, and the subsequent capital investment in pipelines, refineries, service stations, etc., all contributed to make oil and its byproducts the global energy standard for nearly 100 years.

But that's all about to change.

The world's markets for energy are in the midst of a shattering reconfiguration. How can I prove it to you? There are many ways. But the best... and most humorous... is to show you what our monetary mandarins made of natural gas' first dramatic break from oil...

In 2007, in response to a sudden decrease in natural gas prices relative to oil, two economists at the Federal Reserve Bank of Dallas – Stephen Brown and Mine Yucel – published a “white paper.” (A white paper is a bunch of worthless facts, compiled by pure imbeciles, in an effort to defend the status quo.)

In the oilfields all around Dallas, drillers were using new horizontal drilling and hydraulic fracking technologies to tap gigantic natural gas reservoirs for the first time. This caused natural gas supplies to soar. Natural gas production in Louisiana has doubled since 2009. These fields – the Haynesville, Barnett, and the giant Eagle Ford shales – (which cover areas of Texas and Louisiana) were being produced for the first time in 2007.

But like squirrels watching a bank robbery, the economists at the Dallas Fed saw the whole thing happening... and understood nothing.

The authors concluded, with typical academic banality: “*Our findings imply a continuum of prices*

at which natural gas and petroleum products are substitutes.” In plain English, the authors believed nothing much was happening with natural gas prices and the historic relationship between oil and natural gas prices was likely to continue.

Rarely have economists ever been more wrong about an important question. Roughly 18 months after the Dallas Fed published the paper – “What Drives Natural Gas Prices” – the entire historic relationship between natural gas and oil completely broke down. We don't know if Brown and Yucel have apologized for their woeful ignorance. But given they still work for the Fed, we feel safe in assuming they're both still gainfully employed. More so than any other institution in America, the Federal Reserve rewards stupidity in pursuit of the status quo.

Nevertheless, their paper – in addition to being good for a laugh – is instructive. It captures the previous market conditions in perfect detail. To understand what's happening now in these markets, it's critical you understand how much things have changed since 2007.

In their report, Brown and Yucel clung to two rules of thumb about energy pricing as though they were immutable, unchanging laws of nature...

First, they noted natural gas generally traded for one-tenth the price of crude oil price. So when the benchmark West Texas Intermediate (WTI) crude sold for \$20 per barrel, then natural gas should trade for about \$2 per million British thermal units (mmBtu). Similarly, \$50-per-barrel of oil would mean \$5 for natural gas.

Alternately, Brown and Yucel judged the relationship based on the energy content of a barrel of oil. Since one barrel of WTI contains 5.825 million Btu, 1 million Btu of natural gas should trade for roughly one-sixth the price of a barrel of oil. Under this rule of thumb, a WTI price of \$20 per barrel would mean a natural gas price of \$3.33 per million Btu, and \$50 oil would mean \$8.33 natural gas. In sum, they wrote...

When used to assess the relationship between U.S. natural gas prices and WTI

over the past 20+ years, neither the 10-to-1 nor the 6-to-1 rule of thumb seems to perform well. The 10-to-1 rule consistently under-forecasts natural gas prices, and the 6-to-1 rule consistently overforecasts them.

Saying these guys didn't know the first thing about the world's energy markets would be kind. They were working in the midst of the greatest natural gas discoveries in history and yet, *they had no idea what it meant.*

While the authors of this paper believed natural gas was too cheap at one-tenth the price of oil, *it was about to fall to one-twentieth the price of oil.*

They also believed the energy equivalent ratio of 6-to-1 didn't reflect true market conditions (because oil has certain advantages over natural gas). It's important to understand why they'd look at that ratio. You see, they knew, sooner or later, the energy value of the relative commodities would appear.

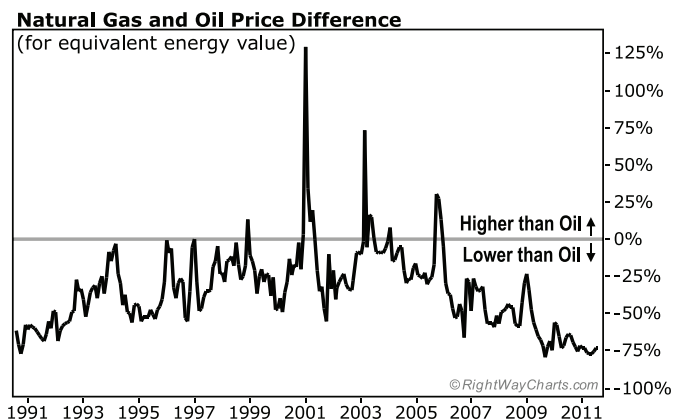
And yet... it hasn't. Not yet.

