GOLD & ENERGY ADVISOR

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"China Awakens!"

"They've patiently given us the rope, and now they're hanging us with it. The Chinese have launched a massive takeover wave of American industry, and we're helpless to stop it. We're even *paying* them to do it!

"The major economic trend of the decade has begun! Prepare now!"

- **The new Chinese grab for American industry: the surprising causes (and unstoppable results!)**
- **The truth about the "yuan devaluation"**
- **Oil hits highest prices in history...my predictions for what's next!**

There are several major stories breaking this month, and as usual, the media is completely missing the importance of them.

You've probably heard about the attempted takeover of Unocal (America's ninth-largest oil company) by Cnooc (pronounced see-nook: a Chinese oil company). Unocal was already being bought by Chevron for $16.5 billion in cash and stock, but Cnooc has raised the ante by bidding $18.5 billion in cash. (In response, Chevron raised its bid up to $17 billion.)

I've analyzed and mentioned Unocal in a couple of the *GEA* Alerts and Special Reports, and I mentioned there might be a bidding war for it. That's certainly turned out to be the case!

Right now, it's unclear which of these bids will be successful. Unocal shareholders were supposed to vote on the Chevron bid next month (which the Unocal board of directors has endorsed), but now Cnooc is racing to finalize details of its bid to give the shareholders another option.

The competitive bidding shows us how tight the oil markets are getting. But there's a lot more to the story than that…

A Communist Grab for Oil

Some commentators have said we should just let the markets decide the outcome of this takeover battle. Let the best company win—and normally I'd agree.

But not this time. This isn't a battle between two companies. Instead, it's a fight between an American company (Chevron) and the Communist Chinese government.

First of all, Cnooc isn't a real "company" at all: it's 70% owned by the Chinese state, making it little more than an agency of the Communist regime.

And that's also reflected in Cnooc's bid. As energy companies go, Cnooc isn't a giant. Its market capitalization is little more than Unocal's, the company it's trying to take over. To make the bid work, Cnooc is getting low-cost financing from Chinese state-owned banks. Some of the financing will even be ***no***-cost, a ridiculously unfair advantage...

THE GOLD AND ENERGY ADVISOR

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James Woolsey, the former director of the CIA, recently said the bid is a "takeover attempt of a U.S. company by the most powerful dictatorship in the world"!

Why are the Chinese going after Unocal? Because it fits perfectly with their long-term plans. Unocal is known for doing business in tough places all over the world (like Burma and Afghanistan). As the *International Herald Tribune* recently noted, "Unocal sounds like exactly the kind of company the Chinese government might want to control if it envisions a sort of "great game" in which major powers scramble for access to far-flung oil and natural gas reserves."

I've warned you about how Chinese oil companies are squeezing out American energy companies all over the world. Time after time, the Chinese are starting to outbid American companies for exploration and drilling rights in new locations. Our corporations simply can't compete with "companies" that can get low- or no-cost loans from their government, and that don't have to make any profit on their projects. American companies just can't afford the outrageous prices the Chinese are paying for new oil rights.

So Unocal is just the next step in their strategy. First, the Chinese shut out American companies from new projects. Now China will just flat-out swallow them whole.

And Unocal would give the Chinese crucial advantages in this strategy. If Cnooc grabs Unocal, China would also get a 9 percent share of the new $6 billion oil pipeline at the Caspian Sea, which was meant to reduce American reliance on Middle

Eastern oil. Plus, as Britain's *Observer* said, "Wall Street oil analysts agree that what makes Unocal a must-have is the technical expertise that will allow Cnooc to compete for giant gas and oil exploration projects."

So a successful grab of Unocal would equip China to shut down even more American companies, by becoming even more competitive in further contests. Plus, we'd lose access to the Caspian Sea oil, making us even more dependent on oil from our Middle Eastern "friends" like Saudi Arabia and Iran.

That's why former CIA director James Woolsey is warning our government about the Cnooc grab, pointing out that "Oil can be used as a weapon of war." A Cnooc takeover of Unocal would be an ominous development for our national security.

