

# ***GOLD & ENERGY ADVISOR***

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August 2005

## **“Oil smashes through \$63... \$65... and breaches \$67!”**

**“But I’m expecting to see oil at \$100! Energy will be the hottest investment of the 2000s, outperforming all the rest by far.**

**“Don’t get left behind!”**



*James DiGeorgia, Editor*

- **Oil: the best investment for the 2000s**
- **Demand is swelling, supply is shrinking**
- **OPEC is lying to us!**
- **Why energy stocks are still undervalued**

Over and over again this year, oil has shattered its previous record, setting breathtaking new highs. But where is it going from here?

I’m expecting a short-term correction (which might even have started by the time you get this). But longer term, it has only one direction to go: Up! I’m looking for \$100 oil.

I was recently interviewed on this exact topic, and I think the interview gave a concise summary of why our energy situation will be tight for years to come.

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### **James DiGeorgia on Oil in the 2000s**

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**Q: James, by anybody’s standards you’re a very successful investor. Can you share the secrets of your success?**

One of the best strategies for investors to make huge profits is to identify major long-term trends and investment themes, and start building positions in them.

In the 1970s and early 80s, the major investment theme was inflation hedges. During this period the U.S. experienced one of the worst decades of inflation in its history. The causes were manifold: “Guns and butter” economy, failed fiscal and monetary policies, several oil shocks and shortages, and the decoupling of the dollar and gold. Investors flocked to inflation hedges: oil made over 35% in compounded annual gains, gold was about 32%, and real estate soared as well.

I made my first million during this period by

investing and trading in gold coins.

In the 1980s, the major trend was baby boomers starting their families. Certain stocks became the best way to ride this wave. The big gainers were companies like Wal-Mart, Home Depot, Hasbro, and Circuit City. For example, Wal-Mart started out as a small retailer out of Bentonville, Arkansas, and now has revenues of over \$288 billion. It's one of the best success stories in American business.

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Investment	Approximate Compound Annual Return (%)
Stocks	6
Bonds	7
(Consumer Price Index)	8
Housing	10
Farmland	14
Silver	23
U.S. Coins	27
Gold	32
Oil	35

### The 1970s: A Decade for Collectibles and Commodities

Company Name	% Gain
Circuit City Strs-Carmax Grp	8,252
Limited Inc.	6,100
Hasbro Inc.	5,582
Home Depot Inc.	4,997
Wal Mart Stores Inc.	4,032

### The 1980s: Biggest Gainers of the S&P 500

In the 1990s, the theme was personal computers and the Internet. Stocks like eBay, Yahoo, Dell, and Cisco were huge winners. These companies have changed the way we invest, learn, and entertain ourselves.

Company Name	% Gain
America Online Inc	79,629
Dell Computer Corp	72,445
EMC Corp	69,638
Cisco Systems Inc	64,498
CMGI Inc	61,189

### The 1990s: Biggest Gainers of the S&P 500

**Q. What do you think will be the major trend in the 2000s?**

In the inflation of the 1970s, the best performing assets were inflation hedges like real estate and (especially) oil.

The markets have come full circle: so far, the best performing assets in the 2000s again include real estate and oil.

The last oil crisis started in 1973 with the Arab Oil Embargo and long lines at gas stations. After billions of investment dollars flowed to the

industry, shortages turned around and gas lines disappeared. By 1986, we had a global glut of oil, and oil prices finally fell and stabilized.

But this took 13 years, and today we're right back where we started in the early 1970s. It will take another 10 to 15 years for our situation to stabilize. (But this time the outcome will probably be very different.)

I believe oil will continue to be the major investment theme for the rest of the decade.

**Q. So you think oil investments will be among the best-performing investments in the 2000s?**

Yes. Oil prices will be volatile but I expect them to continue higher. There are seven major reasons why I believe oil investments will soar this decade:

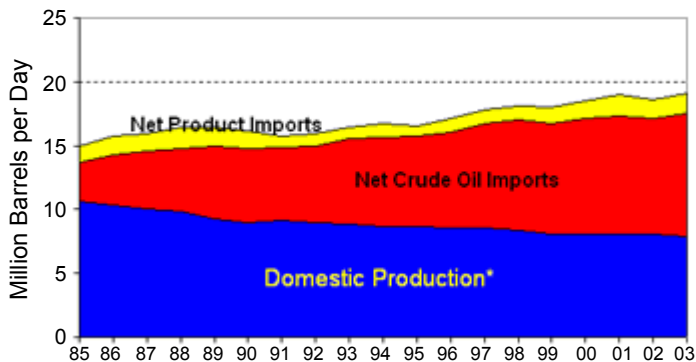
1. The U.S. is not only the largest consumer of oil in the world, but we're quickly using up our reserves of oil. This will give more pricing power to OPEC. This oil cartel already exerts tremendous influence in the oil markets, but it will soon have a death-grip on us.
2. Worldwide, demand for oil is growing.
3. Producers will find it very difficult to keep up with increasing demand. It's unlikely we will find new, significant reserves.
4. We have a lot less oil in the world than we think. OPEC probably does not have the huge reserves it claims.
5. All this means that on the global level, we've probably already reached peak production. Many prominent oil scientists are warning that global oil production could start to decline in the near future.
6. Global energy supplies come from unstable places.
7. Oil stocks are still cheap.