To understand why I'm so bullish on certain aspects of the world's natural gas markets, you must realize that hydrocarbons – natural gas, coal, crude oil, etc. – are simply energy. They have various qualities that make them more or less useful and marketable. But at some point, they can be valued by their energy content. How do I know? Eventually, entrepreneurs and traders will adjust the prices to reflect the differences in the energy content of each source. (In financial circles, trading to equalize markets is called "arbitrage.")

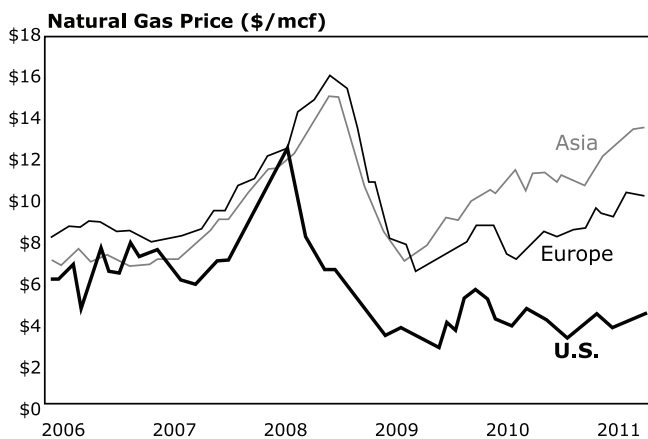
And that's our opportunity. Right now, natural gas is being sold at prices that defy all logic when measured by energy equivalent. In the U.S., natural gas is trading at prices that defy all logic based on market prices *anywhere else in the world.* My bet is, this situation doesn't last. Billions of dollars will be made as this discrepancy closes.

Let me show you what I mean in two ways. First, this chart shows the relative prices of West Texas Intermediate crude oil and U.S. natural gas based on energy equivalence. As you can see, buy-

ing energy in the form of natural gas is now 75% cheaper than buying oil. That's a record-breaking difference. That means, wherever possible, energy buyers are going to prefer natural gas.



Here's the other key chart. (Our friends at the Motley Fool published this recently.) It shows how since the discovery in America of vast new natural gas reservoirs in 2007, natural gas prices have diverged substantially for the world's major markets – U.S., Europe, and Asia. Today in Asia, natural gas is selling for almost \$14 per thousand cubic feet (mcf), while the price in the U.S. is barely more than \$4 per mcf.



These two charts imply a *huge* opportunity. Here's the best way I can describe it. Right now, U.S. energy is 75% cheaper than any other energy source in the world. And right now, prices for U.S. energy are roughly half the world's existing energy prices.

Such a dramatic difference in price in the same commodity – energy – shouldn't exist for long.

Traders will always arbitrage the prices back towards equilibrium. I'm going to say that again, just to make sure everyone gets it: **Such dramatic differences in price in the same commodity – energy – shouldn't exist for long. Traders will always arbitrage the prices back toward equilibrium.**

One way or another, in five to 10 years, the prices of crude oil and natural gas will not sit so far apart. They will converge, because wherever and however possible natural gas will be used in place of more expensive forms of energy, such as coal and crude oil.

Only one major obstacle blocks this equalizing of the world's price of natural gas – global access to the major new sources of shale gas in North America.

And therein lies our big idea.

The Big Opportunity in Energy

Longtime subscribers know we're enthusiastic about natural gas...

We've covered the new technologies and the huge discoveries they've enabled (like the Eagle Ford) here and in our free daily e-letter, the *SC&A Digest*, for several years. Australian resource giant BHP Billiton bought out our first shale-gas recommendation, **Petrohawk Energy (NYSE: HK)**, for \$12 billion – a 65% premium to its existing share price and roughly 100% more than where we first recommended the shares. While we didn't discuss the acquisition with BHP's executives personally, we wouldn't be surprised if they'd read our issue, as their acquisition comes straight out of our "playbook."

Here's what we wrote in April 2010:

... the company that originally pioneered the Eagle Ford – Petrohawk Energy (NYSE: HK) – is still a relatively small oil and gas company, with a market cap of "only" \$6 billion and total current production worth "only" about \$1 billion a year. Currently, the company's proven reserves at Eagle Ford make up only 13% of its resource base. But it controls more

than 300,000 acres in the Eagle Ford, making it one of the largest landholders. It also controls what's widely believed to be the best field in the Eagle Ford play, the Hawkville field. Additionally, it owns what will probably be the first major oil-field in the play, Red Hawk... Petrohawk was the first company to figure out how to get to Eagle Ford's oil and gas. Its horizontal wells were the first major producers of oil and gas there, coming online in late 2008 in LaSalle County. Given its track record, I believe Petrohawk is the best operator in the field and will increase both reserves and production faster than any other company in the field.

