GOLD & ENERGY ADVISOR

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"US Government Bailouts Spiral Out of Control!"

"Why did the dollar get pounded after the Fed meeting this month? Because the world is finally waking up to what we're about to do to our currency.

"The Fed has now cranked up the printing presses to full speed. At current rates, our money supply is expanding by over *ten times per year*.

"The effects haven't hit us yet, but they're coming. Here's what to expect!"

James DiGeorgia, Editor

- **IMF chief economist says, "The worst is yet to come"**
- **Congressional panel predicts biological terrorist attack on US**
- **US money supply: Now inflating at over 1,140 percent annually!**

I'm sure you heard that the Fed has announced a new 'almost-zero' interest rate policy, to kick-start the economy.

According to the media, this was an historic decision. This is true.

But you might have missed the real shocker, announced by the Fed that same day. The *New York Times* described it best:

"The Fed bluntly announced that it would print as much money as necessary to revive the frozen credit markets…

"The Fed has already announced or outlined a range of unorthodox new tools that it can use to keep stimulating the economy once the federal funds rate effectively reaches zero. On Tuesday, Fed officials said they stood ready to expand them or create new ones to relieve bottlenecks in the credit markets.

"All of the tools involve borrowing by the Fed, which amounts to printing money in *vast new quantities*, a process the Fed has already started."

Capitalism has been abandoned in a very fundamental way. In fact, it's fair to say that…

Our financial system has been turned upside down.

As Vikram Pandit of Citigroup recently commented, we've gone from free-market capitalism to a system where the only source of credit for large businesses is the government.

As a result, our government is creating trillions of dollars out of thin air. (A trillion is a "1" with twelve zeroes after it!) And the process is accelerating.

As two economics and finance professors recently wrote in the *Wall Street Journal*, "Practically every day the government launches a massively expensive new initiative to solve the problems that the last day's initiative did not."

Each new bailout is bigger than the one before—but the problems are getting worse instead of better.

Our country is plunging down a path that's all too familiar. If you're a student of history, you've seen lots of examples of this in the past… and you know how badly this usually ends.

That's our primary topic this month. We'll start with…

Why the Government is Panicking

Despite all the government interventions, many important economic indicators are falling off a cliff.

For example, you've probably heard that the United States lost over a half-million jobs in November. That's the largest one-month drop since 1974.

Also, unemployment claims for the first week in December were at 573,000. That's the highest level in 26 years.

Other indicators are just as bad. For example, the Institute for Supply Management manufacturing index has fallen to its lowest level since 1982.

Its new orders index—which looks forward into the future—has plunged to the lowest level since 1980. (This index has only been below 30 three times during the last 60 years. It's currently at 27.9.)

We can also look at the transportation sector. This tends to be a good gauge of the economy, because raw materials and finished goods have to be shipped. But the outlook here is terrible.

American trucking companies are projected to buy only 101,000 tractor-trailers next year—that's down 64 percent from two years ago. And railcar delivery has fallen from 58,000 to a projected 40,000. Meanwhile, UPS and FedEx have both canceled their annual predictions of holiday demand.

What about international trade? It's falling too. Exports fell 2.2 percent in October from last year. The US monthly trade deficit has risen to $57.2 billion, even though oil prices are down.

All this explains why government officials are panicking, and are setting up…

The Biggest Bailout in History

The Fed and other government agencies have committed to a jaw-dropping $8 trillion in bailouts and backstops. That's over half the annual output of the American economy.

Put another way, it's $26,700 for every man, woman, and child in this country. And that's in addition to the $10.65 trillion national debt, which is another $35,500 per person.

This is a staggering amount of money. Where is it all going?

Here are the items the Fed has already put on its balance sheet:

- $493.8 billion in US government debt
- $447.9 billion in Term Auction Credit loans
- $90.2 billion in "primary credit" loans
- $80.0 billion in repurchase agreements
- $47.3 billion in dealer credit
- $27.4 billion in money market paper
- $41.6 billion lent to AIG
- $318.8 billion in commercial paper
- $26.9 billion for the Bear Stearns bailout
- $20.0 billion to buy AIG's mortgage-backed securities

International Monetary Fund's chief economist says, "The worst is yet to come."

