



Better Than Gold

We are at a strange and, for some, dangerous crossroads.

What follows are a few details about my great concerns for what's going on just beneath the surface of our otherwise improving economy. As you will see, looking simply at the numbers as they stand leads me to a very bullish position on stocks.

As a result, we will continue to urge you to buy stocks that give us the greatest possible advantages in a rising market. This month, we will begin to position ourselves to make a tremendous fortune in energy.

But our energy strategy is almost surely going to surprise you... so read carefully.

And let me amplify the warning that began this month's letter. I'm about to share several critical secrets – things about finance that few people ever consider and even fewer understand thoroughly.

It's going to be fun breaking down these arcane corners of the market – like insurance and energy resource accounting – and put them in plain English. But make no mistake: We are tackling some sophisticated ideas in this month's letter. I urge you to read it twice or save a copy to review later. Although I'm afraid I might lose more than a few of you with a letter of this depth and complexity... I hope you'll be patient with me, as it was a labor of love. I sincerely hope you get a lot out of it! I know if you read it carefully and think about these ideas, you will become a much better investor than you already are. That's always my goal.

But first... I want to make sure you understand the differences between our tactical decisions (like buying stocks this year) and our strategic position. We know exactly what's driving this market – colossal amounts of new paper money. We know this rally merely presages an enormous inflation, the likes of which the world has never seen.

I continue to urge people around the world to protect themselves from an inevitable catastrophe. I'd wager I've personally spent more money than anyone else in the world advertising a stern warning about the huge risks being taken by central banks. These risks are imminent. They aren't going to go away.

Sure, economic growth will probably return. And yes, stock prices are almost surely going to soar. But will any of this actually lead to any real prosperity? No. You can't print yourself to wealth. Nor can you tax yourself to prosperity... or borrow yourself into solvency.

Inside This Issue

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- The U.S. Treasury Market Begins to Collapse
- 'Bribing' Shareholders with Dividends
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Editor: Porter Stansberry

Nothing that's happening now will solve our country's massive financial problems.

Having said that... I also believe you must "make hay when the sun shines." Monetary debasement comes with a flipside: rising asset prices – things like stocks and real estate.

That's why I believe 2012 might be the best year for stocks that we've seen in more than a decade. I'd like to do all that I can to help you make as much money as possible – as that's the single best way to protect yourself from the falling value of the U.S. dollar (and every other major paper currency.)

My goal for this issue is to give you two ways to manage the risk of a large inflation that will perform substantially better than gold over the next decade. Given gold's incredible run over the last 12 years, stocks represent a better value in many sectors of the market.

Normally, we put our market indicators at the rear of each month's issue. But this month, I'm dragging them front and center because I want you to understand why I'm so bullish on stocks right now – far more bullish than I've been at any time since late-2008/early-2009.

Why I'm Bullish on Stocks in 2012

As longtime readers know, I rely on three simple indicators. They show me, in real time, using real market-derived values whether or not money is likely to flow into (or out of) stocks.

The most important indicator is the risk spread in fixed income (top chart, p.3).

I want to make sure you understand this chart... so forgive me if you're already well aware of what it means. The black line is the S&P 500 – stocks. The gray line is the spread (the difference) between high-yield bonds and U.S. Treasury bonds of a similar duration. This chart shows how expensive capital is for most of the small and medium-sized businesses in America, as the price of credit is based on the 10-year Treasury yield.

When credit is cheap, stocks soar. And when credit is expensive, they plummet. As you can see in the chart, the price of credit right now is "rolling over" – meaning, it has stopped increasing and seems poised to contract. That's what will propel the bull market forward this year in stocks.

I warned you in the October 2011 issue that my indicators were "rolling" over and were predicting an imminent rally in stocks...

Our market indicators show us a significant rally in stocks is likely. In particular, our Money Flow Gauge reveals mutual-fund outflows have grown big enough to be significant. The volume of selling is roughly equal to what we saw near the bottom in 2002... and the spread between high-yield bonds and Treasuries is surging. That tells me unless the situation in Europe boils over immediately, we will almost surely see a 20%-30% rally in stocks to end the year.

As you know, stocks bottomed in early October at around 1,100 on the S&P 500. And Europe did not collapse. Instead, the European Central Bank (ECB) caved to political pressures and has provided more than 1 trillion euros to the insolvent banks of Europe, led most notably by our old favorite UniCredit.

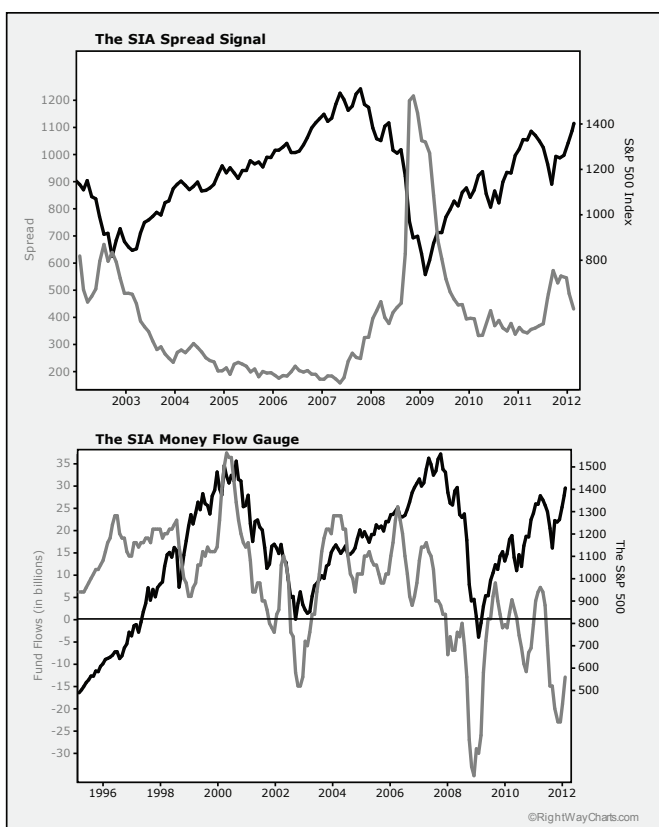
Here's what matters now: Most individual investors have not bought back into stocks yet. My second leading indicator – money flows – tells us so....