I urge all our new subscribers to read the April 2010 issue, "All the Oil in Texas." It details the scale of the discoveries in both the Eagle Ford field and the other major shale gas fields in the United States. Without these facts, the rest of this letter may seem unbelievable. And yet... our forecast of major increases to production and reserves has come to pass.

Last week, the U.S. Energy Information Administration (EIA) raised its estimate for U.S. domestic natural gas production – again. The EIA now says U.S. production in 2011 will equal 65.39 billion cubic feet (bcf) per day in 2011. That's up 5.8% from 2010 production levels. And it represents an all-time high, exceeding the 1973 record of 62.05 bcf a day.

Thanks to new technologies that can produce natural gas and gas liquids from massive shale deposits, growth in new natural gas production will continue for the next several decades. Yes, *decades*. This has already begun to change the landscape for energy in the U.S. and will reshape the world's power markets, too. U.S. shale gas is the fastest-growing reserve of energy in the world. And it's the cheapest. There's a tremendous opportunity for investors who understand how shale gas will change the world's energy markets.

In this month's issue... I'll show you what I

believe is the easiest way to make \$1 billion right now. I'll introduce you to the men who are doing it. And I'll show you how you can invest, safely, alongside them. They're exploiting an age-old trader's secret to make a killing in the market for energy – without taking on any risk. All they are doing is arbitraging a price differential.

I can show you how they'll do it. But first... to grasp the significance of these events, let's discuss the economics of this boom... how it happened... and why it's inevitably going to continue for years and years.

How an Investment Mania Created a Natural Gas Glut

Let's step back about a decade...

You might recall how energy prices rose higher and higher in the 2000s. At the time, lots of people were voicing fears of declining hydrocarbon production (so-called "peak oil"). These fears fueled a speculative mania that pushed oil and gas prices higher.

I began warning in 2006 that what was happening was nothing more than an investment mania that would eventually collapse. Here's how I described the scene back then...

I've seen many investment manias and this one has all of the trimmings... First and foremost, the soaring price of natural gas and oil was caused almost entirely by financial speculation. Every 20-something who could use a computer to solve a differential equation was pouring money (other people's money) into energy assets. Hedge Fund Research counts 68 hedge funds dedicated to energy... up from 14 in 2000. Doug Leggate, of Citigroup, says speculative financial positions account for more than half of the energy future contracts traded on the NYMEX, up from 25% in 2000. In the last three years, the number of crude oil futures contracts and options contracts grew from 600,000 to 2 million...

Every big investment mania needs a financial guru and an idea guru. In the oil business, there is no shortage of interesting financial characters. This is the sector of 10-gallon hats and lizard-skin boots. But there is one man whom out-Texans them all: Boone Pickens... His commodities pool was up 700% last year, making ol' Boone the highest paid hedge-fund manager in the world in 2005. Investors who gave Boone money in 1999 have made more than 28 times their money. Boone told BusinessWeek that he made more money in the last five years as a trader than he did in the 50 years he worked as an oil producer. (Talk about a financial bubble!) In fact, Boone made more money than any energy trader in the world. Curiously, the No. 2 energy trader, according to Trader Monthly, was 32-year-old Brian Hunter, until his now notorious Amaranth hedge fund collapsed.

The idea guru of this mania is dead – Marion King Hubbert died in 1989. Hubbert became the most famous Malthusian philosopher since Malthus himself. His theory was breathtakingly simple: Because oil is a finite resource and every well's production reaches a peak at some point and then begins to decline, the world must be reaching a point of peak production. Hubbert got out a slide rule, did a few calculations, and predicted that world oil production would peak around the year 2000. After this point – "Hubbert's Peak" – there would be less oil available each year... until finally the world would be out of oil. It's a great theory – simple, elegant, logical... but it's wrong.

First, Hubbert's assumptions about the life of each oil well were wrong. New technologies can "resurrect" old fields, dramatically increasing production in places Hubbert thought were "out of oil." And second, geologists have found oil in many places Hubbert didn't know we could

explore, such as deep oceans and very deep land-based wells.

If we were on the verge of running out of oil, wouldn't you expect to see a decline in the number of rotary rigs operating onshore in the United States? After all, the oil fields in Oklahoma and Texas are some of the oldest in the world. Hubbert believed that oil production in the U.S. peaked in the early 1970s. He thought we'd be out of oil by now in America. And yet, when you look at the Baker Hughes domestic rotary rig counts, you see that every time the price of oil goes up a bit, the number of rigs soars... And it's not just Patterson. Since oil prices bottomed in 1998, the total number of working rotary rigs onshore in the United States has increased from 625 to over 1,600 – an increase of 160%.

