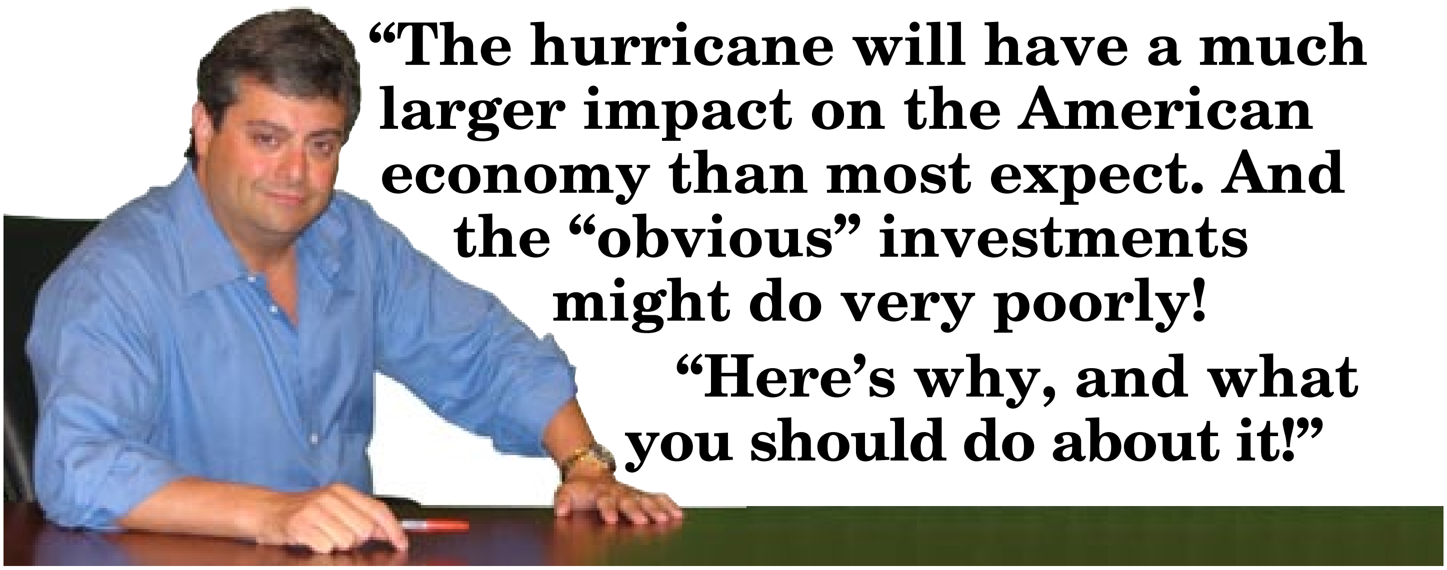
GOLD & ENERGY ADVISOR

Vol. II, No. 9 $19 September 2005

"After the Hurricane: Katrina's Effects on Your Investments!"



"The hurricane will have a much larger impact on the American economy than most expect. And the "obvious" investments might do very poorly!

"Here's why, and what you should do about it!"

- **Will rebuilding be "good for our economy"? Nonsense!**
- **How has the hurricane changed our energy outlook?**
- **Washington think-tank predicts oil at $160!**

The shock is wearing off. Now comes the grieving for the lost, and the recovery.

But the recovery is going to be much longer than most expect. In fact, our overall economy might never recover completely.

Katrina might be the final death-knell for the U.S. dollar. It's certainly changed the outlook for our energy supply.

That's what this month's issue is all about!

Katrina, Oil, and Your Investments

As you know, Katrina's devastation in human terms has been almost unreal. The same is true for the economic damage.

For our energy industry, the hurricane couldn't have picked a worse place to wreak its havoc.

The U.S. is utterly dependent on oil and natural gas from the Gulf of Mexico. The Gulf accounts for 29 percent of our domestic oil production, and 21 percent of our domestic natural gas.

Or at least it did.

Katrina knocked out a substantial portion of our energy production. Much of it has been restored already, but some of the damage is long-term – even permanent. As I write this, almost half the Gulf's production is still offline.

