



The Best Opportunities of the Next Two Years

I just got off the phone with iconic value investor David Dreman, and what he said shocked me...

I called Dreman to discuss what I think will be one of the best investing opportunities of the next couple years... I'll get to the details in a moment, but it's in a sector Dreman knows better than anyone...

But before that subject came up, Dreman lit into the world's central banks, like our Federal Reserve. He said the central banks had done "nothing" to aid the world's economy for decades... He suggested we would be far better off getting rid of them and basing the growth in money supply to some nominal factor, such as industrial production.

I was agape. Dreman is among the investing world's blue bloods...

He manages about \$5 billion from his eponymous New York firm, Dreman Value Management. He's been managing money for more than 40 years. And he's been the head of his own firm since 1977.

On Wall Street, Dreman is well-respected for both his excellent long-term results and his gentlemanly manners. You've probably read his column in *Forbes* magazine, where he's written for decades. Dreman's father was a prominent Canadian commodities trader. So he's been around finance his entire life – and he's 75. There isn't much he hasn't seen before on Wall Street or in the markets.

I can't recall ever hearing any major Wall Street figure calling for an outright end of the Federal Reserve. To me, this was like hearing the Pope say, "Maybe condoms are a good idea."

Perhaps I shouldn't have been surprised... I knew from reading his *Forbes* columns that Dreman shares my view that we face much higher inflation in years to come. That's essentially why I called him...

You see, the coming bout of inflation is going to have disastrous consequences on our economy and most Americans. But I believe it represents a chance for businesses in one sector of our economy to log huge profits. As I'll show you in this issue... investing in these businesses today could lead to big gains for investors over the next two years...

So I called Dreman to see if this lion of Wall Street sees things the way I do...

Turns out, he does...

Inside This Issue

- The "People Be Crazy" School of Behavioral Finance
- Inflation: A Bank's Best Friend
- A Massive Opportunity for Shipping Profits
- Portfolio Update

Editor: Porter Stansberry

The 'People Be Crazy' School of Finance

To start... you should know a little more about Dreman's style of investing.

His experiences led him to become a founding member of what's called the "behavioral finance" school, whose basic premise is that investors overreact to most events. Around our office, I refer to behavior finance in a more colloquial way: The "People Be Crazy" School of Finance.

And Dreman's right... In the markets, people be crazy.

For emotionally stable investors, the crowd's periodic overreactions offer the opportunity to outperform the market by taking a contrarian approach. In short, if you know how to properly value securities, the secret to investment success is as simple as waiting for other investors to do something stupid (like selling at market bottoms and piling into securities at the tops).

So-called "value investors" – like Dreman – try to base their investments on an asset's "inherent value"... buying when that asset trades for less than its value and selling when it brings in more than that value. And you can find different approaches to value investing, and each defines value in subtly different ways.

Dreman uses a company's earnings as a yardstick. He's written the best book you can purchase about this approach. It's called *Contrarian Investment Strategies*, and it has been published in one form or another since the early 1980s. I highly endorse it to anyone who is attempting to invest for the long term. It's one of the five or six books that I believe should be mandatory reading for every investor before they begin to buy securities.

I called Dreman to talk about his disastrous foray into bank stocks in 2007 and 2008. Dreman was heavily invested in financial stocks heading into the crisis of 2008. He was one of the largest shareholders in several of the worst offenders in the mortgage crisis... including Washington Mutual, Wachovia, Fannie Mae, and Freddie Mac.

He owned these stocks because he trusted the bank managers and believed their 2007 financial statements were accurate. On paper, these banks appeared cheap based on earnings. In reality, they were sitting on losses that dwarfed their annual earnings by 20 or 30 times.

These bad investments cost him control of the mutual fund he founded, the DWS Dreman High Return Equity Fund. The fund's owner – Deutsche Bank – declined to renew Dreman's management agreement. He was fired on April 6, 2009.

Note the date... I'm sure you recognize that was about a month after U.S. financial stocks put in their bottom and began a huge rise. For reference, consider Citigroup traded at a split-adjusted \$10.29 on March 6, 2009. A year later, the shares were more than \$30 – where they've lingered ever since.

Fund management companies have a long history of dumping their value-oriented managers at (or very near) key market turning points. Mutual funds are often forced to make a change in leadership because so many fund investors redeem their shares at exactly the wrong times. Perhaps most famously, Tiger Management closed its doors in March 2000... on almost the exact day the tech stock boom came to a crashing end. Tiger Management had famously avoided investing in tech stocks... much to the chagrin of many of its investors.

In the case of Dreman... it's particularly ironic. One of the world's leading theorists of behavioral finance lost his job at precisely the bottom of the market because his investors were acting irrationally. They were selling – and selling him – at precisely the moment they should have been buying. Yes, indeed... people be crazy.

I wanted to talk to Dreman because after going through the ringer on big financial stocks, I wondered what he thought about them today. Did he see the opportunity for them to make huge profits as central banks hold down commercial banks' cost of capital... while longer-term rates rise and drastically increase their profit margins?

Who better to teach me something about banks than the guy who took the biggest beating from those stocks in 2008-2009?

In any case... Dreman agreed that the situation seems good today for the big banks. He owns a substantial amount of Wells Fargo, and he also specifically mentioned the bullish prospects of JPMorgan, which picked up a branch network and now has \$30 billion or so in loan guarantees from the Federal Reserve.

While I wouldn't argue against him (I believe it's likely that both Wells Fargo and JPMorgan are likely to do well over the next two to three years)... I think by taking a bit more risk, we could do better buying banks that are less expensive relative to book value.

According to Yahoo Finance, Wells Fargo trades at 1.3 times book value (which is a measure of its assets minus its liabilities). JPMorgan trades at 0.92 times book – neither bank strikes me as particularly cheap. I'm looking for banks trading at \$0.75 times book value or less.