**Q: OK, I'm sure our readers will want more detail on each of those reasons. Let's start with the U.S. running out of oil.**

America is by far the largest consumer of oil in the world. We burn through almost 21 million barrels of oil *each day*.

A few decades ago, our domestic production was more than enough for our own needs. We even exported oil to the rest of the world. But those days are long gone. Last year we produced about 7.67 million barrels per day, less than 40 percent of our consumption. The rest came from foreign imports.

And it gets worse each year. As the following chart shows, our domestic production is falling, and our imports are rising:



**U.S. Oil Production and Imports**

Notice that combined crude imports and net imports of already-refined petroleum products were less than one-third our consumption just 20 years ago. But our domestic production is falling fast, while imports steadily climb.

As of January 1, 2005, the U.S. had 21.9 billion barrels of oil. If you divide our reserves by our production, you'll see that **we'll run out of U.S. oil in less than 8 years**. That will place us completely at the mercy of OPEC and foreign oil suppliers.

This is actually a hypothetical, best-case scenario. In real life, we won't be able to produce 7.67 million barrels per day until the wells are dry. As a well depletes, it gets harder to pump out the oil, so the production rate slows. So we'll produce less oil each year, just as we have every year since U.S. production peaked in 1971.

On the one hand, this means our oil will last longer than 8 years. But that's not good news at all: it just means we'll get less oil each year, and will be all the more dependent on OPEC even sooner.

Just think of who we'll be reliant on. Saudi Arabia has the most oil, and they also run a savage Islamic dictatorship that leads the world in public beheadings. Iran is next: they invented the term "Great Satan" to describe us. Then there's Iraq, which is already bloody anarchy and will be worse once our troops leave. And the list goes on.

**“I believe oil will continue to be the major investment theme for the rest of the decade.”**

Country	2003 Reserves	% World Reserves
S. Arabia	263	23
Iran	131	11.4
Iraq	115	10
U. Arab Emir.	98	8.5
Kuwait	97	8.4
Venezuela	78	6.8
Russia (non-OPEC)	69	6.0
Libya	36	3.1
Nigeria	34	3.0
U.S. (non-OPEC)	31	2.7

*The 10 largest oil reserves in the world, in billions of barrels. We're at #10. 80% of the world's oil is in the other 9 countries, and they're all OPEC members (except for Russia).*

This list looks like a police line-up. But these are the nations we'll be dependent on for our oil supply. Gives you a nice warm feeling, doesn't it?

With every passing year, we're more under OPEC's heel...a process that will be complete very soon. They'll be able to charge whatever prices they want for their oil, and we'll have to pay it.

**Q: That's very sobering. But in your second and third reasons, you're saying there are growing supply and demand problems all over the world, not just in the U.S. Elaborate on this, please.**

When a Third World country industrializes, its oil consumption shoots up. We've seen this over and over again during the last century. This is why global oil demand has gradually, and steadily, increased over the last century.

But what we haven't seen before is one-third of the entire world's population industrializing at once. China and India alone contain more than two billion people, and their oil usage is skyrocketing. And both countries are just in the beginning stages of the industrialization process.

By 2010 worldwide demand is forecasted at 93 million barrels per day, but supply will be about 90 million barrels per day—a shortage of 3 million barrels per day. That's a huge shortage, and prices will go through the roof.

**Q. But economics teaches us that when prices go up, producers will increase supply, and prices will fall to equilibrium.**

In a perfect economic world, supply would meet demand and prices would fall. But that's not the world we live in. Instead, major producers such as Russia, Mexico, Iran, Venezuela, and Iraq have seen their production decrease. They aren't

run by profit-oriented companies, but by large bureaucratic governments, many of which are corrupt and inefficient.

Also, OPEC countries control the majority of global oil reserves. They can and will restrict supply if prices fall too much—they've done this in the past, and kept oil prices artificially high. Again, this will become more of a problem as we draw down our own reserves.

And the Chinese situation further distorts supply and demand. I've told my readers about the potential conflicts the U.S. and China will have over global energy reserves. The Chinese have been competing with U.S. firms to negotiate partnerships with Iran, Russia, Venezuela, and Canada. The Communist-owned Chinese companies don't have the same profit incentive as U.S. firms, and so they're paying outrageous prices for even marginal resources. The U.S. companies can't hope to compete, so now our energy firms are getting squeezed out of access to global oil reserves. This competition will continue for the foreseeable future.

