GOLD & ENERGY ADVISOR

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"GEA portfolio soars while the markets fall!"

"Our third-quarter numbers are in, and they're spectacular. We're up 44.37% year to date, while the Dow has *fallen* 4.2%."

"Now the public is facing more risks than ever. There's some ominous news this month. Make sure you're ready!"

- **Inflation hits an annualized rate of 14%!**
- **Iraq threatens to ignite entire Middle East**
- **China attacks U.S. Defense computers!**

The GEA portfolio has done spectacularly well this year. We're up 44.37% so far in 2005. That's 77% since our inception in March last year!

But that's not true for the stock market overall. The Dow has fallen 4.2% in 2005…and the economy's future outlook is worsening almost by the day.

The U.S. economy is sick, and getting sicker. With deficits and shortfalls everywhere you look, the American economy is bleeding red ink.

Average weekly earnings for manufacturing and non-management service jobs, adjusted for inflation, plunged *again* in September (down another 1.2%). Hourly earnings have fallen for 15 of the last 17 months.

No surprise then that credit card delinquencies hit a new record in the 2nd quarter. A whopping 4.81 percent of all accounts were 30 days or more past due.

The previous quarter had itself set a new delinquency record. The American Bankers Association's chief economist said things "have not been pretty."

As unsecured debt, credit cards are the "canary in the coal mine" for our economy. When consumers are drowning in debt, credit card payments are the first to be cut. Now almost one in every twenty accounts is delinquent by more than a month—and this trend is accelerating rapidly.

Six years ago, late fees and other non-interest charges were only a minor portion of revenue for credit card issuers. Today, according to an industry

New Recommendations This Month. See page 6!

publication, fees account for more than 30 percent of issuer revenue! This is a staggering figure.

And these figures were *before* the two Gulf hurricanes hit our economy. No doubt the current numbers are far worse.

In July (again, *before* the hurricanes), the personal savings rate sank to a record low of -1.1%. Yes, that's a negative number. When averaged together, *every single person* in our country is now spending more than he or she earns. In July alone, personal spending exceeded savings by $100.5 billion.

Consumers are in serious trouble, but so are our businesses. Delta and Northwest Airlines have now joined United and US Airways in bankruptcy. At least half the air travel industry is now bankrupt.

Other major industries are also in downward spirals. General Motors lost $2.5 *billion* in the first half of the year. And the huge auto-parts maker Delphi, the former unit of GM, just went bust. It's the largest bankruptcy in U.S. automotive history, and among the 15 biggest in the last 25 years. This will cripple GM even further—analysts estimate it will cost GM several billion dollars in higher costs.

Earlier this year, Moody's downgraded Ford and GM debt to "junk" grade. S&P is now considering following suit. A consistent "junk" rating makes the bonds' interest rates soar, and the companies' debt payments rocket upwards.

Ford and GM have a combined debt of $442 billion. These two companies have been the "heart" of American industry—but these icons might go down in flames soon.

What about the rest of the transportation industry? News there is grim too. FedEx is jacking up its rates by 5.5%. Railroad transportation costs are going up 5.6% in the next six months.

All transportation costs, whether for travel or cargo, are surging upwards.

Soaring costs mean soaring prices — inflation is coming back!

Over the last few years, American consumers have enjoyed an unprecedented "have your cake and eat it too" situation. Despite our national borrow-and-spend orgy, consumer prices in the U.S. have remained tame.

This is because we've "exported our inflation" to China. China's policy of fixing its currency to the U.S. dollar has allowed our dollar to sink in value, while consumer goods remained cheap.

That policy is changing, as I've explained in past issues. (And this month there's ominous news from China in other ways—more on that later.)

But despite China's accommodation of our dying dollar, inflation is growing anyway.

Consumer prices were up a whopping 1.2% in August, thanks to skyrocketing energy prices. That's an annualized inflation rate of **14.4%**. We

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haven't seen inflation so high since 1980—and you might remember the crippling recession that years of inflation had caused then.