So I asked our new analyst Bryan Beach to study the world's largest banks to find banks that give us the best combination of safety and value.

My thesis on the world's biggest banks is simple. Despite the ongoing financial problems in Europe, both the European Central Bank (ECB) and the U.S. Federal Reserve have the ability (thanks to the printing press) to stop any run on the banks. Their previous actions (quantitative easing) have committed them to an inflationary policy to save the banks and continue the monetary system as it exists today.

The price we will all pay is inflation – and ultimately the loss of the U.S. dollar as the world's reserve currency. But these problems can be kicked down the road a bit, allowing more time for the wealthy to prepare for the inevitable collapse. I believe that's exactly what's going to happen. *And that means the world's largest banks will continue to be bailed out via continuous manipulation of the money supply.*

That's what happened in the U.S. in the fall of 2008 and 2009. And that's what has happened in Europe, starting in December 2011.

Thus, the world's largest banks are de-facto sovereign credits. *They cannot fail.* So to make safe investments in them... all we need to do is ensure the individual bank has enough of a capital cushion to protect the common stock shareholders from any remaining bumps in the road.

For example, I wouldn't recommend UniCredit – even though it's now a de-facto sovereign credit. Why not? Because if there's another downturn and it must be bailed out directly, it's unlikely its common shareholders will be spared. (Remember... the creditors of Bear Stearns escaped unharmed, while the shareholders got almost nothing.)

What I'm looking for today are big banks with plenty of high-quality capital that are trading well below tangible book value. Specifically, we're looking at what's called "Tier 1" capital. (The differences among the various "tiers" of bank capital can be arcane. Just know, "Tier 1" is the highest quality. This is the amount of "real" reserves the bank holds against total assets.)

In the chart below, you'll find the world's 10 cheapest banks with the most high-quality (Tier 1) capital... The table lists each bank and its price measured as a ratio against tangible book value. (So Royal Bank of Scotland's share price indicates it is trading for only 45% of its tangible book value). It also shows the amount of Tier 1 capital as a percentage of total assets. (So Royal Bank of Scotland's Tier 1 capital represents 13% of its assets.)

Take a look...

Bank	Price-to-Book Value*	Tier 1
Royal Bank of Scotland	0.45	13.00%
Citigroup	0.70	13.55%
Barclay's	0.55	12.90%
Caixabank	0.55	12.80%
Lloyds Banking	0.51	12.50%
Keycorp	0.91	12.99%
Deutsche Bank	0.84	12.90%
Regions Financial	1.03	13.28%
Natixis	0.44	11.30%
Bank of America	0.73	12.40%
* Market capitalization/tangible equity		

It's funny that the Royal Bank of Scotland ended up in the No. 1 position. That's one of the names we successfully sold short last year. Likewise, I wasn't surprised to see Citigroup at the top of the list. The bank would have failed during the crisis of 2008 had the Fed not bailed it out. Another name I like is Bank of America.

Today, these three banks – RBS, Citi, and Bank of America – offer us a big discount to tangible book value, plus an adequate amount of "cushion" – Tier 1 capital – to protect from any downside risk. The only assumption in this analysis is that the central banks continue their inflationary policies. The central banks can't risk a global deflation and credit collapse, so they are going to continue printing.

Please understand this... *I am not in favor of these policies.* The inflationary path we are on will wipe out the middle class. Central bank created inflation enables speculators and Wall Street interests. It provides them with more and better ways to increase their wealth – via things like carry trades, leveraged buyouts, and net interest margin – at the expense of the entire nation. These central bank policies and the resulting inflation will cause a huge rise in income inequality as real wages decrease and financial profits greatly increase. These policies will ultimately cause a severe breakdown in civil society.

This is how the "End of America" will develop. It's happened in dozens of other countries over the last few decades. It is the inevitable result of paper money systems and government-led central banks.

But over the next few months, these policies will cause the value of these banks' assets to rise substantially. *Inflation is the salve that heals all financial wounds.*

Consider Miami Beach, where I've been living for the last year. I bought a waterfront property here last February for around \$400 per square foot... Those properties are now selling for more than \$1,000 per square foot. I've already re-

ceived one unsolicited offer for the property. That's one small example.

Rising housing prices in Miami (one of the worst hit areas of the mortgage crisis) will also flow through to the balance sheets of these banks. It will take another 18-24 months... but it will happen. And as the bad debts turn into performing loans and the value of the collateral rises... some of the huge write-offs that were taken in 2008 and 2009 will be reversed. Let's say rising prices lift the average value of Bank of America's assets by 10% over three years. That would increase the bank's equity by \$200 billion. That's a *huge* increase for a stock with a \$90 billion market cap.

The coming inflation will also cause banks' net interest margin to widen. That's what determines how much cash flow and earnings they generate. It's the difference between what they pay to borrow money and what they collect by lending it. As long-term rates rise because of inflation, banks' profitability should increase substantially because the Federal Reserve (and the ECB) have fixed short-term interest rates near zero.

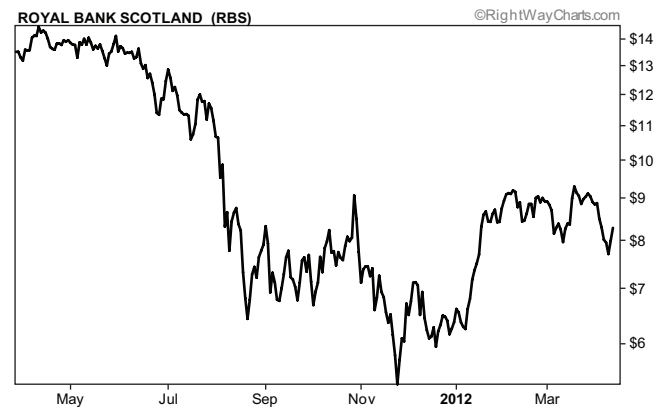
These two factors – rising asset prices and increasing net interest margin – should cause the share prices of these banks to double (at least) over the next 12 months. And because these banks are all trading for less than book value, despite having high Tier 1 capital ratios, we can capture profits without taking on much risk.