The IMF is being overwhelmed with cries for help from emerging countries. It was already helping Iceland, Hungary, Ukraine, Serbia, Pakistan, and Latvia, and has blown through one-fifth of its $250 billion bailout fund in just two weeks in November.

Now the IMF is being deluged with new aid requests, totaling hundreds of billions of dollars. But as IMF chief economist Olivier Blanchard just explained to a German newspaper, "We don't have this money. We never had it."

So all those failing countries are out of luck. This will depress international trade, and drag down the industrial economies even further.

- $19.7 billion to buy CDOs from AIG
- And $682.4 billion in "other" credit.

All told, the Fed has already lent out $2.29 trillion. Plus, there's another $6 trillion or so in pending commitments:

- The Fed will buy up to $600 billion in debt and mortgage-backed securities from Fannie Mae, Freddie Mac, Ginnie Mae and Federal Home Loan Banks.
- The Fed will also buy $200 billion of securities backed by student loans, car loans, small business loans, and credit card debt.
- The Fed has promised to buy up to $1.3 *trillion* in commercial paper.
- The Treasury will buy more bank stocks. So far, it has injected $161.5 billion directly into banks.
- The Treasury has also promised to backstop $3 trillion of money market funds.
- The Department of Housing and Urban Development has pledged $300 billion in its Hope for Homeowners program, to help homeowners avoid foreclosure.
- The FDIC is now backing $700 billion in bank debt, plus it has expanded its bank-deposit insurance coverage.

All together, the government's promises add up to well over $8 trillion. And that doesn't include open-ended commitments, like the Treasury's plan to buy enough mortgage securities to push down interest rates by a full point. Or the Treasury's plan to buy paper backed by commercial real estate.

Yes, you read that last one correctly. The US government is now investing in shopping malls.

When will the madness end? Not until the government finally realizes that…

The Bailout Won't Work

Some financial crises can be solved by throwing money at them. But the frozen-credit type we're experiencing today isn't one of those.

Financial interventions don't always work. In fact, there are lots of examples of failed bailouts.

A great example of this is Japan's effort to spend its way out of its depressionary slump in the 1990s. The Japanese government executed a whole series of bailout packages, including:

- $85 billion in August 1992…
- $117 billion in April 1993…
- $137 billion in September 1995…
- $128 billion in April 1998…
- $195 billion in November 1998…
- and $147 billion in November 1999.

But nothing worked—until the government finally admitted defeat, and forced the banking system to rid itself of the mismanagement and covered-

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up bad debts it had been laboring under. *Then* the economy finally recovered.

Another example is the Great Depression here in the US. Despite the popular misconceptions, the Depression wasn't solved by Franklin Roosevelt's New Deal. Instead, as a growing number of economists now recognize, the New Deal actually prolonged the agony.

Nor did the government interventions start with Roosevelt. They actually started under Herbert Hoover, who started to throw money at the Depression immediately after it started.

Between 1929 and 1932, federal spending exploded upward by more than 50 percent. The government built massive public projects, including the Hoover Dam, the San Francisco Bay Bridge, and the Los Angeles Aqueduct.

But the economy just sank further into depression. In 1938, after almost a full decade of "economic stimulus packages" from the government, almost one of every five workers remained unemployed.

If you think about it, an "economic stimulus" is a ridiculous idea anyway. After all, where does the money for the stimulus come from? From the taxpayer.

The government just takes money from one person so it can "give back" to someone else. What economic activity is being "stimulated" there? Nothing.

Unfortunately, many people seem to get confused by this process. They don't realize the money is coming from the taxpayers.

This happens because politicians in Washington have learned to avoid raising taxes whenever possible. (After all, this would call attention to the $3 *billion* they're adding to our debt every day.)

No, politicians have learned to borrow the money instead. And if that doesn't work, they just print it instead.

But either way, you and I still pay for it. We'll pay higher taxes later when the loans come due. Or, if the government just printed the money, we'll still pay, because the government steals purchasing power from our financial assets through inflation.