The U.S. Coast Guard has been surveying the offshore oil and gas platforms in the Gulf. So far, they've found 52 were destroyed, and dozens more sustained damage.

An offshore platform can cost hundreds of millions to build. So replacing the lost ones will cost a significant amount of money.

Insurance will cover quite a bit of that. But this happened right before the oil industry's insurance contracts were scheduled to be renewed next month.

The insurance industry got walloped from Hurricane Ivan last year, and Katrina is far worse than Ivan was. So major insurers have announced they'll jack up their rates to the oil industry by over 50 percent. Annual insurance for an oil platform already runs 0.75 – 1 percent of the value of the platform, which can be as high as $1 billion. And "business interruption" insurance costs another 1 percent. Now all these costs are promised to go up by more than one and a half times their previous amounts.

So the oil industry is looking at hundreds of millions in additional insurance costs every year, starting next month. Their higher costs mean consumers will pay more for natural gas, gasoline, and other products.

And oil companies haven't even started surveying the damage to underwater pipelines yet. There's a huge spaghetti-tangle of pipes on the ocean floor, and they're used to pump oil and gas from the offshore platforms to onshore terminals.

But these pipelines are very vulnerable to storms. Hurricanes can trigger underwater mudslides, which can break the pipes and move them hundreds of feet. You might remember Hurricane Ivan trashed a large number of pipes last year, causing oil prices to rise for several months. Katrina promises to be even worse.

Platforms and pipelines are bad. But Katrina ravaged something even more significant…

Our national "Achille's heel"

It's been recognized for a long time that our national oil refining capability is grossly inadequate.

We haven't built a refinery in the U.S. for 30 years. But every year, American consumption of petroleum products has increased. So our existing refineries have been groaning under the strain of producing those products.

Ten years ago, we imported only 4 percent of our gasoline. By early 2005, that number had shot up to 10 percent.

Our refineries were aready operating at over 96 percent capacity, which is far too high. Breakdowns, deferred maintenance, and other problems caused intermittent outages a few months ago at various refineries. Some of oil's volatility earlier this year came from this.

Now the situation is worse. *Far* worse.

Katrina knocked out 10 percent of our refining capacity. That's the primary reason for skyrocketing gasoline prices and regional shortages since the

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The **GOLD & ENERGY ADVISOR** is published 12 times a year by The Silver & Gold Report, LLC, 925 South Federal Highway, Suite 500, Boca Raton, Florida 33432 (800-819-8693 or 561-750-2030). Subscription rates: Single issue, $19. One year (12 issues), $189. Two years (24 issues), $279.

hurricane. Oil is useless if there are no refineries to make fuel, plastics, and other products from it!

About half the refining capacity is back on-line now, or will be very soon. But four major refineries have been knocked out.

According to the Energy Department, Chevron's 325,000 bpd (barrel-per-day) facility in Pascagoula, Mississippi, and ConocoPhillip's 255,000 bpd refinery in Belle Chasse, Louisiana, both suffered "major damage."

Murphy Oil's 120,000 bpd facility in Meraux Louisiana still has several feet of water in it. Draining the water out will be only the first step to bringing it back on-line. Among other things, every single piece of electrical equipment will have to be taken apart, dried, and (most likely) have its electrical motors and other parts replaced.

In Chalmette, Louisiana, the Exxon Mobil plant used to refine 185,000 barrels/day. Not any more – it got hammered hard by the storm. Reports say it will be off-line for *months*.

This is grim news. About 5 percent of U.S. refining capacity has been knocked out long-term.

Oil prices have already subsided from their $70 peak, but you've probably noticed gasoline prices are still sky-high. Now you know why. We'll see gas stay at ruinous prices until our refineries are back…*if* they come back, that is.

Gas prices have shot up worldwide

Due to local shortages of gasoline, American companies are diverting their gas from international markets and shipping it back home. As a result, even in faraway places like Australia and Germany, gas prices are up. Katrina is having a global impact.