To summarize... thanks to the policies of the world's major central banks (which is creating a huge inflation) and the panic in financial stocks (which led investors to abandon these banks), we have a nearly risk-free way to make huge gains.

Now believe me... I know what the reaction to this advice will be...

Most of my subscribers will *never* buy these banks – or any others. Some of you will even stop reading my newsletter because I've suggested what is, in your eyes, a heresy. How could I recommend buying RBS, for example, when just last year I was telling you to sell the bank short?

Well... look at the following chart. We recommended shorting RBS early last July when the European financial crisis threatened to boil over because the ECB resisted bailing out the banks as the Fed did here in 2008-2009. We reversed course and covered our short later that year. Then, following the huge ECB bailout of December 21, we changed our global view on stocks...



Our trading and my constant warnings about Europe's banks (as embodied by UniCredit) from February 2010 until late last year kept us out of the collapse in Europe. We even captured some profits by shorting some of these banks last year.

But... when the facts change, I change my mind. If the ECB is going to paper over the giant losses these banks face holding sovereign debt that's likely to default, shareholders face little risk and a much greater likelihood that inflation will propel asset values and earnings.

Combined with the actions of the U.S. Federal Reserve (which is underwriting much of the ECB actions via swaps), this sets the stage for a global financial reset. The central bankers plan to use inflation to wipe away the bad debts and save the commercial banks. That is their only hope. They believe they'll be able to control the inflation, and it won't end up getting out of control and destroying the system they've built. We'll see.

But for now, it seems likely that the banks will do well.

Buy Royal Bank of Scotland (NYSE: RBS), Citigroup (NYSE: C), and Bank of America (NYSE: BAC).

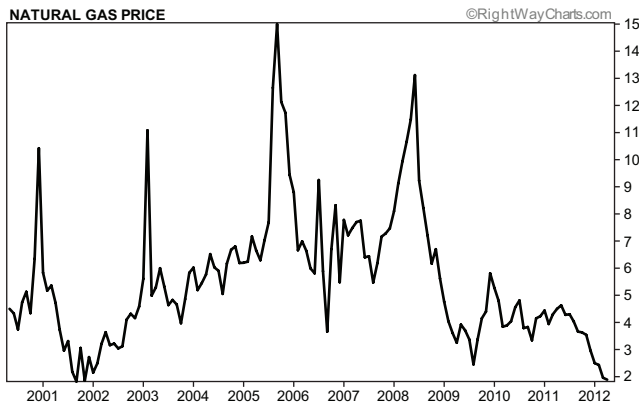
Use a 25% trailing stop loss on this group of recommendations. That is, rather than using individual stop losses on each stock, consider these three stocks as one "sovereign bank" position.

This group stop-loss strategy is important because all these banks do essentially the same things – provide banking, mortgage, and financial services to large corporations. They all earn their profits from the net interest margin that's completely manipulated by the central banks. They are essentially the same thing. If one of them suddenly collapses, dragging down our average stop loss, we should sell all of them.

The Best Way to Profit from the Collapse of Natural Gas Prices

I am extremely *bullish* on natural gas.

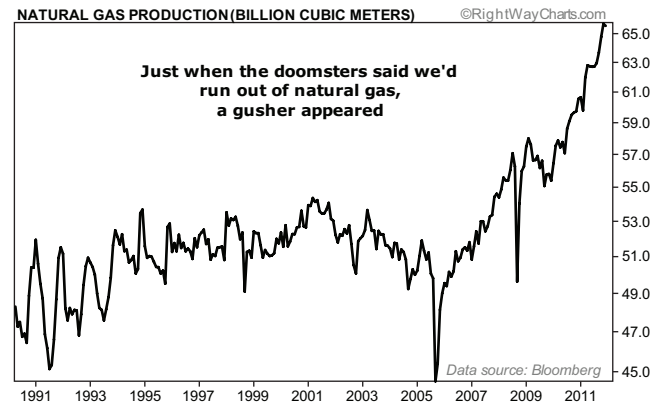
For those of you who have been watching the price chart of natural gas... that probably seems strange. As you can see, the price of natural gas has been trending down for years. I don't expect this to change much for several years.



What explains the historic and dramatic collapse of natural gas prices? As you'll recall from extensive reporting over the years (see the April and May 2010 issues for details)... a series of innovations – horizontal drilling and hydraulic fracturing (or “fracking”) – has led to huge new oil and gas discoveries in areas (usually below 5,000 feet) impossible to tap economically. The result has been a flood of new supply – supplies many, many experts believed would never be exploited.

In 1995, the U.S. produced just a little more than 23.7 trillion cubic feet of gas. That rate of production stood essentially unchanged for more than a decade. Even as late as 2006, we were still only producing 23.5 trillion cubic feet of natural gas. You will recall the doomsters talking about “peak oil” – the view that domestic production of hydrocarbons would never increase. But starting in 2007, production began to soar, reaching more than 26.8 trillion cubic feet in 2010 and 28.6 trillion cubic feet in 2011 – a 22% increase over 2006. Demand for energy rarely grows much faster than the economy as a whole. Our economy has been mostly stagnant since 2007, which means natural gas supply in the U.S. has vastly outpaced demand.

The same trends of increased production are occurring in many places in the world. Globally, the supply of natural gas has increased from around 96 trillion cubic feet in 1995 to more than 141.6 trillion in 2010 (which is the latest data available). That's almost a 50% increase.



And these vast new global supplies form the foundation for the single biggest current opportunity in the natural gas boom. While the global economy has grown over the last decade (creating new demand for energy)... and natural gas supplies have soared... our ability to *transport* natural gas hasn't grown enough to equalize the global markets. That's why gas is so cheap in the U.S., but so expensive in Asia and Europe. I'll return to this idea in a moment... but first, I'd like to tell you about how you can literally get natural gas for free right now.