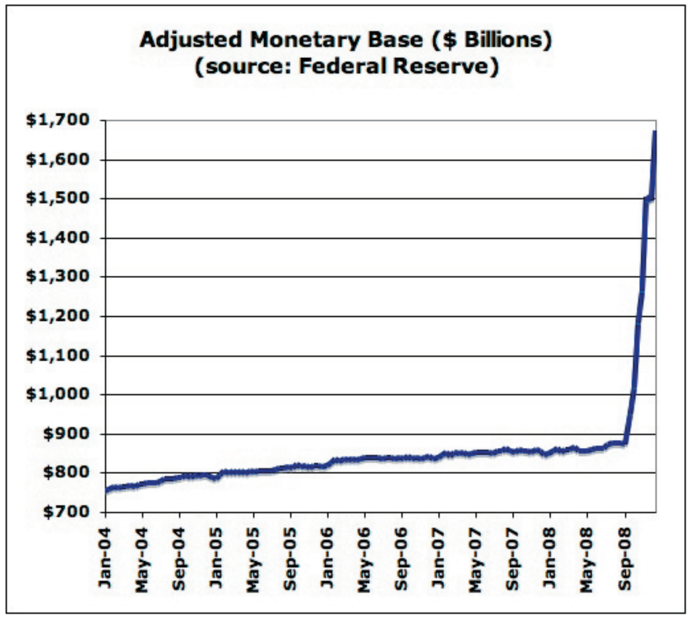
This is all basic economics. Unfortunately, few of our "leaders" in Washington understand any of it.

So they'll keep making the stimulus packages bigger and bigger, hoping that *this* time, it will finally work.

And that explains why…

The Situation is Spinning Out of Control

According to the Federal Reserve, the US money supply has increased by $798 billion just since September (almost doubling from an initial level of $873.8 billion).



This is an annual growth rate of *over 1,140 percent*. In all of history, few nations have ever inflated their currencies this badly. (And they all ruined their economies in the process.)

So why haven't we seen price inflation in our economy yet? Because banks are hoarding the cash instead of lending it out.

This is what I've been warning about in *GEA* for the last several months. The government isn't addressing the underlying problems that have plugged up the credit markets. Instead, it's just been flooding the banking system with dollars.

So far, those dollars haven't hit the economy. But once the credit markets open up—once the floodgates are finally blown open—that tsunami of money will come blasting through the economy.

Not only that, the fractional reserve effect will kick in again. Remember that once banks start lending again, they create money too—up to 10 times the amount in the banking system.

There's an historic period of inflation ahead of us. Hard assets of all kind will explode upwards. Investors in gold, and to a lesser extent platinum and silver, will be *very* happy.

Yes, I know the government is promising to prevent this. Fed Chairman Bernanke has promised that he'll unwind all those hyperinflationary swaps and loans the instant the credit markets thaw out.

But this is absurd. It ain't gonna happen.

First of all, the Fed won't know when to shut down the printing presses until it's far too late. For the most part, the Fed's economic indicators look backwards, not into the future. (Remember Alan Greenspan's famous comment about being unable to spot a bubble until after it had already burst?)

Second of all, the government won't have the political courage to stop the inflation. The first period during any big inflation is a burst of (apparent) prosperity. This is called an "inflationary boom." Asset prices go up, businesses get swamped with orders, and lots of jobs are created.

To think that a Democratic Administration, with a Democratic Congress, will shut this process down in the early stages is ridiculous.

Eventually, inflation creates a tremendous amount of pain. But it takes time for it to roll through the economy. And it will have to build up to quite a level before it creates the political will to stop it.

Think back to the last big inflationary period, starting around 1970 or so. It lasted an entire decade before Paul Volcker finally shut it down.

Think about how bad it got in 1979 and 1980 before the government finally acted. And even then, it took a tremendous amount of courage for Volcker

Portfolio Update

In Update #609, we advised subscribers who had written options against COP, OXY, XTO, APA, DVN, SU, APC, TLM, EAC, GIFI, NE, and BBG. We allowed the options to expire worthless, and kept the $4,500 or so in premiums.

We also noted that the following stocks would be put to us: PXD (via the Nov. $22.50 put), TLM (via the Nov. $10 put), and APA (via the Nov. $75 put).

In Update #610, we issued hedging instructions for subscribers who own Pioneer Natural Resources (PXD), Noble Corp. (NE), Suncor Energy (SU), and XTO. For PXD, we sold 2 contracts of the Dec $22.50 calls (PXDLX). For NE, we sold the Oct. $30 calls (NELF). For SU, we sold 2 contracts of the Oct. $25 calls (SULE), one against the stock and the other against our long-term SU option (YYUAJ). For XTO, we sold the Dec. $40 calls (XTOLH).

