



America's Oil Boom

Zoroastrianism is an ancient religion.

Perhaps a thousand years before Christianity began to spread across Europe... and many believe before even Moses... the Persian prophet Zoroaster taught his followers a revolutionary idea: monotheism.

Zoroaster taught there was only one universal and transcendent God, who created the universe and everything in it. Zoroaster called his God "Ahura Mazda."

Life, according to Zoroaster's teaching, was a battle between truth (*asha*) and falsehood (*druj*). When truth finally overcame falsehood, time would end and everyone, even the dead, would be reborn and reunited with Ahura Mazda.

Thus, the purpose of life was to seek truth and the order of the universe and defend it against falsehood and chaos.

Fire was important in the religion, as light was a symbol of truth. Some of Zoroaster's followers settled around Baku (in modern day Azerbaijan, just north Iran) on the shores of the Caspian Sea. Here oil seeped from the surface of the Earth, providing a ready fuel, and natural gas could be vented directly into their temples.

As the great explorer Marco Polo recorded in the 13th century...

Near the Georgian border there is a spring from which gushes a stream of oil, in such abundance that a hundred ships may load there at once. This oil is not good to eat; but it is good for burning and as a salve for men and camels affected with itch or scab. Men come from a long distance to fetch this oil, and in all the neighborhood no other oil is burnt but this...

Robert Nobel surely knew about Zoroastrianism and its flaming temples before he arrived in Baku in 1876. As a wealthy, highly educated Russian, it's likely he read *The Travels of Marco Polo*. But whether or not he went to Baku specifically for oil remains a matter of historical debate.

His *younger* brother, Ludvig, had been placed in charge of the remnants of his father's business – an arms and heavy-equipment manufacturer that was best-known for its mining operations. And it was his *younger* brother who banished him from the relative luxury of St. Petersburg to the wilds of Azerbaijan – reportedly to find high-quality walnut forests, not oil.

The Nobels had long been one of Russia's most prosperous arms merchants... until their fortunes declined in the 1860s. First, Russia's czar stopped buying the firm's legendary mines. Then the czar cut back on steam engines, too. By the end of the decade, creditors had seized the firm and sent Robert's father back home to Sweden in shame.

There, Ludvig was trying to revive his father's company by manufacturing rifle stocks. And he needed more timber. This is the reason, according to most historical accounts, he ordered Robert to travel to Azerbaijan.

But Robert Nobel didn't find any trees.

Inside This Issue

- Why the Brent/WTI spread is driving U.S. crude exports
- Growth in the Eagle Ford exceeds expectations
- Why shipping is the key to the global oil markets
- Europe on the verge of collapse

Editor: Porter Stansberry

In fact, there's almost no natural vegetation whatsoever in Baku. It's extremely dry and windswept. The timber he found wasn't alive anymore. It had been lumbered for oil derricks. Hundreds of them. Robert Nobel claimed he "stumbled" onto perhaps the greatest oil boom in history – by accident... while shopping for timber. I don't believe the story. Not for a moment. But that's what the gullible historians have recorded.

What we know for certain is wildcat wells dotted the landscape of Baku. The story goes that Robert Nobel decided on the spot that derricks were better than living trees. Whether he was really acting on orders from his brother or not, he certainly began buying leases on the spot. Over the next few years, the Nobel brothers invested heavily in Baku.

Then, in 1872, the oil boom took off when the Russian crown auctioned off the rights to hundreds of leases. Refiners built dozens of factories to transform the heavy crude into easier burning kerosene, demand for which was insatiable.

By 1880, the Nobels were the leading oil producers in Baku. *And by 1900, just 20 years later, Baku was producing half of all of the oil in the world.*

When big, new resources like this are discovered, the resulting increases to production are often unimaginable.

As production greatly increased, the difficulties of storing and transporting Baku's oil and kerosene became paramount. At first, refineries simply put the kerosene in wooden barrels and shipped it on barges across the Caspian and up the Volga River to markets in Russia. But this wasn't as easy as it might seem...

First of all, the wooden barrels were expensive – as I mentioned, there wasn't any timber in Baku. Additionally, they leaked. That made the process difficult, dangerous, and inefficient. Before production could be economically increased further, the challenges of distribution had to be tackled.

Ludvig Nobel became the "King of Baku," primarily because he figured out how to distribute oil – not because he discovered it. His solution? Pump it directly into the hull of a ship that was specially designed to navigate the Volga.

The first oil "tanker" ship the Nobels built was called *Zoroaster*. Launched in 1878, it took oil from Baku, across the Caspian and up the Volga, where it could be distributed across Russia. A fleet of such ships made Baku the world's busiest port. Production continued to grow... and grow. Production grew so much (to 10 million barrels per year by the 1880s), the entire Russian market was flooded with kerosene.

The resulting price war led to desperation for the smaller producers in Baku, who couldn't compete with the Nobels. They sought a way to sell their kerosene in Europe. They built a railroad to the west, connecting Baku to Batum on the Black Sea. To finance its construction, they sold leases and supply

contracts to the Rothschilds, who became major players in Baku as a result. The Rothschilds sold their newly acquired oil and kerosene in the European market, where Standard Oil had a dominant presence.

To better compete with Standard Oil, the Rothschilds made a deal with the Nobels to greatly increase the flow of oil to Batum and Europe. The Nobels cleared the railroad's bottleneck by blasting a 42-mile pipeline through the mountains (using dynamite, invented by their third brother, who also endowed the eponymous prize, Alfred Nobel). The Rothschilds and the Nobels could now battle directly against Standard Oil for control of Europe's vast market.

And yet... the endless wells at Baku produced still more oil. More and more oil was dumped on the markets, as Standard Oil fought its new competitors with fiercely lower prices, designed to force them out of business.

The oil barons of Baku only had one market left: Asia. But how would oil reach Asia from the Black Sea?

