

GOLD & ENERGY ADVISOR

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“The profits are already rolling in!”

“Just one month into the new year—and more importantly, one month into the new *GEA* portfolio—we’ve already taken in \$1,384 in cash flow (including \$378 in locked-in option profits).

“I’m frequently asked how we get such market-beating returns, year after year. (Since inception in 2004, *GEA*’s cumulative returns are an impressive 233.1 percent—an average of 29.1 percent per year.)

“As we ramp up our new portfolio—which I expect to be very lucrative—this is a great time to discuss how we do it, and how *you* can get the most out of your investing as well!”

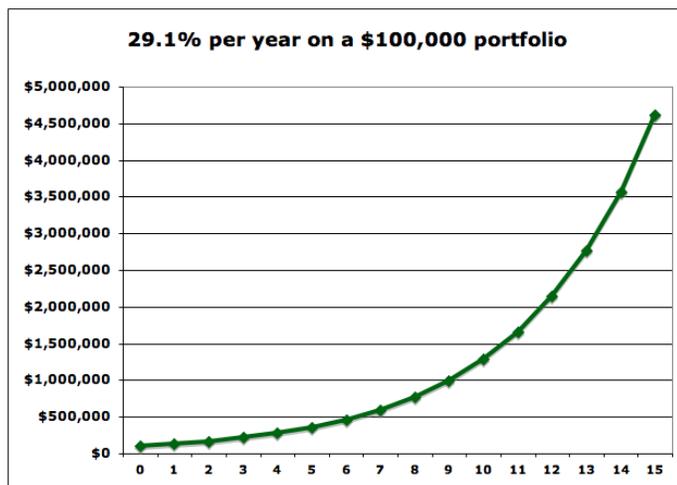


James DiGeorgia, Editor

What could you achieve with a 29.1 percent return, year after year?

Well, that depends on how much you start with. Let’s assume you start with a portfolio of \$100,000.

Starting with \$100,000, an annual 29.1% return with all proceeds reinvested would give you \$1.28 million dollars after just ten years.



And as you can see, waiting just 5 years more brings you up past \$4.5 million.

Most conventional advisors would tell you that a 29.1% return is absurd—and it is, when you use

their investing approach. But as I said earlier, that’s the average we’ve achieved for eight years running.

And it’s worth noting that those eight years included some of the most brutal market conditions in living memory.



From mid-2007 to early 2009, the S&P 500 was slashed by more than one-half its value. After clawing partway back, it crashed by 15 percent, recovered, and then crashed again by 19 percent (from which it’s still trying to recover).

So why have we done so much better here in *GEA*? More specifically, how can you achieve these results in your portfolio?

Our ‘Secret Recipe’

The *GEA* approach has many important nuances, of course. As I’ve discussed before, an overview of our approach is to:

1. Ride the biggest trends, and buy the best stocks within them
2. Buy on weakness
3. Hedge on strength
4. Use smart option strategies to harvest a continual stream of cash flow into your account. (In other words, get paid to own stocks. Few other advisories explain how to do this.)
5. Minimize risk, and if the markets do go against us, use our repair strategies to minimize losses and turn losers into winners.

Now that we’re starting a new *GEA* portfolio—the third in our history—it’s worth revisiting our approach. We’ll begin with our goal to...

Ride the Biggest Trend

Back in 2004, with oil at \$35, I predicted it was headed to \$100. (I later revised that prediction to \$150.)

People thought I was a lunatic... until oil hit \$147 just four years later.

Of course, it sank back down when the financial crisis hit in 2007. But that was temporary. Today, even while the West wallows in recession and Europe teeters on the brink of a banking meltdown, oil is solidly at \$100 again.

Sometimes *GEA* readers ask me if oil really has much potential left. It’s come so far already.

My answer is yes. Although the first leg of the oil bull is behind us, I believe oil will have at least one more run up, for a list of reasons. In the November issue, I discussed these:

- The decades-long (since the early 1990s) failure of the oil industry to replace production with new reserves. Most new discoveries are natural gas.
- The deception about how much oil the OPEC nations actually have.
- The failure of supply to keep up with

demand. According to BP, production falls short of demand by 5.3 Mbpd (million barrels per day). The deficit is being filled by the drawdown of existing reserves (along with “non-petroleum substitutes”), but they can’t last forever.