The *Stansberry's Investment Advisory (SIA)* Money Flow Gauge (second chart, p.3) compares stock prices to equity mutual fund inflows and withdrawals. Again, the black line is the S&P 500. The gray line is the amount of money (in billions) that people are putting into equity mutual funds or taking out. As you can see... during 2011, folks were withdrawing money from equity mutual funds in amounts that nearly matched the horrific bear market/panic of 2008.

Now, the tide in mutual funds has only begun to turn. And as mutual funds receive billions of dollars in inflows during 2012, their buying will power

this market higher.

My two most important indicators are almost as bullish as I've ever seen in my career. The only warning sign is the *SIA* Black List (table below). The Black List shows how many companies are trading at prices that simply don't make sense. Right now, 10 companies with market caps greater than \$10



billion are trading for a value that's simply hard to fathom – more than 10 years' of sales.

While a small growth stock trading at that kind of valuation might not raise any red flags, stocks of this size (\$10 billion) and this super-high valuation must be viewed skeptically. In some rare cases, a big company may warrant that valuation if it has huge future opportunities and/or limited current sales prospects. Even so, some companies on this list certainly appear too richly valued by investors. But the important thing to remember is the Black List isn't where we shop for stocks to sell short – I never short valuation alone.

What matters on the Black List isn't the individual names... it's the number of stocks on the list. When the list sports fewer than 10 names, that's evidence of a calm market. No names on the Black List (or only one or two) has typically signaled a market bottom. But when the list swells to more than 10 names, that indicates the market has gotten far too expensive... investors have thrown away valuation and simply begun to chase momentum.

Thus today... at exactly 10 stocks... the Black List is neutral.

Given the inflationary nature of the current stock market rally, I fully expect to see a record number of names on the Black List before the

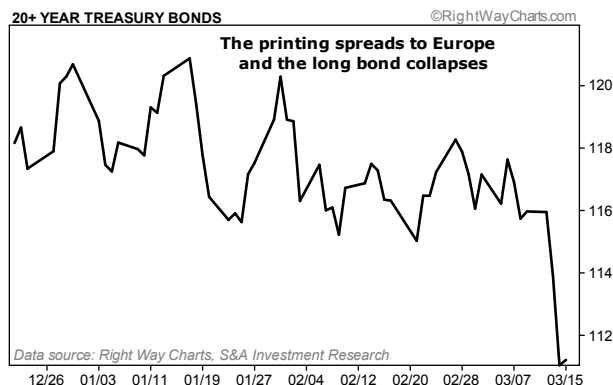
The SIA Black List					
Short Name	Ticker	Market Cap	P/S	P/E	Total Return YTD
Baidu Inc	BIDU	\$48,942,604,288	21.36	46.77	20.36
Vmware Inc	VMW	\$44,362,588,160	11.73	62.92	26.31
American Tower	AMT	\$24,370,970,624	10.02	61.90	3.15
Public Storage	PSA	\$23,810,869,248	12.83	39.80	-0.60
Intuitive Surgical	ISRG	\$21,053,804,544	11.84	43.20	14.75
Alexion Pharmaceuticals	ALXN	\$16,648,269,824	20.95	103.48	25.19
AvalonBay Communities	AVB	\$13,366,347,776	12.84	28.77	7.50
Check Point Software	CHKP	\$12,748,789,760	10.21	24.14	17.15
lululemon	LULU	\$10,487,704,576	11.90	63.66	56.22
Regeneron	REGN	\$10,374,959,104	22.78	N/A	102.18

market has topped. I'll make the prediction here: We'll see 20 or more stocks on this list before the rally is over. During big inflations, nothing matters but momentum. People will become desperate to get out of paper dollars into something – anything – that will hold its value. Sadly, many, many people will end up gambling their savings away.

Now... how do I know this is really it? How do I know we're sitting at the beginning of a real inflation? I could give you all the data on the size of the debts in Europe and the U.S. and show you how much money has been printed by the central banks. I could explain why once they've started down this path, they have no choice but to continue printing. I could explain the personal connections between the people with political power, the bankers, the central bankers, and the hedge-fund managers...

But since I've already done all these things in previous issues, I don't think it's necessary.

Instead... I'd like to show you the one gauge that won't lie to us. I'm talking about the market value of long-dated U.S. Treasury bonds. I've been writing about the "long bond" market for many years. I've shown you charts comparing long bonds to gold and explaining that the long-bond market is the best way to measure the credit worthiness of the U.S. government. Those things are all still true.



And... look what's happened to the long bond since Europe joined with America and started printing huge amounts of money... The long-bond market has collapsed, falling by almost 10% in three months.

Bullish in the Short Term Doesn't Mean Bullish on the Dollar

Now... I want to discuss one more thing before we move on to this month's new recommendations...

At some point in the next few months, I will walk through a hotel bar... or ride a convention center escalator... or sit with a group of subscribers at the next Alliance meeting, and one of our dear subscribers will say...

"Stansberry, you're such a phony. You were out there predicting the end of the world. But in fact, all you did was recommend a bunch of stocks. Yes, they were good stocks for the most part. But boy, were you wrong about the end of the world. How's that egg on your face taste?"

If only that were true, I'd enjoy every bit of the egg. I sincerely hope I'm dead wrong about the fate of the dollar. But I know this rally is merely the beginning of the great inflation I've been predicting since 2009. The West – the richest, most developed and most sophisticated economies in the world – is broke. Our leaders, hamstrung by the false beliefs of the folks voting them into office, have no choice but to try printing our way out of these debts and obligations. Unfortunately, I know what that means for the world, my country, and most of my subscribers. And it's horrible.

The standard of living will plummet. The cost of capital (interest rates) will soar. The value of wages and savings will collapse. The great inflation will spark civil unrest and, most likely, war. There will be a significant breakdown in the cooperation between nations, which will greatly handicap the division of labor, resulting in widespread poverty.

I know these things will happen, just like you know when the barometer drops, bad weather is on the way. Most of the world has forgotten about the importance of gold – about how critical it is to have a standard of value to balance the interests of debtors and creditors, to allow for fair international trade, and to limit the power of governments (and

the special interests that corrupt them).

If during this big rally you forget what's really about to happen, just think back to last fall, when it seemed like Europe was going to implode. Remember how the stock market was trading back then, at the lows last October.