Samuel Marcus was the son of an English shell merchant. With his knowledge of importing goods, he became a shipbroker and something of an investment banker, too. After visiting Baku and seeing the Nobels' tankers, he was certain larger tankers could open the world's markets to Baku oil.

His idea was to take Baku oil from Batum (where it was cheap because Russian and European markets were flooded) and distribute it into the Asian markets, where the price was very high. He was able to get the cooperation of the Rothschilds, who offered him a 10-year supply contract. They believed by targeting Standard Oil's high profit margins in Asia, Rockefeller wouldn't be able to continue selling kerosene at a loss in Europe.

Marcus began to secretly build storage facilities and refineries across all the major Asian markets, while also building a large new fleet of tankers. The only problem with his plan was... oil tankers weren't allowed to pass through the Suez Canal because they were considered extremely dangerous. (Several of Standard Oil's tankers had exploded while loading or unloading their cargo.)

Gaining access to the Suez was critical to his plan. If his tankers had to travel all the way around Africa, his plan wouldn't work because the oil couldn't be sold cheaply enough in Asia to compete with Standard Oil. Rather than argue with the various governments, Samuel went to Lloyd's of London. He got them to insure his tankers – certifying they were safe to transit the canal and agreeing to cover any damage they caused. This convinced the British government, which governed the canal, to allow his ships (and only his ships) to pass.

On July 22, 1892, Samuel's first tanker, the *Murex*, sailed from London for Batum, where it picked up the Rothschild's

oil. It passed through the Suez Canal on August 23, 1892. Then, it delivered the oil in Singapore and Bangkok. By the end of 1893, Marcus had 10 tankers in his fleet. His tankers controlled the marginal price of crude because the oil they moved determined prices in Russia, Europe, and Asia. Even as late as 1902, when his contract with Shell expired, Marcus controlled 90% of the oil flowing through the Suez Canal.

Marcus Samuel became one of the world's richest men because he understood something about the market for oil that sets it apart from every other commodity: It's almost impossible to replace. As a result, at certain times, huge discrepancies in its price will develop in various markets around the world.

When these discrepancies develop, the key to making a fortune is owning both the oil and the distribution required to equalize the prices.

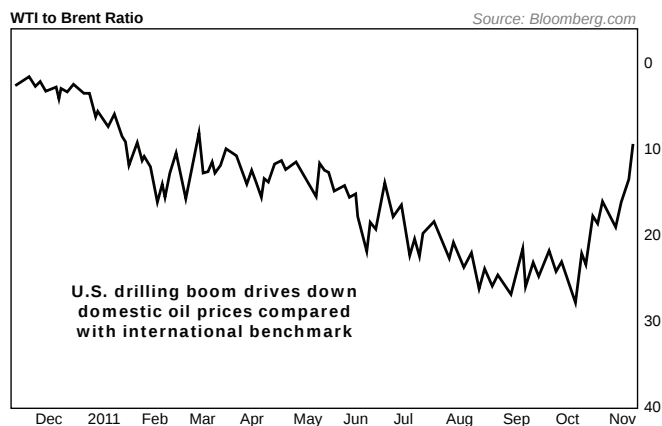
This month's letter explains why the exact same situation exists today in the global oil markets, presenting us with almost the same opportunity Marcus Samuel had.

Why Texas Crude Is Suddenly 30% Cheaper Than Brent

Today, two unusual (and large) price discrepancies have developed in the global energy markets. The price of West Texas Intermediate (WTI) crude oil and the price of Brent crude have been widely divergent. Both are benchmark measures of oil prices. WTI is the price set when futures contracts are settled by physical delivery in Cushing, Oklahoma. Brent crude is sourced from the North Sea and is primarily used to price international oil.

For several decades, the prices of WTI and Brent have been within \$3 per barrel of each other. That's because global distribution of crude oil is extremely efficient. Tankers can deliver crude from almost any source to almost any refinery in the world. Refiners buy where they can get the oil they need at the best price.

As you can see, however, beginning in early 2011, some-



thing fundamentally changed about the market for crude oil in the United States. WTI began trading at a large discount. By February, the spread was \$10 per barrel. Given a roughly \$100 per barrel price for Brent crude, Texas crude was selling at a 10% discount – an economically meaningful difference. Then, by June, the WTI discount to Brent crude had expanded to \$20. I've never seen the spread so wide. Finally, the discount peaked in late October at about 30%.

This huge price discrepancy was caused by something most oil analysts thought was impossible: **a large and sustained increase in U.S. onshore crude oil production.**

Lane Riggs, the senior vice president of Valero, which is one of the largest refiners in the U.S., says the company processed 37,000 barrels of Eagle Ford oil *per day* in the second quarter of 2011. Valero has 13 refineries onshore in the U.S., with six of these currently along the Gulf Coast. By using Eagle Ford oil (which is priced using the WTI benchmark) instead of seaborne oil (which is priced using the Brent crude benchmark), Valero saved \$16 per barrel. *That's \$592,000 per day... or \$53 million for the quarter.*

Riggs says Eagle Ford oil is "liquid gold. We would run as much of it as we could."

This is an unbelievable, tectonic change in the global oil business. As the chairman of Valero, Bill Klesse, says in regard to the Texas expansion: "Those are projects that we... would not have considered one year ago."

One critical side effect of this market-warping increase in onshore U.S. oil production was the complete destruction of the oil tanker market.

As U.S. refiners stopped buying international crude and China's and Europe's economies slowed... the tanker market was wiped out. Take a look at the shares of Frontline, one of the leading oil tanker companies in the world. Its collapse mirrors the spread between WTI and Brent. But sooner or later, demand for these ships will return because, as you'll see, the global distribution of crude oil is about to completely change.



A Flood of Oil Is on the Way

What we've seen in the oil markets so far in 2011 is only the tip of the iceberg.

We are seeing the first trickle of oil from these fields, where drilling is now going on night and day. *Tens of thousands* of new wells will be drilled over the next decade. The amount of new oil that will be produced can't even yet be imagined. Trust me on this... *every projection you'll see over the next 12-24 months about the amount of future production will end up being woefully, laughably conservative.*

The amount of oil and gas that will be produced from U.S. shale plays over the next decade cannot even be imagined today. My bet is U.S. production at least *triples* over the next 10 years.