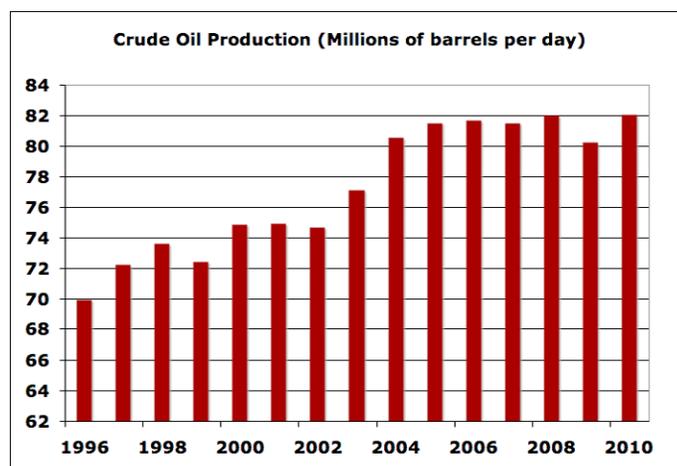
- The failure of unconventional sources to provide enough cheap oil. There’s plenty of non-conventional petroleum in the world, but it’s all very expensive to obtain and convert into usable products.

In addition to these, some other information is now coming to light about a disturbing aspect of the oil market...

Oil Production Is No Longer Responding to Price

In a healthy commodity market, as demand goes up, production will increase. This is *not* the case with oil today.

Even though oil has doubled in price since 2005, oil production has not responded.



Note that production does respond when the price drops. (At lower prices, marginal production is no longer profitable, so production falls.) But when the price rises again, production can’t follow. It’s been unable to break through 82 Mbpd.

This is not to say that higher production is impossible. But for production to grow, major investments need to be made to bring down the costs of marginal supplies.

Prices have not yet been high enough for long enough to make this possible. Investors and companies need assurance that prices will be

sustainably high at the time production occurs.
And while production has stalled...

Demand Threatens to Overwhelm the Market

Global demand is currently 87.4 Mbpd (million barrels per day). According to the International Energy Agency (IEA), demand will rise 15% by 2035, so we'll need another 13.1 Mbpd.

That seems like a gross underestimate. Even during the ongoing global financial crisis, demand is rising by 1.5-1.6% per year.

Using this number, we'll need another 37.5 Mbpd by 2035.

But let's ignore this for the moment. Even with the IEA's low figure, the world is facing a crisis-level oil shortage.

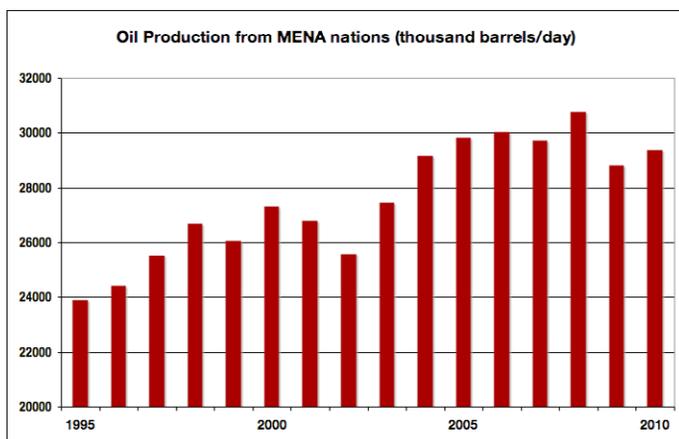
And even the IEA admits that the world has a tiny fraction of the oil needed. The only possible sources that remain are the MENA (Middle East and North African) nations.

As IEA Chief Economist Faith Birol recently said, "In the next 10 years, more than 90% of the growth in global oil production needs to come from MENA countries. There are major risks if this investment doesn't come in a timely manner."

This is a False Hope

The MENA countries have little additional oil to contribute to global supplies.

Optimists like to point out that MENA production has been growing:



Since 1995, MENA production has grown by about 5.4 Mbpd (million barrels per day).

But this is grossly inadequate to meet world needs. It's an average of only .36 Mbpd per year.

By 2035, this is only 8.64 Mbpd—almost 5 Mbpd short of even the IEA's Pollyanna predictions.

This isn't a surprise to anybody who's been paying attention. Oil analysts have known for a long

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time that large increases from most of the oil-rich nations were very unlikely.

First, most of the world's reserves have been nationalized (whether officially or not). And post-nationalization, oil production almost always goes down.