The whole idea of peak oil was so absurd, I had a hard time even addressing questions about the idea. For a few years in 2005 and 2006, I spent hours each week explaining basic economics to subscribers who were terrified we were going to run out of oil tomorrow. What did I tell them? That higher oil and gas prices would encourage capital investment in new technologies and new resources... and that sooner or later, there would be a new oil glut, just as there has been every 20 or 30 years in the oil business. After all, OPEC wasn't formed because there's too little oil. It was formed because there's too much. The entire history of the oil industry is nothing more than a story of economics... of booms and busts. The "peak oil" mania would prove to be no different.

And I knew we'd seen the top of the "peak oil" mania when a former penny-stock promoter, Charif Souki, raised *billions* of dollars in capital to build a natural gas *import* facility in the heart of the Texas oil patch.

This was the single dumbest investment idea I had ever seen promoted.

In June 2006, I wrote an entire issue (titled "Madness") about shorting the company Souki cre-

ated, Cheniere Energy. It sported a too-clever symbol – LNG – the abbreviation for liquefied natural gas. (Hint... when a CEO spends time and effort making sure his company trades under a catchy symbol, he probably cares more about selling stock than earning a profit.)

The idea of importing natural gas into America was positively stupid – the worst idea I'd ever seen in the capital markets. Keep in mind, to ship natural gas, you have to cool it to negative 260 degrees Fahrenheit. And at the time, the U.S. had the world's second-largest reserves of natural gas. (We're now the world's leader.) Why would we import natural gas here? It doesn't make any sense... But that didn't stop investors from putting up nearly \$1 billion for Cheniere Energy to build a huge LNG terminal. Here's how I explained the situation five years ago...

While it might make sense for a large, integrated oil company like Shell to own an LNG facility in order to guarantee a global supply of natural gas, it doesn't make any sense for LNG facilities to be the sole business of a stand-alone public company... Ninety percent of the time, domestic natural gas will be cheaper. And even when it's not, Canadian gas is cheaper. Very rarely will gas that's been extracted thousands of miles away, chilled to negative 260 degrees Fahrenheit, and shipped across the ocean be cheaper than the gas we can produce in North America. That's why more than 25 years after LNG technology was commonly available, there's still only 2.8 billion cubic feet per day of capacity at all of the existing LNG facilities in the United States (about 4% of total natural-gas supply). Cheniere plans to expand this capacity by 10 billion cubic feet per day – essentially quadrupling existing facilities. But as Cheniere says in its own 10K: "LNG's contribution to the North American market has historically been minimal, due mainly to an abundant supply of domestically sourced, low cost natural gas."

We shorted the stock successfully. It was the

most obvious short sell opportunity of my entire career. Cheniere's business plan back then was tantamount to Saudi Arabia building oil import facilities... or Dubai buying sand from Chile.

On the other hand... What makes a lot more sense is for America to become a leading **exporter** of natural gas. It's never been economically viable because shipping oil has always been cheaper. But now... considering how cheap American natural gas has become, compared with other global energy supplies... it's the most obvious energy strategy in the world.

You see... all the nonsense about peak oil enabled oil and gas exploration companies to gain access to huge amounts of capital. They put that capital to work and discovered new ways of producing oil and gas. The investment mania around peak oil led to the most important breakthrough in the energy markets since Texas' Spindletop oilfield blew, heralding a shift in petroleum production from Pennsylvania to the America West. Three new technologies – 3-D seismic mapping, horizontal drilling, and well-fracking – almost eliminated dry holes, while opening up vast new resources. The result was a colossal increase to production. And that energy is going to go somewhere...

Let me give you a recent example of how lower prices for American LNG will stimulate demand globally. *LNG World News*, a trade publication investors rarely read, reported in June: "Japanese power utilities and South Korean users bought a combined 6 million metric tons of liquefied natural gas in May, adequate to supply India for eight months, as oil cost almost twice as much as gas to burn." South Korea paid an average \$631 a ton delivered, equivalent to about \$12 per Btu. Japanese power plants increased LNG purchases by 28% from a year earlier.

These are *extremely* big numbers. A sea change is happening right now in the energy markets. And most U.S. investors remain totally unaware.

The International Energy Agency (IEA) now predicts a "golden age" of natural gas. It expects natural gas consumption to rise 50% over the next 25 years, reaching 25% of global energy demand (up from

21% currently.) In my opinion, that's conservative. I believe a gigantic expansion of LNG fleets and export plants in the U.S. combined with a move away from nuclear power in both Japan and Europe will result in a 50% increase in natural gas consumption in *the next 10 years*. I believe natural gas will grow from fueling roughly 21% of energy used worldwide today to close to 40% within a decade.

Quite simply, natural gas is the safest and cleanest fuel available on the market... and it's the cheapest by a wide margin. All that remains is to build a global transportation system to support the marketing of the fuel. While that seems like a big hurdle, given the economics of the price discrepancy between gas and oil I don't expect it to be a barrier for long.