The Coming Chinese Takeover of American Industry

Unocal isn't the only American company the Chinese are grabbing for. You might have heard about IBM selling its PC division to China last year. Or the takeover of Maytag that China just launched a few weeks ago.

These companies are the first, but they won't be the last. Even if the Cnooc bid for Unocal fails, the overall Chinese takeover wave will be unstoppable.

First of all, as I've already said, Chinese companies have access to very low-cost loans from their state banks. They can afford to pay huge sums that privately-financed competitors can't hope to match.

Once a company is acquired, it's moved to China. American factories are shut down, and manufacturing moves overseas where costs and labor are much lower. Plus, the company gets new, unrestricted access to the Chinese markets to sell its products.

All this means the acquired companies get huge boosts in profits, which just gives their Chinese owners more ammunition to go buy even *more* of our companies. Meanwhile, American factories close down, and our jobs bleed away. It's a vicious circle that we won't be able to escape from, and the worst part is…

China isn't the only hostile power trying to take over our oil industry. You might have seen Mobil and Getty gas stations in your neighborhood disappearing, replaced by Lukoil (pronounced luke-oil) stations.

But you might not know who Lukoil is—it's a behemoth Russian oil company (the largest in Russia, with the second-largest oil and gas reserves in the world). Lukoil has acquired 1,300 Getty Gas stations and 800 Mobil stations in the Northeast, and is now launching ad campaigns to introduce itself to consumers in 13 states (Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont, Virginia, and West Virginia). Lukoil said it wants a "friendly" image in our minds.

Ten Mobil stations *per week* are disappearing and morphing into Russian property. Even if Americans don't understand the importance of this, the Russians sure do. That's why Russian President Vladimir Putin personally attended a ribbon-cutting ceremony for a Lukoil station in Manhattan two years ago.

We're *Paying* Them to Destroy Our Economy!

I've told you before about the outrageous borrow-and-spend binge that we've been on. We've been buying much more than we've been producing. Now the chickens are coming home to roost with a vengeance.

Every month, China sells much more stuff to us than we sell to them. In the first quarter of 2005, the US imported from China *5.7 times as much as we exported*. China nets about $20 billion per month from foreign trade.

Think about this. The Unocal bid was $18.5 billion—that's less than one month's worth of the trade imbalance. **China can afford to gobble up a new Unocal every single month!** And even if the imbalance was to stop tomorrow (which it can't, unless there's a devastating simultaneous crash of all the world's economies), China has already accumulated over $700 billion in foreign reserves ($230 billion just in US Treasuries alone).

They could swallow dozens more US companies without even noticing the dent in their savings.

We've been borrowing and spending, while the Chinese have been saving. Now we're completely

Latest prices as GEA goes to press—July 20, 2005

Comex spot contract: silver $7.04, gold $422.95
Nymex spot platinum: $871.00, palladium $188.00
Nymex Light Sweet Crude Oil $58.08

Silver coins			Dealer will buy at this price	Dealer will sell at this price
100 1 oz. silver American Eagles			$810	$940
100 1 oz. common rounds			$700	$840
$1,000 face value US pre-1965 coin bag (circulated)			$4,700	$5,700
$1,000 face value US circulated silver dollar bag (VG or better)			$8,200	$9,200
US Morgan silver dollars	PCGS MS64		$38	$52
	PCGS MS65		$100	$150
	PCGS MS66		$300	$360
Platinum coins				
U.S. Platinum Eagle:	1 oz.		$870	$990
	1/2 oz.		$440	$520
	1/4 oz.		$220	$320
	1/10 oz.		$90	$160
Gold coins				
Australian Kangaroo			$415	$470
British sovereign (Kings)			$96	$135
(Elizabeths)			$97	$135
Canadian Maple Leaf			$415	$480
Credit Suisse 1 oz. gold bar			$410	$480
Mexican 50 peso Centenario			$490	$560
South African Krugerrand			$410	$470
US Gold Eagle:	1 oz.		$423	$480
	1/2 oz.		$200	$250
	1/4 oz.		$98	$140
	1/10 oz.		$44	$57
US $20 double eagle:				
Liberty	Raw	MS60	$490	$570
	NGC	MS63	$700	$850
	NGC	MS64	$1,150	$1,750
	NGC	MS65	$4,150	$4,850
Saint Gaudens	Raw	MS60	$500	$600
	NGC	MS63	$600	$725
	NGC	MS64	$650	$780
	NGC	MS65	$1,100	$1,350