Morgan Stanley says the storm and recent high energy prices will slash about half a percent from the entire globe's economic growth. That might be an underestimate: for example, Asian economies rely heavily on American consumers, and Asia is extremely vulnerable to any slowdown in U.S. consumption.

Domestic refiners were already hurting. New low-sulfur restrictions on diesel will require about $25 billion in refining facility upgrades. $8 billion has already been spent, another $13 billion will be required over the next seven years.

At a time when we desperately need new refining capacity, none will be coming on-line. Instead, energy companies were being forced to spend their money modifying existing facilities to meet regulations.

Now Katrina has slashed our capacity even further. This is an utter disaster for our energy supply.

And we haven't even seen the worst yet. Once winter arrives, demand for heating oil will soar, requiring even more output from our straining refineries.

Up to $2 billion in crop losses

The Port of South Louisiana is the largest-volume shipping terminal in the United States (and the fifth-largest in the world.) As a result, New Orleans and southern Mississippi are the hub for U.S. agricultural exports: corn, coffee, sugar, soybeans, and so on.

Half our grain exports and almost two-thirds of our corn and soybeans go through the port. The U.S. Farm Bureau says the port is "absolutely critical" to our agriculture.

But Katrina has clobbered the port's entire infrastructure. The river is clogged and choked by mud flows and sunken vessels. Port facilities have been destroyed. Port workers have been scattered as refugees across several states.

Of course, agricultural commodities are perishable. The harvest season is short, and there's a limited time to get the food shipped out. If it doesn't make it out in time, it will rot and be a complete loss.

As a result of all this, the Farm Bureau has estimated a potential $2 billion loss to our farmers in unsold crops, higher fuel bills, and other disruptions.

Of course, agricultural losses are not the only economic impact we'll see from Katrina. Some officials have estimated total damages of up to $200 billion. (FEMA is currently paying out about $2 billion *per day*.)

Now Congress is talking about starting a new government entity just to manage the rebuilding effort. It's already turning into a pork-barrel fiasco: huge contracts are being handed out, with no competing bids being required.

Despite all this, some commentators are asking…

Latest prices as GEA goes to press— September 19, 2005

Comex spot contract: silver $7.42, gold $467.80
Nymex spot platinum: $922.00, palladium $196.00
Nymex Light Sweet Crude Oil $65.45

Silver coins		Dealer will buy at this price	Dealer will sell at this price
100 1 oz. silver American Eagles		$850	$980
100 1 oz. common rounds		$745	$890
$1,000 face value US pre-1965 coin bag (circulated)		$4,950	$5,950
$1,000 face value US circulated silver dollar bag (VG or better)		$8,700	$9,400
US Morgan silver dollars	PCGS MS64	$38	$52
	PCGS MS65	$100	$150
	PCGS MS66	$300	$360
Platinum coins			
U.S. Platinum Eagle:	1 oz.	$975	$1,150
	1/2 oz.	$475	$575
	1/4 oz.	$240	$375
	1/10 oz.	$98	$190
Gold coins			
Australian Kangaroo		$460	$525
British sovereign (Kings)		$100	$150
(Elizabeths)		$100	$150
Canadian Maple Leaf		$460	$520
Credit Suisse 1 oz. gold bar		$460	$520
Mexican 50 peso Centenario		$540	$620
South African Krugerrand		$460	$510
US Gold Eagle:	1 oz.	$460	$520
	1/2 oz.	$210	$290
	1/4 oz.	$100	$170
	1/10 oz.	$47	$69
US $20 double eagle:			
Liberty	Raw MS60	$490	$580
	NGC MS63	$720	$875
	NGC MS64	$1,150	$1,750
	NGC MS65	$4,150	$5,250
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.

Will rebuilding cause an economic boom and offset the damage?

The correct answer is…**No**! Some commentators say it will, but this is pure fantasy.

Think of it this way. If destroying a city and rebuilding it is so good for our economy, then why don't we just bulldoze *every* city and town in the country?

We'll lose everything. We'll have to rebuild all of it. We'll be *rich*.