In Update #611, we issued hedging instructions for owners of Apache Corp. (APA), Bill Barrett Corp. (BBG), and ConocoPhillips (COP). For APA, we sold the Dec $85 calls (APALQ). For BBG, we sold the Dec. $25 calls (BBGLE). For COP, we sold the Dec. $55 calls (COPLK).

In Update #612, we issued hedging instructions for owners of Occidental Petroleum (OXY), Anadarko Petroleum (APC), Devon Energy (DVN), Encore Acquisition (EAC), Gulf Island Fabrication (GIFI), and Talisman Energy (TLM). For OXY, we sold the Dec. $55 call (OXYLK). For APC, we sold the Dec. $40 calls (APCLH). For DVN, we sold the Dec. $80 calls (DVNLP). For EAC, we sold the Dec. $30 calls (EACLF). For GIFI, we sold the Dec. $15 call (GQILC). For TLM, we sold the Jan. $10.00 calls (TLMAB). Note: the TLM hedge was for the *GEA* 2 portfolio only, as the TLM position in the *GEA* 1 portfolio already had a December hedge.

In Update #617, we recommended a new position for both portfolios. We bought Berry Petroleum (BRY) at the market, and also sold short the BRY Jan. 2009 $7.50 put (BRYMU).

In Update #619, we issued instructions for subscribers who had hedged Occidental Petroleum (OXY). We rolled up the Dec. $55 call (OXYLK) to the Jan. 2009 $55 call (OXYAK).

In Update #621, we issued instructions for subscribers who sold SULE and NELF. We bought SULE to close, and simultaneously sold to open the Jan. $25 calls (SUAE). We also bought NELF to close, and simultaneously sold to open the Sept. $27.50 calls (NNDAY).

In Update #622, we issued instructions for subscribers who own hedges on PXD, APA, BBG, and DVN. For PXD, we rolled up our Dec $22.50 calls (PXDLX) to the January $20 calls (PXDAD). For APA, we rolled up our Dec. $85 calls (APALQ) to the Jan. $80 calls (APAAP). For BBG, we rolled up our Dec. $25 calls (BBGLE) to the Jan. $22.50 calls (BBGAX). For DVN, we rolled up our Dec. $80 calls (DVNLP) to the Jan. $75 calls (DVNAO).

In Update #623, we issued instructions for subscribers who sold XOAXB, XTOLH, COPLH, APCLH, and EACLH. We allowed the options to expire, and kept the premiums.

In Update #624, we issued hedging instructions for subscribers who own APC, COP, EAC, and XTO. For APC, we sold the Jan. $40 calls (APCAH). For COP, we sold the Jan. $55 calls (COPAK). For EAC, we sold the Jan. $22.50 calls (EACAX). For XTO, we sold the Jan. $40 calls (XTOAH).

to bring inflation under control. (Remember the farmers and others marching on Washington, calling for his head?)

No, the Fed is creating a monster today. One that's going to rampage for a long time, once he's finally unleashed.

Does this scenario seem far-fetched? It shouldn't.

Just look at what's going on Washington today, before the inflation has even arrived…

The Pigs Are Lining Up at the Trough

President-elect Obama has said the economy is the most important thing on his agenda. He's promised another "stimulus package" as soon as he takes office. This would consist of tax-rebate checks, child credits, and maybe even payroll-tax relief.

Originally, he wanted a package of $150 billion. Then it was $200 billion. Then $300 billion. Today, $600 billion is now a "very low-end estimate," according to Obama's team.

The *Wall Street Journal* reported that Obama is now planning for up to $1.2 *trillion*: "$600 billion in the first year and $300 to $600 billion in the second, depending on economic conditions in 2010." (This from the man who complained about "swelling budget deficits" during the campaign.)

And that's just *one* of the bailouts that are coming. Another huge one has been promised to the state governments.

Forty-three states are in financial trouble. The worst is California, with a staggering $31.7 billion deficit. Governor Schwarzenegger said the state will run out of cash in February.

Other states are bleeding too. New York is facing a $6.4 billion shortfall. Florida's budget is $5.1 billion in the red. New Jersey, Arizona, Massachusetts, and Virginia are all in deficit by more than $2 billion each. The '$1 billion deficit club' includes Georgia, Illinois, Nevada, and Ohio.