How do I know? Because that's what always happens with oil discoveries. Somewhere out there an elephant is hiding in the shale. Who knows who will find it... but if we drill enough holes out there, someone will. Consider this, one small example...

This week, Anadarko announced it had discovered what it believes will be a 1 billion-2 billion barrel resource in the Niobrara shale that sits under the Wattenberg field in northeast Colorado. That's the largest new discovery in the U.S. in more than 40 years. Anadarko drilled 11 horizontal wells to make this discovery. Next year, it will drill 160 more. And in the fu-

ture, it will drill 1,200-2,700 horizontal wells in the Wattenberg field. My bet is, the resource estimate continues to get bigger.

Now, consider this. The Wattenberg field has been in production since 1901. Yes, that's correct. It's not a typo. The field has *already* produced 4 trillion cubic feet of natural gas and hosts 14,000 wells. In 2007, it produced 11 million barrels of oil.

The geology of Wattenberg is well understood. This was an old field – something that had been picked over by every major oil company in the U.S. for decades. The accepted conventional wisdom said nothing new was to be found there... until Anadarko found another 1 billion barrels of oil... or maybe 2 billion.

New drilling technologies – such as hydraulic fracturing (fracking) and horizontal drilling – won't merely allow the discovery of many large, new oil fields, they will also completely reshape the production curves of existing fields. That's a big part of the equation that most people haven't figured out yet. *New technologies won't just bring new fields into production, they will revive our existing fields. Many older fields may even surpass their previous total production.*

Of course, no one knows exactly how much more oil and gas will be discovered. Looking at what his firm has found so far, Anadarko's CEO says total American production will double in 25 years. "The resource is there, and the technology is there."



And according to Greg Armstrong, chairman and CEO of the Plains All American Pipeline company, a \$16 billion partnership with a 16,000-mile network of onshore pipelines...

It's hard to forecast at this point, because you don't know which of the many projects that have been announced are actually going to get done... You're talking about probably an aggregate – no matter whose story you believe – of at least 1 million barrels a day of new, very light product. And it's going to change the dynamics in an industry that's been gearing up for heavy or sour product.

Goldman Sachs came out with its forecast this week, too. It now says America will be the world's largest crude oil producer by 2017 – surpassing even Saudi Arabia.

Hard to Believe... But Not a Surprise

Longtime subscribers shouldn't be surprised. This is what we told you would happen. In April 2010, we published what I believe will go down in history as one of the most prescient letters of my career: *All the Oil in Texas*. We wrote several things that, at the time, I knew no one would believe...

- The Eagle Ford would become the largest oilfield in the history of the United States.
- Wells already drilled would produce at least 40,000 barrels per day of oil within 24 months.
- The Eagle Ford would yield more than \$2 billion in oil and gas by 2013, and its production would increase steadily for at least 20 years.

No... I can't say for certain whether or not production will increase steadily for the next 20 years. But I'd be willing to place a very large bet on it. Meanwhile, the two stocks I recommended you buy in that issue – **Petrohawk** and **SM Energy** – have both done extremely well. In both situations, the eventual outcome was almost *exactly* as I expected.

Regarding Petrohawk, I wrote...

I expect a larger competitor will buy Petrohawk in the next 12 months. That's the cheapest and fastest way for a major oil company to significantly increase its onshore oil production and reserves. Expect a takeout price of between \$50 and \$75 per share.

In August 2011, BHP Billiton acquired Petrohawk for \$38.75 per share.

On SM Energy – which I said was the cheapest way to buy Eagle Ford acreage through a publicly listed company – I predicted its production from the Eagle Ford would soar in 2011. On August 2, 2011, the company reported second-quarter Eagle Ford oil production of 605,000 barrels, up from

181,000 barrels a year earlier – a 234% increase.

The company's production of 436 million cubic feet (MMCFE) per day compares with 276 MMCFE per day in 2010 – a 57% increase. (MMCFE is an industry measure that combines gas, condensate, and oil production into the energy equivalent of dry gas. It's also equal to 1.091 petajoules of energy.)

The stock, which I recommended at \$40, was recently trading for more than \$80.

The only problem with these recommendations – which should have made us incredible profits – was that we were stopped out in the summer of 2010 because of the extreme market volatility associated with the end of the Fed's quantitative easing program. Dealing with the volatility of these stocks is a big problem, something we've got to find a way to manage.

Quite simply... after the Internet and the associated technologies... this is the biggest investment opportunity of my lifetime.

What's happening here is bigger than just one or two oil companies having some success. It's even bigger than the Eagle Ford play. We are in the midst of a massive, global discovery and expansion phase for oil and gas. Two things in particular make this new phase so powerful.

First, thanks to seismic technology and a better understanding of geology, finding the source rock for these new oil and gas reservoirs is relatively easy. These are colossal layers of rock that cover hundreds of miles. They're typically fairly thick, too. As a result, drillers hit very few dry holes – almost none. Thus, the expansion of these fields is much more of an engineering project than a conventional oil and gas discovery. The companies know exactly where the rock is. They know, more or less, what's in it. The game is played based on how well you can get it out. And that means spending a lot more money per well. But it also means much lower capital costs because lending money for an engineering project is a lot less risky for banks and investors than lending money for wildcatting.

And secondly... most of the world's best shale resources are located in North America. These new fields, believe it or not, position us to become a global *exporter* of energy – and probably the world's largest exporter. Trust me, I know how difficult that must be to believe. But that's how huge these new discoveries are going to be. Most of the world's energy infrastructure is designed to bring energy into the U.S., not take it out. That's why for the first time in my life major infrastructure projects are underway that will allow U.S. companies to export both LNG (liquefied natural gas) and crude oil.