Prices courtesy of Finest Known, Boca Raton, FL. (800) 806-3468.

helpless against this new economic form of aggression. As the *Wall Street Journal* said, "We've outsourced our savings to China…The Unocal bid brings into stark relief just how much the U.S. is partying today. The country has spent future earning streams already and now must start paying for it."

Think I'm being extreme by calling this "economic aggression"? Not at all. As the British *Observer* said, "The enemy has landed…This could be the moment the world realizes a rival superpower to America has come of age…The world's two superpowers are on a collision course over crude oil."

Even Fu Chengyu, the CEO of Cnooc (!), recognizes how aggressive his action is. He said, "It's made an impression on people that [China's] enterprises are ravenous, eating whatever they can get their hands on."

When some US officials expressed concern about the Cnooc bid, China's response was immediate and angry. China's Foreign Ministry said, "We demand that the U.S. Congress stop interfering…"

But how is this possible? Who is China to demand the US Government does anything? Well, that's easy. We gave them the power to do so. After all, the debtor can't dictate terms to the lender.

With several hundred billions of dollars in US debt, the Chinese have us by the throat. We'll have to dance to their tune now. If we don't, they can just dump Treasuries on the market and collapse the US dollar.

Yes, they'll lose some money too—but with $20 billion dollars in net trade income every month, who cares about a short-term loss?

Now that we're drowning in debt to China (and others)…now that we're caught in the jaws of our self-made trap…China has us under its heel. And now they don't need to lend to us any more. Instead, they'll start using that massive income to take over American industry. As a Shanghai professor told the *Washington Post,* "We invest too much in U.S. federal bonds, and they don't make us much money. Now we're learning to invest more wisely, to try to invest in American companies and industries."

This is a double blow to the US economy. Fewer buyers for our debt will sink the US economy (we're borrowing $2 billion per day just to stay afloat). Then the Chinese will buy our companies and move them offshore, sending American jobs overseas and tanking the American economy even further. The resulting economic turmoil will just make our companies plunge in value, making them even cheaper for the Chinese to buy more…and on it goes until there's nothing left.

Our economic position isn't just weak—it's hopeless. The *International Herald Tribune* even commented, "We should be relieved that at least for now the Chinese aren't dumping their dollars; they're using them to buy American companies."

Think about that. We're so pathetic, we should be *thankful* that all they're doing is taking over our companies.

How do we get out of this trap? We can't.

Every month, we're giving the Chinese billions more dollars in "ammunition" to use against us. We need to export more, and import less. But outsourcing has made it impossible to fix the imbalance. As Paul Craig Roberts, formerly Asst. Secretary of the Treasury under Ronald Reagan, recently wrote,

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"Offshore outsourcing makes it impossible for the U.S. to rectify its trade imbalances through exports. As more and more production of goods and services for U.S. markets moves offshore, we have less capability to boost our exports, and the trade deficit automatically widens. Economic catastrophe at some point in the future seems assured…"

And month after month, the situation just gets worse. The latest jobs report said we lost another 24,000 manufacturing jobs, the fourth consecutive monthly decline. They've fallen in 10 of the last 12 months. After adjusting for inflation, average weekly earnings have fallen over the last year. This isn't the sign of a healthy economy.

But what about the imbalance of the dollar vs. the yuan (the Chinese currency)? Politicians have been stumping lately, claiming the yuan is undervalued, and so it's artificially skewing trade in China's favor (by making Chinese goods less expensive than they should be).