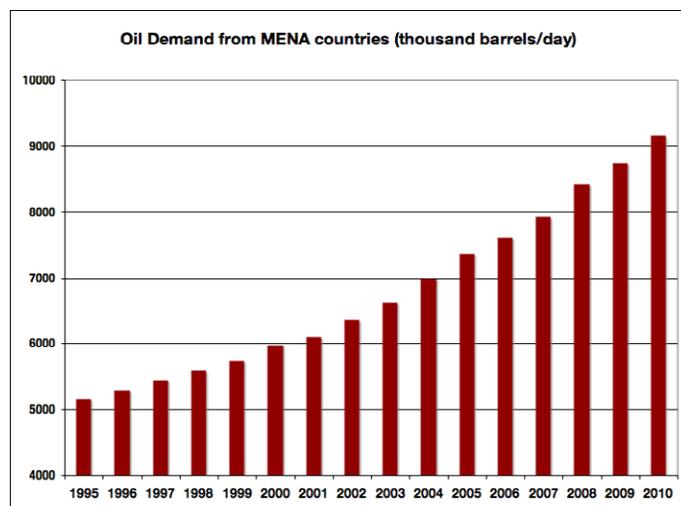
After nationalization, Western corporations are chased out. They take their expertise with them. The government stooges that take over usually drive the industry into the ground.

We've seen this over and over again. With the exception of Saudi Arabia, output from all the other nationalized oil industries (such as Iran, Venezuela, Mexico...) plunged after Western companies were kicked out.

And here's something else that the optimists are carefully ignoring. Along with production,

MENA demand is rising too.

It went up by 4 Mbdp during that same period:



Portfolio Update

In Update #1241, we moved our hedged position in Forest Oil (symbol FST) to the new *GEA 3* portfolio. We also recommended buying 100 shares of Talisman Energy (TLM), and selling the TLM Feb. \$11 puts (symbol TLM120218P11), for which we received \$37.

In Update #1243, we recommended selling the Devon Energy Feb. \$55 puts (DVN120218P55). We received \$120.

In Update #1245, we issued two new recommendations. On Newfield Exploration (NFX), we sold the Feb. \$35 puts (NFX120218P35). We received \$130. On Bill Barrett Corp. (BBG), we sold the Mar. \$30 puts (BBG120317P30). We received \$125.

In Update #1247, we issue two new short put recommendations. On Conocophillips (COP), we sold the Feb. \$70 puts (COP120218P70). We received \$134. On Magellan Midstream Partners LP (MMP), we sold the Apr. \$62.5 puts (MMP120421P62.5). We received \$75.

In Update #1248, we sold the Feb. \$40 puts (BRY120218P40) on Berry Petroleum (BRY). We received \$137.

In Update #1250, we sold the Feb. \$41 puts (BP120218P21) on British Petroleum (BP). We received \$55.

In Update #1251, we sold the Feb. \$85 puts (APA120218P85) on Apache Corp. (APA). We received \$125.

In Update #1253, we took profits on two put contracts. On Newfield Exploration (NFX), we bought to close the Feb. \$35 puts (NFX120218P35). Our profit was \$50 in 14 days. On Devon Energy

(DVN), we bought to close the Feb. \$55 puts (DVN120218P55). Our profit was \$70 in 16 days.

In Update #1254, we took profits on our BRY Feb. \$40 puts (BRY120218P40). Our profit was \$52 in 12 days.

In Update #1258, we sold the March \$45 puts (WLL120317P45) on Whiting Petroleum (WLL). We received \$230.

In Update #1260, we issued hedge instructions for subscribers who own Forest Oil (FST) and Talisman Energy (TLM). On FST, we sold the Feb. \$15 calls (FST120218C15). We received \$45. On TLM, we sold the Apr. \$13 calls (TLM120421C13). We received \$60.

In Update #1261, we issued new short put recommendations on Hess Corp. (HES) and Devon Energy (DVN). On HES, we sold the Mar. \$57.50 puts (HES20317P57.50). We received \$187. On DVN, we sold the Mar. \$62.50 puts (DVN120317P62.50). We received \$212.

In Update #1262, we issued new short put recommendations on Sandridge Energy (SD) and Canadian Natural Resources (CNQ). On SD, we sold the June \$6.00 puts (SD120616P6). We received \$71. On CNQ, we sold the Mar. \$35 puts (CNQ120317P35). We received \$50.