This conflict has even spread into our own land. We just saw the Communist government make a grab for Unocal, the ninth-largest American energy company. (The takeover was attempted by Cnooc, a "private" company, but the whole thing was actually orchestrated by the Communist state. The company is 70% owned by the Chinese government, and the takeover would have been financed with low-cost loans by China's state-owned banks.)

This particular grab failed, thanks to a public uproar in the U.S. But the Chinese are patient, and I'm expecting them to try again, maybe by covert proxy takeovers next time. People seem to forget about our massive trade deficit with China: the Chinese have a net trade income of almost \$20 billion each month, most of which comes from us. Unocal would have been an \$18 billion deal, so the Chinese can afford to "do a Unocal" *every single month* from now on. Even worse, **we're** the ones paying them to do it.

**Q: What was it you said about being unable to find significant amounts of new oil?**

The "dirty little secret" of the oil industry is that all the big fields have been found already. Major discoveries peaked in the 1960s and have plummeted since then.

We need to find about 30 billion barrels of oil each year, just to replace consumption (never mind keep up with expanding demand). But for many years now, we've only found a small fraction of that: 3-7 billion barrels per year.

## BONUS SECTION:

# China cuts the dollar's last lifeline, and Saudi Arabia gives the United States a 'kick in the groin'!

**M**y interview this month fills the entire issue. But there's some other big news on other fronts that I wanted to discuss. I'll start with...

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### The King of Saudi Arabia Is Dead. Now What?

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King Fahd of Saudi Arabia has died. How will this affect Saudi-American relations, and the flow of Saudi oil to American markets?

The outlook isn't good.

Fahd's death was expected for years: he was incapacitated by a stroke a decade ago, and rumors had swirled that he was being kept alive on life-support. Whether or not that was true, he obviously wasn't running the kingdom anymore.

Then why wasn't he replaced as king? Mai Yamani is an expert on Saudi Arabia at the Royal Institute of International Affairs in London, and herself the daughter of a former Saudi oil minister. As she explained, "They kept King Fahd despite the fact he was ailing for 10 years, which shows the ruling family was afraid of what's next" (my emphasis).

In Chapter Seven of *The Global War for Oil*, I wrote about Saudi Arabia. The current Saudi government was formed by Ibn Saud, a bloodthirsty thug who massacred countless men, women, and children. His offspring are today's "royal" family, and their extravagant lifestyles are widely resented by the Saudi people, especially as the common people sink further into poverty.

Now the former Crown Prince, Abdullah, is the new king. He's widely distrusted among the other royals, as he condemns their "Westernized" ways and wants to steer the kingdom back to its Bedouin roots. (You know, the good old days. That wonderful time when Ibn Saud's troops terrorized the deserts, pillaging and destroying any village that didn't submit to him or his fanatical Wahhabi Islam clerics, and slaughtering large groups of people even after they surrendered to him.)

Officially, Abdullah's policy is still pro-American, but there are already grim warnings of the future. He's appointing Prince Turki al-Faisal as the new ambassador to the United States, and a more blatant "slap to our face" could hardly be imagined. (More on this in a moment.)

And as bad as Abdullah's reign could be, it might be replaced by a worse one at any time. At 82, he's just two years younger than Fahd was.

The next in line is Crown Prince Sultan. After him, Interior Minister Prince Nayef waits. Both men are reported to be involved in making deals with Al-Qaeda.

In my book, I wrote about the deals the royal family made with Osama bin Laden, paying him large amounts of money to shift his attacks away from Saudi territory and onto the U.S. (The deal-making was led by Princes Ahmed bin Salman, Sultan bin Faisal, and Fahd bin Turki, all of which died under *very* mysterious circumstances a few days after the story came out. But Sultan and Nayef were reportedly involved too.)

So Abdullah wants to return the kingdom to its fanatical Wahhabi (and therefore anti-American) roots. He might not last long on the throne, but if he goes, he'll be replaced by someone even worse.

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### Prince Turki al-Faisal: The New Saudi Ambassador to the United States

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Prince Bandar, long-time Saudi ambassador to the U.S. (and close friend to the Bush family), has stepped down from his post. He's being replaced by Prince Turki al-Faisal, a man who's been "credited" with creating Osama bin Laden, and who's been linked to the 9/11 attacks in New York. This seems to be a deliberate provocation and "slap in the face" to America.

**Latest prices as GEA goes to press—  
August 17, 2005**

Comex spot contract: silver \$6.94, gold \$441.00  
 Nymex spot platinum: \$890.00, palladium \$182.00  
 Nymex Light Sweet Crude Oil \$64.50

<b>Silver coins</b>	<b>Dealer will buy at this price</b>	<b>Dealer will sell at this price</b>
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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.	\$880	\$1000
	1/2 oz.	\$440	\$540
	1/4 oz.	\$220	\$340
	1/10 oz.	\$90	\$180

**Gold coins**

Australian Kangaroo		\$435	\$480
British sovereign (Kings)		\$96	\$140
(Elizabeths)		\$97	\$140
Canadian Maple Leaf		\$415	\$490
Credit Suisse 1 oz. gold bar		\$410	\$490
Mexican 50 peso Centenario		\$490	\$580
South African Krugerrand		\$410	\$480
US Gold Eagle:	1 oz.	\$430	\$500
	1/2 oz.	\$200	\$270
	1/4 oz.	\$98	\$160
	1/10 oz.	\$44	\$59
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.