The first tiny wave of this new production has already turned the global energy markets upside down, with the huge (30%) discrepancies between global oil (Brent crude) and

domestic oil (WTI). To profit from this price differential – as Samuel Marcus would have advised – several companies are angling to own key elements of the U.S. export supply chain.

Enbridge bought 50% of the Gulf Coast Seaway pipeline this week from ConocoPhillips for \$1.15 billion. The other 50% owner of the pipeline, Enterprise Products Partners, and Enbridge plan to reverse the pipeline's flow. You see, this pipeline was built to move supplies of imported crude oil north from coastal ports to the heart of the U.S. pipeline network in Cushing, Oklahoma. Now, it's going to be used to take oil south, out of the U.S. domestic market.

It's not the only pipeline that's going to be necessary, either. The same two companies, Enbridge and Enterprise Products, are building "Wrangler" – another Cushing-to-the-Gulf pipeline with 800,000 barrels a day capacity.

Kinder Morgan Energy Partners, which in my opinion is the best-managed energy firm in the country, announced this week it will build – in partnership with liquid products transport and storage firm TransMontaigne Partners – a new \$400 million fuel oil export terminal on the Houston Ship Channel. The project will include 52 storage tanks with a 6.6 million barrel capacity. The first phase of the project is expected to be finished by the end of 2013.

What Happens Now

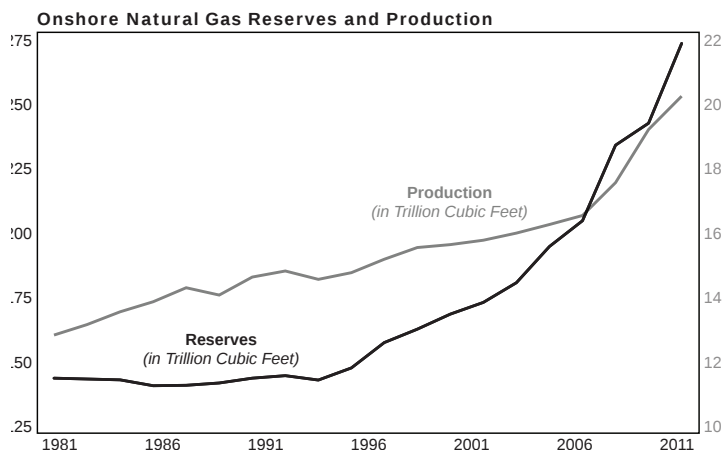
Let me show you why these firms are committing billions of dollars to improving the infrastructure that's available for energy exports.

The first chart I'd like you to consider shows you the proven reserves and the current production of natural gas in the U.S.

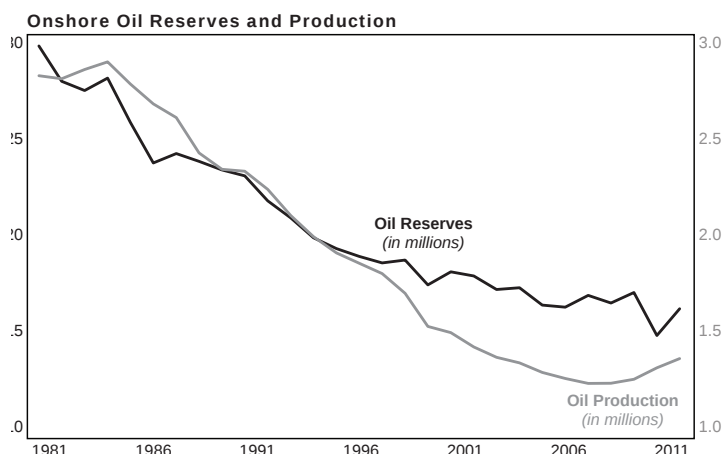
Our staff geologist and the editor of our *SC&A Resource Report*, Matt Badiali, created this chart for me using data collected by the U.S. government. It shows you the size of the proven, onshore natural gas reserves in the United States. Something I hope you'll notice: the trend for reserves began increasing rapidly back in 2000. It's been increasing at an accelerating pace ever since. The technologies that allow these new reserves to be found and produced are getting better.

Something else to note: Increases to production lagged behind increases to reserves. Obviously, it takes more time to produce the resource than it does to discover it.

One final thing I hope you'll notice: Neither of these lines is curving downward. That's because peak oil (the idea the world is running out of oil) is complete nonsense – and it always has been. Natural gas is a hydrocarbon. If we were really running out of hydrocarbons, why would natural gas reserves and production keep increasing at a faster and faster pace?



The next chart – also made for us by Matt Badiali using U.S. government data – shows the amount of *proven* onshore oil reserves and onshore oil production. Here's the chart the peak oil fanatics would also present at their conferences. "Look," they say, "we're running out of reserves... We're running out of oil... and soon production is going to stop." Nope.



What you don't see yet, is the size of the reserves that are sitting in the new shale discoveries.

You don't see them because the government doesn't count them as "proven" yet for technical and accounting reasons. According to this chart, total onshore oil reserves are less than 15 million barrels. But in fact, the Bakken field of Montana and North Dakota alone likely holds more than 20 billion barrels. And Eagle Ford likely holds more than 20 billion barrels, too. Likewise, the Marcellus field in western Pennsylvania and New York probably contains more than 20 billion barrels. Each one of these fields will double our country's existing reserves. And that's not even counting the smaller shale plays like the Niobrara/Wattenberg.

Harold Hamm is the CEO of Continental Resources and the pioneer of the Bakken shale fields. He scoffs at the

official U.S. Geological Survey estimate of 4 billion-5 billion barrels of reserves in the Bakken. “No way,” he says. “We estimate that the entire field, fully developed, in Bakken is 24 billion barrels. Bakken is almost twice as big as the oil reserve in Prudhoe Bay, Alaska.”

How does he know? As he says, the more we drill, the more oil we find. “We expect our reserves and our production to triple over the next five years.”

What Does All This Mean for Investors?

