GOLD & ENERGY ADVISOR

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"Will We See $100 Oil in 2006?"

"There's big news this month in oil. Iran re-started its nuclear program, Russia is throwing its weight around in energy markets, and world oil reserves fell by almost *five percent*!

"2006 is shaping up into a wild ride in the oil markets!"

James DiGeorgia, Editor

- **Iran progresses towards nuclear weapons, plans to attack the U.S. and Israel. Will Israel and the U.S. strike first?**
- **World loses almost 5% of oil reserves; another 27% now in question!**
- **Experts predict oil at $100, $131, even $262!**

Well, it finally happened.

Iran has broken the United Nations seals on its nuclear facilities. It has reopened them to start full-scale uranium enrichment. In turn, the International Atomic Energy Agency has referred Iran to the U.N. Security Council for punitive action.

I started warning about this here in *GEA* almost two years ago. Few were paying attention to Iran then. But now the Islamic Republic is being discussed in capital cities all over the world.

Before 9/11, Iran had killed more Americans through terrorist activity than any other nation. It's an open sponsor of Hezbollah and other terrorist groups across the world.

Now this terrorist state is going nuclear.

The American Ambassador to the U.N. said that President Bush "has made clear that a nuclear Iran is not acceptable…that is just not something he is going to accept."

Israel won't accept it either, for obvious reasons. Iranian clerics have openly mused that nuclear weapons could easily "destroy" Israel, while doing only moderate damage to surrounding Muslim countries. During a recent Iranian military parade, a Shihab-3 missile had a sign draped over it that said, "Israel must be uprooted and erased from history." On Iranian national TV, Iran's previous President said, "We should mobilize the whole Islamic world for a sharp confrontation with the Zionist regime. If we abide by the Koran, all of us should mobilize to kill." And the current President said he wants to "wipe Israel off the map."

So, as I mentioned last month, the U.S. is reportedly considering an attack. Israel is too: the Israeli defense minister recently said, "We cannot tolerate a nuclear option for Iran."

Both governments want to take out Iran's nuclear program before it produces a weapon.

Our officials would like to duplicate Israel's example from 1981. Israeli forces destroyed Saddam Hussein's nuclear plant at Osirak, and put a permanent halt to his drive for nuclear weapons.

THE GOLD AND ENERGY ADVISOR

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But that's just wishful thinking. It won't be so easy this time. Iran has learned the lesson of Osirak very well, and there's no single facility to attack. Instead, the Iranian program is spread across more than 100 sites.

Time is Running Out

Every passing day makes an attack more problematic—and Iranian nukes more probable.

According to the UK's *Telegraph*, Iran is "racing" to dig a network of tunnels and underground bunkers for its nuclear facilities. *Jane's Defense Weekly* reported that Ayatollah Ali Khamenei, Iran's supreme leader, has ordered they be finished by the beginning of July.

Once the facilities go underground, the game's over. There will be no way to shut down Iran's nuclear program without sending in a ground invasion. Even our bunker-buster bombs couldn't penetrate deeply enough (some of the tunnels are being dug into mountainsides).

This is very bad for the Israelis, and creates extreme time pressure. The UK's *Times* reported that Israel's Prime Minister has ordered the Israeli military to be ready to strike Iranian facilities by the end of March. As he told the media, "Israel—and not only Israel—cannot accept a nuclear Iran. We have the ability to deal with this and we're making all the necessary preparations to be ready for such a situation."

Israel is racing against time on several fronts. Iran recently launched its first satellite (the Sinah-1) on a Russian space launcher. As an Israeli official said, "The Iranians' space program is a matter of deep concern to us. If and when we launch an attack on several Iranian targets, the last thing we need is Iranian early warning received by satellite."

Also, Iran just signed a $1 billion contract with Russia for the Tor-M1 system to destroy guided missiles and laser-guided bombs from aircraft. This would make a strike very difficult. As an Israeli air force official said, "Once the Iranians get the Tor-M1, it will make our life much more difficult. The installation of this system can be relatively quick and we can't waste time on this one."