Turki was the head of the bloodsoaked Saudi intelligence service from 1977 to 2001. Two years after he began, he was approached by a young man who was outraged at the Soviet invasion of Afghanistan. Turki encouraged the man to use his considerable wealth to help the *mujahideen* (Muslim resistance fighters). The man got involved in the war, eventually became a hero and leader among the fanatical Muslim guerrillas, and gathered some of them into a new organization. This organization was called "The Base," which in Arabic is pronounced Al-Qaeda. The man was, of course, Osama bin Laden.

As head of external intelligence, Prince Turki was responsible for coordinating Saudi policy with groups like Al-Qaeda and the Taliban. Turki has described mass-murderer Osama as "a relatively pleasant man, very shy, soft spoken..."

Turki is at least indirectly responsible for 9/11. In 1996, Sudan offered to extradite Osama bin Laden to Saudi Arabia. President Clinton called Prince Turki, hoping he would take Osama and hand him over to us. We wanted to bring bin Laden to justice for the (first) World Trade Center bombings three years earlier, along with other attacks against U.S. targets around the world.

But the Saudis refused. Osama escaped from Sudan, and as it turned out, he was already planning the next WTC attacks, which occurred five years later. If Prince Turki hadn't refused to take Osama, 9/11 would never have happened.

Turki "resigned" his intelligence post on August 31, 2001, just 12 days before the 9/11 attacks. It's rumored that he was fired because he knew the attacks were coming, but refused to give details or warn the U.S. Apparently he was actually in the U.S. on 9/11, because reportedly he was one of 31 Saudis (along with his brother) who fled Las Vegas back to Saudi Arabia a couple of days later. Notice that this occurred despite the entire U.S. air fleet being grounded—this required special clearance from someone high in our government. (There were several planeloads of Saudis, including members of bin Laden's immediate family, who were allowed to flee U.S. soil without even being questioned about the attacks.)

The magazine *Paris Match* has linked Prince Turki to the 9/11 attacks. Also, in August 2002, Turki was one of three Saudis sued for helping finance Al-Qaeda's 9/11 operation. (A couple of months ago, U.S. Judge Richard Casey ruled Prince Turki has diplomatic immunity from litigation, so we'll never know what this trial might have revealed.)

In March 2004, a story broke from German intelligence analysts. They discovered connections between Al-Qaeda cells in Germany and Prince Turki and his intelligence agency, via some private Saudi companies.

As the *New York Times* wrote, Turki's appointment raises questions about "the darker aspects of Saudi Arabia's historic relations with the world of Islamic extremists and terrorists... Anyone else who had dealings with even a small fraction of the notorious characters the prince has worked with over the years would never make it past the immigration counter at (Washington's) Dulles Airport."

So what does it say about Saudi Arabia that Prince Turki is the new ambassador to the U.S.? Our "unique friendship" with the Saudis was already severely strained by the continual Saudi funding of terrorism around the world...

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**Now one of the officials most directly implicated in terrorism, especially terrorist attacks on America, will be the official representative of the Saudi government to the United States.**

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This is the diplomatic equivalent of walking up to our President and kicking him in the groin.

Our "unique friendship" with the Saudis is over.

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**China Revalues the Yuan**

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In last month's newsletter, I warned of a possible yuan revaluation. On the *same day* that newsletter was published, the Chinese went ahead and did it.

The Chinese allowed the yuan to strengthen by only a small amount: 2.1% against the dollar.

But the central bank said this is just an "initial step."

Also, the yuan is no longer pegged exclusively to the dollar. Instead, it will be measured against a broader basket of currencies. The bank declined to specify the exact mixture of currencies, but the euro will have a significant role.

U.S. politicians are optimistic: their attitude is that "this is a good start." But in reality, this is grim news for the dollar. Here's why:

- Since China is now linking to a basket of currencies, they don't need as many dollars as before. (Some analysts are calculating the dollar will make up less than half of the basket.) That means the Chinese won't be buying as many Treasuries either. Overall this is less support for the dollar, which will weaken it.
- This means that bond yields will go up. Corporate borrowing costs will get more expensive, and our housing bubble might even be pricked. "This could be the shot heard 'round the world, in the sense that it could start that significant move higher in interest rates that could ultimately curb housing activity": Jeffrey Kleintop, chief investment strategist at PNC Advisors.
- As the Chinese buy euros, the euro will strengthen, making it more attractive as an investment. The dollar will look less attractive by comparison, again making it weaker.
- Commodities will get more expensive for us. Chinese manufacturers who buy commodities with the yuan will pay the same prices. But U.S. manufacturers, paying in dollars, will see higher prices.
- A stronger yuan means the Communists can step up their efforts to buy U.S. companies, as we're already starting to see.
- Costs to U.S. consumers will go up. Wal-Mart, Home Depot and Lowe's, electronics stores, clothing retailers, and anybody else who sells goods manufactured in China will see their costs go up. These will be passed along to the U.S. consumer.
- Other Asian countries are now less pressured to keep their currencies low to compete with the yuan. Now they'll feel comfortable letting their currencies rise,

which means all the same effects listed above for the yuan will apply to other Asian currencies as well.