No, obviously this is nonsense. Katrina is a catastrophe for our economy.

- A half-million people were forced from their homes and scattered as refugees across the country. The economy has lost the fruits of their labor, and will do so until they return home and start working again. This will take *years*.
- Farm exports are already starting to rot on their barges, threatening large losses. Longer-term, these and other exports will be depressed. All this will just worsen our national trade deficit, which is already at nosebleed heights. (Some analysts are expecting the deficit to leap as high as $70 billion per month!)
- 140,000-160,000 homes have been made unusable. This will need a massive rebuilding effort, and construction materials are going to skyrocket in price all across the country. (All the more since New Orleans was a major import terminal for them.)
- Construction wages are going to skyrocket too, as skilled workers are drawn to the impacted Gulf states. Overall, the cost of new construction anywhere in the country will become outrageous.
- Construction costs will make newly-built homes unobtainable for many buyers. Will this be the pin that pops the national housing bubble?
- New Orleans floodwaters are now contaminated with sewage, battery acid, oil, gasoline and antifreeze from submerged cars, hazardous materials from submerged rail cars, and more. This water will be pumped into Lake Pontchartrain, the enormous lake next to the city. According to the Louisiana State Dept. of Environmental Quality, it could be years before clean drinking water is restored to everybody in the region: "It is almost *unimaginable* the things we're going to have to plan for and deal with." This casts strong doubts on the

restoration of the largest shipping terminal in our country.

A recent article in the *Wall Street Journal* pointed out that Katrina has put even the Federal Reserve in a dilemma. Katrina has slashed national growth prospects, and this would normally require lower interest rates to stimulate growth. But at the same time, elevated prices and shortages will create inflationary pressures, which require higher rates to squelch them…

The Fed is trapped. Our economy has just taken a huge body blow!

And the timing is horrible. Katrina tore into an economy that was in no condition to receive such a shock.

For example, Americans pulled $140 billion from their homes last year in cash-out refinancing. That number is expected to leap up to $162 billion for 2005.

Where is the money going? Are we paying off debts, or are we wasting the money? Sadly, it's the latter. In the latest quarter alone, Americans spent $41 *billion* more on clothing and shoes than we did two years ago. Plus tens of billions more were spent on furniture, health care, and recreation.

For most families, their homes are their greatest asset, and their largest store of wealth. But now people are treating their homes like giant ATM machines: they're pulling out the money and blowing it on frivolous goodies.

But once the real estate bubble bursts, the party will be over. Countless people will suddenly owe more on their homes than they're worth. Foreclosures will tank prices even further, causing even more foreclosures, and starting a vicious downward spiral.

Even bubble-meister Alan Greenspan is worried. He recently warned that high asset prices are "too often viewed by market participants as structural and permanent…History has not dealt kindly with the aftermath of protracted periods" of complacency.

Greenspan warned of "imbalances" in the economy: our outrageous trade and current-account deficits, the nationwide housing bubble, the complete collapse of personal savings, and others. He said the inevitable readjustment will be "wrenching." For a man who said he couldn't see any stock bubbles back during the dot-com mania, these are grim warnings.

Danger ahead: the yield curve is continuing to flatten

The yield curve (the difference between short-term and long-term interest rates) has flattened significantly since the Fed started raising rates. It started at 1.90, now it's a mere 0.27. Some analysts expect it to dissolve completely by the end of the year, especially if the Fed raises rates again.

Among other things, this is strangling the U.S. banking system. Banks borrow at low long-term rates, and lend at higher short-term rates. The difference in rates is their profit. When this difference disappears, as it's been doing, so do their profits, and our banking system is jeopardized.

As the *Wall Street Journal* wrote, our banks are "scrambling." They're cutting costs, laying off employees, and (most ominously) slashing the reserves they keep to cushion against bad loans. But there are only so many costs they can cut.

If this trend doesn't reverse, bank lending will dry up completely. That means businesses won't be able to borrow money to expand, or to smooth over cash-flow problems.