Israel knows it needs to strike quickly. But it also knows that it can't pull off a successful attack without U.S. help. A large-scale simultaneous strike of multiple targets would be required, but Israel couldn't even get one sortie of aircraft over the target area without refueling.

Will the U.S. agree to a joint attack on Iran? It's too soon to tell, but U.S. officials seem to be laying the groundwork for it. Senator John McCain was just on CBS's *Face the Nation* and said, "To say under no circumstances would we exercise a military option, that would be crazy." Democratic Senator Bayh of Illinois (a member of the Senate Intelligence Committee) agreed. He also pointed out Iran has key elements of its program, which if attacked, "would dramatically delay its development."

US officials are now faced with an agonizing decision: do we attack, or not? It seems like we're caught in a trap, because…

Iran's Leader is a Complete Nutjob!

Iranian President Mahmoud Ahmadinejad is crazy. That's why we can't let him have nukes.

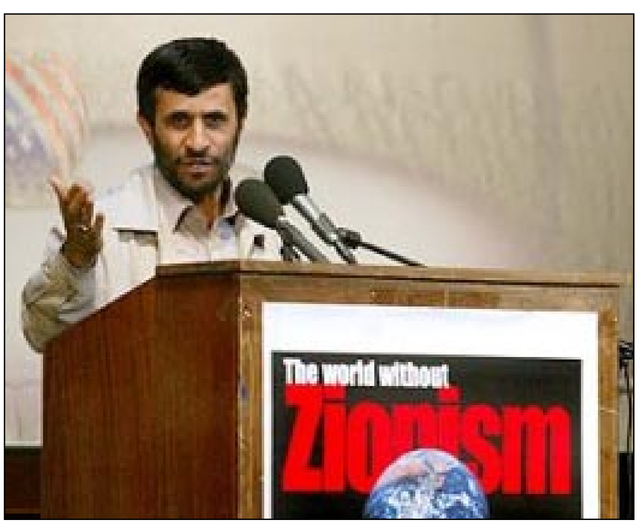
But if we do attack Iran, it's impossible to predict what he'll do.

How crazy is he? For one thing, he recently told some Iranian theological students that "Islam is ready to rule the world…We must prepare ourselves to rule the world." According to Iran's speaker of parliament, many of the people working closely with Ahmadinejad believe the Mahdi (the Shiite Messiah) will return in the next two years.

Here's a worse example. Ahmadinejad spoke to the U.N. last September. Afterward, he said he was bathed in "green light" from Allah himself—he saw and felt an "aura" from heaven surrounding him as he gave his speech.

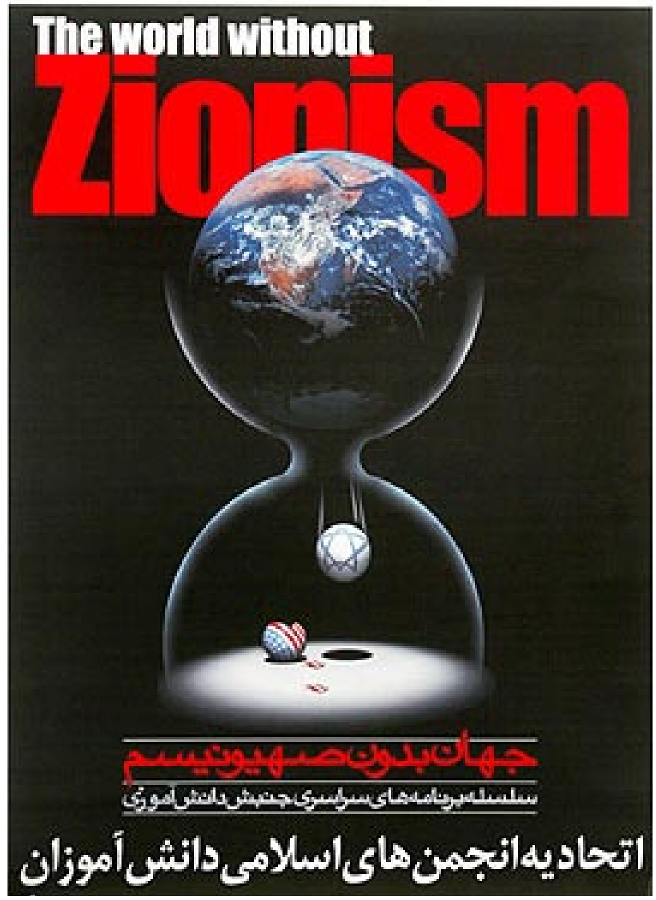
The following month, his government held a "World Without Zionism" conference in Iran's capital of Tehran. You might have seen this photo of Ahmadinejad:

ISNA Photo



But let's take a closer look at that podium banner…

ISNA Photo



Did you notice what's at the bottom of the hourglass? Here's Ahmadinejad standing in front of a larger version. Notice that the "Israel" ball is about to shatter. But see what's already been destroyed? America!

AFP Photo

Does Ahmadinejad seriously think he can attack the U.S. and win? Well, for someone who expects the Mahdi to return and help him take over the world, nothing is impossible.

And the rest of the Iranian government is just as crazy. You might remember that Hassan Abbassi, a leading advisor to Supreme Leader Ali Khamenei, has said this:

"We have a strategy drawn up for the destruction of Anglo-Saxon civilization…we must make use of everything we have at hand to strike by means of our suicide operations or by means of our missiles. There are 29 sensitive sites in the U.S. and in the West. We have already spied on these sites and we

Latest prices as GEA goes to press—February 13, 2006

Comex spot contract: silver $9.15, gold $540.90
Nymex spot platinum: $1011.00, palladium $272.00
Nymex Light Sweet Crude Oil $61.15

Silver coins		Dealer will buy at this price	Dealer will sell at this price
100 1 oz. silver American Eagles		$925	$1,190
100 1 oz. common rounds		$890	$1,150
$1,000 face value US pre-1965 coin bag (circulated)		$6,000	$7,350
$1,000 face value US circulated silver dollar bag (VG or better)		$9,000	$10,000
US Morgan silver dollars	PCGS MS64	$45	$65
	PCGS MS65	$110	$140
	PCGS MS66	$280	$375
Platinum coins			
U.S. Platinum Eagle:	1 oz.	$1,000	$1,275
	1/2 oz.	$500	$695
	1/4 oz.	$275	$450
	1/10 oz.	$110	$175
Gold coins			
Australian Kangaroo		$535	$615
British sovereign (Kings)		$116	$166
(Elizabeths)		$116	$166
Canadian Maple Leaf		$535	$570
Credit Suisse 1 oz. gold bar		$530	$570
Mexican 50 peso Centenario		$585	$695
South African Krugerrand		$535	$570
US Gold Eagle:	1 oz.	$550	$595
	1/2 oz.	$287.50	$387.50
	1/4 oz.	$131.25	$206.25
	1/10 oz.	$67.50	$97.50
US $20 double eagle:			
Liberty	Raw MS60	$550	$675
	NGC MS63	$775	$950
	NGC MS64	$1,200	$1,950
	NGC MS65	$4,150	$5,950
Saint Gaudens	Raw MS60	$575	$700
	NGC MS63	$625	$795
	NGC MS64	$775	$925
	NGC MS65	$1,250	$1,495

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

know how we are going to attack them."

The UK *Telegraph* obtained a copy of the latest U.S. intelligence assessment. It said, "Iran's clerical regime is supremely confident, has a firm grip on power, and is ready to retaliate against attacks by America or Israel with missiles or by activating terrorist allies."

As it pointed out, the Iranian-backed Hezbollah terrorist group "has a worldwide support network and is capable of attacks against U.S. interests if it feels its Iranian patron is threatened."