China rigidly holds the yuan to its current value (it's been at 8.28 yuan to the dollar since June 1995). If China would just revalue the yuan to its proper value, our politicians and commentators say, this whole trade imbalance thing would just go away, and everything would be peachy again.

Are they right? Here's…

China Threatens to Nuke US Cities!

Still unsure that China has us by the throat? Well, they're confident enough to threaten to **nuke our cities** if we interfere with their plans to take over Taiwan!

You might remember that when the Communists took over China, the existing government fled to the island of Taiwan. Ever since, the official Communist doctrine is that Taiwan actually belongs to China—but they couldn't actually take it over because the US has pledged to protect the Taiwanese against the Communists.

But now, the Chinese are openly planning to invade. Secretary of State Condoleeza Rice just said, "There is no doubt that we have concerns about the size and pace of the Chinese military buildup."

More importantly, the Chinese are brushing aside the US pledge to protect Taiwan. General Zhu Chenghu of the People's Liberation Army just said that if we interfere with China's plans, "I think we will have to respond with nuclear weapons…If the Americans are determined to interfere, we will be determined to respond…The Americans will have to be prepared that hundreds of cities will be destroyed by the Chinese."

Hmmm…'Break your promise to Taiwan (and be humiliated in the eyes of the world), or we will nuke you.' Still think we have the upper hand over China?

The Truth About a Yuan Devaluation

A devaluation sounds very nice in theory. But in reality, it won't help us. In fact, it could be a complete disaster.

First of all, our politicians are proposing a gentle, "controlled" devaluation. But such a thing doesn't exist. When rigid currency controls are released, the built-up imbalances snap back viciously. A study by *Bridgewater Daily Observations* looked at 56 historical devaluations since the 1930s, and found the average devaluation was 25%.

Imagine everything that's made in China going up in price by 25% overnight. What would the effects be on the American economy? It would be catastrophic.

As Paul Craig Roberts noted, "When China's currency ceases to be undervalued, American shoppers in Wal-Mart, where 70 percent of the goods on the shelves are made in China, will think they are in Neiman Marcus. Price increases will cause a dramatic reduction in American real incomes…American consumers will experience the hardest times since the Great Depression."

Plus, here's an effect that none of the politicians seem to anticipate. If the yuan strengthens against the dollar, it will just make American assets (companies, real estate, etc.) ***cheaper*** for China to buy! The cure would just make the disease worse. (Nor would it necessarily fix our trade imbalances: the trade deficit would just shift to countries other than China.)

A severe-enough revaluation might even throw the entire world economy into a tailspin. The Chinese economy, with one-sixth the entire world's population, would be crippled, sucking the global economy down with it.

To see what would happen in China, just look at Japan. Twenty years ago, when we had a huge trade deficit with Japan, US officials pressured Japan to let the yen strengthen. Japanese officials caved in, and Japan was soon thrown into deflationary chaos. The Nikkei stock index went from 38,134 in December 1989 to 7,909 in March 2004. And now, almost twenty years later, Japan *still* hasn't recovered. (Plus, it didn't even help the US trade deficit, which got bigger anyway despite Japan's actions.)

As the Nobel-winning economist Robert Mundell has noted, a yuan revaluation would cut foreign investment in China, slash its growth rate, increase bad loans, increase unemployment, cause deflation, destabilize all of Southeast Asia, and undermine China's compliance with World Trade Organization rules.

And two economists in the *Wall Street Journal* commented, "We estimate that a 25% yuan devaluation against the dollar would result in a deflation of at least 15%. China would be forced to relive the terrible economic conditions induced by the 1930s yuan revaluation. In 1934, the U.S. Silver Purchase Act monetized silver. This effectively revalued the yuan by 24% because China was on the silver standard. The price of the yuan against the dollar went from 33 cents at the end of 1933 to 41 cents in 1935."