Lots of businesses will go under. That's why a flat yield curve almost always causes a recession. And that's what we're headed for.

Our "imbalances" are snowballing rapidly. And as *The Economist* recently complained, all the "economic traffic lights" are on the blink. The forces that would normally correct our problems aren't working this time.

We have a severe current account deficit: $60 billion flows out of our country every month. Normally this would cause higher interest rates and slow down spending, and the problem would be corrected – but not this time. Instead, interest rates are staying low because of foreigners buying our Treasury debt.

In turn, low interest rates are fueling our housing bubble, and encouraging consumer spending. Instead of shrinking, the balloon is inflating bigger and bigger…worsening the inevitable "bang" at the end.

Meanwhile, many of our most important industries are in trouble. For example, airlines are getting hammered by high fuel prices. The nine largest airlines paid $4.34 *billion* for fuel just in the second quarter alone.

Even the smallest move upwards in fuel prices whacks airline profits. A recent article explained that American Airlines pays an extra $29 million (annually) each time jet fuel goes up by a *penny* per gallon. To get a single Boeing 757 from Los Angeles to Newark, New Jersey costs $12,202 just for fuel.

Northwest Airlines is now threatening bankruptcy, due largely to fuel prices spiraling out of control. Delta is also expected to go bankrupt at any time. And of course, United Airlines has been insolvent for some time.

Katrina promises to make all this worse. We've lost a huge amount of refining capacity, and politicians are screeching about high gasoline prices. Since demand for gasoline is much higher than jet fuel, our limited refining capacity will go to make gas and not jet fuel. So jet fuel will only get even more expensive.

Katrina's Effect on the U.S. Dollar

Skyrocketing fuel prices, huge agricultural losses, bankrupt airlines, energy shortages, an inflating trade deficit…Katrina's impact on our economy will be devastating.

The dollar was already gasping for air, and has now taken another smash from the hurricane.

Foreign investors and governments were already questioning the dollar's long-term viability. We just saw China remove its currency's support for the dollar. Now Saudi Arabia is considering the same thing: moving its currency (the riyal) away from its dollar peg and towards the euro instead.

Now these same foreigners have seen America helpless to save one of its own cities from a widely-predicted, and easily *preventable*, destruction.

Our image abroad, already in question thanks to the quagmire in Iraq, has now been shattered. Foreigners have seen Americans rampaging and looting their own city like animals…even shooting at rescue helicopters.

The British newsmagazine *The Economist* just ran a cover story, "The Shaming of America." It wrote, "The world's view of America has changed. The disaster has exposed shocking truths about the place…"

Trouble Brewing in South America

I've written before about Venezuelan dictator Hugo Chávez, whose country supplies 15 percent of our oil. He's getting much more aggressive lately, worrying U.S. officials.

His record was already very anti-Western. Before he came to power, the foreign oil companies active in Venezuela included Exxon Mobil, Chevron, and ConocoPhillips (all from the U.S.), BP (the U.K.), Total (France), and Royal Dutch Shell (U.K./Holland). Since he came to power, these companies have won deals instead: China's National Petroleum Corporation, India's Oil and Natural Gas Corp., Brazil's Petrobras, Spain's Repsol, and Russia's Lukoil. Chávez even kicked Royal Dutch Shell out of a large project.

He's slapped 32 Western companies with a $4 billion bill for "back taxes." He's also jacked up production royalties from 1 percent to 16.7 percent, hiked taxes from 32 percent to 50 percent, and even declared an end to previously-contracted payments to foreign field operators.

Now he's courting governments all over Central and South America. U.S. officials are concerned he's "aggressively" planning to export his Marxist "revolution" on our southern borders.

In June, Chávez signed 13 Caribbean countries to an oil agreement. Within the last month, he's also forged agreements with Argentina, Brazil, Uruguay, and Paraguay. He recently made offers to Columbia, Bolivia, Ecuador, and Peru. And since April, Venezuela is supplying Cuba with almost all its oil.

Normally we wouldn't care who he sells his oil to. But he's signing agreements for oil at prices far below market value. The Cuban deal alone will cost Venezuela $1.7 billion this year in lost revenue.