Here are a few stocks I’d like you to put on your watch list. You should follow these companies closely. Learn more about them. And when the time is right... be prepared to buy a lot of shares. (Don’t worry... I’ll tell you when the time is right.)

In the Eagle Ford, the best-positioned company now is **EOG Resources (NYSE: EOG)**. This is a *huge* oil company – \$26 billion in market value today. Ordinarily, you wouldn’t expect a stock this big to grow very fast. But the Eagle Ford is such a huge opportunity, it wouldn’t surprise me to see EOG become a \$100 billion company by this time next year.

In the Bakken, the company to watch is definitely **Continental Resources (NYSE: CLR)**. As I explained above, its CEO was the pioneer of the Bakken. He got there first, got the best land, and is now growing reserves and production faster than anyone else. The thing I like best about the company is that Harold Hamm and the other insiders own 77% of the shares... and Harold keeps buying. If only all public companies had such strong owners/managers.

In the Marcellus, **Range Resources (NYSE: RRC)** is the undisputed leader. Like the others, this is suddenly a very big business – worth \$10 billion today. Its shares have soared from \$10 in 2005 to nearly \$70 today. And, in my view, that’s just far too rich – although I continue to hear rumors of an impending deal to buy Range at an even higher price. It’s certainly possible.

The only one of these stocks that I’d consider buying today is EOG. At roughly two times book value, the share price is reasonable, compared with Continental at five times book value and Range at 4.6 times book value. Ideally, you should buy asset-based businesses like oil companies at book value or less. I believe, when the market corrects, you’ll get that opportunity. Until then, just be patient. This is a long-term story... It won’t end tomorrow. And there will be big bumps in the road, as production falls temporarily or oil prices collapse temporarily (which will definitely happen at some points).

If you feel like you must – absolutely must – buy something now, buy shares of **Newfield Exploration (NYSE: NFX)**. It has assets in several of the best shale plays across the country, including the Bakken and the Marcellus. It has had a terrible

year from a production standpoint and has greatly disappointed investors because all of its wells cost more than expected... and produced less oil than expected.

As usual, investors overreacted. The stock is down about 40% this year as a result, and it trades at less than 1.5 times book value. I’m certain Newfield will trade back in line with its peers (at three to five times book value) over the next 12-24 months. It’s also likely (though not assured) that its book value will grow as well. I’d be surprised if the stock doesn’t move to more than \$100 per share within that timeframe... But even so... I’m not advocating you to buy. Not yet.

Why I’m Bullish on Tankers

The only stocks I’m interested in right now are shipping companies. I think the biggest changes to the global oil business are going to be felt in distribution. That’s why I led this issue with the story of the Nobels and Samuel Marcus. They understood that a glut leads to more distribution. The same thing will be true over the next decade in the U.S. And the biggest glut will be in natural gas. But... our best opportunity right now, in the short term, is probably in oil tankers.

On November 16, I received a confidential fax from... well... let’s just call him Mr. Shipping. He’s been in the industry for 40 years as a broker, an owner, and now a consultant. He knows everyone... knows all of the boats... knows what they’re worth.

Mr. Shipping sent me a third-party report about **Frontline (NYSE: FRO)**, something most of the people in the industry would have seen, saying the company will be down to \$25 million in cash by the end of 2012 if the market for tankers doesn’t immediately improve. The bad news didn’t surprise me. What did surprise me was the stock didn’t move lower.



In my experience, when a stock like this can ignore bad news... it’s usually a sign of the bottom. I also believe that the tanker market will greatly improve as the Brent/WTI spread

narrows, as it's likely that U.S. demand for foreign crude will pick up. Or as Mr. Shipping says: "Historically, it is often a political situation that heats up the tanker market – pardon the pun. Closing of the Suez, a major oil supply being taken offline, or any other unforeseen development."

Don't get me wrong on this... shipping isn't a business I want to be in for the long term. But historically, these companies offer us two things we value as individual investors: volatility and dividends.

Take 2008... a good year for oil tankers. Frontline paid out more than \$600 million in cash dividends. That's considerably more than the company's entire market cap today (\$450 million).

Volatility can be our friend, too... because if this thing doesn't go out of business, its share price will likely rocket higher – far higher than seems plausible right now. It topped out around \$60 per share during the 2000s. I don't expect to see a share price like that any time soon, and I wouldn't want to wait long enough to get it. But... \$25-\$30 a share seems possible, if the world doesn't end. I'd take four or five times my money in capital gains, plus maybe 100%-200% in additional dividends, wouldn't you?

My thesis here is that the company will be able to weather the storm by selling boats. We could wait until the storm has

passed and take a lot less risk. Buying now offers us far more upside. And since Frontline is trading at half of book value right now, we have some coverage before asset sales – even if made at bad prices – would hurt us. Nevertheless, that's our big risk – that Frontline won't be able to get an acceptable price for its boats if it's forced to sell.

Mr. Shipping offers us a very dire warning about the market value of Frontline's boats in the current market...

In 2008, SAMHO in Korea bought a 319,000 VLCC built in 2002 for \$137 million. They recently declared bankruptcy and the estimated value of the vessel at auction has been appraised at about \$30 million. That's a lot of volatility for a three-year span of time.

Here's what I suggest you do. **Wait and get shares for less than \$5.** Getting the right price matters in situations like this. Your entry price could determine your stop loss. You want the lowest entry price possible, not merely because that gives you the most upside, but also because it gives you the lowest possible stop price, which will help you stay in the trade.

If you are an experienced trader, I'd look to sell puts on this stock. The January \$5 puts are trading for \$0.60, and there's plenty of liquidity. Assuming you get put the stock (and yes, I think it's likely), your premium adjusted entry price will only be \$4.40. Putting a 25% stop loss on from that point would take you down to \$3.30 – well below the company's lowest recent trading price. That gives you a reasonably good chance to stick with the stock, while maintaining strict risk control.