You might remember this economic crash was responsible for the Chinese Communist Revolution and China's devastating civil war, which encouraged Japan to invade…and the Japanese aggression in Asia led to the US oil embargo, leading the Japanese to invade Indonesia for its oil…which they knew the US would defend, so they pre-emptively attacked Pearl Harbor, sucking us into World War II.

Yes, a currency devaluation in China was responsible (at least partially) for World War II in the Pacific!

Another yuan devaluation would be disastrous, not only for China but also the rest of the world, and the Chinese are well aware of this. That's why they're fighting against it so hard.

But chest-beating US politicians are threatening the Chinese with sanctions if they don't value. So the Chinese might just decide to "give us what we're asking for." We'll have to wait and see.

Summary: a devaluation would tank our economy. But the current situation isn't any better.

We're caught in a no-win situation…a trap that we set for ourselves.

Meanwhile…

Oil Sets Another All-Time Record!

Since the last issue of the *GEA*, oil has hit yet another all-time record high, over $62 per barrel. This was caused by fears—not reality, just fears—of a tropical storm in the Gulf of Mexico. This confirms what I said a few issues ago about oil's new volatility—with no spare capacity left in the world, even a rumor is enough to make oil swing wildly.

The media is still in denial, but a few analysts here and there are trying to get the news out about our situation. The Institute for International

Economics in Washington just predicted oil at $90 per barrel by March 31 of next year. Texas oil analyst Matthew Simmons has said $100 per barrel is possible even before then.

Barclays Capital recently noted that despite record high prices, "There is absolutely no sign of flagging demand in the US...Indeed, oil-demand growth is actually *speeding up*." Increasing demand just means more support for higher prices.

I've written before about tar sands in Canada: frozen hydrocarbon gunk that can be converted into oil. Tar sands are costly to process, and are only worthwhile when crude oil itself is expensive. Several companies have now announced a total of $60 billion worth of investments into the Alberta tar sands. This means these companies believe oil prices will stay permanently high.

Elsewhere in the world, energy companies are in big trouble. The *New York Times* just wrote that oil and gas producing countries are "squeezing energy companies as never before." They're canceling contracts, and renegotiating them with harsh terms.

All over the Third World, there are mass movements of people complaining about American companies 'taking advantage of our resources'… even though these companies spent billions of dollars and uncounted thousands of hours of labor to develop these resources and make them available. Bolivia is an example of a growing trend: "Angry protests against the country's energy policies have already led two presidents to resign in 20 months… Talk of nationalization is in the air."

'Nationalization' just means the country steals the local facilities and equipment of American energy companies, and puts them under "national" (government) ownership. In actual practice, this has been disastrous for the oil productivity of every country that's tried it. When Western companies are forced out, they take all their workers and managers with them. The local workers have little training and experience, and the industry is soon taken over by corrupt and incompetent bureaucrats. Productivity plummets, as seen in Venezuela, Mexico, Russia, Iran, and many other countries that nationalized early in the 20th century.

Nevertheless, this is a growing trend today. In 2004, Russia increased its production tax rate by 15 percentage points, and raised export taxes on crude. The government is even discussing limiting foreign involvement in certain large energy projects.

Kazakhstan has a new law, requiring a minimum of 90 percent of profits be kept by the government. Nigeria is creating new royalty levies. Venezuela just jacked up government royalties from 1 percent to 16.6 percent in the huge Orinoco region. It's also considering raising the income tax rate from 34 to 50 percent. And it's also going after $3 billion in "back taxes" from energy companies.

All this just means oil production in these countries is going to suffer, and there'll be less oil for world markets.

While the US is getting squeezed out of a stable oil supply, China is worming its way in. China has signed $100 billion in agreements with Latin America, 19 just with Venezuela alone. As the *Wall Street Journal* noted, "What has begun to disturb many US officials is that the Chinese are not intent just on buying oil but on gaining control over future oil capacity." Congressman William Jefferson has said, "Here we have the Chinese government… Their idea is not to compete on the world market; they're looking to corner it, so it isn't available to anyone else…It's quite worrisome."