So what's he up to? Officials are concerned he's worming himself into tight agreements with Central and South American countries, to entangle them into his anti-American alliances with Iran and other states. (He's already proposed a joint nuclear research program with Iran.)

In a more direct threat, Chávez has also threatened to cut off all oil to the United States.

Televangelist Pat Robertson has now suggested we assassinate Chávez, which was a really stupid move. Chávez is fond of blustering and screeching about American imperialism, and has accused President Bush of sending CIA hit squads against him. Robertson has given Chávez public "confirmation" of his claims, and Chávez is making the most of it.

Over the next year or so, I predict we'll be hearing a lot more about Venezuela. With the fifth-largest oil reserves in the world, and a crackpot lunatic like Chávez in charge, Venezuela is going to become very important in world affairs.

The article noted that “America’s enemies, from Cuba to Iran, lined up with unconcealed smirks to offer aid.”

We’ve even received offers of aid from countries like Afghanistan and Nigeria. When some of the poorest countries in the world (and complete economic disasters in their own right) offer to send you aid, you know you’re in serious trouble.

Katrina might turn out to be the final “push over the edge” that finally topples the dollar.

The greenback has been a “dead currency walking” for quite some time. Now we might see it plunge to its true intrinsic value…and most Americans will be shocked at just how low that really is.

Even Before Katrina, Oil Markets Were Already Stretched to the Breaking Point

Shortly before Katrina, oil had popped up several dollars. Why? There were some protests in Ecuador, which produces less than 1% of global oil. When a minor event in a backwater country can do this, you know the oil markets are ready to snap.

I’ve previously warned about India and China bidding up oil assets around the world. China just bought PetroKazakhstan, a tiny energy company that produces only 100,000 barrels per day. How much did China pay? $4.18 *billion*. This shows the Chinese are happy to pay ridiculous prices for even small amounts of oil. (China also has a massive refining problem: three-hour waits are now occurring at some Chinese gas stations.)

India is now importing 70% of its oil, and is also desperate for energy. The Indian oil minister has predicted a cumulative $9 billion loss for the year, thanks to government subsidies to keep energy costs down. He’s urging Indian companies to intensify their efforts to buy foreign oil assets.

Both countries are desperate. So it’s no wonder that India and China just made a major announcement. Their oil companies will soon bid *jointly* for selected foreign assets. The two governments will also sign agreements on political and technological cooperation.

Imagine this: these two countries, with one-third the *entire* world’s population, are now teaming up to bid against us for oil reserves around the world. Western energy companies will be completely outclassed, and any reserves we do get rights to will be outrageously expensive.

The American National Commission on Energy Policy (NCEP) is a group of politicians (from both political parties) and energy-industry experts. They just did a study to answer this question: what if an unforeseen event (natural disaster, terrorist strike, coup, or whatever) was to take out just four percent of the global oil supply?

Obviously four percent isn’t very much, especially with all the instability in various oil countries, al-Qaeda gunning for Saudi oil, and so on. Nevertheless, oil is so tight that the NCEP study predicted a price of $160 per barrel!

Does this mean you should stampede into oil investments? Absolutely not!

Katrina has whipped up hysteria about energy prices, for obvious reasons. That alone is reason to be cautious: when everybody expects an investment to go in a certain direction, it usually goes the

Natural Gas Shortages Also?

Most people are sharply aware of Katrina’s effect at the gas pumps. But we’re in for a big surprise this winter too, especially for those people who heat their homes with natural gas.

Even before Katrina, energy companies were sounding the alarm. The CEO of Western Gas Resources Inc. recently said that “Even with the most optimistic conservation scenarios,” we’ll need 400,000 more gas wells drilled in the Rocky Mountain states during the next 15 years.

He pointed out that not only do we need a lot more natural gas, we’ll also have to replace one-third of the current wells due to slumping production.

Now that Katrina has hit the Gulf, responsible for one-fifth of our entire gas production, this is all worse – much worse.