A healthy, organic market normally has ups and downs. Some companies thrive. Others wilt. But for a time last fall... almost every stock in the S&P 500 traded in unison. The statistics are simply extraordinary, and they bear repeating.

Since 1972, individual stocks in the S&P 500 (the 500 largest stocks listed in the United States) have shown a three-month correlation of 0.46. That's very little correlation. A statistician would tell you there's essentially no meaningful correlation whatsoever. But during the market's swoon last fall, that correlation rose to 0.86.

Things like this simply don't happen under normal conditions. Never. I first brought this extraordinary situation to your attention in January...

During the market's correction last fall, almost everything fell or rose together. This has never happened before. Never before in the market's history have so many stocks been so tightly correlated before. Not in 1987 (when correlation hit 0.81). Not in the days before World War II (0.6). Not even during the Lehman crisis of 2008 (0.78).

If the concept of correlation is a little too remote for you to get your head around, just think about this oddity. Most of the time in the market, some stocks go up and some go down. Rarely do essentially all stocks move in the same direction. But last fall, they did.

The S&P 1,500 (yes, that's the largest 1,500 stocks) experienced only 14 trading days in 2006 when 90% of its stocks moved in the same direction. In 2007, it had 23 such days. In 2008, it had 39. In 2010, there were 44. And in 2011, the S&P 1,500 had an astounding 58 days when 90% of its

stocks moved in unison.

I repeat this analysis here because you should be astounded by this data. It ought to cause you to stop everything else you're doing with your money and your investing and simply ponder what this portends.

It means something... something important. Something that's bigger than any event we've seen in America during the last 100 years. This has never happened before...

I have my ideas. And I admit... This is only conjecture. But you pay me to tell you more than just what I can prove. This is what I believe.

Most of the people living in the West have become little more than puppets. We dance or dive at the whim of our monetary masters, while we continue to believe in the myth of a free market. When they spill trillions into the commercial banking sector – like the U.S. Fed did in March 2008 and like the Europe's ECB did in late December 2011 – we do our part. We buy stocks. We look for the inevitable economic improvement. When they inject oil into the markets through the Strategic Petroleum Reserve (aka, the Insider's Petroleum Reserve), we immediately sell oil futures contracts and predict lower gas prices.

We give precious little thought to any of the real underlying fundamentals – like earnings and dividends or supply and demand – because the value of everything in our paper system is dictated mainly by the supply of money, not the quality of our assets.

But it is all a stupid game.

And the worst part... the very worst part... is that we have no choice but to play.

Under this paper regime, you have no viable way to protect your savings without speculating. Gold pays no dividend. So all of us have been forced to buy stocks or other risky assets, like high-yield bonds or leveraged derivatives (options). We put our

savings into the capital markets almost blindly. And we do so not because we're interested in providing capital to entrepreneurs... but because we have no choice. By forcing the rightful owners of capital into a position of financial apostasy, the entire free market system has been turned on its head.

Consider this anecdote...

Steve Jobs built the most successful public company in history (Apple). At no time when he was in charge of the company did it ever pay a dividend to its investors. Jobs referred to dividends as "bribes" to shareholders. Imagine parting with your savings to invest in the company of a man who viewed your investment in his business as little more than a shakedown.

And so the question becomes.... Why? Why would we willingly participate in capital markets under such conditions? Because we have no other way to protect our savings.

The buffoon who will, later this year, lampoon me for warning about the coming inflation, while telling my readers to buy stocks is ignoring the most relevant fact: *We have no better way to protect our wealth.*

No, I don't like it. And yes, I am aware the stock market has stopped functioning as a mechanism to distribute capital across our economy. It has mostly become a casino where the crowd is simply guessing between two binary outcomes – black or red. You can think of "black" as the collapse of the global banking system and "red" as the inevitable inflation that will result if the banking system is bailed out with trillions in new dollars/euro/yen.

That is what explains the extraordinary correlation we saw back in the fall of last year. And the big rally we've begun to experience confirms that what I've been predicting for years (since at least 2009) is underway.

Let me be perfectly clear: I continue to believe that you must bet on "red." My logic is simple: No one in history with the power to print the reserve

currency has ever defaulted. No paper currency has ever collapsed because of deflation. The opposite is true: Every legal tender paper currency has failed because the paper lost all of its value. The same, sadly, will happen here.

And I hope you'll think about what this really means. It's not merely that we've all been forced to become speculators merely to hang on to what we have... It's that we've lost a huge part of the sovereignty we once held.

As Americans, our fathers and grandfathers bet their honor, their lives, and the lives of their families to win us freedom from government tyranny – and paper money was part of that tyranny. One of the first pieces of major legislation passed by Congress was the Coinage Act of 1792. The act established exactly how much gold would be in our national coins – 270 grains of standard gold in the Eagle. The dollar was to be 416 grains of standard silver. The proscription for violating these standards? Death. (You can read the Coinage Act of 1792 for yourself at <http://www.constitution.org/uslaw/coinage1792.txt>.)

That if any of the gold or silver coins which shall be struck or coined at the said mint shall be debased... through the default or with the connivance of any of the officers or persons who shall be employed at the said mint, for the purpose of profit or gain, or otherwise with a fraudulent intent... every such officer or person who shall commit any or either of the said offenses, shall be deemed guilty of felony, and shall suffer death.

These laws weren't enacted to empower bankers. The death penalty here wasn't meant to inspire an unlimited amount of government borrowing and spending. These laws and the serious consequences that stood behind them were put in place to ensure that economic sovereignty remained firmly in the hands of the people – forever. It is a horrible crime that these rights and safeguards were taken from us. And it is ironic that today the markets cheer Ber-

nanke's decision to print trillions of dollars... acts that a little more than 200 years ago would have resulted in a death sentence.

Make no mistake. I know what's coming. And I know how horrible it will be for most Americans. But all I can do about it is try to warn the few who will listen. And try to position you to keep pace with the inflation that's coming.

My two best ideas today are insurance stocks and natural gas reserves. I'd like to explain why I think these two assets might serve you well over the next decade – or even longer.

The Best Business in the World: Insurance

There's a reason insurance is the largest business in the world, as measured by revenue. And that reason isn't because insurance is a smart buy.

Insurance is usually a terrible thing to purchase. After all, for the insurance industry to make a profit, you have to have wasted your money. And the fact that the insurance industry not only exists but is the largest industry in the world is nearly a guarantee that when you buy insurance, you're wasting your money. Except of course, if your house does get blown away in a tornado...