For most investors, the opportunity unfolding in natural gas will be one of the best investment opportunities of the next decade. You're going to see me writing about it frequently. And for new subscribers, I'd like to start at the beginning...

I haven't always been a natural gas bull. In fact, I was *extremely* bearish on natural gas and oil prices for many, many years. In the mid-2000s, I was convinced that energy represented one of the biggest investment manias I'd ever seen...

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

Every big investment mania needs a financial guru and an idea guru. In the oil business, there is no shortage of interesting financial characters. This is the sector of 10-gallon hats and lizard-skin boots. But there is one man whom out-Texans them all: Boone Pickens... His commodities pool was up 700% last year, making ol' Boone the highest paid hedge-fund manager in the world in 2005. Investors who gave Boone money in 1999

have made more than 28 times their money. Boone told *BusinessWeek* that he made more money in the last five years as a trader than he did in the 50 years he worked as an oil producer. (Talk about a financial bubble!) In fact, Boone made more money than any energy trader in the world. Curiously, the No. 2 energy trader, according to *Trader Monthly*, was 32-year-old Brian Hunter, until his now notorious Amaranth hedge fund collapsed.

*The idea guru of this mania is dead – Marion King Hubbert died in 1989. Hubbert became the most famous Malthusian philosopher since Malthus himself. His theory was breathtakingly simple: Because oil is a finite resource and every well's production reaches a peak at some point and then begins to decline, the world must be reaching a point of peak production. Hubbert got out a slide rule, did a few calculations, and predicted that world oil production would peak around the year 2000. After this point – "Hubbert's Peak" – there would be less oil available each year... until finally the world would be out of oil. It's a great theory – simple, elegant, logical... but it's wrong. First, Hubbert's assumptions about the life of each oil well were wrong. New technologies can "resurrect" old fields, dramatically increasing production in places Hubbert thought were "out of oil." And second, geologists have found oil in many places Hubbert didn't know we could explore, such as deep oceans and very deep land-based wells. – "The Oil Bust: How Bad Will It Be," *SE&A Digest*, October 4, 2006*

Given that the mania lasted for another two years, peaking in mid-2008 with oil at more than \$150 per barrel, I'm used to being the contrarian in the room in regards to oil and gas. Likewise, today I'm sure my bullishness on natural gas probably doesn't make much sense to most people.

I also know that my enthusiasm for natural gas is unusual in a financial world driven by day-traders, chart-readers, momentum-followers, and other types of financial astrologers. But my rationale is far easier to understand than the mumbo jumbo I frequently see posited as financial advice... ***I prefer to buy high-quality assets when they're trading for as close to free as possible.*** And right now, natural gas is so cheap that many companies are simply flaring it off – they're burning it – rather than bothering to pipe it across the country and sell it. Not only that, but right now you can buy natural gas reserves in the stock market for *free*.

And wouldn't you know it... just as the price of natural gas has fallen far below its cost of production, Wall Street is suddenly interested in shorting it. A headline in yesterday's *Wall Street Journal* says it all: "As Natural Gas Cools, Trading Sizzles." The article quotes Sid Perkins, a natural gas broker in Houston: "Over the past month, we have actually seen much more interest from traders and funds than at any point over

the past year." Daily trading volume of natural gas futures is up 31% over last year on the Chicago Mercantile Exchange. Total open interest on the New York Mercantile Exchange is up 20% over last year. Most of the big firms are shorting.

Sooner or later, the price of natural gas will rebound sharply... and not just because it always has in the past. What will propel natural gas prices over the medium term (say, five years) is an economic truism: It's impossible for a surplus of energy to exist for long. As prices fall, more and more uses for natural gas will appear. At some price, natural gas becomes competitive with other forms of energy.

A barrel of oil has 5.825 million British thermal units (Btu) of energy. (Btu is the standard measure of energy content across fuel types.) One thousand cubic feet (MCF) of gas contains just a little more than 1 million Btu – approximately a 6:1 relationship. Thus, on an energy-equivalent basis, you might expect natural gas to trade for one-sixth the price of oil – or about \$16 per MCF today.

But of course, oil is more highly prized as a fuel source because it's more easily portable and thus a better fuel for transportation. Historically, the rule of thumb was that natural gas would generally trade about one-tenth the price of oil. That would imply a natural gas price today of about \$10 MCF.

As you probably know, natural gas now trades for less than \$2 per MCF, a price that's lost all relationship with its utility in the world's economy. There's no reasonable fundamental explanation for the size of the spread between oil prices and natural gas prices. Natural gas is trading at the *lowest* price I've ever seen compared to the price of oil. There are few things in life I know with certainty... But I know this: *Barring the end of the world, the price of oil is going to fall and the price of natural gas is going to rise.*



In my mind, you ought to buy all the natural gas you can afford because these energy resources will not be cheap forever. I'd suggest waiting for the bankruptcy of at least three or four dry-gas exploration and production companies.

(“Wet” gas refers to resource that has natural gas and liquid hydrocarbons – like butane – which sell at a premium. “Dry” gas is gas only, no liquids.) Read the section titled “How I Plan to Make \$1 Billion in Natural Gas” from the March issue for companies to watch.

Then, I’d try to buy the bonds of these companies while they are reorganized in bankruptcy court. My bet is that you’ll be able to pick up proven undeveloped resources (PUDs) of natural gas for about half of what they were trading for prior to bankruptcy.

For example, in our analysis last month, we found that a PUD would cost investors about \$2 per MCF via an investment in the common stock of the exploration company Ultra Petroleum. In bankruptcy court, I’d expect the price to fall to less than \$1.

Or... you can just buy PUD natural gas for free in the stock market right now. How?