And that's just part of the money the states are begging for. According to the National Governors Association, the state governments also need $136 billion for infrastructure projects (roads and bridges)… $40 billion for Medicaid funding… $2 billion for unemployment benefits… $3.5 billion for college grant deficits… and more.

According to Senate Majority Leader Harry Reid, the state bailout will be about a half-trillion dollars. Reid and House Speaker Nancy Pelosi have pledged to get a package together by Obama's inauguration on January 20th. (And Obama has promised to sign it.)

But wait, there's more. Earlier this month, the US Conference of Mayors also went hat-in-hand to Congress. The mayors presented their own wish list: 11,391 important infrastructure projects that are "ready to go" as soon as Washington ponies up the $73,163,299,303 to pay for it all.

You might think that "infrastructure" refers to roads and bridges, but you'd be wrong. No, we're talking about vital projects like these:

- A "Waterfront Duck Pond Park" in Hercules, California. Cost: $2.5 million (not counting the $200,000 Hercules wants for a dog park).
- A senior center and aquatic facility in Euless, Texas. Cost: $15 million.
- A $9.5 million sports complex, which is desperately "needed" by Natchez, Mississippi in order "to host major regional and national sports tournaments."
- A $20 million sports field complex in Henderson, Nevada.
- A $15 million sports park in Brigham City, Utah.
- A $4 million expansion of the tennis center in Arlington, Texas.
- A $15 million "tennis center and day care" facility in Miami, Florida.

...and the list goes on and on.

Is this list stuffed full of pork? Absolutely. Will

Congress pay for it anyway? What do you think?

Then there are private-company bailouts. President Bush has announced a $17.4 bailout to the auto industry. Some analysts say the eventual cost will be as high as $125 billion.

Meanwhile, other industries are awaiting their turn at the trough. The latest group of beggars comes from the life insurance industry: Prudential, Hartford, Lincoln National, and Genworth Financial are all asking for money from the TARP program.

And none of this even addresses the real problems in this country. For example, according to the Reason Foundation's Annual Highway Report, some 24 percent of US bridges are either structurally deficient or functionally obsolete, and need to be repaired.

So you can add hundreds of billions more to the multi-trillions of dollars that will be printed to pay for all this.

We're watching history being made, right in front of us. This will be a hyperinflation for the history books. Just like Rome debased its money 2,000 years ago… just like the Weimar Republic turned its currency into toilet paper… so will this period in US history be remembered in the future.

I'm not alone in recognizing this, of course. Nor am I alone in expecting gold to hit multiples of its current price. And that's the reason why…

Don't Expect Stocks to Turn Around Before 2009

December is usually a tough time for stocks. There are several reasons for this:

- Tax-loss selling. If you have a loss in a stock, you need to sell it to realize the loss for tax purposes. Obviously, there are a lot of investors sitting on losses right now.
- Mutual fund redemptions. Investors also sell mutual funds at this time of year for tax purposes.
- Mutual fund capital gains. A mutual fund might have capital gains even if the overall fund is down for the year. Investors can get hit with unexpected tax bills.
- Hedge-fund problems. Many hedge funds are down for the year. In many cases, this means their managers are basically working for free until the fund comes back up. Since this isn't likely to happen, we're probably going to see some hedge funds close down soon and liquidate their holdings.

Also, thanks to the holidays, trading tends to be thin this time of year. This amplifies the effect of pressure in either direction.

Summary: stocks will have a tough time through the end of the year.

Explosive Gold Demand Just Shattered its Previous Record

Gold demand hit an all-time record last quarter: 1,133.4 tonnes of gold. In dollar terms, this is up a staggering 45 percent from the previous quarter—which was itself a record.

Investment demand and jewelry demand are both soaring. During one five-day trading period in the quarter, $7 billion poured into the gold ETFs (exchange traded funds) alone.

Meanwhile, physical gold supply is down by almost 10 percent from last year. The World Gold Council reports that "shortages of bars and coins" have been reported by bullion dealers in many parts of the world.

A report from Saudi Arabia revealed that investors there are buying $3.5 billion in physical gold <u>every two weeks</u>. A Saudi gold market expert told a regional newspaper, "Many Saudi investors see this as the right time for making investments in gold as the price is the most reasonable one at present."