In Update #1264, we took profits on our puts on WLL, APA, and SD. On WLL, we bought to close the March \$45 puts (WLL120317P45). On APA, we bought to close the Feb. \$85 puts (APA120218P85). On SD, we bought to close the June \$6.00 puts (SD120616P6). Our total profits were \$206.

So on a net basis, all the MENA countries combined have increased production by a mere 1.4 Mbpd in 15 years.

Again, this alarming statistic wasn't a surprise to some of us. It's perfectly consistent with the work of Dallas petroleum consultant Jeffery Brown. He was among the first to realize that...

Oil Exporters Make Global Supply/Demand Trends Worse

Many analysts tend to treat the world's oil market as one cohesive unit. This seems reasonable, because crude is fungible and it's traded across international boundaries.

But this type of analysis has a fatal flaw. Oil prices aren't the same for everybody. Petroleum is cheaper for consumers within oil-producing nations than for those within oil-importing nations.

Brown realized that this has a major impact on the markets, especially for predicting global supply and demand trends.

Within oil-producing nations, demand tends to inflate above its normal levels, because locally-produced oil is cheap. In effect, local users get it 'wholesale' (especially for producing nations that have nationalized their industries), while importing nations must pay 'retail'.

So within an oil-producing nation, crude becomes a primary source of energy. In all its uses (heating, transportation, chemical feedstocks, fertilizers, and so on), crude becomes a vital part of the producer's economy. Local demand for it grows year after year.

This is fine as long as production remains strong. However, production will eventually peak and fall. And Jeffery Brown discovered that when the peak occurs, the local economy's demand doesn't decrease as you might expect. The opposite occurs: since cheap oil is still available locally, demand usually continues to *increase* instead.

The fall in production, combined with rising local demand, means that exports fall quickly—much more rapidly than we'd other-

wise expect.

Brown did some numerical modeling of this effect. The results are ominous for oil importers like the United States.

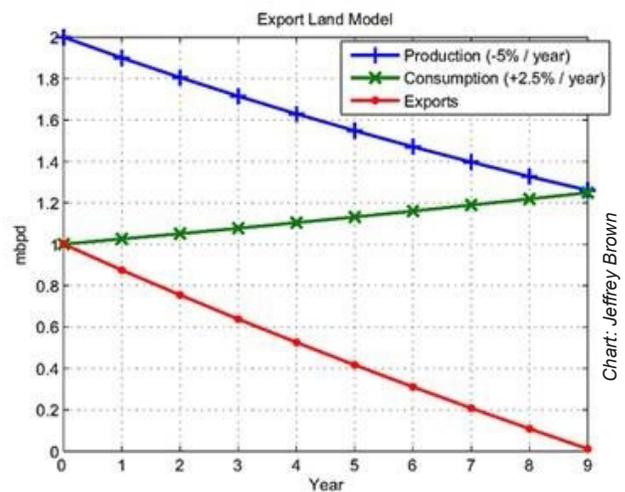
The "Export Land" Model

Let's model an oil-exporting nation ("Export Land") as follows. It uses half its production locally, and sends the rest abroad. Local consumption is growing at a modest 2.5 percent per year.

This year, Export Land's production peaks. From now on, production will be less every year. The decline is a modest 5 percent per year.

How long will it be before Export Land stops exporting oil to the rest of the world?

Answer: only nine years.



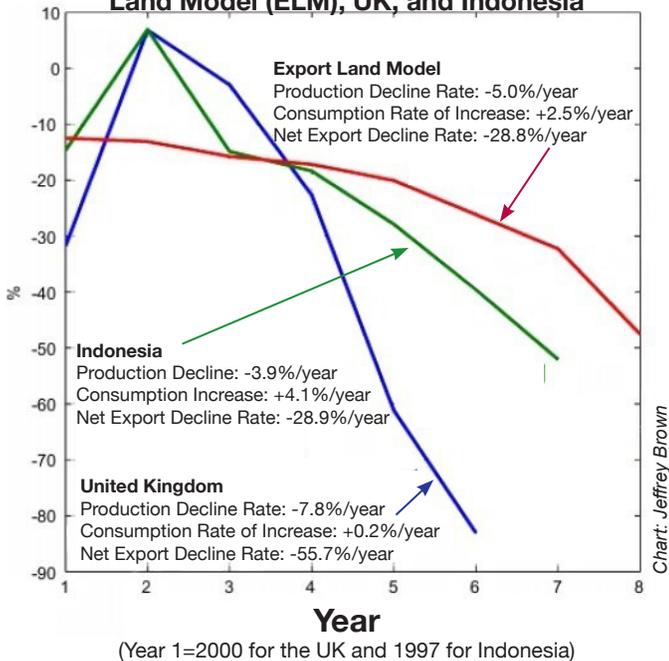
As Brown commented, "Only 10 percent of all post-peak production is exported... I was flabbergasted at how quickly exports went to zero."