Look at Chesapeake Energy. The company is selling *billions* of dry-gas resources this year to Wall Street firms and smart energy companies. Chesapeake has lots of different deals in the works. Recently, Chesapeake sold 58,400 acres of gas-producing land in Oklahoma to XTO (a subsidiary of Exxon-Mobil) for \$590 million. It sold preferred stock in a gas/liquids spinoff company for \$1.25 billion. And it sold forward 10 years of gas sales from certain fields for \$745 million.

I’d bet the buyers got the better end of these deals – by a wide margin. For example, the 10-year forward gas sale locks in a price of \$4.68 per MCF. That price is above today’s \$2.30 MCF rate, but well below the recent peaks in natural gas prices.

Even so, the moves will probably benefit Chesapeake’s shareholders, too. The market currently values the company on the basis of its earnings (around \$1 billion per year). At \$13 billion in total market cap, the stock market is essentially saying Chesapeake’s gas reserves are worthless. Chesapeake estimates the gas reserves at more than \$20 billion. By selling some of these resources – even at a low price – the company’s management team says it will raise \$10 billion this year.

Yes, you read that correctly. Chesapeake has announced it will generate \$10 billion in cash by selling noncore dry-gas assets... moves it says will not hurt sales and earnings projections. Assuming Chesapeake invests this capital in higher-margin oil wells, this stock could easily double over the next year, simply because of an increase in oil reserves and earnings. I like situations where I can buy a pretty good company for a low price, get \$10 billion in natural gas for free, and receive \$10 billion in cash as a sweetener. (That’s why Chesapeake has already been recommended in our model portfolio.)

Even so, Chesapeake is probably not the best way to play the global boom in natural gas production.

You see... the big problem with the natural gas markets isn’t that there’s too much gas. You really can’t have too much energy. People will always consume it, if it’s cheap enough. **The real problem with the natural gas markets is there’s no global distribution.**

We have some parts of the world with far too much gas... and some parts of the world with far too little gas. Given the economics, I believe the best and surest way to profit is likely to be from owning the liquefied natural gas (LNG) tankers that will distribute natural gas to markets around the world. There’s going to be a huge boom in these ships, which are expensive to build and operate.

Instead of focusing on the gas production companies... I think we should focus on the distribution end – the LNG shipping companies.

Fortunes will be made as entrepreneurs and investors build the ships and pipelines necessary to take advantage of the higher price of LNG across the world’s markets. And it won’t be the first time shipping has played a deciding role in the world’s energy markets...

Better Than Owning the Wells

Moving natural gas around has been a big business since World War II.

That’s when welding techniques, pipe rolling, and metallurgical advances enabled the construction of reliable natural gas pipelines. This construction boom lasted well into the 1960s and resulted in the thousands of miles of pipeline in America.

At the same time, LNG – the process of cooling natural gas until it reaches a shippable liquid form – fundamentally changed the global energy market forever. In 1959, the world’s first LNG tanker, the Methane Pioneer, safely carried LNG from Lake Charles, Louisiana, to Canvey Island, U.K., initiating commercial LNG shipping. And in 1964, the British Gas Council then began importing LNG from Algeria, making the United Kingdom the world’s first LNG importer.

These kinds of breakthroughs have happened before in the oil business. I first wrote about Marcus Samuel in the November 2011 issue. Recall that in the late 19th century, Samuel established a tanker fleet to ship oil between London and the city of Batum on the Black Sea in present-day Georgia. Within a year... Samuel controlled the Suez Canal route so that he could deliver crude for market-beating prices all across Europe. His tankers controlled

the marginal price of crude. His profits were colossal.

Around 50 years after Samuel started sailing tankers through the Suez Canal, Jens Torben Karlshøj was born in Denmark. In his early 20s, he would embark on a path similar to that of Marcus Samuel ... After emigrating to the United States in the 1960s, Karlshøj held various jobs with shipping companies in New York and Los Angeles.

In 1973, Karlshøj decided to set up his own company in New York. His strategy was to manage and operate a range of tankers, but charter the vessels from independent shipowners, not to own them. He spent his life building his fleet by adding ships during down markets and saving capital during boom periods. But in 1992, his firm suffered a major setback. He lost a ship in a tragic collision with another vessel, which cost the lives of 20 crewmembers. The stress killed him. One month after this tragic accident, Jens Torben Karlshøj died in his sleep of a massive heart attack. He was 51.

Captain James Hood, a Scotsman who'd been with the company since 1977, took over. Three years later, he took the company public to gain greater financial flexibility. The company was named Teekay Shipping for its founder's initials.

A Safe Stock in the Middle of a Powerful Change

We're familiar with Teekay Shipping, as we've followed the company for years and recommended it several times. But today, we're more interested in a spinoff of Teekay – Teekay LNG Partners.

Teekay LNG is a master limited partnership (MLP). Most MLPs (but not all) operate in the resource sector. They have certain tax benefits of a partnership, but enjoy the liquidity of a public corporation. Shares in the ownership are called "units." The most important thing for us to understand is that the MLP pays us regular distributions, normally quarterly. These payments are called "distributions" and are similar to dividends.

Teekay LNG Partners is the world's third-largest independent owner and operator of LNG vessels. As of February 1, its fleet included 27 LNG carriers. Since it went public in 2005, its distribution payments have grown steadily, as you can see in this table...

Year	2005	2006	2007	2008	2009	2010	2011
Amount	\$0.64	\$1.80	\$1.98	\$2.18	\$2.28	\$2.37	\$2.52

Based on today's price of \$39, last year's cash distribution gives us a healthy 6.4% dividend yield. In line with dividend

increases over the past seven years, management has just announced its intention to raise dividends this year by an additional 7%. In a world where you earn 0% interest on your money in the bank, a 6%-7% yield is great. But we're looking at a much larger opportunity here.

Our interest in the company is because of the abundance of the natural gas about to come available for export and the need to move it around the world. This is where Teekay comes into play. Natural gas is the world's fastest-growing primary energy source.