Iran might even be plotting a joint attack with al-Qaeda. According to a report in the German media, Iran is allowing about 25 high-ranking al-Qaeda officials to live in Tehran, including three sons of Osama bin Laden (Saeed, Mohammad, and Othman). They live in homes belonging to Iran's Revolutionary Guard.

So what should we make of all this?

If we attacked Iran, world oil markets would be in chaos. Oil rose more than 60 percent in the run-up to the Iraq war—the equivalent today would bring us up to $94 or so. (The Center for Global Energy Studies predicted $100.)

But that assumes no Iranian retaliation. And President Ahmadinejad has already threatened to take Iran's 2.6 million barrels of oil per day off the market, just because of the referral to the U.N. Security Council. He'd certainly do that if attacked. Oil might hit $150.

He'd probably even close the Strait of Hormuz.

Time might be shorter than we think.

Mohamed ElBaradei, Director-General of the United Nations' International Atomic Energy Agency, was just interviewed by *Newsweek*. He said, "If they [the Iranians] have the nuclear material and they have a parallel weaponization program along the way, they are really not very far—a few months—from a weapon."

When asked if they had such a program, he said he "won´t exclude the possibility." Remember, this is the guy in charge of the "watchdog" agency that's been monitoring Iran's nuclear research.

Also remember that the facilities we do know about—like the uranium enrichment plant at Natanz, and heavy water production at Arak—were built and successfully kept secret for over 15 years until they were revealed in 2002 by an internal opposition group.

What else has Iran built that we don't know about?

Closing the Strait would instantly cut 25% of the world's oil supply. Oil might hit $200, or worse.

Many Americans think this is all impossible—surely Iran wouldn't take its own oil off the market, and lose all that money. But they don't understand the Iranian mindset.

The Iranians still look back proudly to the time in 1951, when the world refused to buy Iranian oil after the Iranians "nationalized" (stole) the entire petroleum industry built there by Britain. Rather than cave in to international pressure, Iranian leader Mohammed Mossadegh refused to sell any oil. He said, "Let it sit in the ground for future generations!" So they don't think like we do.

Maybe this whole situation will somehow be resolved. I doubt it, but we'll see. In the meanwhile, our *GEA* energy portfolio should do very well.

And Iran's not the only reason our portfolio is looking strong. There's also…

Grim News from Kuwait

With claimed reserves of about 99 billion barrels, Kuwait has almost 10% of the world's oil reserves.

For almost 60 years, Kuwait has relied heavily on a gargantuan oil field named Burgan. This is the world's second-largest oil field (second only to the Ghawar in Saudi Arabia). With 55 billion barrels, Burgan accounts for more than half of Kuwait's claimed reserves, and has produced more than 28 billion barrels of oil over its lifetime.

But in a little-noticed recent announcement, Kuwait quietly admitted Burgan is "exhausted." Despite a huge amount of oil left in the ground, Burgan's production has plummeted.

Kuwait will now have to spend an enormous amount of money ($3 billion per year for the next several years) on Burgan and its other fields. This is part of "Project Kuwait," a huge, expensive effort to coax more oil from Kuwait's aging fields.

As I explained in my book *Global War for Oil*, the early days of an oil field are the easiest. The oil comes out fast and cheap. (Often it even squirts out by itself.)

But eventually, production slows. Soon, pumping isn't enough. You have to start pumping water, gas, or solvents into the field to flush out the oil.

These production methods are not only expensive, but much less efficient. You get a lot less oil than before, and it costs a lot more. Eventually, the oil gets too expensive to extract, and production stops. (And this happens even though there's still lots of oil left in the ground!)

That's what Kuwait is facing. But that's not the real shocker…

You might be wondering: if everything I've talked about this month is true, why isn't the *GEA* portfolio fully leveraged to be long in oil? Why have I hedged with options to protect the downside?

It's simple. I can't predict the future, and neither can anybody else.

I position our portfolio to take advantage of long-term trends I see developing. But I also take prudent hedges in case I'm wrong, and to protect our recommendations against swings in the market. And I'm constantly adjusting our portfolio and outlook as new developments occur.