For the purposes of our model portfolio, **we'll enter the trade officially if the stock closes at less than \$5.50.** And to help manage the risk, we'll sell call options against our position. The **January 2012 \$7 (FRO120121C00007000) calls** are trading for \$0.50. Assuming we can get that much when we open this trade, **that would give us an adjusted entry price of \$5.** We will use a 25% trailing stop loss against that price to determine our exit, if the stock falls. Otherwise, we'll continue selling calls to generate premium and offset our risk.

Fair warning: This is a risky situation. The outcome is far from certain. And there is a real chance that we'll end up "going down with the ship." But I think the risk is manageable and worth it, given the upside potential. I also believe the spread between Brent and WTI will close quickly because of the pipeline capacity that's becoming available. If, as I suspect, that leads to more oil shipping... this speculation could be incredibly lucrative for us.

You, on the other hand, may decide this isn't the right situation for your capital. That's fine. There's nothing lost in a trade you don't make. Whatever you do... do not put too much capital in this trade and do not ignore our risk parameters. It's fine to swing for the fences every now and then as long as you

How to Trade Covered Calls

One of the strategies I recommend for investing in **Frontline (NYSE: FRO)** – buying shares and selling a call against the same stock – is commonly called "selling covered calls."

This is not a new strategy for us... We sold calls against the silver bullion fund, SLV, in the August issue. However, many subscribers feel they're unfamiliar with options trading, and the idea makes them uncomfortable. My friend and colleague, Dr. David Eifrig, recently wrote an excellent piece leading subscribers to his service, *Retirement Millionaire*, through the process, step by step.

For those of you new to selling covered calls (or who want to review the basics), I urge you read his report, "How Europe's First 'Bubble' Led to This Simple Strategy to Make a SAFE 33% Yield in the Next 12 Months." I've made it available to you under the "Special Reports" section of the *Stansberry's Investment Advisory* webpage.

Also... for subscribers interested in pursuing our put selling approach... I encourage you to review my special report, "The 100% Secret – The Easiest Way to Make Money in a Risky Stock Market," which details this strategy.

have the emotional stability to avoid the urge to gamble. This isn't gambling. It's risk arbitrage. And there's a big difference.

For the conservative investors out there, or maybe just for the folks who don't want to have a position they have to watch like a hawk, I suggest buying shares of **Teekay LNG Partners (NYSE: TGP)**.

This is a \$2 billion partnership that owns 21 LNG carriers – ships that can transport liquefied natural gas. Despite the horrendous market for oil tankers this year, the market for LNG tankers remains strong. Cash distributions for the most recent quarter were up 19% over last year.

The partnership is growing by adding capacity (five new ships in the last quarter, all of which are chartered under long-term agreements). And last month, it agreed to spend \$1.4 billion on acquiring eight LNG carriers from shipping firm A.P. Moller-Maersk. I believe Teekay LNG will continue to grow its distribution, which is currently 7.6%.

LNG is a huge growth industry, given the scope of the increases to natural gas production in the U.S. and the development of several LNG export terminals, as well as the growth in demand for natural gas in Japan, China, and parts of Europe.

I recommend buying Teekay LNG Partners (NYSE: TGP) up to \$40. Use a 25% trailing stop loss, adjusted for the distributions.

Europe Hasn't Collapsed... Yet

As you surely know by now, I have long believed the failure of Italy's UniCredit – one of the largest banks in Europe – would be the critical domino... the fall of which unleashes the destruction of the euro and begins the crisis that eventually leads the entire world away from paper currencies and back to gold and silver.

(If you haven't yet, please go back and read my March 2010 letter, where I explain the history of UniCredit. It will open your eyes to the dire risks we currently face.)

The last 30 days brought still more evidence underscoring the scope and seriousness of the problems UniCredit faces. Of all the major European banks, UniCredit has the greatest amount of bonds coming due next year – \$51 billion. Currently, its bonds are trading at prices that represent four notches below investment grade and eight notches below its official Moody's A2 rating.

This is a serious problem. The bank cannot operate without an investment-grade credit rating. Nor can it possibly refinance the \$51 billion coming due. Compounding matters, the bank took a \$14.3 billion loss in the most recent quarter, which Bloomberg labeled "surprising." Surprising to whom?

I draw a few conclusions from this information...

First, UniCredit is insolvent because its creditors are refusing to lend to it at any reasonable price. You'll recall my August issue, in which hedge-fund manager Howard Marks described how the entire structure of credit ratings had shifted over the last decade...

One of the most striking aspects of debt in the modern era is that little if any attention is paid to repayment of principal. No one pays off their debt. They merely roll it over... and add to it. Thus credit ratings are highly deficient (shocker!) in a way that few people talk about.

What ratings describe isn't the borrower's ability to repay principal, but its ability to make interest payments and refinance principal. But the assessment of their ability to roll their debt – likewise – isn't based on an ability to repay, but rather to refinance again.

So ultimately, the security of capital providers stems not from the borrower, but from the continued willingness of other capital providers to roll debts in the future. (It was their occasional refusal in 2007-08 that caused the worst moments of the financial crisis.)

I believe UniCredit has clearly reached this point. Its bonds are now trading at prices that indicate an eight-notch reduction in credit rating – prices at which the bank cannot hope to operate profitably. To raise desperately needed capital, it has organized a huge equity offering. The problem is, it has little equity left to offer. On the company's balance sheet, you'll find \$13.5 billion euros of "tax-deferred assets" – these are literally the value of the future tax savings UniCredit has earned by taking horrendous losses. They are worth nothing if the bank doesn't return to profitability. Likewise, the bank lists \$11.5 billion euros of goodwill – an intangible asset that's worth nothing if the bank doesn't survive. That's \$24.5 billion worth of assets that can't be traded or sold. Are they really assets? Only to an accountant.

Given the bank's size (a nearly 1 trillion euro balance sheet), I don't believe Italy can bail out UniCredit. Quite simply, it doesn't have the money. That leaves the European Central Bank (ECB). However, it has rules against national bailouts (Article 125 of the Treaty on the Functioning of the European Union).