How to Invest in the New Gas Boom

Not surprisingly, all of the companies associated with the Eagle Ford shale field soared last Friday on news of the BHP-Petrohawk deal. For example, **SM Energy (NYSE: SM)**, our other top Eagle Ford recommendation, was up 8% to \$77 per share. We originally told you about it at \$37 per share, when it was still known as St. Mary's Land. I have no doubt the leading Eagle Ford companies and the other high-quality onshore oil and gas firms (like Pioneer Natural Resources, Rosetta Resources, Newfield Exploration, Cabot, EOG Resources, and Range Resources) will continue to do well for investors. But... I suspect the richer payday will come from the companies that can *distribute* the gas and gas liquids to *foreign* markets.

Lots of people will be competing to produce and market gas in the U.S. *Few firms will be able to market gas to the world.* The firms that can will generate massive profits because of the discrepancy between U.S. gas prices and global gas and oil prices. That's why our next investment will be investing in the LNG export business...

Ironically, **that means we should buy Cheniere**, a company we have profitably mocked for more than five years.

Why on Earth would we recommend Cheniere?
Are we hypocrites?

No. When the facts change, so do our opinions. Souki came to his senses about three years ago when he realized that, far from running out of hydrocarbons, the U.S. was probably the world's leader in total reserves. He recruited new capital investors – New York's Blackrock firm – and changed his business model. Rather than importing gas, Souki would use Cheniere's massive LNG plant at Louisiana's Sabine Pass to *export* gas.

Last May, Cheniere received critical approval from the Energy Department to export as much as 803 bcf a year. The company still needs to get the Federal Energy Regulatory Commission's approval to build its planned \$6.4 billion export facility on the site. And of course, Cheniere still needs to acquire the capital required to build it.

Meanwhile, the company's balance sheet is a wreck. Over the last three years, the company has burned through \$250 million. It has total liabilities today of more than \$3 billion. It's spending more than \$250 million per year in interest alone. Ordinarily, I would expect this stock to go bankrupt... imminently. And seeing as how I've been predicting this company's failure for years, it wouldn't be surprising to see that happen. So... again... why on Earth am I recommending you purchase it?

Because so much money can be made right now exporting America's natural gas to the world, I wouldn't be surprised to see someone simply put up all the capital required for the project to acquire a long-term supply of American LNG for export.

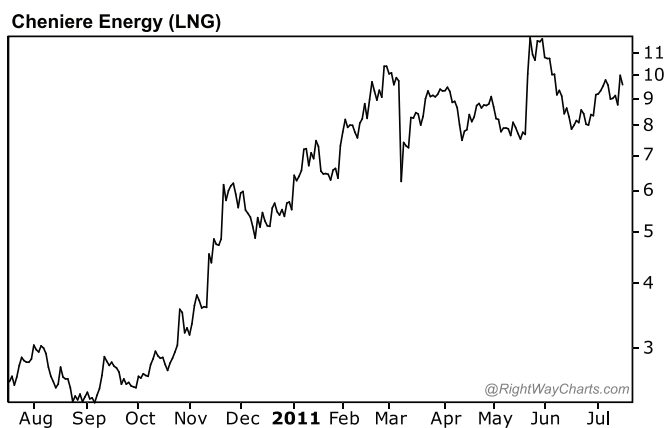
Think about it this way. BHP was willing to spend \$12 billion on Petrohawk, which is only one of a dozen leading U.S. natural gas firms. Why wouldn't someone spend at least that much to get the only approved and ready-to-build LNG export terminal, which would roughly double your money on every one million cubic feet of gas you exported?

Cheniere's market cap of only \$650 million (the total value of all its outstanding shares) reflects the enormous risks in the company's capital structure. It's

a much safer bet to buy the company's senior debt. But... with a total enterprise value (equity + debt) of around \$3.5 billion, there's a good chance a buyer comes along who is willing to pay up for the equity just to gain control of the assets. After all, it won't cost that much more. **I expect we'll see a deal for Cheniere as soon as it gets its last key regulatory approval, which should happen this year.**

I bet the take out price is something around \$7 billion – double enterprise value – which implies huge upside for the share price. If a deal happens in that neighborhood, the equity would be worth \$3 billion or \$4 billion, up from \$650 million today.

That's why you've seen the stock already soaring this year from around \$3 per share to more than \$10.



The problem with this rosy forecast is, if anything goes wrong, the stock is worth nothing. Zero. Its debts will wipe it out quickly, and the bondholders will capture all the eventual upside. You can't buy this stock without a trailing stop loss. You can't put more than 4%-5% of your portfolio into the position – and only if you can afford to lose that much.

Let me reiterate this as clearly as I can: This stock can (and probably should) go to zero. However, the opportunities in exporting U.S. natural gas are so incredibly lucrative, it's more likely a major global energy company will buy the stock at a huge premium. It's worth betting on – but it's still just a bet... and a risky one.