For the rest of us, insurance is simply a cost of living. It's like rent and your electric bill. You have to have it. So you pay the toll.

Few investors pay much attention to insurance companies because they are hard to understand... and they seem to take on awfully big risks. But I've learned over my career that many of the best investors always focus their portfolios on insurance stocks. Consider Warren Buffett, the greatest investor who has ever lived.

The basis of his conglomerate, Berkshire Hathaway, is insurance companies. He writes about insurance in almost every one of his annual letters. This year, he once again explained why he's put insurance

companies at the center of his financial empire...

Insurers receive premiums upfront and pay claims later. In extreme cases, such as those arising from certain workers' compensation accidents, payments can stretch over decades. This collect-now, pay-later model leaves us holding large sums – money we call "float" – that will eventually go to others. Meanwhile, we get to invest this float for Berkshire's benefit... If our premiums exceed the total of our expenses and eventual losses, we register an underwriting profit that adds to the investment income our float produces. When such a profit occurs, we enjoy the use of free money – and, better yet, get paid for holding it.

I want to make sure you understand this point. All of the people who make their living providing financial services – banks, brokers, hedge-fund managers, etc. – all of them pay for the capital they use to earn a living. Banks borrow from depositors and investors (who buy CDs) and also from other banks. They have to pay for capital. Likewise virtually every actor in the financial services food chain must pay for the right to use capital.

Everyone that is, except insurance companies. Using Berkshire again, as our example, let's consider the benefit of getting capital for free (or even being paid to hold it) over time.

We have now operated at an underwriting profit for nine consecutive years, our gain for the period having totaled \$17 billion. I believe it likely that we will continue to underwrite profitably in most – though certainly not all – future years. If we accomplish that, our float will be better than cost-free. We will profit just as we would if some party deposited \$70.6 billion with us, paid us a fee for holding its money and then let us invest its funds for our own benefit.

Again... I want to make sure you understand how extraordinary this business model can be. Buffett's insurance companies have earned more in pre-

miums than they've paid in claims for nine years in a row. That's pretty remarkable considering that, as a whole, the industry loses money on underwriting. The result is, he's been able to invest the premiums (which total \$70 billion) and keep all of the gains for Berkshire. Additionally, he's made \$17 billion on the premiums alone. That greatly increases his ability to compound his returns over time.

Just since 2000, the size of Berkshire's float – the amount of insurance premiums it holds for investment, has grown from \$27 billion to \$70 billion. These premiums aren't like bank deposits. They can't be taken back. They aren't like an investment with a hedge fund, they can't be redeemed. They are paid in full. Thus, they are a form of permanent capital. That is, even though they are held in trust for the payment of future benefits, all of the actual privileges and income of this capital accrues to Berkshire.

Just imagine if you were given \$70 billion a year to manage, where you got to keep all of the investment gains. Now imagine if, in addition to the investment income, you were also paid \$17 billion over nine years simply for the privilege of holding the capital!

The nature of this business gives Berkshire – and other insurance firms who can earn a profit with their underwriting and their investments – a truly mind-boggling advantage. And that's not the only one.

Their other huge advantage – and it's a doozy – is that they don't have to pay taxes on those underwriting gains for many, many years because, on paper, they haven't technically earned any of the float until all of the possible claims on the capital have expired. So unlike most companies that have to pay taxes on revenue and profits before investing capital, Berkshire and other insurance companies get to invest all of the float, without paying any taxes for years and years and years.

These companies then... much like Visa (see my June 2009 issue)... are very sensitive to increased economic activity (which leads to more insurance

being sold), inflation, and interest rates because they are extremely leveraged to the capital markets thanks to their float.

Let's assume that I'm right and that the value of the U.S. dollar is going to collapse over the next five years. If that happens, the dollars these insurance companies are collecting in premiums today will be invested with the full purchasing power the dollar has now. But they will only pay out claims over the next 10 or 20 years... when the value of that dollar will have fallen by 50% or more. This inflation/time arbitrage almost guarantees big profits for the entire industry.

The biggest profits will go to the companies that earn a profit on their underwriting – that is, they collect more in premiums than they pay out in claims. Inflation will make future claims more expensive. (Prices will rise, damages will rise with them.) But inflation will also push up the value of the investments the insurance companies make – especially those firms that make equity investments.

And there's one other important thing you should know about insurance stocks. Normal measures of valuation don't usually apply to these companies, which gives knowledgeable investors a great advantage. The float we've been discussing – the permanent capital that these firms use to make investment gains – is actually put on the balance sheet as a liability. Technically, it's money that the firm might one day owe on a policy. So... when you're looking at insurance stocks to invest in, it's usually possible to buy the float at a tremendous discount to its actual intrinsic value.

But there's one overriding consideration... and you must be extremely careful about this... most insurance companies aren't able to consistently earn a profit on their underwriting. And in those cases, the float indeed becomes a liability.

As Buffett also says in his latest letter, "In most years the insurance industry as a whole operates at a significant underwriting loss. For example, State Farm, by far the country's largest insurer and a well-

managed company besides, has incurred an underwriting loss in eight of the last eleven years. There are a lot of ways to lose money in insurance, and the industry is resourceful in creating new ones.”

To reiterate... we want to own insurance stocks because we believe inflation will increase the size of policies sold, increase the return on float, and enable these companies to profit from the time arbitrage of inflation. (The dollars paid today in premiums will be worth substantially more than those same dollars paid back later.) Also, the nature of the float means that these companies are hugely leveraged to the financial markets – their investment portfolios are typically large relative to the equity of the firms. If I’m right about a big bull market this year, these stocks will soar.

I asked one of our new analysts – Bryan Beach – to figure out how much Buffett has paid for well-managed insurance stocks in the past. I wanted some benchmark to help us figure out a fair price to pay for these stocks since book value often underestimates their value by a wide margin. Rather than complain that all of Buffett’s deals are private and he never reveals the details, Bryan reversed engineered the deals.