The U.S. led the way with its horizontal drilling technology and is now considered the Saudi Arabia of natural gas. The U.S. is the world's largest market. Australia is another country ramping up LNG production. It expects to surpass Qatar (currently the world leader in LNG exports) by 2017.

Growth in 2011 LNG demand came mainly from Japan and China. The March 2011 tsunami in Japan that killed thousands of people also resulted in the closure of nuclear plants. To make up for the power lost by these closures, Japan turned to LNG. The island nation increased its LNG imports by 12% in 2011 to 78.5 million tons. Similarly, China increased its imports by a massive 31%.

Teekay forecasts steady growth over the next three years of around 4%. But it gets really interesting after 2015. Growth in LNG supply is forecast at 7.7% between 2015 and 2020 – as several big new LNG terminals come online, including at least two in the U.S. The rest of the growth in supply will likely come from Australia.

Teekay LNG has been managed conservatively. Its strategy is to only build or acquire vessels as the market requires. It doesn't acquire a ship until after it has gotten an order to lease it. This has been a smart strategy in recent times, in particular 2011 when asset prices dropped by 20%-40%. The company maintained its liquidity and kept its capital ready for a rainy day, so to speak.

In October 2011, that opportunity arose...

That's when Teekay LNG purchased six vessels in a joint venture with Marubeni Corp. Teekay owns 52% of these additional six vessels. All vessels have already been leased, with contracts in place. The average contract length is nine years.

We know a bit about the global fleet of LNG Tankers thanks to Lloyds, which insures the vessels. The existing global fleet is 355 tankers. Another 65 additional tankers are being built. Last year, the load rate for the existing tankers was 340 loads per month – or roughly 95% of capacity.

The question is, will the 65 new tankers be too many? The global LNG tanker fleet is young, with a majority of the

tankers less than five years old. Even so, 50-60 ships are older than 25 years – just about ready for the scrap yard. As a result, we don't see any substantial increase in the size of the global fleet over the next few years. And given the surge of natural gas production and the dozens of new LNG export/import facilities being built around the world, we expect lease pricing to remain extremely firm.

As I mentioned earlier, unlike several other larger tanker companies, Teekay has always been conservatively run, and the same is true for Teekay LNG. Debt is a big part of this business, as the capital to expand its fleet is most cheaply obtained through fixed-rate, long-term loans. The company's existing long-term debt has maturities ranging from 2018 to 2020... and it's paying around 3.7% annually for this capital, which is breathtakingly cheap.

This is a very safe stock that pays a great quarterly distribution that is sitting right in the middle of the most powerful changes in a generation to the energy business.

Although the stock has gone up since we first recommended it, we like the story so much that we wanted to remind all of our subscribers to...

Buy Teekay LNG (NYSE: TGP) up to \$40. Using a 25% trailing stop loss, adjusted for dividends. I expect this will be one of the best-performing recommendations of my entire career.

Portfolio Review

We continue to see pressure on our precious metals recommendations – **Silver Wheaton (NYSE: SLW)**, **Royal Gold (Nasdaq: RGLD)**, and the **Gold Miners Fund (NYSE: GDX)**. Precious metals are being sold because of the huge run-up they enjoyed over the past 12 years. In addition, the improving results from financial stocks will likely spur a rotation out of gold stocks. The best trade of the last six years was to sell financial stocks and to buy gold and precious metals stocks. That trade is probably going to reverse course. Even so, we prefer to hold our core bullion position because we know gold and silver will provide us the best protection from the coming inflation.

On the other hand, last month we tightened our trailing stops on our gold and silver stocks...

*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 **Gold Miners 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.

As a result, we stopped out of all of these positions. I want to emphasize that this doesn't mean to sell your core bullion holdings. I believe everyone should hold 10%-15% of his net worth in gold and/or silver. But for now...

Sell Silver Wheaton (NYSE: SLW).

Sell Royal Gold (Nasdaq: RGLD).

Sell Market Vectors Gold Miners ETF (NYSE: GDX).

The rest of our portfolio looks good, but there are two important updates on **ConocoPhillips (NYSE: COP)** and **Johnson & Johnson (NYSE: JNJ)**.

ConocoPhillips has been one of our most successful recommendations. Subscribers who bought COP when it was recommended in April 2009 are up roughly 100%, including dividends.



Three years after the initial recommendation, ConocoPhillips is still generating exceptional cash flows and has demonstrated an almost unparalleled commitment to returning shareholder capital. **It's spent \$35 billion in buybacks and dividends between 2010 and 2012.**

Last July, ConocoPhillips announced it would spinoff into two separate companies – a “refining and marketing” (so-called “downstream” in industry parlance) company and an “exploration and production” (upstream) company.

The new exploration and production company will trade under the ConocoPhillips name, using the existing COP ticker. The new refining and marketing company will be called “Phillips 66” and trade as PSX.

The breakup is now imminent. So let's spend some time understanding what's behind this transaction and what it means for shareholders.

Oil and gas companies can generally be divided into three categories: upstream, midstream, and downstream. “Upstream” activities include locating, testing, and drilling for oil and gas. These activities are usually lumped together as “exploration and production.” Midstream and downstream activities include refining, storing, shipping, marketing, and pretty much anything else that happens once the oil or gas is out of the ground.

Downstream results are generally worse than upstream. Price pressure and lower-than-normal demand can compress margins and suffocate cash flow. Not surprisingly, upstream companies generally sell at higher multiples than their downstream counterparts. ConocoPhillips is considered an “integrated” company because it performs upstream, midstream, and downstream operations. By spinning off its downstream operations, the management team hopes to make itself look more profitable... by increasing the earnings multiple that its shares trade at on the stock market. To us, as long-term investors in the stock, the increase in multiple isn’t as important as the ongoing increases to the company’s dividends. So one crucial question to answer is: Will this spinoff alter the dividend?