The other, far safer way to play this opportunity comes from buying a stock that's the polar oppo-

site of Cheniere.

The other company that has the near-term possibility of delivering U.S. gas for export is Dominion Resources (NYSE: D). Dominion is a \$30 billion energy giant with operations in regulated utilities, nonregulated power generation, and natural gas distribution. Most importantly, it owns the Cove Point, Maryland LNG import facility, which has been used primarily for storage. In February, the company announced plans to convert the import facility to an export facility. The company's CEO says he's in discussion with several major global companies to raise the capital necessary to make the conversion.

I like buying both stocks and thinking of the trade as a single position.

For example, Dominion pays a handsome dividend – almost 5%. If you're a conservative investor, it might make more sense for you to structure your position heavily in favor of the Dominion portion of the trade. You could put 80% of your position into Dominion and 20% into Cheniere. That would position you to profit from the emergence of the export LNG market, but would largely protect you from any downside and give you a solid dividend.

For the purposes of this newsletter, we'll establish equal positions in both stocks. We do so fully recognizing the risks we're taking with Cheniere. But I am confident in the value of this idea and want the opportunity to capitalize as much as possible. Even if Dominion were to make \$5 billion or \$6 billion on its export LNG business over the next few years, it's such a big company that it wouldn't produce much in the way of capital gains.

I recommend buying shares of Cheniere (AMEX: LNG) up to \$12 a share and Dominion Resources (NYSE: D) up to \$60 a share. Use a 25% trailing stop loss on both positions. Furthermore, we recommend conservative investors limit the position size of the Cheniere portion of this trade to less than 5% of their portfolios, as there is a substantial risk that the business will fail before it can complete its planned LNG export facility.

What Next for Europe and Global Fiat Money?

As interesting as the opportunity in American exported LNG really is... a bigger question for investors today is, "Should I own any stocks at all?" I continue to believe the answer is *no, not unless you're also willing to short stocks.*

The simple fact is, the world's reserve currency is administered by a bankrupt government – ours. Its major allies, the other Western democracies, are also largely bankrupt. The question of how all of these bad debts will be resolved has not yet even begun to be answered.

As I write this letter to you, the U.S., with the world's most gold-plated triple-A rating, is within about two weeks of defaulting on its debts. There's simply little more in the way of explaining the dire straits of our financial order that I could say or explain. We are and have been living in a period of intense financial denial.

I've been writing about these ideas for several years. Most of the time, I've felt a bit like the boy who cried wolf... or Chicken Little. Except that my core advice – to own plenty of gold and silver bullion – has been exceptionally rewarding. Even if that weren't the case, I wouldn't have changed my tune. I write what I see in the numbers *and nothing else*. In all my years in financial research, I've never once seen the crowd make better decisions than the numbers.

Nevertheless... I was gratified last weekend when *Barron's* published an interview with Sean Egan. Mr. Egan is one of the two principals at the widely respected Egan-Jones rating agency. Whenever you say, "respected" and "rating agency" in the same sentence, everyone makes a strange face. Most of the world's leading ratings agencies (Moody's and S&P, for example) are nothing more than analytical whores. They're accountants for hire. The biggest ratings agencies sell their services to the *sellers* of financial assets. Good ratings are good for the agencies' core clientele.

Egan-Jones, like Stansberry Research, takes its

revenues from the *buyers* of financial assets, which is quite a different business than the major ratings agencies. Realistic ratings are what's good for Egan-Jones clients.

To date, I had never heard of anyone else speculating that the Federal Reserve would end up bailing out Europe's banks... but that's exactly what Sean Egan believes too. I don't generally seek consensus... but when the "crowd" consists of Sean Egan, I'm extremely pleased. He is one of the truly gifted (and independent) financial minds in the world.

Says Mr. Egan about the conundrum of Europe's unsustainable sovereign debt...

... the most likely source of support for the [European Central Bank] is the U.S. via Ben Bernanke, who during the first signs of the crisis, ginned up more than \$580 billion in dollar swaps in 2008 and 2009 with central banks around the world. These lines went out in a size and with a velocity never before seen in the Federal Reserve system, but were repaid. The swap lines have been extended through August 2012. The dollar-liquidity swap lines are with four major central banks – the ECB, the Bank of England, the Swiss National Bank and the Bank of Canada. The lines with the ECB are unlimited. The rationale was that there is no credit risk, because they are short-term, and the ECB was interposing itself between the sick European member banks and the Fed.

In last month's issue ("New American Socialism"), I reiterated my position on the European sovereign debt crisis and the special role the major Italian bank Unicredit will play in unleashing the next crisis. It's an important issue, and I urge to you review it. There's no reason to dwell on the things already explained. But I must point out Unicredit in particular and Italy in general dominated the headlines last month. This will continue until actual sovereign defaults occur.