Brown then investigated how well this model describes the real world. He analyzed two significant oil exporters: the United Kingdom and former OPEC member Indonesia.

(These two countries were chosen because they represent extremes of the variables involved. Indonesia is a developing country with growing consumption, a low rate of production decline, and a subsidized oil industry. The UK is industrialized with little growth in consumption, a high production decline, and a heavily regulated and taxed industry.)

Here are the results.

Year over year change in net exports for the Export Land Model (ELM), UK, and Indonesia



The red line shows the hypothetical Export Land model. The green and blue lines show the actual figures for Indonesia and the UK, which were both worse than the model results.

Indonesia went from peak oil production in 1997 to zero exports in just eight years. The UK went from peak production in 2000 to zero exports in a mere seven years.

Note how abruptly exports collapsed once these producers peaked. As Brown commented:

“I’ve compared a typical production decline profile to a commercial airliner doing a normal gradual descent for landing. An export crash, like the UK and perhaps Mexico, looks more like a terrifying near vertical dive into the ground.”

Why This Is Important Today

The top five oil exporters today are Saudi Arabia, Russia, Norway, Iran, and the United Arab Emirates. Combined, they account for almost half of global net exports.

Of these, Norway has already peaked. So has Iran. Russia is declining, and appears to be post-peak. As for the Emirates, they might be peaking right now.

That means that at least three, and possibly four, of the world’s top exporters are struggling to maintain export levels.

Whether these nations’ exports collapse soon or not, it’s clear that this is an additional source of pressure on global oil supplies.

Add up everything we’ve discussed so far, and it’s small wonder why...

Global Production Has Flatlined

Even though crude oil prices have doubled since 2005, global production has hardly

Saudis Can’t Increase Production

The only nation in the world today with any spare oil production capacity is Saudi Arabia. Unsurprisingly, most mainstream analysts are expecting the Saudis to increase production to satisfy rising demand.

But the Saudis themselves say otherwise. They don’t plan to increase production.

Question: is it because they don’t *want* to increase production, or because they *can’t*?

They’d like us to believe it’s the former. The *Wall Street Journal* quoted Khalid Al Falih (CEO of Saudi Aramco) who said, “There is no reason for Saudi Aramco to pursue 15 million barrels.” He made a bizarre excuse about “too many announcements” of new finds from Brazil and Iraq, and said, “The market demand is addressed by others.”

This is one of the lamest excuses on record. This is like the CEO of Coca-Cola saying that even though demand for soft drinks is skyrocketing, he won’t increase production, because Pepsi can make as many beverages as people want.

The Saudis are famously secretive about their oil industry, but as I’ve reported in past issues of *GEA*, enough information has leaked out for us to know that the Saudis couldn’t increase production beyond 13 Mbpd or so, even if they wanted to do so.

Judging by their lame excuses, this assessment is 100% accurate.

budgeted. This imbalance will drive prices to far higher levels than they are currently.

That being the case, we need to know the best way to ride the trend. And that returns us to our previous discussion about...

The \$1,384 We've Already Received in Cash Flow Into the New Portfolio

The *GEA 3* portfolio is only a month old, and we've already issued over a dozen recommendations in the portfolio. More importantly, we've already taken in over \$1,300—even though we have yet to buy a single share of stock.

If you're a new subscriber, this might seem odd to you. So here's what's going on.

If you invest in the conventional way (or in other words, if you take the typical advice that's peddled in the financial media), you would usually buy stocks and/or mutual funds and wait—usually for many years—for your investments to grow.

But if you do this, you're losing a tremendous amount of money.

Here in *GEA*, we like to make profits in three different ways:

1. When we buy
2. When we sell
3. And at all times in-between.

We do all three with stock options, using both calls and puts. If you're unfamiliar with options, see the sidebar to the right. Then read on for a quick overview of our strategies.