Until now, the U.S. has been on a wild spending spree, and printing up dollars to pay for it all. But we haven't had to suffer the full effects. Normally we'd see higher prices ripple throughout the U.S. economy, but since China always weakened the yuan in lockstep with the dollar, they could continue to export cheap goods to us.

Essentially, we've been exporting our inflation to China. But as the yuan strengthens, the party is going to end. Our self-created inflationary waves are going to start crashing against U.S. shores, and the full effect of our borrowing orgy will roll over us.

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## The "Perfect Storm" Is Gathering

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The yuan has now been cut loose from the dollar, freeing our currency to sink as low as it wants.

Terrorist-supporting hardliners are taking control of Saudi Arabia.

Oil has blasted up to \$67 per barrel. This is probably a short-term high, or close to it. I expect it to come back down, at least for a little while. But refinery outages and other factors will keep gas prices in the stratosphere. Gasoline has already hit \$3.00 in some parts of the country. And high fuel prices are already pummeling our economy—we can't take \$3.00 gas for long without taking some serious damage.

Iran has restarted its nuclear enrichment program. Iran has already processed 37 tons of yellowcake, from which you can make 200 pounds of fully-enriched uranium. That's enough for five nuclear weapons.

A year ago I predicted Europe's appeasement program would fail, and the Iranians would officially start up their program again. Unfortunately, this prediction has come true. The Iranians were cheating anyway, but now they can proceed more openly than before, and this will only speed up the process.

They might even have nukes already. They have the uranium, and they've bought the

scientific talent. If nuclear bombs start going off in the Middle East, we'll know why.

Meanwhile, the Saudis aren't content with punching us in the nose with Turki's ambassadorial appointment. They also just announced they're pulling \$360 billion out of foreign markets, and bringing it all back home.

That's a tremendous amount of cash. Why would they do this now? It's not that there's suddenly a wonderful investment opportunity at home to put it all in. So why the sudden announcement?

All we can do is speculate. But think about this. The Saudis have information we don't. They know the true state of their oil industry, especially the gargantuan Ghawar field that all by itself supplies about five percent of the world's oil.

We know Ghawar requires an intense waterflooding program to keep it active (in other words, seawater is pumped in to force the oil out). But waterflooding is usually a "secondary production" technique, done to extend an aging field's lifetime. And waterflooding is extremely dangerous in fields that were horizontally drilled (a technique the Saudis were fond of). Once the water table rises up into the horizontal shafts, the water spreads through the entire field and it dies, instantly.

What if the Saudis knew that production at Ghawar, or one of their other giant fields, was on the brink of collapse? (Nobody else would know, since the Saudis refuse to share their production data with anybody else.) They aren't stupid: they know this would cause a massive, instant oil shock, and crash the Western economies.

So what would you do if you were in their shoes? You wouldn't warn anybody. Instead, you'd quietly pull all your investments out of foreign economies before they collapsed. You'd salvage everything you could before the bubble burst.

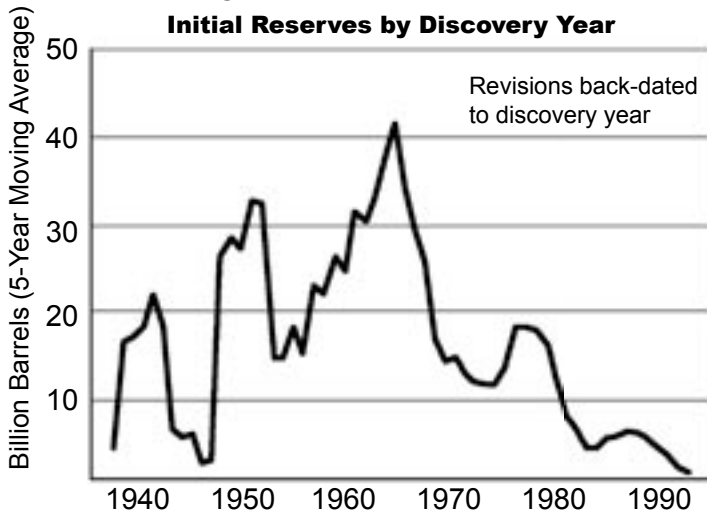
Is this what's going on? I don't know, I'm just speculating. But again, I don't see any great need for \$360 billion in investments to be yanked out of the markets and brought home. They're up to something, and we won't find out what it is until it's too late.