Inflation is popping up everywhere—even the government itself isn't immune. For example, the metal in a U.S. nickel is now worth about 6 cents. (Two years ago, a nickel cost under 4 cents to produce.) So the government loses one cent every time it mints a nickel.

(Only the U.S. government could create money and *lose money* doing it!)

This shows how badly mismanaged our national finances are. The five-cent coin itself hasn't changed. It's still the same chunk of copper-nickel alloy that it's been for decades. But the dollar itself has lost a tremendous amount of value: an item costing $2 in 1970 would cost $10.08 today. So the value represented by "five cents" has now fallen beneath the inherent value of the metal itself.

(Of course, this is only the most recent example of the dollar's value plunging below the value of its notes and coins. This has been going on since the early 1930s, when the government first defaulted on its gold notes. But that's a different story…)

This month we saw something else unprecedented. The Presidents of three separate Federal Reserve banks gave public warnings about inflation. Dallas Fed President Richard Fisher even said we can't "let the inflation virus infect the blood supply and poison the system."

In other words, the Fed is going to continue to jack up interest rates. They've already raised rates 11 times in 15 months, but they're not done by a long shot.

As you know, rising interest rates are one of the "classic" killers of stock prices. Even worse is the yield curve being strangled more than it already has (see last month's GEA for details).

But the Fed's efforts will be largely impotent. Higher interest rates dampen the demand for capital, but we're seeing costs spiral upwards for reasons that have nothing to do with capital demand.

Hurricanes Katrina and Rita have torpedoed production of key chemicals and feedstocks, much of which was in the Gulf region. Prices are now soaring for asphalt, roofing materials, plastic pipe, insulations, synthetic rubber, printing ink, tires, adhesives, and other key industrial products.

As I wrote in the May GEA, the government has consistently under-reported inflation for years now. The politicians didn't want to 'fess up to the mess they've made of our economy.

But now inflation will swell beyond all possibility of cover-up. No longer is it content to gnaw away at our economy from underneath. Soon it will be roaring, too loudly to ignore or explain away.

Of course, history tells us that once inflation reaches a certain point, it turns into a runaway train. It will be the 1970s all over again—except that this time, certain sectors (especially real estate) are already over-inflated and will probably crash instead. (No consolation there.)

Meanwhile, Alan Greenspan is getting ready for retirement. He's being unusually open (for him) about the financial time bombs that he's leaving behind for his successor.

He recently told the French government that the U.S. has "lost control" of its budget deficit. (Did he just realize this now?)

He's also warned of "significant losses" ahead for banks who are making interest-only and other types of "exotic" mortgages. Why? It's because of…

U.S. housing: A bubble in search of a pin

American real estate is now a trainwreck waiting to happen.

In July, the National Association of Realtors said existing-home sales have "exploded" previous records. Sales are up to a rate of 7.33 million per year.

Nationwide, prices are up a staggering 14.7 % in just 12 months (June 2004-June 2005). This is the highest one-year jump since November 1980. (Remember what happened to real estate after that?)

According to the Associated Press, for the first time ever, there are more than a million owner-occupied homes in the U.S. that are worth $1 million or more. The Census Bureau's 2004 American Community Survey showed 1,034,386 homes worth more than $1 million. Five years ago, it was less than 400,000.

Of course, prices are far higher in many places. A broker in Arizona said in certain places, $1 million won't buy you more than "an acre of dirt."

The article said even in rough neighborhoods, prices were astronomical. A section of Brooklyn

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

Comex spot contract: silver $7.59, gold $461.15
Nymex spot platinum: $921.00, palladium $206.00
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	$54
	PCGS MS65		$90	$150
	PCGS MS66		$280	$360
Platinum coins				
U.S. Platinum Eagle:		1 oz.	$925	$1,150
		1/2 oz.	$460	$575
		1/4 oz.	$220	$375
		1/10 oz.	$96	$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	$750
	NGC	MS64	$700	$850
	NGC	MS65	$1,100	$1,350

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

that had rioting in the 1960s and a crack epidemic in the late 1980s now has town houses selling for $975,000.