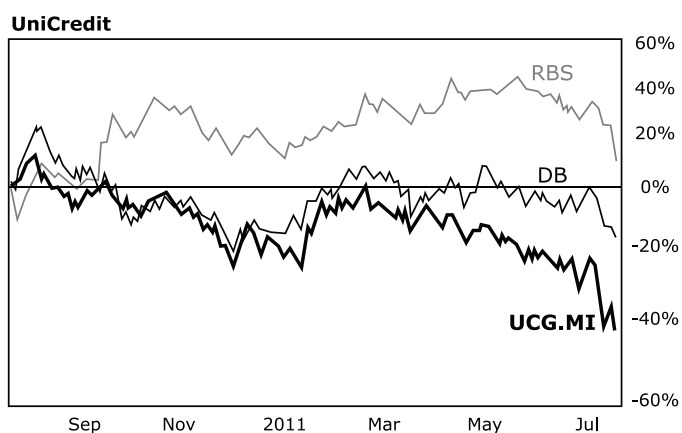
The only question now is... will a European sovereign default before America does?

We don't know... and that's not bullish for financial assets of any stripe.

Here's what I recommend you do this month: Hedge your remaining equity investments, which we hope will include some combination of Cheniere and Dominion Resources. And sell short Europe's two leading banks – **Deutsche Bank (NYSE: DB)** and **Royal Bank of Scotland (NYSE: RBS)**.

Several years ago, when it established the capital requirements of European banks, the Bank for International Settlements (BIS) made an exception to the reserve requirements for sovereign debts. As a result, European banks were greatly encouraged to buy government debt, which enabled them to raise their leverage ratios and report far bigger profits. The rub, of course, is these debts are not safe and will surely default. That will cost the equity investors in these banks all or most of their investments. These stocks, which are very liquid and trade in the U.S., should be easy for you to sell short and will provide a great hedge against the coming global volatility.

While I would recommend shorting Unicredit, I know that will be nearly impossible for all but my wealthiest subscribers. The stock trades in Milan, where most readers don't have brokers. But as you can see from the chart below... when it comes to a sovereign debt crisis, all of Europe's banks are more or less in the same boat. Shorting any of them will be a proxy for all of them.

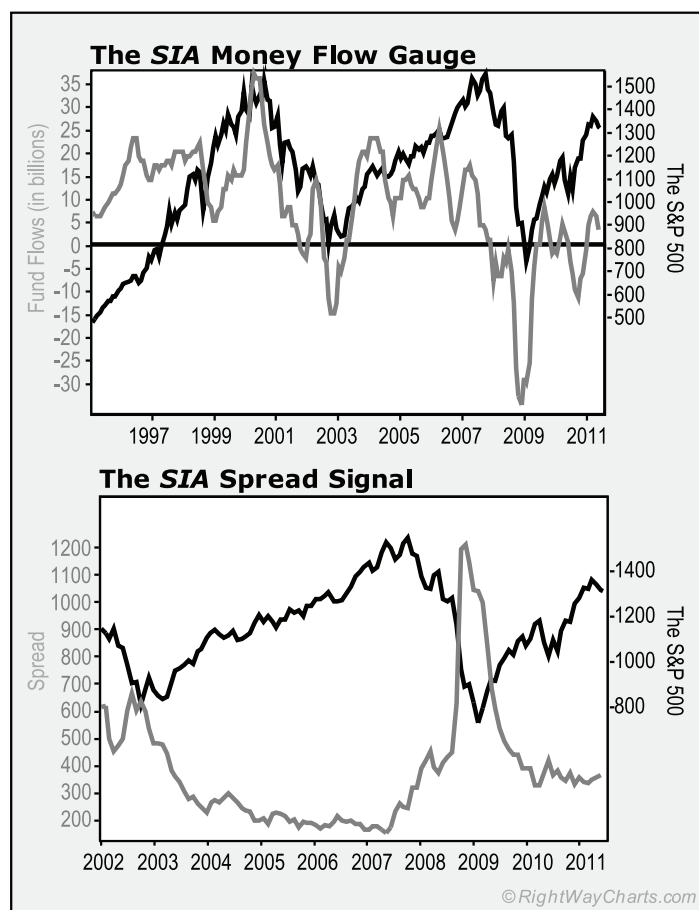


Our Indicators & Our Portfolio

Our most important indicator (The *SLA Spread*)

has definitely begun to narrow, which is a very *bearish sign*. Likewise, money flows into stocks have begun to decrease and the *SIA* Blacklist has suddenly diminished with far fewer stocks trading at absurd multiples.

If I were purely in the prognostication business, I would expect a long and serious bear market. Things do not look good for the world's economy as credit is tightening, fear is rising, and people are beginning to become more cautious with their money.