Our economy is no condition to withstand all the storms that are coming. Get your portfolio ready.



## Major Oil Field Discoveries

### Initial Reserves by Discovery Year



Major oil discoveries peaked 40 years ago, and have plummeted ever since.

This problem isn't new: it's been going on for decades. Annual discoveries have failed to replace production every year **since the early 1980s**.

It's not because we aren't looking. For example, in 2003, the top 10 oil companies spent \$8 billion on exploration: an impressive figure, to be sure. But in that year, they found less than \$4 billion worth of oil and gas. (And even that was inflated by a huge lucky gas strike in Brazil.) That's less than half the money they spent to find it.

Merrill Lynch expects the 70 largest energy companies to return \$110 billion to their shareholders this year in dividends and share buybacks. This is a grim indication for our oil supply, but everyone seems to miss it.

Here's what I mean. These companies are supposed to make money for their shareholders by investing in energy. But they've learned that if they used this money to look for oil and gas, they'd **lose** two dollars for every dollar they spent. So all they can do is write checks to the shareholders instead—they're admitting they **can't find anything profitable** to do with the money.

Oil exploration and development becomes a bleeding wound in the side of any company that tries it. Costs are skyrocketing across the industry, as I mentioned in last month's newsletter.

As an example, Shell just announced a massive **\$10 billion** cost overrun in its Sakhalin natural gas project in Russia. Analysts are calculating that in the next year, American energy companies will lose \$25 billion of their net income to these sorts of problems.

And it's not just Western companies experiencing this. Of the top 20 non-OPEC oil producing countries, 17 have failed to replace their produc-

tion over the last 10 years.

The top two—Russia and Mexico, producing a combined 12 million barrels or so per day—replaced just 11 percent and 10 percent respectively, in the last ten years.

We've been scouring the globe looking for oil for over 100 years now. But it's time to face the music: we've apparently found almost all of it. There are just no big reserves left to find.

**Q: And you said the reserves we think we already have, might not be there either?**

Correct. We've already caught some countries lying about the size of their reserves, and much of OPEC's claimed reserves are almost certainly bogus too.

I've included a chart from my book (*The Global War for Oil*, page 25) showing how some OPEC countries have expanded their claimed reserves:

(Year)	UAE	Iran	Iraq	Kuwait	Saudi Arabia	Venez.
1980	28.0	58.0	31.0	65.4	163.3	17.9
1981	29.0	57.5	30.0	65.9	165.0	18.0
1982	30.6	57.0	29.7	64.5	164.6	20.3
1983	30.5	55.3	41.0	64.2	162.4	21.5
1984	30.4	51.0	43.0	63.9	166.0	24.9
1985	30.5	48.5	44.5	<b>90.0</b>	169.0	25.9
1986	31.0	47.9	44.1	89.8	168.8	25.6
1987	31.0	48.8	47.1	91.9	166.6	25.0
1988	<b>92.2</b>	<b>93.0</b>	<b>100.0</b>	91.9	167.0	<b>56.3</b>
1989	92.2	92.9	100.0	91.9	167.0	58.0
1990	92.2	92.9	100.0	94.5	<b>257.5</b>	59.0
1995	92.2	88.2	100.0	94.0	258.7	64.5

*Claimed oil reserves for six OPEC countries (in billions of barrels).*

There are several important points here.

First of all, notice from 1980 to 1985, countries like Iran, Kuwait, and Saudi Arabia had their reserves falling. As you'd expect, their production reduced their reserves.

But then in 1985, OPEC decided each member's quota would depend on the size of its reserves. The more oil it had, the more oil it was allowed to sell. Suddenly, Kuwait reported huge increases in its oil reserves.

Then, in 1988, the Iran-Iraq War ended. Both countries were exhausted and on the brink of ruin. Both countries desperately needed more oil revenue...and conveniently, their stated reserves

leaped upwards to accommodate this. Was this just an amazing coincidence?

All this seems to have been too much for the other OPEC members. Venezuela and the United Arab Emirates jacked their reported reserves upwards that same year. Saudi Arabia followed a couple of years later.

Of course, it's certainly possible for oil countries to increase their reserves by finding more oil. Sometimes a new assessment technique even reveals previously-unknown oil in existing locations. But none of the countries listed above announced any significant discoveries in the 1980s or 90s, nor were assessment methodologies improved. The countries explained their increases as corrections to past mistakes and underreporting of reserves. This might be true for some of the increases, but it doesn't explain the dramatic jumps in oil reserves.

It's not too much of a stretch to believe that these OPEC members are lying, and have increased their reported oil reserves to take advantage of the new quotas.

**Q. How much oil do you think they actually have?**

These countries claim enormous gains in reserves. But they've also pumped a lot of oil out of the ground since 1980. That means they've had to find not only the oil for the gains, but also enough to cover their production as well. Let's look at the production numbers and see what they tell us.