I can't figure out how this problem will be resolved... And I've been studying it for years. What the Europeans seem to be doing is "kicking the can down the road." For example, it's widely understood (though not yet public) that the European Commission is working on a new law that will allow Europe's banks to completely ignore the losses they've taken on European sovereign debt so far this year. They're simply pretending the problem doesn't exist.

What you need to understand is that these problems and Europe's inability to deal with these losses will have a huge

impact on the world's economy and the U.S. financial system moving forward. Europe's banking system holds \$55 billion in assets – roughly equal to the total debt (public, private, corporate) in the United States. Europe's banking system is four times larger than the U.S. banking system. And it is stuffed to the brim with sovereign debts that will never be repaid.

The main way these problems will spread to the U.S. is through money-market funds. As of September, 37% of the \$1.5 trillion in U.S. money-market funds was invested in European bank bonds and CDs. Even though that's down from 51.5% in May, it still leaves more than \$500 billion of U.S. assets in Europe's banks.

An unnamed bank executive in Europe told Reuters this week that “the market for unsecured funding with maturities that go beyond two years is literally dead.” Given that Europe's banks can't presently fund themselves without government support... **you should view the exit of the U.S. money-market funds as a run on Europe's banks.** This crisis is very much underway.

And what most people don't understand yet is that it's going to be much, much worse than the Lehman Brothers collapse. We're not talking about the failure of a single bank – though it seems more and more likely that a single bank (UniCredit) will be first. We're talking about the failure of an entire system, the largest system of credit and banking on Earth.

Why, then, don't we simply short everything?

Because shorting the sovereign is incredibly risky. The paper currency system we have in place means there is no actual limit to the size of the bailout that can (and in my view, will) be organized. Yes, the ECB has rules against bailing out countries. But those rules will be changed, you can bet on it.

The Federal Reserve cannot allow U.S. money-market funds to lose \$500 billion. It cannot allow Europe's entire economy to collapse. Whatever the other risks – inflation, a panic out of euros and dollars – anything will be tolerated except a complete collapse.

Thus, for now, all I can advise is caution. Wait for the volatility that's coming. In the next 12 months, we will have the opportunity to buy stocks at much, much better prices. But we must be patient.

My other core recommendation is for you to own plenty of gold (and silver) bullion. I've explained many times why this is so important, and I won't beat that dead horse again here... But consider this: Total central bank gold purchases in the third quarter more than doubled over the third quarter of 2010. This is the world fleeing to gold. This is the death of the U.S. dollar as the world's reserve currency.

All of the folks who've criticized my work over the last year... saying I was exaggerating these risks, mocking my predictions of civil unrest and soaring inflation... where are they

now? They're in line at the coin dealer.

Portfolio Review

While I believe both **Gannett (NYSE: GCI)** and **D.R. Horton (NYSE: DHI)** face difficult and uncertain futures, we've learned the hard way not to cut our losses short when we're shorting stocks. And so, we've closed both positions at a small loss. Don't worry about it... that's the nature of short selling. We'll get 'em eventually, as the downside from here is always 100%.

On the other hand, our solar short is way up, right out of the gate. And finally, our euro short seems to be working, too.

I would much rather have six to eight short sells in our portfolio right now... But I can't find opportunities that are safe enough for us, given the huge volatility in the market right now. That means you should cut back on your long positions to make sure you're still fairly hedged. Be at least 20% short. Favor the euro trade if you need additional short exposure to hedge your long portfolio.

And... as I've been saying for 18 months now... if you're not hedging your long portfolio, you have to be out of stocks for now. The way to position yourself for maximum safety is to be 50% long dollars via Treasury bills and 50% long gold. If you want to make this trade via exchange-traded funds, you can use Barclay's short-term Treasury fund (SHY) and the giant SPDR Gold Trust fund (GLD).

But be aware that I strongly recommend holding your gold as a physical asset – that is, I recommend you buy and store gold bullion coins. It takes a bit longer to buy and sell them, and you've got to store them someplace safe. But there are real risks that a European banking collapse will spark a run on physical gold, making it impossible for the futures market to deliver. In that kind of scenario, I think holding GLD would be very uncomfortable. But holding gold in your hand will still feel great.

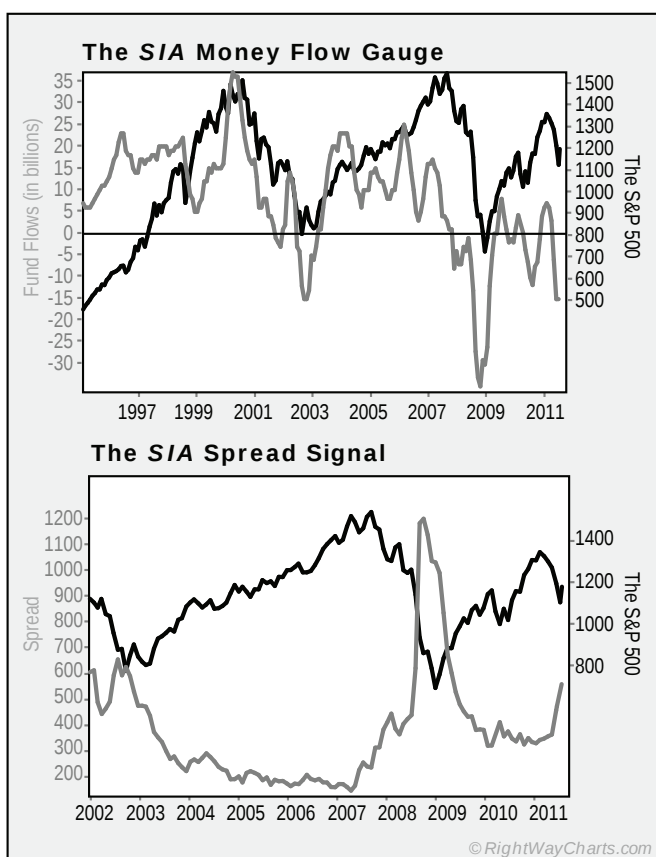
SIA Indicators

Our indicators are designed to give us a feel for the value of stocks relative to bonds, to show us whether stocks are popular or out of favor, and tell us if investors are doing stupid things with their money in the stock market.