I found info on three of Buffett’s biggest insurance purchases. In 1995, Buffett bought 49% of GEICO for \$2.3 billion, which added \$3 billion to Berkshire’s float and \$750 million in additional book value. So Buffett paid \$0.61 for every dollar of float and book value. In 1998, Buffett bought General Re for \$21 billion, which added \$15.2 billion to Berkshire’s float and \$8 billion in additional book value. So Buffett paid \$0.94 for every dollar of float and book value. Way back in 1967, Buffett paid \$9 million for \$17 million worth of National Indemnity float. That’s \$0.51 for every dollar of float. This was Buffett’s first insurance purchase.

Looking at these numbers, I’d expect to pay something between \$0.75 and \$1 for every dollar

of float and book value. Yes, I realize Buffett got GEICO for less than this amount (what a deal!)... But you have to remember, he already owned 51% of the business at the time. In short, he was selling to himself. (Surely Uncle Warren would never take advantage of minority shareholders this way... Oh, no! Oh, yes.)

So my dear subscribers... are there well-managed insurance companies that earn a consistent profit on underwriting... that invest in stocks... and whose shares we can buy for a considerable discount to float and book value? Yes, there are. Thanks to a “soft” market in insurance since the mid-2000s, many of these stocks are trading near record-low valuations.

Let me show you the first one that jumped out at us...

W.R. Berkley (NYSE: WRB) is today valued by the stock market for a little less than \$5 billion. That is, if you could buy all the shares (137 million) at today’s price, you’d pay nearly \$5 billion. What would you get in return?

First and foremost, you’d get an insurance company that knows how to price risk. Its 10-year average combined ratio (a standard term in the industry that refers to underwriting profit) is 94%. Anything less than 100 means it collected more in premium than it paid out in claims. Over the last five years (beginning in 2007), W.R. Berkley’s combined ratios have been 88.1%, 93.1%, 94.2%, 94.5%, and 98.3%. I can’t stress this enough... nothing is more important to the value of an insurance company than underwriting discipline. It is the key to the entire model. With it, vast wealth will accrue. Without it, all is quickly lost. The thing I admire most about W.R. Berkley is its proven underwriting discipline.

And something that’s easily overlooked...

To invest in an insurance company requires a huge amount of trust. The revenues and profits the company is booking today depend on what happens tomorrow. The enviable human tendency is

to imagine a brighter tomorrow... especially when doing so results in income today for the insiders, while tomorrow's losses will rain down on others far in the future. So when you invest in an insurance company, you have to have a lot of confidence in the integrity of the principals. Bill Berkley, the principal at the firm, is the man you're investing in. He started the company from his dorm at Harvard. And he still owns 18% of the stock. He will only continue to do well if we do well. And for us to do well, W.R. Berkley has to maintain its strict underwriting process.

I know it's doing exactly that because for the last several years, revenue hasn't grown at all. It might seem strange to advertise that a company hasn't been growing in the midst of an otherwise bullish analysis. But that's the whole secret to insurance stocks. The industry tends to swing widely between so-called "hard markets" when pricing is good and "soft markets" when pricing is weak. In a weak price environment, the best insurance firms pull back. They refuse to write policies when the premiums paid aren't enough to cover their likely future losses. It's really that simple. When less disciplined companies enter this business, they tend to write policies at low prices, which eventually leads to losses.

You can't maintain a solid combined ratio (underwriting profits) unless you're willing to turn away business when necessary. And that's why revenue at W.R. Berkley dropped by more than \$1 billion between 2007 and 2009, from \$5.5 billion down to \$4.4 billion. The good news for us is that the market has turned much "harder" and revenues are bouncing back. The company took in \$5.1 billion in premiums in 2011.

As important as these fundamentals are to the business (without them no investment would be safe), the fact that W.R. Berkley is a well-managed insurance company wouldn't necessarily be all that attractive to us. We're looking for deeply undervalued assets... assets lost in a sector of the market most investors simply don't understand.

As I mentioned above, it would cost you about \$5 billion to buy the company at today's market price. But at the end of 2011, the firm held investments worth \$13.6 billion and produced net investment income of more than \$525 million and net investment gains of more than \$125 million – for total investment returns of more than \$650 million. The company holds \$4 billion in equity (book value). So its return on equity for last year was greater than 16%. I don't know many investors who did that well in 2011.

Here's the best part. We found in our research that Buffett – who's famous for paying low prices for his investments – bought high-quality insurance companies for more than \$0.50 on the dollar of their assets, including equity and float. W.R. Berkley has roughly \$9 billion in float (that's its investment portfolio, minus its equity capital) plus its equity capital of \$4 billion... so the functional book value of the firm (the amount of semi-permanent capital it can employ today, thanks to its rock solid underwriting) is around \$13 billion. Paying \$0.50 on the dollar for this capital would give you a price of \$6.5 billion.

The way we see it, you can buy one of the best insurance companies in the world, right now, for about 30% less than Buffett would pay. Even if the market doesn't act immediately to close this pretty wide valuation gap, I'm confident W.R. Berkley will continue to grow its book value at high double-digit rates. How do I know? When you're collecting rents on \$13 billion on investments, you don't have to hit the ball out of the park to grow \$4 billion in equity by double-digit amounts.

The only thing I don't like about W.R. Berkley is that it doesn't invest in stocks. But on the other hand, why take risks at all when you can do extremely well without them? The company's portfolio is 85% fixed income. The average duration is a little more than three years (so inflation isn't likely to hurt it) and the average rating is double-A. In short, W.R. Berkley is playing the game to make sure it never, ever loses money.

Again let's just look at what it means for us. Let's assume it earns 5% on its \$13 billion next year. That's \$650 million. And let's assume it continues to make about 5% a year on its underwriting, where premiums are expected to be around \$5.5 billion. That's \$275 million. Add both of those together, and W.R. Berkley will likely earn \$925 million next year. That's 23% on \$4 billion in equity. You know anyone else who's able to make so much money on his equity, so consistently? Me, neither. Yes, I recognize that we're paying \$5 billion to buy into the company, not book value (\$4 billion). So our compound returns will be less. We should only expect to make 18.5% – next year, that is.

The real excitement comes after you've owned a stock like this for about a decade. The price you paid for the stock won't increase. But the size of the company's float will continue to grow and grow. The earnings from that float will likewise compound – even if the company sticks to only double-A-rated, short-term paper.