The *Wall Street Journal* has been running worrisome articles about the housing boom cooling off. One estimate was that housing and construction are responsible for *40% of all jobs* created in the last two years. When the bubble pops, all those jobs go away. It's going to be ugly.

What will burst the bubble? The article said, "People who have studied past busts point to two main causes: a drying up of liquidity—often through tighter lending standards or higher interest rates—or a serious economic shock, like an oil or currency crisis."

Let's see…do we have liquidity drying up? With the Fed jacking up rates, and its Chairman warning banks to stop lending money, the answer is a definite yes.

What about an economic shock—either skyrocketing oil, or a falling dollar? Yes on both counts.

Shrinking liquidity, and economic shock. Either is enough to crash the real estate market by itself. But we have *both*.

Iraq: The bloody quagmire is deepening

Despite optimistic reports in the media, Iraq is rapidly getting worse.

Saudi Foreign Minister Saud al-Faisal has warned Iraq is disintegrating. The Kurds, Shiites, and Sunnis are continuing to kill each other, and their conflict is accelerating. Instead of random violence, it's starting to change into an organized war for the country's natural resources.

Our military agrees. The U.S. Army issued a report in August that warned, "Sectarian fault lines are inexorably pushing the country towards civil war."

But al-Faisal also warned that war in Iraq could spread to its neighbors. Once the fighting comes out into the open, Iran will intervene for the Shiites. And Turkey will invade from the north to grab land from the Kurds.

That will leave the Sunni minority heavily outgunned. But Saudi Arabia is a Sunni country, and as al-Faisal delicately put it, "I don't see how the Arab countries will be left out of the conflict in one way or another." Translation: Saudi Arabia, and probably Jordan, will storm into Iraq too.

The entire Middle East will erupt into war.

This shouldn't be a surprise to anybody. In my book *Global War for Oil*, I described how this same exact quagmire situation occurred in Iraq over one hundred years ago. Back then, it was the British stuck in it, while today it's us. But everything else is the same: the sectarian violence, guerilla warfare against the occupying forces, terrorist murders of women and children, everything.

Iraq has *always* been a seething mass of hatred and violence. The only time it's ever been peaceful is when a brutal dictator has stomped everybody else into submission. (Saddam Hussein was one of the few in Iraq's history who was vicious enough to pull it off.) Without such a dictator, Iraq has reverted to its "natural" condition: bloody mayhem and chaos.

President Bush just promised we'll stay in Iraq until the country is peaceful. But top U.S. generals said recently that we're fanning the flames of the insurgency just by being there. The Iraqis hate being under military occupation (just like we would), and more Iraqis turn into anti-American fighters every day.

According to www.iraqbodycount.net, more than 26,000 Iraqi civilians have died since we invaded. Even if that number is exaggerated, it's small wonder so many Iraqis hate us.

But at the same time, we can't leave, because (as the Saudi foreign minister said) the entire area will go up in flames. American attempts to train Iraqis to take over peacekeeping roles have been a miserable failure. Our top generals in the area —Central Command leader Gen. John Abizaid and ground commander Gen. George Casey—just admitted that in two years, we've only successfully trained one battalion of Iraqi security forces.

Saudi Arabia has plenty of troubles of its own. There was just a three-day battle with terrorists in the eastern Saudi city of Damman. A number of Saudi security officers died in the fighting.

Apparently the terrorists had been planning to attack several key Saudi oil facilities. I warned about this in my book: terrorists are planning to wreck certain key Saudi oil facilities, and this will have a grave impact on global markets.

We've spent untold millions—maybe billions—trying to train 200,000 Iraqi soldiers and policemen to fight the home-grown insurgents and foreign jihad terrorists. What do we have to show for it? One battalion of 700 troops.