China is also happy to deal with rogue countries. China Petroleum & Chemical (Sinopec) has signed a 20-year contract with Iran for natural gas, and is the largest investor in Sudan's oil industry. (Now China is maneuvering in the United Nations to avoid condemnations of Iran's nuclear program and Sudan's genocidal atrocities in the Darfur region. Do you think there's a connection?)

The weakness of the American energy industry is illustrated by a new agreement Exxon Mobil just struck. It just signed a joint venture with Saudi Aramco and Sinopec to build a $3.5 billion project (a refinery and other petrochemical facilities). Previously, Exxon would have been the dominant player in such an arrangement. But this time, Exxon only got 25% ownership.

Meanwhile, China has announced it will start filling its long-planned strategic oil reserve in the fourth quarter. This will probably take several years to complete, and will just add more upwards pressure on oil prices.

Of course, the media tries to put a happy spin on our situation. For example, Shell just announced it will increase its output 30% over the next decade. The media made lots of happy noises about the announcement, but they left out some important facts.

First of all, it will take ten years to get there. Second, this only means an increase of 1.15 million barrels per day, not even enough to cover *this* year's anticipated increase in world demand. Finally, Shell also admitted production will be flat for the next several years. This announcement had grim implications, not hopeful ones.

Small wonder that gas prices are so high nowadays. And they'll probably get higher still. The *Wall Street Journal* recently wrote that gas station owners are now desperately trying to hedge gas prices. "Intense gyrations in world oil prices have station owners obsessed about timing fuel purchases to the hour, so they can buy more at the troughs and less at the peaks. This year has seen wholesale gas prices gyrate as much as 10 cents a gallon within a day."

Apparently, refinery outages in California have been causing wild swings in gas prices. When output is restricted, refineries only make branded gas, causing unbranded gas prices to soar. In California, many off-brand stations had to close down completely for several weeks—their gas cost as much as 15 cents a gallon more than the branded.

The article noted that now, many gas station chains are even trying to hedge their purchases in the futures markets. For unwary traders, the commodities markets are little more than casinos, so this just means some gas station chains are going to get wiped out.

Ultimately, all this means there will be fewer gas stations surviving…so there'll be less competition, and higher prices for consumers.

We need more oil, but no relief is in sight. The *Wall Street Journal* has written about the skyrocketing costs of new energy projects:

"Two decades of penny pinching during an era of low prices have taken their toll on the industrial capacity and expertise needed to bring new supplies online... There is growing concern that there won't be enough technical expertise available to design these complex projects. The number of petroleum engineers in the US—long the main global supplier of such talent—has fallen by nearly half since the 1980s."

I recently told you about Qatar's huge multi-billion dollar project to make diesel from natural gas. Well, it didn't last long: Qatar just announced it's postponing the project. Energy Minister Al Attiyah said there wasn't enough materials and engineering skill to design the plants: he'd "never seen such high costs in my career. Projects have become very expensive." Even in Saudi Arabia, energy project costs are up a whopping 60%.

There's a massive shortage of petroleum engineers. The *Journal* noted that "Oil service providers face a shortage of professionals—tens of thousands of whom have been laid off or retired in the past 20 years or so."

According to the American Petroleum Institute, energy industry employment peaked at 860,000 jobs in 1982, then lost 500,000 through 2000. Current university enrollment is a mere 1,500 students. But the industry needs an estimated 30,000 engineers in the next 5 years.

And drilling costs have skyrocketed around the world as well. Costs for one onshore well in the US went from $800,000 to $1.5 million in just 15 months!

Swelling demand, shrinking supply, and skyrocketing costs—normally, all these would be "cured" by higher prices. But notice that all this is happening ***while oil prices are at record highs***! The oil bull still has a long way to run!

Does all this mean oil will move straight up from here? No!

Oil prices, and oil stock prices, will still move up and down. That's the nature of any bull market.

For specific strategies, recommendations, and comments, watch your e-mail for my weekly updates and special reports. My monthly newsletters discuss the longer-term trends, while the Updates and Special Reports discuss shorter-term trends and specific recommendations.