Profits When We Buy

How much easier would it be to get high returns on your portfolio, if you got paid 10-25 percent of a stock's price, before you bought it?

In effect, you'd be buying stocks at a 10-25 percent discount.

Sometimes you don't even have to buy the stocks. You just sit back and collect the money.

Options

A stock "option" is a contractual agreement that gives the buyer an option to buy or sell a particular stock at a particular price by a particular date.

Calls give the buyer the right (but not the obligation) to buy the stock from the seller. Puts are the opposite: they give the buyer the right (but not the obligation) to sell the stock to the seller.

For calls, if at expiration the stock is priced higher than the call's strike price, the call is worth the difference. Otherwise the call expires worthless, and the seller keeps the premium that was paid. Puts work the same way, except that they are 'in the money' when the stock is priced lower than the puts' strike price.

Both calls and puts are sold in contracts of 100.

Options trade at smaller prices than the underlying stocks. Therefore, many investors use options as a form of leverage. They can control a greater number of shares for less money than if they bought (or sold) the shares outright.

Most options expire 'out of the money'. In *GEA*, we usually sell ("write") options rather than buying them. Among other things, this allows us to keep almost all of the premiums we collect.

In *GEA*, we often find a stock that we would like to buy, but at a price lower than it currently is. In this case, we'll sell a contract of puts against the stock.

If the stock price dips down to the put strike price, the puts will be exercised and we'll automatically buy the stock. If the price never gets down that far, we'll just keep the money.

For example, in Update #1262, we recommended selling a put on Sandridge Energy (symbol SD). The stock is attractive, but we preferred to open the position at below its then-current price of \$8.14.

So we sold one contract of the \$6 puts for \$.71, and received \$71 into our account (100 puts at \$.71 each).

If on the expiration date, SD has moved

below \$6, we will automatically buy it at that price.

Since we already received \$.71 per share, we are effectively buying it at $\$6.00 - \$.71 = \$5.29$. That's a 35 percent discount from its price when we decided to buy it.

If the price doesn't go down that far, we keep the money instead. We win either way.

A third possibility is that we'll decide to 'buy back' the put before it expires. This will close out our position. (In fact, as *GEA* goes to press, we just bought back the SD puts to lock in our profits.)

Profits when we sell

We also use options to sell stocks at a premium to the market price.

Instead of merely selling the stock, we sell calls at the strike price that we want to get for the stock. We did this when closing out some of our *GEA 2* positions.

If the stock is at or above that price on the expiration date, we get that price, plus we keep the cash we received from selling the call.

If the stock hasn't reached that price, we just keep the cash—and the stock.

Profits While We Own Stocks

We use options to receive a regular flow of cash into our account. This allows us to profit even if the stocks themselves go up very little—or not at all.

The key to keeping the cash without having the stocks called away (i.e., sold) is to choose the strike price to be well above the current price of the stock. The higher the price, the less likely that the call will be "in the money" and exercised upon expiration.

Even the call gets exercised, the 'worst' thing that happens is that we sell the stock for a high price (plus the premium we received for selling the call).

The Secret to Our Success

Options are responsible for a large part of our success in *GEA*. Since October 2008, we've received \$8,582 from selling puts, and \$11,179 from writing calls. That's an average cash flow of about \$550 per month—all for placing a few trades in your brokerage account or making an occasional phone call to your broker.

How to Achieve These Results in Your Portfolio

It's easy—just implement our recommendations. In each recommendation, we give you exact instructions to pass along to your broker. For less than 10 minutes or so on the phone each month, your portfolio can receive the same returns as ours.

Don't pick and choose—implement all the recommendations, including the options trades. We've achieved a 29.1 percent return per year (on average) by harvesting a continual flow of cash and profits into our portfolio. If you try to pick and choose, you'll lose a lot of profits.

A Ground Floor Opportunity

The first *GEA* portfolio rode oil prices up from \$35, and made 144.33 percent. The second portfolio took advantage of the massive hit that oil stocks took from the financial crisis, and made 88.76 percent.

Now we're ramping up to do it again. For a variety of reasons, many oil stocks are down again—temporarily, I believe. If you're a new subscriber to *GEA*—or even if you've been with us for a while, but haven't been following our recommendations for whatever reason—now is the time to start.

Getting in at the beginning of a new portfolio is when the greatest profits are made. I expect the returns from *GEA 3* will be just as spectacular as *GEA 1* and *GEA 2*!