We have over 100,000 troops stationed in Iraq, and terrorists are running amuck anyway. If we leave, how much will only 700 troops be able to do? Nothing.

The terrorists in Iraq are even spilling out into surrounding countries.

Kuwaiti police raided a Kuwait City bomb-making operation (run by Iraqi terrorists), and found maps of the bombers' targets: military bases and shopping malls. Other al-Qaeda members smuggled Katyusha missiles from Iraq into Jordan, planning to destroy Jordanian and American political targets. When heightened security made that impossible, they fired them at U.S. Navy ships instead. (The missiles narrowly missed our ships.)

Newsweek reported that early in October, U.S. officials met to discuss military strikes on Syria, to stop the Iraqi insurgents using it as a base for their operations. Secretary of State Rice opposed the plan, and stopped it—so far. But I wouldn't be surprised if she was overruled soon, and we attacked Syria too.

The war is widening across multiple fronts. We're hopelessly mired in a long, bloody quagmire. If we leave, the entire Middle East will erupt into war. If we stay, the same might happen anyway.

Chaos and war in the Middle East will have a devastating effect on the oil and energy markets. $60 oil will be the "good old days."

And our energy industry is in no shape to receive any more shocks…

U.S. Energy Industry: Devastated by the Hurricanes

The long-term damage from the hurricanes is becoming clear…and it's incredibly ugly.

Katrina tore through a mature section of the Gulf that was bristling with platforms producing oil and gas. It also took out several major refineries. Recent reports are that most of the Gulf's natural gas production, and almost all its oil production, are still off-line.

Then Hurricane Rita hit a part of the Gulf where there's lots of exploration still going on, and blasted an area thick with drilling rigs. Rita has

New Recommendations This Month

As you know, new stock recommendations are usually issued in our e-mail Updates. When new opportunities arise, I want subscribers to get the information immediately, and this is the quickest way.

Starting this month, in the monthly newsletter I'll also summarize the recommendations we've sent out since the last issue.

So here are the recommendations issued since late September. There has been some significant profit-taking among energy stocks; this has created some buying opportunities.

New Recommendations

- Burlington Northern (symbol BR), buy at $68 or better, Update #96, 9/20/05
- Pioneer Natural Resources (symbol PXD), buy at $49 or better, Update #97, 9/21/05
- Noble Energy (symbol NBL), buy at $42.50 or better, Update #100, 9/28/05

Please read the Updates for fundamentals, technicals and risks for each recommendation.

Recommendations for new subscribers (these stocks are already in the GEA portfolio):

- Devon (symbol DVN), buy at $61 or better
- Newfield Exploration (symbol NPX), buy at $44 or better
- Cononcophillips (symbol COP), buy at $63 or better
- Encore Exploration (symbol EAC), buy at $32 or better
- EOG Resources (symbol EOG), buy at $67 or better

Please read Update #109 (10/10/05) to read more about these recommendations. You can also check the portfolio page of the Gold and Energy Advisor website to find out about the original date of recommendation, purchase and research report.

http://www.goldandenergyadvisor.com/page/gez/portfolio/

caused more damage to oil rigs than any other storm in history. Plus, it clobbered some major refineries too.

The production platforms that were sank or smashed (discussed in last month's issue) had already promised to devastate the industry. But the damage to the exploration rigs is just as important.

Together, the two hurricanes sank or crippled 13 drilling rigs. These rigs cost as much as a half-billion dollars *each*. Even worse, the rig industry is severely backlogged. Rigs ordered today won't be delivered until 2008 or 2009. It will take years to replace the losses in the Gulf.

As a result, exploration and drilling costs are up around the entire world, as far away as the Middle East.

Even before the hurricanes, our exploration and drilling capacity was grossly inadequate. Now we've lost a full 12% of that capacity.

We desperately need more oil and gas. But we can't get it unless we have the drilling rigs. And a bunch of them are now sitting at the bottom of the ocean…with no replacements possible for years.

I don't have to tell you that we're already seeing suffocating prices at the gas pumps because of all this. But there will be other effects too.