I have no doubt that if you are able to hold this stock for five years or more, you will vastly outperform the S&P 500 and any index of inflation. **Buy W.R. Berkley (NYSE: WRB) up to \$50 per share. Use a 25% trailing stop loss.**

Now... before we move on to a natural gas strategy I think will surprise you... I'd like to comment on my October 2007 issue when I analyzed another high-quality insurance stock – Markel (NYSE: MKL). I made many of the same promises to investors about Markel that I've made in this issue about W.R. Berkley. Here's what I said...

I recommend you buy shares of Markel Corporation (NYSE: MKL) with up to 10% of your investable assets, as long as you're willing to be a very long-term investor in the stock. If you invest \$35,000 today, I believe you'll be sitting on more than \$1 million in less than 20 years – even if you never buy another penny of the stock. If you add some money into these shares every now and then,

you could easily build a substantial fortune. I don't recommend you use a stop loss of any kind on this stock. Just buy it and put it away for your retirement or for your estate.

Was I right?

When we bought the stock, book value was \$2.6 billion and the investment portfolio was \$7.7 billion. Today, book value per share has increased by 27% to \$3.3 billion. The investment portfolio is now worth \$8.7 billion, a 12% increase. These gains accrued despite a weak insurance market and the worst bear market since the Great Depression.

We sold Markel shares in July 2008. As you may recall, Fannie Mae and Freddie Mac had just gone bust (as we expected)... And the financial world was in upheaval. I recommended against holding this financial stock through the turmoil, saying, "Given the huge financial disruption I expect, I believe we'll be able to buy it again at an even lower price in the future." And in fact... today, we can.

Unfortunately (or fortunately, depending on where you sit), the stock market hasn't treated the stock kindly. Today, Markel shares trade at a slight discount to the price we paid in 2007 – despite the large increase to book value and investment assets.

By my calculations, the functional capital of the firm is \$12 billion, but the market value of the stock is only \$4 billion. That's just \$0.33 on the dollar – far less than Buffett paid for GEICO. And it's slightly cheaper than W.R. Berkley. So... why didn't I simply re-recommend Markel?

Well... actually... that's what I intended to do in this issue. But I was shocked to find that Markel has lost some of its underwriting discipline. It recorded an underwriting loss in 2011. Now understand... Markel has only had underwriting losses in three of the last 10 years. But that's still 30% of the time. That's not what we signed up for.

It's interesting to note... Berkshire Hathaway only records underwriting profits about half the time. So we're holding our insurance companies to an even

higher standard than the great Warren Buffett.

If you happen to still hold shares in Markel what should you do? I wouldn't sell them yet. But if you don't have an insurance firm as your portfolio's core foundation yet, I'd pick W.R. Berkley over Markel at the moment. The truth is, you're overwhelmingly likely to do well with either stock this year.

Now, let's move on to the real debacle in the global markets – natural gas. (Remember... any time there's a crisis, there's likely also a great opportunity.)

How I Plan to Make \$1 Billion in Natural Gas

The market action in natural gas might be the single biggest anomaly I've seen in my entire career.

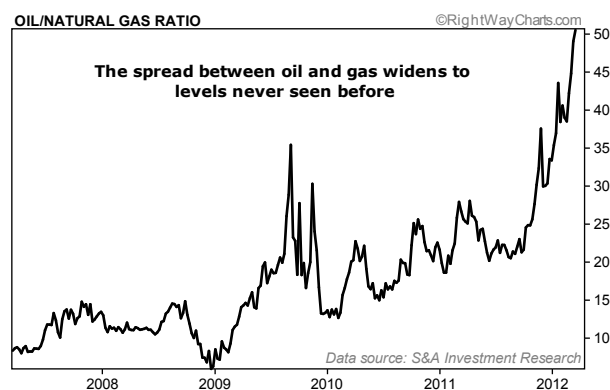
Natural gas is energy. That means, the lower the price goes and the more supply expands, the more people will begin to use it. There's simply no such thing as a permanent glut of energy. Sooner or later, demand will expand to exhaust the supply. That's especially true in the U.S., where natural gas is easily transportable, thanks to our huge pipeline infrastructure.

And soon (starting in 2015), we'll also be able to easily ship it overseas, thanks to the export facilities being built by Cheniere Energy (AMEX: LNG) and **Dominion Resources (NYSE: D)** (see the July 2011 issue for details). This will allow U.S. natural gas to power the markets in Asia and Europe where natural gas prices are still much higher than in the U.S. This will make the U.S. a world energy power, give us a big leg up in our trade deficit and help to equalize the world's price of natural gas – which will mean higher prices here for our producers.

These things will all undoubtedly occur. Thus... it is only a matter of time before natural gas prices increase from around \$2.50 per thousand cubic feet (mcf) up toward the global average price of around \$7 per mcf.

Now... how can I be so sure this will happen over the next five years?

Again, remember... natural gas is energy. It's the same thing as oil basically – although oil is more widely used as a transportation fuel and thus more highly prized. But... at some price... natural gas can also be refined into just about any hydrocarbon product you want. That's why, historically, oil has only been worth six to 10 times more than natural gas, on an energy-equivalent basis. Today, oil is trading at more than 50 times the price of natural gas, on an energy-equivalent basis.



That price difference simply makes no sense. It's a lock that this situation won't last forever. Unfortunately, before it gets resolved, several natural gas companies are likely to go bust. I suspect we're going to see a big wipeout in natural gas equities over the next 12 to 18 months.

Several publicly traded natural gas exploration and production companies borrowed heavily and bought into expensive areas – like Deepwater Gulf of Mexico and some of the tighter shale plays that require lots of expensive hydraulic fracturing. These stocks have never produced free cash flow for their owners because all of the revenue they made was reinvested in more drilling and more leases. These companies only survive by the grace of their creditors... And with natural gas prices collapsing, their ability to service these debts is going to be wiped out.

Let me give you one obvious example: ATP Oil & Gas (Nasdaq: ATPG).

It is one of the most widely shorted stocks in the United States right now. The company invested

heavily in building offshore hubs to service deepwater wells in the Gulf of Mexico. Delays in executing the wells (because of the moratorium on deepwater drilling following the BP/Macondo accident) and the collapse in gas prices has left the company struggling to service its \$2.8 billion in debts.

Despite a respectable increase in production (17%) and a huge increase in revenue (57%) in the fourth quarter of last year, the company still couldn't turn a profit. It lost \$28 million in the period. One of the company's biggest problems is it doesn't have enough cash to pay for critical services... So it's been paying for contract work by giving away rights to profits from its wells. It's hard for investors to know who owns what anymore... a bad situation for a firm facing large debt repayment obligations.