So that's why there are hedges and other conservative investments included in the portfolio.

Either way, we do have long-term energy problems. And these represent investment opportunities, especially as many asset-based energy companies are undervalued.

And I have to say it again—make sure you're also invested in gold, for financial insurance!

World Oil Reserves Were Just Slashed By Almost Five Percent!

The oil industry was rocked by a recent report in *Petroleum Intelligence Weekly*.

The industry newsletter published reports about internal data it had seen from Kuwait Oil Co., a part of state-owned Kuwait Petroleum Corporation. The data revealed that proven and non-proven oil reserves in the country are only 48 billion barrels—not the 99 billion that the country has officially claimed.

That's a difference of 51 billion barrels of oil. Kuwait accounts for almost 10 percent of world oil reserves, so we just lost almost five percent of the world's oil overnight. *Poof*, it's gone.

What's worse, of the 48 billion barrels remaining, only half are fully proven. So the other half (24 billion barrels or so) might be just as illusory as that 51 billion we just lost.

Surprised? We shouldn't be.

It's been obvious for some time that most OPEC oil, including Kuwait's, has been grossly (and fraudulently) overstated. They have a lot less oil than they claim.

I wrote about this in Chapter Two of *Global War for Oil*. The OPEC countries started inflating their reported reserves back in 1985. Now the truth is finally coming out.

Kuwait actually started the trend. In 1984, Kuwait reported total reserves of 63.9 billion barrels. The next year, they suddenly claimed 90 billion. And the number has hovered around 90 or so ever since.

This additional 26 billion barrels of oil would have required a huge discovery. In the entire world, there have been only a handful of fields discovered above that amount. Yet Kuwait didn't announce any huge new finds as the source of all this oil. So where did it come from?

While oil-consuming nations were scratching their heads over this question, the other OPEC countries fumed. OPEC restricts the amount of oil each member can export, but the quotas are allocated based on reported reserves. So Kuwait's "discoveries" meant it could now sell more oil.

Unsurprisingly, the other OPEC countries soon did the same thing. In 1988, Abu Dhabi's reported reserves skyrocketed from 31 to 92.2 billion barrels. Iran's leaped up from 48.8 to 93. Iraq's more than doubled, from 47.1 to 100. Not to be left out, Venezuela doubled its reserves too, jumping up from 25 to 56.3.

These "discoveries" were obviously shams. For example, when Iran and Iraq "found" their oil in 1988, they had been locked in an all-out war with each other for eight years—one that included human wave attacks, chemical weapons, and mass attacks against each other's cities. How did they find time to look for and discover a combined 100 billion barrels of oil during this time? Simple—they didn't. They were both bankrupt from the war, and desperately needed to sell more oil.

The Saudis held out for a while, but they caved in eventually too. But they did it bigger and better than anybody else. In 1990, with the stroke of a pen, they "found" almost 100 billion barrels of oil (going from 167 to 257.5 billion barrels).

All together, the anomalous OPEC oil "discoveries" total more than 300 billion barrels. That's about 27 percent of the world's total claimed reserves.

But Kuwait's share was apparently a fraud. What about the rest of the 300 billion? How much of that is fraudulent too? Half? Three-quarters? Maybe *all* of it?

Time will tell.

Portfolio Updates

Here are the changes to the *GEA* portfolio since the last issue.

We rolled over some of our energy options into February. We bought the following January calls to close out our positions, and sold the corresponding ones in February:

- Conocophillips $65 calls
- Encore Energy $35 calls
- Apache Corp. $65 calls
- Anadarko Petroleum $95 calls
- EOG Resources $75 calls
- Cimarex $40 calls.

For Talisman Energy, we're trying a different strategy. We rolled out into April at a higher strike price (see Update #147 for details).

We allowed our options on Noble Energy, Devon Energy, and the XLE to be exercised.

In Update #149, we took profits on Bill Barrett Corp. (we made 26.49 percent in 11 months.)

We also sold calls on Newfield Exploration (March $55 calls, symbol NFXCK) to lower our costs on that stock.