Normally, we'd be storing up natural gas right now for use this winter. But the hurricanes changed all that. We're storing far less gas than we should: almost 2 billion cubic *per day* short of requirements.

And the surviving oil refineries aren't making any heating oil, since they're already overwhelmed trying to make enough gasoline.

As a result, heating costs are expected to be up by 50% this winter.

There's a massive shortage of diesel too. Diesel prices are exploding—the American Trucking Association predicted truckers will pay an extra $23 billion in fuel costs this year. Of course, these costs will get passed along to us as higher prices.

Amidst all this chaos, the oil refineries are entering the time when many of them were scheduled to go off-line for maintenance. They desperately need it: they've been running flat-out all year.

Some are planning to shut down soon, which will strangle our supply of gasoline, diesel, jet fuel, plastics, etc. even further. Others are deferring the maintenance—but this is dangerous in a different way.

This increases the risks of accidents, which would not only disrupt fuel supply anyway but can also kill people. For example, the BP plant in Texas City, Texas, had a deadly explosion last March, because of deferred maintenance.

All this means gas prices will remain high for the foreseeable future.

And other ugliness is coming too. As a preview of coming attractions, look at Hawaii. Drivers there are being faced with mile-long lines at gas pumps, and to "solve" this problem, politicians instituted a price-control law. Wholesale gas prices will now be set according to certain prices on the U.S. mainland.

How stupid can you be? Didn't these people learn anything from Nixon's price controls? When supply is tight, free markets ensure the best distribution by raising prices. Only those with the highest need for an item will pay the higher prices for it, so they're the ones who'll get it.

But price controls take away the market's ability to do that. That's why price controls *always cause shortages*.

But it's asking too much to expect politicians to use common sense. I predict Congress will start making noises about national price controls on gasoline soon, just like in the 1970s.

Terrorism risks are increasing

The White House announced we've foiled at least ten (!) al-Qaeda terror plots since 9-11. Two of these planned attacks were targeting cities on the East and West Coasts using hijacked airplanes.

Here's what I wonder. These attacks were planned years *after* 9-11. Why does al-Qaeda think it can still use airplanes? Despite all the increased security measures, Bin Laden apparently is still confident his murderers can penetrate our airports at will.

What does he know that we don't?

China Attacks U.S. Defense Computer Networks!

The U.S. government recently admitted that people in China have been attacking our defense and other computers for at least 2-3 years. Hundreds of networks have been breached.

This isn't the work of bored teenagers or random hackers. The *Washington Post* quoted a government official as saying, "This is an ongoing, organized attempt" to get information from our systems.

Time interviewed one counter-spy who worked for the FBI. He said these were highly skilled professionals: he "had never seen hackers work so quickly, with such a sense of purpose. They would commandeer a hidden section of a hard drive, zip up as many files as possible and immediately transmit the data to way stations in South Korea, Hong Kong, or Taiwan before sending them to mainland China. They always made a silent escape, wiping their electronic fingerprints clean and leaving behind an almost undetectable beacon allowing them to re-enter the machine at will. An entire attack took 10 to 30 minutes."

These attacks are systematic and ongoing. They're also continuous, so apparently the hacker organization is staffed around the clock.

The targets have included the Redstone Arsenal military base (the heart of our Army's rocket and missile programs), NASA, military laboratories like Sandia, aerospace giants like Lockheed Martin, even the World Bank. The attackers have stolen everything from spaceship schematics to Army flight-planning software.

The U.S. has asked China to help our investigation into the attacks. Unsurprisingly, China has refused to cooperate.

There's every sign that this is a deliberate attack by the Chinese military. According to a recent Pentagon report, the People's Liberation Army wants "electromagnetic dominance" over its enemies. The report says the PLA has developed viruses and other "information warfare" capabilities to "attack enemy systems and networks."