A \$1.5 billion ATP bond is due in May 2015. That bond is currently trading for around \$0.75 on the dollar and yielding more than 22%, which suggests the company will have difficulty refinancing on reasonable terms and might have to file for bankruptcy.

As these assets (and others like it) end up on the auction block over the next few years, I believe we'll have the chance to buy high-quality natural gas energy assets at extremely low prices. In ATP's case, the stock was once worth nearly \$60 per share, implying an enterprise value of \$4 billion. I'd guess its bonds will fall to around \$0.30-\$0.40 on the dollar if the company continues to head toward bankruptcy.

(Please understand... these are just rough estimates based on my experience with assets in this situation. I'll have to do a lot more work on these bonds before I'm ready to issue a buy recommendation.)

The point is... if we can buy bonds like these in bankruptcy for \$0.30 on the dollar, we could end up owning assets the market once valued for \$4 billion for about \$450 million. It's not hard to imagine making several billion dollars over the next decade in deals just like this one. The trick is knowing what these gas reserves are really worth to private market buyers who have the expertise and capital to pro-

duce the gas.

And... the really hard part in these deals is that just when you think the company will file for bankruptcy, it announces a sale to a major oil and gas firm. So if you wait too long, you won't make anything. But if you buy too soon, you risk the stock going to zero and the bonds trading far below where you thought they would bottom. That's why you've got to find the exact right situation. It won't be easy, but I'm convinced a lot of big money will be made with these assets when they begin to trade at distressed prices.

I asked my analyst team to show me which publicly traded gas companies offer the most proven undeveloped reserves (PUDs) for the lowest enterprise value. (Enterprise value is market cap plus debt minus cash.) Or in other words, where is the most bang for our buck? Where today can we buy these assets for the lowest possible price?

Stock	Market Cap	Net Debt	PPP
Ultra	\$3.6 billion	53%	\$1.94
Advantage	\$608 million	67%	\$2.28
Penn Virginia	\$219 million	315%	\$2.64
WPX Energy	\$3.7 billion	29%	\$2.87
Comstock	\$734 million	155%	\$3.09
Memorial	\$297 million	65%	\$3.24
Encana	\$14.5 billion	52%	\$3.62
Bill Barrett	\$1.4 billion	59%	\$3.83
EQT	\$7.8 billion	25%	\$4.04
Quicksilver	\$932 million	222%	\$4.20
Swift	\$1.3 billion	36%	\$4.41
Birchcliff	\$1.3 billion	30%	\$4.55
Goodrich	\$667 million	85%	\$4.61
Forest Oil	\$1.5 billion	114%	\$4.82
Southwestern	\$11.7 billion	11%	\$4.95
Range Resources	\$10.3 billion	19%	\$5.82
QEP Resources	\$5.7 billion	30%	\$5.91
Cabot Oil & Gas	\$7.3 billion	13%	\$6.97
Newfield	\$4.8 billion	61%	\$7.26
Lone Pine	\$632 million	44%	\$7.67

The list above shows the top 20 large-cap stocks on our list, ranked by value in terms of enterprise

value per PUD, or what we'll call "PPP" – price per PUD. Debt here is listed as a percentage of market cap. Although these companies are not all the same, my bet is that the companies whose debts exceed their market cap will have a difficult time avoiding bankruptcy. Those are companies whose assets I'll spend the most time studying, trying to prepare for the day when I can buy these debts for pennies on the dollar and end up getting huge resource reserves for next to nothing.

I'll continue to report on this strategy over the next few years... and I'd really appreciate your help. Please get in touch with me if you're familiar with these companies on an industry level. I'm looking for sources who work with these firms, know their land, and have knowledge of how things are going in the field. There's no substitute for direct, first-hand experience.

One stock on the list I'd recommend buying today is **Swift Energy (NYSE: SFY)**. The company produces oil and gas from leases in Texas and Louisiana. It has large acreage in the Eagle Ford shale gas field, where production of liquid hydrocarbons – things like butane and propane – has increased rapidly. Over the last five years, the company has increased its proved reserves by almost 35%.

I like two things about Swift. First, it effectively uses technology to bring old, proven fields back to life. Its best acreage in Louisiana, for example, is the Lake Washington field. It was first discovered in 1930. Swift bought the field for \$30 million in 2001. Since then, using the latest seismic technology, it's been able to increase production from 700 barrels a day to more than 18,000 barrels a day.

The other thing I really like about Swift is its production is split 50/50 between liquids and gas. Proved reserves total 159 million barrels. Currently, oil and other liquids make up 35% of these reserves – but oil is growing every year as more capital is being put toward finding oil, not gas. Production meanwhile is split right down the middle, with oil and liquids making up 49.7% of the company's

production.

Our analysis shows that right now, Swift's assets in the Eagle Ford make it one of the cheapest ways to buy energy in the ground in the U.S. But unlike most of the other companies on our list, Swift is producing a lot of oil and other liquids, whose prices haven't been wiped out like natural gas. That puts the company in position to survive the debacle in natural gas prices.

Its capital structure is also much more sound. It doesn't have any debt coming due until 2016. Its long-term debt (\$779 million) is manageable, compared with the company's total capital base (equity is almost \$1 billion) and should remain easy (and cheap) to refinance. Currently, its bonds trade at a premium to par.

To figure out what the company might be worth to a larger, acquiring company, we studied Swift's reserves and land leases and compared its acreage with other recently announced deals. Please understand... this is a rough comparison. But we think it's more accurate than using the industry standard "PV-10" method. Without boring you with the technicalities, PV-10 requires you to make too many assumptions about the value of the company's future production. These methods are almost always comically wrong because production tends to increase far beyond what can be safely estimated and "proven" today.

The company owns leases in Colorado, Louisiana, Texas, and Wyoming. We broke down all of the land into either developed acres or undeveloped acres, on a net basis. In total, Swift holds 211,348 acres of net developed land and 160,483 of net undeveloped acres, for a total acreage position today of 371,831.