In Updates #150 and #151, I made a recommendation for aggressive traders only. We bought deep-in-the-money calls on Noble Corp (June 60 calls, symbol NEFL), and Ensco Intl. (June 40 calls, symbol ESVFH).

Famous Analyst Predicts: Oil Might Go as High as $262!

Forbes recently spoke to billionaire investor George Soros. He said he was "very worried" about the supply-demand balance of oil. However, when *Forbes* asked him for a price prediction, he wouldn't provide one.

But another famous investor would, and did. The same article included quotes from Hermitage Capital's Bill Browder. Browder is well-known in the fund world; his $4 billion fund is up a whopping 1,780 percent over the last decade.

Browder wanted to know what would happen to oil if the supply from an oil-producing country was cut. So he had his team run complex simulations on six different scenarios.

The least disruptive scenario was unrest and violence in Algeria, which would bring oil up to $79.

(Yes, events in far-off backwaters like Algeria can have a major effect on oil prices in America. That shows how tight world oil markets have become—every drop of supply is desperately needed.)

They also modeled a major attack on the Iraqi oil infrastructure by the insurgency. This could bring oil up to $88 per barrel.

Civil war in Nigeria is worth $98 per barrel. An oil embargo by Venezuela (which its dictator has openly threatened to do) would shoot oil up to $111. An OPEC-wide embargo like the one in the 1970s would pop oil up to $131.

The worst scenario is the fall of the house of Saud in Saudi Arabia. (I spent an entire chapter on this possibility in my book.) According to Browder's analysis, that would bring oil up to a strangling **$262 per barrel**.

Incidentally, Browder isn't the only one calculating these kinds of scenarios. The World Economic Forum was recently held in Switzerland, and one of the events was an energy-crisis simulation. They concluded that terrorist activities interfering with only 5 percent of world production could send prices up to $120 per barrel.

Of course, we might never experience any of these scenarios. And the numbers are just theoretical results, not guarantees of what would actually happen.

But these analyses show just how precarious our oil situation really is.

The Russian Bear Awakens

In Chapter Ten of *Global War for Oil*, I wrote about dictatorship returning to Russia.

Yes, Vladimir Putin blusters much less than the old Soviet dictators. But the savage war in Chechnya (largely unreported in Western media), among other things, shows he's cut from the same cloth.

Most of the world has been in denial. Surely Russian dictatorship was "the bad old days"—now

In his State of the Union speech, President Bush promised to reduce America's dependence on Middle East oil. How? By cutting imports from there by 75 percent over the next twenty years.

Oops. Turns out he "didn't mean it literally," according to his Energy Secretary Samuel Bodman the next day.

But Bush said we'd "move beyond a petroleum-based economy and make our dependence on Middle Eastern oil a thing of the past."

Well, Bodman explained, "this was purely an example."

The Administration's back-pedalling is amusing, but somebody should tell Secretary Bodman we didn't believe the President anyway. We've heard these kinds of things before:

- Back in 1973, President Richard Nixon promised, "In the year 1980, the United States will not be dependent on any other country for the energy we need to provide our jobs, to heat our homes, and to keep our transportation moving."
- President Gerald Ford realized this wasn't going to happen by 1980, so he moved the date up to 1985.
- Then in 1979, President Jimmy Carter proclaimed, "Beginning this moment, this nation will never use more foreign oil than we did in 1977—never." But he also moved the date of energy independence forward to 1990.
- In 1991, one year after that deadline had come and gone, President George H.W. Bush announced his new national energy strategy "reducing our dependence on foreign oil." Well, we're still dependent.
- Then there was the tax President Clinton wanted to impose on oil (59.9 cents per BTU) in 1992, to discourage oil consumption. Or the $1 billion Partnership for New Generation Vehicles he launched in 1993, to ensure we'd all be driving hybrid vehicles by 2004.

So yes, we've heard all this before.

Now another President has said we'll kick our addiction to foreign oil. What else is new?