U.S. Energy Secretary Sam Bodman has said, “There is no doubt this is going to be a very tough winter for the American economy and for American homeowners.” He anticipates a jump in natural gas heating costs of up to 71 percent.

Residential heating oil will go up too, by an anticipated 31 percent. Even if you heat with electricity, your bill will go up by an estimated 17 percent.

other instead.

But there's another factor. The government has released oil from the Strategic Petroleum Reserve, but the destruction of our refineries has reduced the amount of oil that can be processed. So even while fuel prices stay high, the supply of oil waiting to be refined is growing.

The net result is that the upwards pressure on oil prices has eased significantly, at least in the short term.

Katrina hasn't changed my long-term oil outlook, which is based on our permanent supply problems. But it has caused a softening of oil for now.

The GEA portfolio has had stellar performance so far this year, and we've been going "against the crowd" for most of that time. And now is no different: there are lots of knee-jerk commentators who are suddenly bullish on oil, but I'm taking a more sober view of the markets.

There are still opportunities in oil, but we need to be cautious. As always, watch your e-mail for specific recommendations as I issue them.

Gold Hits 17-Year High

Skyrocketing fuel prices will cause inflationary shockwaves to hit our economy. So it's no surprise that gold is responding by surging up.

But I still believe gold is just beginning a multi-year bull market, even <u>independently</u> of any effects from oil…

Gold's supply continues to tighten, as mining companies continue to suffer. South Africa just had a huge mining strike, with 100,000 miners refusing to work. The mining companies caved in to their demands quickly, because they had little choice. South Africa's gold mines are deep, and heavily dependent on labor.

Despite gold's surge in price, the mining companies are teetering on the verge of collapse. The South African currency (the rand) has more than doubled against dollar since 2001. Since gold is priced in dollars, getting more dollars for your gold is small consolation when you're getting far less rand after the conversion of the dollars.

Now over half of South Africa's gold is produced either at a loss or just over break even. The mining companies have already slashed their costs (they've shed 300,000 jobs in the last two years), and there's nothing left to cut. They're suffocating, and their production of gold is being called into question.

South Africa is the largest gold-producing country in the world. And the rest are having serious problems too.

The *Wall Street Journal* ran a fascinating article about a crisis affecting the global mining industry. There's a severe shortage of labor, and the work force is aging rapidly. Few young people are interested in a career involving considerable danger, grueling conditions, and remote locations.

Mines from Brazil to South Africa to Canada are short of everything from truck drivers to explosive experts to mining engineers. A senior VP at Washington's National Mining Association spoke about American mining: "We're seeing this bubble of workers who are now approaching their mid-50s and early 60s who will soon be leaving the work force, and there's not a similar bubble of workers coming in behind them." For example, the Association says the average age of an underground coal miner is 55 years old, and our other mining industries (including gold) have similar numbers.

The United States is the world's second-largest gold producer, and currently has 219,800 mining jobs across all industries. But the total number of students in American universities who are studying mining-related subjects is a mere 578. So the prices of gold and other mined commodities promise to stay high for the foreseeable future.

Australia is the world's third-largest gold producer, and its mining "skills crisis" has turned into a major political issue in that country. For example, Kalgoorlie is a major region for gold and nickel mining. Electricians there now get $150,000 per year, twice the rate of just five years ago.

Newcrest is Australia's largest independent gold miner, and it's currently constructing the huge Telfer project (which will be Australia's largest gold mine). But the labor and skills shortage has caused many delays and a $150 million overrun (so far). Despite this, one Newcrest manager actually said he was *thankful* the project started when it did, because there would be even more problems if it was started today.

How high will gold go? In the Middle East, the city of Dubai is the center of the gold trade. The Director of the Dubai Gold and Commodities Exchange just predicted gold will hit $500 in the next few months. I think he's right, at least for the short term.

But over the long term, I'm expecting a much higher number than that. $1,000, at least.

Currencies are sinking, inflationary pressures are soaring, and mining supply is shrinking. Gold is looking better than ever. Don't neglect it in your portfolio!