The recent comps for acreage in these areas (both developed and undeveloped) varied widely, so when in doubt, we took the more conservative figure. But as a good median number, consider the China National Offshore Oil Corp. (CNOOC) February 2011 deal to buy into Chesapeake's Eagle Ford

acreage – 600,000 acres of proven oil and gas shale. China's national oil company paid \$16,000 per acre. Other deals for similar land in Eagle Ford have gone for between \$10,000 and \$20,000 per acre.

Looking at a range of such comps, we estimate Swift's oil and gas acreage would be worth something around \$4.5 billion today to a private market buyer. Subtracting net debt of around \$1 billion leaves you with a liquidation value of about \$3.5 billion, which suggests the company's current market price of only \$1.3 billion is a good deal.

Swift is a low-cost way to invest in America's booming oil and gas industries. The company has a tremendous amount of upside. Its liquid hydrocarbon production will continue to increase and, sooner or later, it will be able to make money from its large reserve of natural gas. This is a safe way to play the eventual rebound of natural gas, without having to get near any of the debt-stricken stocks.

Buy Swift Energy (NYSE: SFY) up to \$40 a share. Use a 25% trailing stop loss.

Portfolio Review

I'm not comfortable with the price action in gold and silver lately. I've worried for some time that a correction in these markets was long overdue. But I thought the improving economy and the ECB printing trillions more euros would lead gold- and silver-related stocks to perform better.

That they are not has me worried... Perhaps this is the start of the long-awaited correction...

Don't get me wrong. I'm not suggesting that anyone get out of gold or dump all of their silver. I simply think that, in the short term, the public's interest in gold and silver is likely to wane, as the stock market heats back up.

So I'm going to move most of our publicly traded gold and silver positions – that's **Silver Wheaton (NYSE: SLW)**, **Royal Gold (Nasdaq: RGLD)**, and **the Market Vectors Gold Miners exchange-traded fund (NYSE: GDX)** – into what I call "probation."

For the next 30 days, we'll tighten our trailing stops on all of these positions to 15%. If any of these stocks fall 15% from their high price during our holding period, we'll close the position.

This does *not* mean you should sell any of your core bullion position... I'm simply concerned our portfolio is heavily exposed to highly volatile, publicly traded gold and silver vehicles. I want to protect us from taking any big losses on these positions.

We've long recommended buying physical silver as the best way to profit from any collapse in the U.S. dollar. There are many important reasons why silver is likely to go up the most during a hyperinflation... And I'd strongly recommend reading our May 2006 issue, where I first encouraged subscribers to buy it. You should understand the concept of the silver ratio – it's a key part of our approach to hedging against the risk of a hyperinflation. I strongly believe everyone should hold 10%-15% of their assets in gold and silver bullion – not as an investment, but as insurance.

I've also tried to earn trading profits for us by recommending the **iShares Silver Trust ETF (NYSE: SLV)** from time to time. As you know, silver is extremely volatile. It's possible to trade it for a profit. But I must admit... I don't seem to have the knack. At the moment, I think it's better to sell the silver ETF now, so that we can have the opportunity to buy it again later this year at a better price.

Outside of the precious metals, our portfolio seems to be doing quite well. I'm particularly happy with our profits so far with **Teekay LNG Partners (NYSE: TGP)**. I have a feeling that's going to be a great investment.

Good investing,



Porter Stansberry
March 16, 2012

Stansberry's Investment Advisory Model Portfolio

Prices as of March 15, 2012

	Symbol	Ref. Date	Ref. Price	Recent Price	Dividends	Description	Action	Return*	Risk
"No Risk"									
Johnson & Johnson	JNJ	07/06/06	\$60.52	\$65.07	\$11.03	World Dominator	Buy	25.7%	2
Wal-Mart	WMT	09/09/10	\$51.91	\$61.23	\$2.16	World Dominator	Buy	22.1%	2
Hershey	HSY	12/06/07	\$40.55	\$60.30	\$5.42	World Dominator	Hold	62.1%	2
Exelon	EXC	10/09/02	\$21.47	\$38.95	\$16.25	Nuclear Power	Hold	157.1%	3
Microsoft	MSFT	02/09/12	\$30.77	\$32.85	\$0.20	Tech Giant	Buy	7.4%	2
W.R. Berkley	WRB	03/16/12	NEW	\$35.85		Blue-Chip Insurance	Buy	NEW	2
The "Next Boom"									
ConocoPhillips	COP	04/02/09	\$41.45	\$76.63	\$6.89	Cheap Oil	Hold	101.5%	2
Calpine	CPN	05/13/10	\$13.93	\$17.11		Nat Gas Power	Hold	22.8%	2
Dominion Res.	D	07/18/11	\$48.00	\$50.48	\$1.51	Export LNG	Buy	8.3%	2
Silver	SLV	08/11/11	\$34.10	\$31.53		Inflation Hedge	SELL	-7.5%	2
Activision Blizzard	ATVI	10/13/2011	\$12.92	\$12.46		Gaming Publisher	Buy	-3.6%	2
Union Pacific	UNP	01/19/12	\$112.18	\$113.08	\$0.60	Trophy Railroad	Buy	1.3%	2
Teekay LNG Partners	TGP	11/17/11	\$32.72	\$38.72	\$0.63	LNG tankers	Buy	20.3%	3
EOG Resources	EOG	01/19/12	\$105.08	\$115.63		U.S. Oil Exploration	Buy	10.0%	3
Chesapeake Energy	CHK	01/19/12	\$20.68	\$24.44		U.S. Oil Exploration	Buy	18.2%	3
Gold Miners Fund	GDX	01/19/12	\$52.15	\$50.14		Gold Stocks	Buy	-3.9%	4
Royal Gold	RGLD	01/19/12	\$67.51	\$64.24		Gold Royalty	Buy	-4.8%	4
Silver Wheaton	SLW	12/01/10	\$37.90	\$33.49	\$0.18	Silver Royalty	Buy	-11.2%	5
Monsanto	MON	11/18/10	\$59.63	\$79.30	\$1.44	Soaring Food	Hold	35.4%	5
San Juan Basin	SJT	01/07/10	\$18.34	\$19.02	\$4.33	Cheap Energy	Hold	27.3%	5
Swift Energy	SFY	03/16/12	NEW	\$31.50		Cheap Energy	Buy	NEW	5
Victims									
iShares US Bond	TLT	1/19/2012	\$118.32	\$111.21	0.56	Failing Currency	Sell Short	5.5%	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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