The OPEC countries listed in the table below claim to have 782 billion barrels of oil today. From 1980 to 2004, their reported reserves leaped upwards by about 418.6 billion barrels. But we know that during this time, their existing reserves shrank by 153.25 billion barrels, because that's how much they pumped out of the ground.

That means they need to have found 571.85 billion barrels of oil during this period.

Obviously at least some oil has been discovered during that time, since Venezuela has produced more since 1980 than it started out with. But some of the rest is almost certainly bogus. 571.85 billion barrels of oil is an unbelievable amount, especially in a period where no new "elephant" fields were discovered.

Remember, the biggest discovery in the last several decades in the entire world has been the Caspian Sea, and that has at most 30 billion barrels (some say the true number is much lower). How could these six countries find 19 times that amount, without anybody else noticing?

Now let's calculate the minimum amount they have left. If all their reported increases were false, and if we assume their 1980 numbers were accurate, the last row of the table below shows how much they would have left today. All combined, that's 210.15 billion barrels.

So the true numbers are somewhere between the minimum 210.15 and the reported 782 billion barrels. It's probably lower in that range rather than higher.

I don't believe OPEC's reported reserve numbers. I believe they are grossly overstated.

**Q: When you said global production might be peaking, what did you mean?**

Our oil discoveries peaked in the 1960s and have fallen sharply ever since. This means production will follow eventually. You can only pump the oil you've found, and once your discoveries peak and fall, your production will eventually peak and fall also.

The exact way this happens was first explained in the 1950s by an energy expert named Marion Hubbert. He was a geologist who taught at Columbia University and worked at Shell Oil and the U.S. Geological Survey.

Hubbert recognized that the production of any oil well resembles a bell shaped curve. The oil

	<b>UAE</b>	<b>Iran</b>	<b>Iraq</b>	<b>Kuwait</b>	<b>S Arabia</b>	<b>Venez</b>	<b>Total</b>
<b>1980 reported reserves</b>	28	58	31	65.4	163	18	363.4
<b>2004 reported reserves</b>	98	131	115	97	263	78	<b>782</b>
<b>1980-2004 total gain in reported reserves</b>	70	73	84	31.6	100	60	418.6
<b>total production 1980-2003</b>	16.7	26	13.4	13.75	62.7	20.7	153.25
<b>total new oil required</b>	86.7	99	97.4	45.35	162.7	80.7	<b>571.85</b>
<b>1980 reserves minus 24 years of production</b>	11.3	32	17.6	51.65	100.3	-2.7	<b>210.15</b>

**OPEC countries' claimed reserves, adjusted to production (in billions of barrels)**

comes fast and cheap at first, but then slows down, eventually turning into an expensive trickle. The point at which production begins to slow comes at the top of his bell curve: he called this “peak production.” From that point on, the production curve falls as sharply as it rose.

Hubbert realized that the production of an entire region, even an entire nation, was just a combination of all its wells, so it also followed a bell-shaped curve. He predicted that oil production in the lower 48 states would peak between 1965 and 1970. In 1970 oil production peaked at 9.4 million barrels a day, and has fallen ever since. Hubbert was right.

You can apply the same methodology to global reserves. Some experts say the peak won't come until 2010. But these calculations assume the OPEC reserve numbers are correct, and we've already seen they probably aren't. A more realistic assessment puts the peak at the end of this year, or sometime next year.

There are many signs that we're peaking right now. Shell is expecting a three percent drop in production next year. Exxon has lost 4.3 percent since last year. Chevron expects a seven percent drop.

And this is during a time of record profits, when energy companies have huge amounts to spend on exploration and development. Exxon alone made \$7.64 billion in net income during the second quarter. That's over \$3.5 million per hour!

Again, once production peaks, that doesn't mean we'll run out of oil. It just means the amount of oil produced and marketed in the world will decrease each year. And that means it's going to get a lot more expensive, especially since this will happen as demand is increasing.

For a preview of what we're facing, we can look at Indonesia. This country is one of the original members of OPEC, and in the year 2000 produced well above 300 million barrels of oil. But its production peaked and has fallen off a cliff, and now Indonesia is a net oil importer.

Imagine: this is an OPEC country, now getting hammered by today's high oil prices along with the rest of us. Credit Suisse just issued a report predicting a severe oil shock and economic crisis in Indonesia as early as the fourth quarter this year.

**Q: What did you mean about oil supplies becoming unstable?**

Global spare capacity is down to a mere 1.2%. Since oil is so tight now, any disruption of any kind,

anywhere in the world, can send oil prices soaring. This could be almost anything: oil-worker strikes in Nigeria or Venezuela, terrorist attacks in Iraq, or even a hurricane in the Gulf of Mexico (our largest domestic source of energy).