Even though gold is below its previous high from March, the average price for the quarter ($872/oz) was 28% higher than Q3 2007's $680/oz.

The exciting part is that even the mass media are starting to pay attention to this.

As the *New York Post* recently reported...

"Governments can't handle global run on gold coins"!

The article in the *Post* affirmed what I've been saying in *GEA* for months. If you want to get gold, do it now, because it's getting extremely scarce. Many dealers have been cleaned out completely.

As the article reported, "There's a worldwide run on gold coins… A spokesperson for the US Mint tells me that gold coins in this country, for the past month, 'are being allocated because of an increased demand'…

"Robert Mish, a coin dealer in Menlo Park, Calif., says customers who want to purchase 200 gold coins often have to wait up to two weeks. Six months ago, he said, a purchase that size could have been filled immediately. Someone who recently tried to purchase 100 one-ounce American Eagle coins in the New York City area was turned away."

A month ago, Australia's Perth Mint stopped accepting new orders. Potential customers were told to try again in January.

So why hasn't gold's price broken through to new highs, if it's in such a shortage? Because the "spot" price is, in some ways, an illusion. It reflects the trading of paper contracts on the NYMEX exchange, not the reality of the physical gold market.

In the real world, gold bullion is becoming scarcer than an honest governor in Illinois. If you don't already have 15 percent of your portfolio in gold, I recommend you take care of this before the end of the year.

Which brings up one last question…

'The Next Terror Attack on the US will originate from Pakistan'

That's the conclusion of a recent report by the Congressional commission on weapons of mass destruction and terrorism.

The report specifically cited the northwest part of the country (Pakistan's Federally Administered Tribal Areas) as the likely launching ground for the next major attack. Al-Qaeda and other terrorist groups not only have a haven there, they're being actively supported by the Pakistani ISI (intelligence service) and radical Islamic population.

The head of the panel, former Senator Bob Graham, described Pakistan as "the intersection of nuclear weapons and terrorism," and warned that "terrorist organizations are intent on acquiring nuclear weapons."

But the worst danger, he said, isn't nukes—it's biological warfare.

Bioweapons are cheap, and easier to use than a nuke would be. Not only that, they're a lot easier to obtain.

As Senator Graham explained, "Anthrax is a natural product of dead animals. Other serious pathogens are available in equally accessible forms… There are so many scientists who have the skills to convert a pathogen from benign, helpful purposes into an illicit, very harmful weapon."

As he told CNN, "The consequences of a biological attack are almost beyond comprehension. It would 9/11 times ten or a hundred in terms of the number of people who would be killed."

He mentioned the flu epidemic of 1918, which killed 40 million people. He also pointed out that this deadly flu pathogen—the same one that killed 40 million people—had gone extinct, but has now been re-created in the laboratory.

Senator Graham said terrorists are likely to attack with a weapon of mass destruction within the next five years. Let's hope he's wrong.

Why Don't I Recommend a Portfolio of 100 percent Gold?

If I really believe in gold so strongly, why does the *GEA* portfolio contain stocks and options? Why don't I recommend a portfolio that's 100 percent committed to gold?

The answer is simple. It would be extremely foolish to base your entire portfolio on just one asset class.

No matter how certain the future seems, the market will always surprise you. (As the saying goes, the market trades in the direction that will cause the most pain to the most people!)

I strongly recommend a portfolio made up of 15 percent physical gold. This is enough to not only provide "wealth insurance," but also to create huge profits in the event of hyperinflation or other events.

And that means physical gold in your portfolio. Not mining stocks… not gold certificates… not ETF shares. Physical gold.

The rest of your portfolio can be more conventional asset classes. Here in *GEA*, we'll continue to recommend carefully-selected stocks and options to take advantage of market trends and other opportunities. We also have the *Gold & Energy Options Trader* service for more aggressive, and potentially more lucrative, trading strategies.

Yes, here in the *GEA* monthly issues I tend to talk more about gold than other investments. That's because I know most investors are fully invested in stocks and financial instruments. Very few own any gold at all.

This means they are exposed and vulnerable to whatever market disruptions come along. But if 2008 has taught us anything, it's that you must be prepared for any economic possibility.

So if you haven't protected your wealth yet with gold… do it now!