The first indicator is simple. The gray line shows us the interest rate spread between U.S. Treasuries and risky “junk” bonds. As these spreads widen, the stock market (in black) normally falls. And as these spreads narrow, the stock market should rise. Thus, the spread is a measure of value in stocks as well as bonds. I prefer it to simple stock market measures like the overall price-to-earnings ratio because I don't trust most of modern accounting. And I believe fixed-income investors are, in general, more savvy than equity investors. This spread

The SIA Blacklist

Short Name	Ticker	Market Cap	P/S	P/E	Total Return YTD
Baidu	BIDU	\$49,122,099,200	24.99	54.40	45.80%
Vmware	VMW	\$43,590,000,640	12.20	69.30	16.13%
Public Storage	PSA	\$22,392,629,248	12.28	41.14	26.26%
Intuitive Surgical	ISRG	\$17,499,439,104	10.64	38.79	74.11%
Alexion Pharmaceuticals	ALXN	\$12,464,100,352	17.24	89.17	67.15%
Check Point Software	CHKP	\$12,197,829,632	10.11	24.14	27.30%
AvalonBay Communities	AVB	\$12,163,819,520	11.63	73.95	16.21%
Range Resources	RRC	\$11,489,479,680	10.37	125.00	58.76%



indicator is mildly bullish – but (and this is a big but) I expect spreads to widen dramatically soon because of the European banking crisis. Officially, though, this indicator is mildly bullish.

The second indicator shows money flows into (and out of) U.S. equity mutual funds. The more people sell out of their funds, the more interested in buying stocks I become. That might sound strange, but the time to buy stocks is when they're cheap – when other people don't want them anymore.

We are approaching extremely bullish levels of

mutual-fund redemptions. This leads me to believe that, if spreads were to widen sharply over the next several weeks, the stock market would really collapse. Folks are already heading for the doors. It won't take much to turn this trend into a rout. The good news is, if that comes to pass, we'll have a great chance to buy high-quality onshore oil and gas assets at good prices. I'd rate this indicator bullish.

The last indicator is the hardest for folks to understand, judging by the feedback e-mails I get. It's simply a list of the most expensive big stocks in the world, as measured by the price-to-sales ratio. Now... some of the companies in this list, particularly the asset-holding companies – like a Silver Wheaton or a Range Resources – probably don't belong on it. These companies are valued on the basis of their reserves, not their current sales. But we keep them on the list to maintain the ability to measure apples to apples over time.

What we're interested in with this list is not the individual names, but the number of companies on the list. When investors believe that 10 or more companies over \$10 billion in market value are worth 10x sales, it's a strong indication that their expectations are set far too high. They're going to be disappointed. At market bottoms, this list will dwindle to nothing or maybe just a couple names. Right now, there are eight stocks on the list, which is neither particularly bullish nor bearish for stocks. This indicator is neutral.

Overall, our indicators aren't telling us much this month. Once again, the message is simply to be cautious.

Good investing,

Porter Stansberry
November 18, 2011

Stansberry's Investment Advisory Model Portfolio

Prices as of November 17, 2011

	Symbol	Ref. Date	Ref. Price	Recent Price	Dividends	Description	Action	Return*	Risk
"No Risk"									
Wal-Mart	WMT	09/09/10	\$51.91	\$56.73	\$1.40	World Dominator	Buy	12.0%	5
Johnson & Johnson	JNJ	07/06/06	\$60.52	\$63.94	\$9.89	World Dominator	Buy	22.0%	5
Exelon	EXC	10/09/02	\$21.47	\$43.40	\$15.72	Nuclear Power	Hold	175.4%	5
Hershey	HSY	12/06/07	\$40.55	\$56.24	\$4.70	World Dominator	Hold	50.3%	5
The "Next Boom"									
ConocoPhillips	COP	04/02/09	\$41.45	\$69.56	\$6.23	Cheap Oil	Hold	82.8%	5
Calpine	CPN	05/13/10	\$13.93	\$14.96		Natural Gas Power	Hold	7.4%	5
Silver Wheaton	SLW	12/01/10	\$37.90	\$32.27	\$0.09	Silver Secret	Buy	-14.6%	5
Monsanto	MON	11/18/10	\$59.63	\$70.49	\$1.14	Soaring Food	Hold	20.1%	5
San Juan Basin	SJT	01/07/10	\$18.34	\$24.46	\$2.84	Cheap Energy	Hold	48.9%	5
Dominion Res.	D	07/18/11	\$48.00	\$50.84	\$0.49	Export LNG	Buy	6.9%	3
Silver^	SLV	08/11/11	\$34.10	\$30.64		Inflation Hedge	Buy	-10.2%	2
Activision Blizzard	ATVI	10/13/11	\$12.92	\$12.13		Gaming Publisher	Buy	-6.1%	2
Teekay LNG Partners	TGP	11/17/11	NEW	\$32.72		Tanker Turnaround	Buy	NEW	3
Frontline Limited	FRO	—	—	\$5.74		Tanker Turnaround	Buy below \$5	—	9
Victims									
UltraShort Euro	EUO	05/13/11	\$17.55	\$18.87		Debt Crisis	Buy	7.5%	5
Gannett	GCI	9/8/11	\$9.87	\$10.97		Obsolete	Buy to Cover	-11.1%	5
D.R. Horton	DHI	9/8/11	\$9.80	\$11.33		Obsolete	Buy to Cover	-15.6%	5
First Solar	FSLR	10/13/11	\$56.85	\$45.61		Obsolete	Sell Short	19.8%	5
* This is the return since reference date, including dividends. ^ Price adjusted by profits from selling January 40 calls									
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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