Putting these market-based signs together with what we know about the fundamentals of the world's major economies – half of which appear bankrupt – I'm quite happy to be in the "batten down the hatches" camp. Investors who are merely able to keep what they've earned (in real terms, after inflation) over the next several years will have done a great job. Believe me, I wish we could be more bullish. No one buys newsletters that only offer up bad news for long. But as I said earlier, I write what I see in the numbers and nothing else.

My best advice has been the same since February 2010. If you're not willing to hedge your portfolio by shorting stocks and holding plenty of physical bullion (gold and silver), you should allocate 50% to short-term Treasury bills (or the exchange-traded fund SHY, if you don't buy them directly) and 50% to gold (GLD, if you don't buy it directly).

So far, that's been great advice, as stocks have largely gone nowhere and gold just broke through \$1,600. We expect it will continue to be great advice until the world returns to sanity. Watching our politicians on TV, we're sure that's not going to happen any time soon.

Until then... I wish you all good luck. We will all need it.

Good investing,

Porter Stansberry

THE *SIA* Black List

<u>Ticker</u>	<u>Short Name</u>	<u>Market Cap</u>	<u>P/S</u>	<u>P/E</u>	<u>Total Return YTD</u>
BIDU US Equity	BAIDU INC-SP ADR	51,610,071,040	36.13	79.74	52.21
VMW US Equity	VMWARE INC-CL A	42,343,329,792	13.61	106.34	15.48
PSA US Equity	PUBLIC STORAGE	21,161,771,008	11.91	41.54	19.38
CRM US Equity	SALESFORCE.COM	20,391,630,848	11.19	541.93	16.97
IVN CN Equity	IVANHOE MINES	17,826,019,328	178.69		9.26
SLW CN Equity	SILVER WHEATON	13,389,769,728	27.79	38.09	-4.96
CHKP US Equity	CHECK POINT SOFT	12,629,590,016	10.37	24.94	22.31
CLR US Equity	CONTL RES INC/OK	12,281,669,632	10.61	37.16	17.42
AVB US Equity	AVALONBAY COMMUN	11,544,099,840	12.27	104.00	19.63
YNDX US Equity	YANDEX NV-A	11,368,949,760	24.35	79.78	
VRTX US Equity	VERTEX PHARM	10,198,949,888	51.36		44.68

Stansberry's Investment Advisory Model Portfolio

Prices as of July 18, 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	\$53.32	\$1.03	World dominator	Hold	4.7%	5
Johnson & Johnson	JNJ	7/6/06	\$60.52	\$67.09	\$9.32	World dominator	Hold	26.3%	5
Exelon	EXC	10/9/02	\$21.47	\$43.11	\$14.67	Nuclear power	Hold	169.1%	5
Hershey	HSY	12/6/07	\$40.55	\$56.37	\$4.35	World dominator	Hold	49.7%	5
<u>The "Next Boom"</u>									
ConocoPhillips	COP	4/2/09	\$41.45	\$75.44	\$4.91	Cheap oil	Hold	93.8%	5
Calpine	CPN	5/13/10	\$13.93	\$16.20		Nat gas power	Hold	16.3%	5
BP	BP	2/11/11	\$45.93	\$44.31	\$0.42	Cheap oil	Hold	-2.6%	5
Silver Wheaton	SLW	12/1/10	\$37.90	\$39.69	\$0.06	Silver secret	Buy	4.9%	5
Monsanto	MON	11/18/10	\$59.63	\$73.21	\$0.84	Soaring food	Hold	24.2%	5
San Juan Basin	SJT	1/7/10	\$18.34	\$24.96	\$2.34	Cheap energy	Hold	48.9%	5
Cheniere Energy	LNG	7/19/11	NEW	\$9.57		Export LNG	Buy	NEW	5
Dominion Resources	D	7/19/11	NEW	\$48.00		Export LNG	Buy	NEW	3
<u>Victims</u>									
ProShares UltraShort Euro	EUO	5/13/11	\$17.55	\$17.64		Debt crisis	Buy	0.5%	5
iShares US Bond Fund	TLT	2/11/11	\$88.19	\$95.24	\$1.76	Debt crisis	Sell short	-10.0%	5
Pulte Group	PHM	1/16/11	\$8.23	\$6.94		Real estate crisis	Sell short	15.7%	5
General Electric	GE	6/15/11	\$18.55	\$18.29	\$0.15	Debt crisis	Sell short	0.6%	5
Capital One Financial	COF	6/15/11	\$48.00	\$48.35		Debt crisis	Sell short	-0.7%	5
R. Bank of Scotland	RBS	7/19/11	NEW	\$10.59		Debt crisis	Sell short	NEW	5
Deutsche Bank	DB	7/19/11	NEW	\$50.78		Debt crisis	Sell short	NEW	5

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

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.

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