There are also potential political problems. The dictatorship in Saudi Arabia is having problems with not only internal unrest, but also terrorist activity inside its own borders. If that government falls, it will almost certainly be replaced with one that's very anti-American.

And there are geographical issues. Since oil wells in politically “quiet” places (like the U.S., the U.K., Norway, etc.) are running dry, energy companies are now being forced to set up their energy infrastructure in places you probably wouldn't visit even if someone paid you to do it.

This trend has grown to alarming proportions in just a few years. In 1990, there was lots of energy-industry activity in places like Canada, the United Kingdom, and Norway. But not any more. Today the companies are working in wonderful places like West Africa, Columbia, and Kazakhstan.

Let's take the Caspian Sea as an example. All the countries in the region would like to claim the oil as their own. There's even been some chest-beating and other belligerent posturing going on between Iran and Russia, both of which border the Sea. And even if this situation remains stable, the Sea is landlocked and the oil has to be transported out somehow. Western companies are being faced with wonderful choices such as: do we build a pipeline through Islamic maniac-dictatorships like Iran and Pakistan, or do we build one west to the Black Sea, through mountains infested with homicidal terrorist guerrillas from Chechnya? Which one do you choose?

All this potential instability causes risk, and risk gets factored into the price. These factors will

**“There are many signs that we're peaking right now. Shell is expecting a three percent drop in production next year. Exxon has lost 4.3 percent since last year. Chevron expects a seven percent drop.”**

push up oil prices for the foreseeable future.

**Q. So you think oil stocks will remain good investments? What is your strategy for investing in energy?**

Oil prices will move higher over time but they will be volatile, with violent moves up and down. The instability I just discussed means that even a hint of a disruption can turn the markets upside down instantly.

We've seen several examples of this over the last year: this summer, just the *threat* of a hurricane in the Gulf drove oil prices up.

My service will provide recommendations to take advantage of the long-term move higher, and also short-term opportunities to take advantage of oil's volatility.

**Q: You said oil stocks were cheap. But they've already done extremely well over the last year or so. You think they can still go up from here?**

I was around during the last energy crisis and as I mentioned earlier, energy and inflation hedges were the favored investments, and they performed the best. We saw massive amounts of capital move to energy stocks to solve our problems then: we'll need the same now.

Just compare the last oil crisis to today.

Last time, energy stocks made up 27% of the S&P 500. Today, energy stocks are only 8.75% of the S&P. Investors still have time to position themselves before we see massive amounts of capital flow to the energy industry. Of course, this flow will drive up the prices of energy companies.

Also, during the last crisis oil stocks had about the same average P/E as the Dow 30. Today, the average P/E of the Dow 30 is 18.3, and the average oil and gas exploration stock in the *GEA* portfolio has a P/E in the low teens. (Many are below ten.) I'm expecting these multiples to expand from the low teens up to 18.

The days of cheap and abundant oil are almost over. But so far, most investors are in denial. Once they wake up, energy stocks will be much more expensive. This is an opportunity for my subscribers.

Currently, energy companies have had a substantial rally since May. I believe profit taking will occur soon, and we'll be able to buy at better prices. I'll start recommending new positions and adding to current holdings probably by the September-October time frame. My subscribers will get Updates and Special Reports with specific instructions and recommendations.

**Q. How successful has the *Gold & Energy Advisor* service been?**

My service started in March 2004, and using our unique approach to the markets, we've already racked up spectacular gains:

	<b>GEA Portfolio</b>	<b>S&amp;P 500</b>
<b>2004</b>	35 %	9.8 %
<b>2005 Mid Year</b>	25.19 %	<b>-1.68 %</b>

For example, \$50,000 invested in the *Gold & Energy Advisor* portfolio would have been worth \$67,500 at the end of 2004, and it would now be worth approximately \$84,500 by mid-year 2005.

The *GEA* long-term recommendations should be considered for a portion of your "serious" long-term investment money: IRAs, other retirement accounts, even college accounts.

**Q. What about Gold?**

All subscribers to this newsletter receive my book *The New Bull Market in Gold*. This book shows how gold is a great investment and hedge during troubled economic times. And unfortunately, we're facing serious risks in our global economy today. Some of the risks include:

- The proliferation of nuclear, biological and chemical weapons
- Terrorist attacks
- Major oil supply disruptions
- Currency devaluations and potential trade wars
- Derivative problems similar to the stock market crash of 1987, the Orange County bankruptcy in 1994, the Russian currency collapse and the Long Term Capital Management crisis in 1998
- Potential economic social problems from China, similar to the Asian Contagion meltdown in the 90s.

You need gold to protect yourself against these threats to your "financial health." Gold has been a proven store of value and a safe haven for thousand of years.

My book teaches you how to invest in gold safely, using the same techniques I used to make my first million. In my *GEA* newsletters and Updates, I also recommend specific gold investments to my subscribers.

**Q: James, this has been a great interview. Thank you for everything you've shared today!**

It's been my pleasure.