Over the past couple years, ConocoPhillips management has been busy “repositioning to unlock potential”... which is CEO-speak for “cutting dead weight to boost the share price.” Nothing wrong with that.

From 2010 through the end 2012, ConocoPhillips will have raised more than \$30 billion selling off noncore assets. Most of this cash is going to shareholders in the form of buybacks and dividends. The spinoff fits in with this strategy.

As of May 1, we’ll receive one share of Phillips 66 for every two shares of ConocoPhillips (COP) we own. COP’s margins will improve once the downstream business is peeled off. And there is a real chance the market responds by bidding up COP shares.

There is certainly no reason to sell your COP based solely on this spinoff.

The more interesting question is what to do with your new PSX shares. Generally, the downstream business is not a particularly good place to be, but PSX will be a segment leader and does have some promising prospects for investors. In addition, the Phillips 66 management team shares the same operational discipline and shareholder focus as the ConocoPhillips folks who have served us well for the last three years. Consider...

- PSX should generate plenty of cash flows. From 2009 through the first half of 2011, the ConocoPhillips units that will comprise the new Phillips 66 generated about \$7.5 billion in cash flow from operations.

- Management is projecting a \$0.80 dividend, which represents a huge 21% of PSX’s cash flow from operations. As a point of reference, PSX’s nearest competitors typically return between 4%-8% of cash flow from operations as dividends.
- The earnings per share for the businesses that will comprise Phillips 66 have been growing. These businesses represented \$0.52 per share in 2009, \$2.07 in 2010, and about \$4.30 in 2011.

Given these numbers and our confidence in COP and PSX’s management, **our recommendation is to hold both shares for now.** Assuming PSX continues to increase its dividends, we’re likely to continue to hold it in our model portfolio.

Johnson & Johnson has been a disappointing investment for our model portfolio. The shares have essentially done nothing for the last six years, outside of paying us a handsome dividend.



While the company provided us with lots of stability over the market’s big swoon in 2008 and 2009... we have been frustrated with management, which in our view, has made several overpriced acquisitions.

The good news is that the company’s CEO Bill Weldon has been forced out. The new CEO is Alex Gorsky, who ran the company’s medical-device business. That’s J&J’s best business. The bad news is, one of Gorsky’s first moves was another expensive acquisition – one so big, in fact, it will most likely decide the fate of the company in our portfolio (and for many other investors as well)... Here’s what’s happening...

In June, Johnson & Johnson will close on a \$20 billion purchase of orthopedic-device maker Synthes. At first glance, this looks like a good move, because Synthes has the best profit margins in its field and the price of the deal (roughly 21 times earnings) isn’t outrageous, given the company’s growth prospects. On the other hand, assuming Synthes will yield \$1 billion in cash per year (current cash flows are \$833 million),

Johnson & Johnson spent 20 years of cash earnings to buy the company... which seems odd given that JNJ shares are only trading for about eight times cash earnings.

For now... we'll continue holding the stock, as it has increased its dividend 73% over the years we've owned it. But... the Synthes acquisition will decide whether we continue to recommend the company. It should make up roughly 50% of the company's free cash flow going forward. Keep your eye on these results.

SIA Indicators

Our market indicators continue to look extremely bullish for stocks.

Our interest-rate spread indicator is still trending toward greater liquidity as the difference between the yield on U.S. Treasuries and high-risk bonds narrows. Our Money Flow Gauge shows people continue to pull money out of equity mutual funds. But importantly, the rate of the withdrawals is slowing. I expect to see inflows for the rest of this year, which will push stock prices higher. Although it's counter intuitive, it usually pays to buy stocks when everyone else is selling. So once the inflows start, we'll become less bullish.

And finally, our Black List still shows few companies trading at excessive prices (which we define as more than \$10 billion in market cap and at more than 10x sales). For a more detailed explanation of these indicators, please see last month's issue, where I went into far more detail about how and why they work.

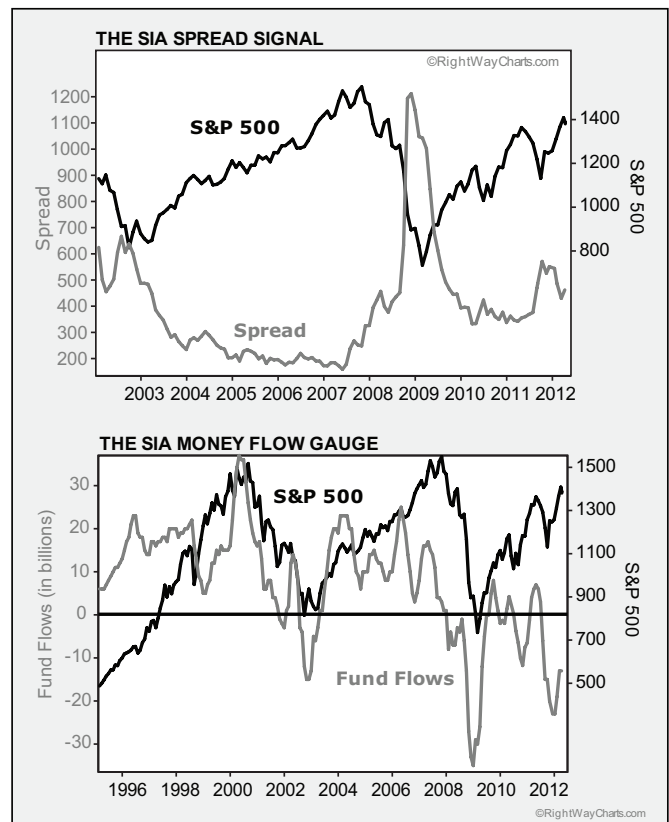
I'd like to thank our two new analysts, Bryan Beach and Brett Aitken. Their work was invaluable to me in understanding the details of Teekay LNG and the big changes at ConocoPhillips and Johnson & Johnson. We're building

a powerhouse team here for you... I hope you'll notice the improvements in our coverage.