The *Wall Street Journal* just ran a front-page story about Michael Pillsbury, a high-level Pentagon insider. Pillsbury has been studying China for over 35 years, is fluent in Mandarin, and has written several books on Chinese strategy. For many years he was enamored of China, but his fondness has turned to "suspicion."

Pillsbury criticizes the "panda huggers" in our government who view China as a "gentle country intent on economic prosperity." He believes Beijing views the U.S. as an "inevitable foe" and is planning for war. He says we "must acknowledge that we are facing in China what may become *the largest* *challenge in our nation's history*" [emphasis added]. For a nation that fought in two global World Wars, and almost fought a nuclear war with Russia during the Cuban Missile Crisis, that's saying a lot.

The *Journal* talked about China's search for a modern "shashoujian": an "assassin's weapon" able to surprise and cripple a larger opponent. The Chinese are especially interested in "acupuncture strikes" to take out our military satellites, whether by firing missiles or launching cyber-attacks at our military computer networks.

Warnings are coming even from Chinese nationals themselves. Wei Jingsheng is a Chinese dissident who spent 18 years in Communist prisons. He recently told a National Press Club forum that the Chinese Communist government is planning for a nuclear war with the United States.

With one-sixth the world's population, the government is not afraid to sacrifice some of its people, he said. As evidence, he quoted Chinese general Zhu Chenghu, who said the government was preparing for "the destruction of all the cities east of Xian." (This would include Beijing, Shanghai, and Canton.)

Why would this happen? He said the government desperately needs to distract its population from its rampant (and growing) corruption, and failed policies—not to mention the murders of an estimated 80 million people since coming to power. So the government is planning to attack Taiwan, the neighboring island which China has always claimed as part of itself.

Of course, the U.S. has pledged to defend Taiwan against a Chinese invasion. So the Chinese are planning to cripple our military, perhaps in a pre-emptive strike.

Will they go through with it? It's too early to tell. But it would be foolish to ignore the threat.

You need to protect yourself against these risks

Our GEA portfolio is carefully balanced. On the one hand, we're positioned to profit from further rises in energy prices. On the other hand, we're hedged against weakness in those positions.

But I also want to emphasize one "general purpose" hedge that will protect you not only against weakness in selected investments, but also against all the trends and events I've described this month. This "hedge" is also a strong investment in its own right.

Of course, I'm talking about gold.

As a commodity, gold will profit from further global economic expansion. Commodities are booming, and show every sign of continuing. Since 2001, copper is up 177%, molybdenum 1170%, zinc 71%, nickel 237%, lead 141%, aluminum 37%, uranium 325%, and natural gas almost 500%.

Is it too late to profit from commodities? Nope. As legendary investor Jim Rogers has said, we're "in the beginning of a multiyear bull market in commodities." (You might remember Rogers co-founded the Quantum Fund with George Soros, and made investors 4,000% in the 1970s. His voice is one to listen to!)

Think of it this way. Since 1991, the Dow Jones Commodity Index has risen by only about 4% per year—barely above inflation during that time. Commodities have surged lately, but they're still undervalued long-term.

However, that assumes continued economic expansion, and smooth market operations. Some of the news I've reported in this issue casts doubt on this being the case. Gold does well when commodities boom, but it also flourishes when the world is rocked by turmoil and crisis. Investors flee to safety, and gold prices explode when that happens.

I've been urging subscribers to pile into gold, and we've done quite well (with gold hitting a 17-year high recently). But the ride's not over yet—far from it.

Make sure you're on board!

You've probably heard of the Refco scandal by now. In less than a week, one of the biggest commodity brokers in the world has completely imploded. A CEO trying to flee to Europe (and being arrested the day before), the exposure of fraud, a plunge into bankruptcy, and the complete collapse of its stock price—all happening in just a few days.

It's far too early to tell what the eventual fallout will be, but there's already untold damage to world markets. This just proves my point: unexpected "out of the blue" events can blindside you if you're not protected!

The GEA approach is to maximize profits *regardless* of unexpected events—in good times or bad!