As usual, government officials don't understand how the economy works. Even with oil at its recent highs, the majority of Americans still choose it over the alternative forms of energy. And government lip-flapping has little effect on this choice.

Oil will have to go up to nosebleed heights—and stay at those heights for a while—before the U.S. weans itself off it. This price rise might be from political events, or natural disasters, or just good old supply and demand. Maybe even a combination of those.

But either way, we'll remain hooked on oil until then. Count on it.

we're all just one big happy family, right?

Wrong. Last month, in the middle of a bitterly cold winter, Russia abruptly cut the two pipelines carrying natural gas to its southern neighbor Georgia (and through Georgia, Armenia as well). This was Georgia's *entire* supply of gas. The Georgian government had to scramble to find alternative supplies before its people started freezing to death.

Russia says the pipelines were blown up by unidentified terrorists. But the explosions were coordinated, and happened in areas protected by Russian security forces. And an electrical supply line was cut, too.

Russia's protests are especially feeble when you consider they had just done the same thing to Ukraine (minus the explosions and "terrorist" excuses). Russia shut down Ukraine's gas (throttling the supply to Western Europe in the process) for several days in January. It wasn't turned on again until Ukraine agreed to pay much higher prices (almost double the previous cost).

Russia says it's just adjusting its prices to meet the market. But this is only happening to neighbors Putin doesn't like.

Russia has wanted to crush Georgia ever since the republic's Russian-puppet government was overthrown and replaced with a democratic one in 2003. Ditto for the Ukraine, which threw off its Russian shackles in 2004 (in a national election that Russia was caught trying to rig).

So now Ukraine has to pay $95 per 1,000 cubic meters of gas, up from $50. (And that original $50 price was supposed to be guaranteed until 2009!) Georgia's costs doubled too. Meanwhile, countries that cozy up to Moscow (for example, Belarus) only have to pay $47.

By the way, Putin turned off the gas to Ukraine and Western Europe on the same day he became president of the 'rich nations' G8 group. Coincidence? Or was he making a deliberate statement?

There *is* a statement being made here, and nobody likes it. The old Russia is returning.

Turning off the heat for entire nations in the middle of winter is a potentially deadly tactic—people can *die* when the power or heat goes off for even brief periods, especially the elderly. That makes it the equivalent of an act of war. But Putin is willing to do whatever it takes to reassert Russian power over the old Soviet states.

Plus, Putin just boasted that Russia has tested missile systems that no one else has. They're "immune" to missile defense systems, since they're hypersonic (traveling faster than sound), and capable of changing their flight path to outmaneuver any defenses.

Who was he threatening with this? The U.S., obviously. No one else has a missile defense system like the one he was talking about.

More ominously, Putin made a point of mentioning that the missiles can carry nuclear warheads.

Yes, the President of Russia is threatening the U.S. with nuclear weapons again. The Cold War is returning.

Even from a purely economic view, the Russian actions are troubling.

Russia has become a large energy and commodity business. Instead of selling their resources at the prevailing price, the Russians have decided to start managing their resources much as OPEC does.

First the Russians started charging $1000 per ounce for platinum. Then they began buying gold instead of selling it. Now they're doubling and tripling their prices for natural gas (except for subservient customers).

The old Soviet Union was militarily strong, but an economic shambles. However, the new Russia is now run by expert capitalists. They realize that the less they sell, the higher prices will rise. They're finally adapting a free-market web theory approach to managing their exportable resources.

At the optimal point of sale, Russia could sell half its resources for two, three, even ten times current price levels. We have to hope this doesn't set off a domino collapse of the world economy.

OPEC has been very sensitive about keeping prices low in an attempt to avoid recessions. But Russia may be less disciplined. Worse, if there's an Iranian confrontation, the combination could lead to hyperinflation.

Summary: Stay the Course!

Events in Iran, Kuwait, and Russia are just reinforcing our *GEA* investment strategy.

We're long in both energy and physical gold. We should maintain this position until we see these events fade as a threat.

But right now these threats are growing. So hold steady!