Good investing,



Porter Stansberry with
Brett Aitken and Bryan Beach
April 13, 2012



The SIA Blacklist					
Short Name	Ticker	Market Cap	P/S	P/E	Total Return YTD
BIDU	Baidu Inc	50,422,968,320	21.93	48.02	24.00
VMW	Vmware Inc	46,595,919,872	12.32	66.09	32.67
PSA	Public Storage	24,134,264,832	13.01	40.34	0.75
ISRG	Intuitive Surgical	21,209,137,152	11.93	43.52	15.60
ALXN	Alexion Pharmaceuticals	16,594,331,648	20.88	103.14	24.78
AVB	AvalonBay Communities	12,985,512,960	12.48	27.95	5.17
CHKP	Check Point Software	12,695,354,368	10.23	24.18	17.36
REGN	Regeneron	10,833,208,320	23.79		111.11
LULU	Lululemon	10,400,192,512	10.23	56.25	53.11

Stansberry's Investment Advisory Model Portfolio

Prices as of April 12, 2012

	Symbol	Ref. Date	Ref. Price	Recent Price	Dividends	Description	Action	Return*	Risk
"No Risk"									
Johnson & Johnson	JNJ	07/06/06	\$60.52	\$64.15	\$11.03	World Dominator	Buy	24.2%	2
Wal-Mart	WMT	09/09/10	\$51.91	\$60.14	\$2.16	World Dominator	Buy	20.0%	2
Hershey	HSY	12/06/07	\$40.55	\$61.65	\$5.42	World Dominator	Hold	65.4%	2
Exelon	EXC	10/09/02	\$21.47	\$37.89	\$16.25	Nuclear power	Hold	152.1%	3
Microsoft	MSFT	02/09/12	\$30.77	\$30.98	\$0.20	Tech Giant	Buy	1.3%	2
W.R. Berkley	WRB	03/16/12	\$35.85	\$36.97	\$0.08	Blue-Chip Insurance	Buy	3.4%	2
The "Next Boom"									
ConocoPhillips	COP	04/02/09	\$41.45	\$74.53	\$6.89	Cheap Oil	Hold	96.4%	2
Calpine	CPN	05/13/10	\$13.93	\$16.99		Nat Gas Power	Hold	22.0%	2
Dominion Resources	D	07/18/11	\$48.00	\$50.30	\$1.51	Export LNG	Buy	8.0%	2
Activision Blizzard	ATVI	10/13/11	\$12.92	\$12.48	\$0.18	Gaming Publisher	Buy	-2.0%	2
Union Pacific	UNP	01/19/12	\$112.18	\$108.80	\$0.60	Trophy Railroad	Buy	-2.5%	2
Teekay LNG Partners	TGP	11/17/11	\$32.72	\$38.50	\$0.63	LNG Tankers	Buy	19.6%	2
EOG Resources	EOG	01/19/12	\$105.08	\$105.22	\$0.17	U.S. Oil Exploration	Buy	0.3%	3
Cheasapeake Energy	CHK	01/19/12	\$20.68	\$20.66	\$0.09	U.S. Oil Exploration	Buy	0.3%	3
Gold Miners Fund	GDX	01/19/12	\$52.15	\$48.16		Gold Stocks	Sell	-7.7%	4
Royal Gold	RGLD	01/19/12	\$67.70	\$63.69	\$0.15	Gold Royalty	Sell	-5.4%	4
Silver Wheaton	SLW	12/01/10	\$37.90	\$32.03	\$0.27	Silver Royalty	Sell	-14.8%	5
Monsanto	MON	11/18/10	\$59.63	\$78.34	\$1.74	Soaring Food	Hold	34.3%	5
San Juan Basin	SJT	01/07/10	\$18.34	\$18.24	\$3.44	Cheap Energy	Hold	23.6%	5
Swift Energy	SFY	03/16/12	\$31.50	\$27.69		Cheap Energy	Buy	-15.9%	5
Royal Bank of Scotland	RBS	04/12/12	NEW	\$8.28		Sovereign Bank	Buy	NEW	3
Citigroup	C	04/12/12	NEW	\$34.63		Sovereign Bank	Buy	NEW	3
Bank of America	BAC	04/12/12	NEW	\$9.17		Sovereign Bank	Buy	NEW	3
Victims									
iShares U.S. Bond	TLT	1/19/2012	\$118.32	\$115.01	\$0.85	Failing Currency	Sell Short	1.7%	5
*Returns include 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 .									
Our risk label is based on current share price and one-year business outlook. 1 = the lowest possible risk. 10 = the highest possible risk.									

Published by Stansberry & Associates Investment Research.

Stansberry & Associates welcomes comments or suggestions at feedback@stansberryresearch.com. This address is for feedback only. For questions about your account or to speak with customer service, call 888-261-2693 (U.S.) or is 443-839-0986 (international) Monday-Friday, 9 a.m.-5 p.m. Eastern time. Or e-mail info@stansberrycustomerservice.com. Please note: The law prohibits us from giving personalized investment advice.

© 2012 Stansberry & Associates Investment Research. All rights reserved. Any reproduction, copying, or redistribution, in whole or in part, is prohibited without written permission from Stansberry & Associates, 1217 Saint Paul Street, Baltimore, MD 21202 or www.stansberryresearch.com.

Any brokers mentioned constitute a partial list of available brokers and is for your information only. Stansberry & Associates does not recommend or endorse any brokers, dealers, or investment advisors.

Stansberry & Associates forbids its writers from having a financial interest in any security they recommend to our subscribers. All employees of Stansberry & Associates (and affiliated companies) must wait 24 hours after an investment recommendation is published online or 72 hours after a direct mail publication is sent before acting on that recommendation.

This work is based on SEC filings, current events, interviews, corporate press releases, and what we've learned as financial journalists. It may contain errors, and you shouldn't make any investment decision based solely on what you read here. It's your money and your responsibility.