GOLD & ENERGY ADVISOR

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"Only Five More Months Until America Runs Off the 'Fiscal Cliff'..."

"And both political parties are proposing plans that would make things worse instead of better.

"Meanwhile, Fed Chairman Bernanke is running scared. He's supposed to be the economy's savior, but he's out of bullets—and he knows it.

"If you thought the crash of 2008 was bad, an even worse one is looming before us. Here's what's going on!"

James DiGeorgia, Editor

Don't be deceived by the laziness of late summer! Big changes are coming—to the US economy, to the global economy, and to your portfolio.

As always, those who prepare in advance will win. Those who don't will lose. This issue is dedicated to keeping you in the former group instead of the latter.

Let's dive right in, starting with...

Trouble Brewing for the 2012 Elections

Why won't Mitt Romney release his tax returns for 1999-2009?

Even conservatives are calling on Romney to release them and get this issue out of the media. Until he does, the Democrats have an easy club to beat him with, over and over.

But he's refusing.

Obviously, he's hiding something. The most likely skeletons in his closet are:

- He paid little, perhaps no, taxes during part of that time. (This looks less likely since his declaration that he paid at least 13 percent each year.)
- He's concerned that his considerable wealth will make him seem out of touch to the average American. (This looks less likely now that he's released his returns for 2010 and 2011. These showed an income over $20 million each year, almost exclusively from investment profits.)
- On some of his tax returns in the early 2000s, he listed himself as having direct managerial responsibility at Bain Capital—something that he now denies.

That last one is looking more and more likely. It would be extremely damaging to Romney. He'd immediately be marked as a "pioneer of outsourcing" American jobs to other countries—which would anger a large number of voters, especially since he's making American job creation one of the central issues of his campaign.

He'd also be revealed as a profiteer from the abortion-services firm Stericycle—which would outrage conservative voters.

No doubt, Republican bigwigs are secretly putting immense pressure on Romney to release the returns now, before the party convention later this month. Party officials want to know about all the skeletons in Romney's closet before they make him the official nominee for the party.

Since Romney hasn't buckled to this pressure, he must really be hiding something big.

This might be the issue that sinks the Republican Party's bid for the Presidency. If Romney doesn't release all the last 12 years of tax returns, the Obama campaign will hammer him relentlessly. It will be easy for the Democrats to portray Romney as a slippery, power-hungry politician who's not being honest with the voters.

And if Romney does release them, then whatever he's hiding now will be used against him. If these revelations are big enough, it might even cost the Republican Party control of the House and Senate too.

Imagine what will happen if the Democrats control the White House <u>and</u> both houses in Congress. It would be the return of the Pelosi-Obama Runaway Spending Machine.

The scary thing is that a Romney Administration wouldn't be much better. After this election, regardless of whether Romney or Obama wins, we know what we're getting…

More Debt!

Both parties—Republicans and Democrats alike—are refusing to address our nation's financial crisis.

The Republicans won't raise taxes on the wealthy or cut military spending. The Democrats won't cut social spending—in fact, they want to increase it substantially.

Bottom line: we're going to see the US federal debt explode up to at least $20 trillion before the 2016 Presidential election occurs.

(That's the *best* case. If the Romney campaign blows up and the Democrats take full control of Washington, the debt could hit $25 trillion.)

Our federal debt is *already* more than 100 percent of US Gross Domestic Product. It works out to $135,500 per American household.

And both parties are offering fiscal plans that will <u>balloon the debt even further</u>.

Both parties have their heads firmly in the sand. There's no reasonable way to repay the debt we <u>already</u> have. Not in today's dollars, anyway.

The only possible solution is to outgrow it—to make the American economy so prosperous that the debt becomes a smaller portion of our economy over time.

But that's not happening either. At best, the US economy will be sluggish, with micro-levels of growth for the next several years.

At worst, there's the growing possibility that…

An Even Worse Crash is Coming

Lately in my interviews by the financial media, I've been focusing on our country's fiscal problems. I'm trying to warn investors about the inevitable consequences of US fiscal policy. "He that sows the wind, will reap the whirlwind"—and Washington's blowout spending has created a monster of a storm that's headed our way.

I'm not alone in recognizing this. For example, Peter Schiff is the CEO and Global Investment Strategist of Euro Pacific Capital. He correctly warned investors of the housing and financial crisis a year ahead of time, in his 2007 book *Crash Proof*.

On a recent episode of the financial show *Breakout*, Schiff said that the 2008 financial crash was only the beginning, and what's coming will be <u>far worse</u>—mostly because of the government's response to the 2008 downturn.

The US government responded to the 2008 crisis by bailing out financial institutions and other companies, propping up the housing market, printing floods of money, and racking up trillions of dollars in additional debt. As Schiff pointed out, this was only "so we could consume more stuff we can't afford, and pay for it with borrowed and printed money." It didn't actually solve any of the underlying economic problems.

Instead, "all we did is delay the day of reckoning." He continued that by printing a mountain of money and racking up huge additional debts, "we exacerbated all the problems that made the day of reckoning necessary…so <u>we've got a much bigger collapse coming</u>. And not just of the markets, but of the economy."

Economist and NYU Professor Nouriel Roubini has a similar view. He also called the 2008 crisis ahead of time. And he also believes that 2013 will be the beginning of serious trouble for the US economy.

Next year, about $1.4 billion of tax cuts and other "transfer payments" expire. This will be a large blow to US consumer spending and might be sufficient to torpedo our economy's recovery all by itself.

Meanwhile, China will be further along its current path of economic slowdown. Even more troubling, the European Union will be much further along its current path of eventual financial meltdown, as Spain and/or Italy begin to drown European banks in an ocean of red ink.

As Roubini told *Bloomberg*, "The problem is that every part of the world is kicking [the can] down the road to 2013... By next year, you could be in a scenario in which we hit a brick wall, and then [the] euro zone breaks up, in the US you have a fiscal cliff, in China the landing could be hard and in the Middle East you could have a war. That is a **perfect storm**."

Despite the growing number of experts who are warning about the future, most financial media commentators are unconcerned. They expect the Fed to ride to the rescue again.

But that won't work this time, because…

The Fed is Impotent

In today's economic environment, the Fed's policy tools are ineffective. Chairman Bernanke needs a rack full of economic bazookas, but all he has are spitwads.

Bernanke only has a few options. One is to cut the interest rate paid on excess reserves (IOER). In theory, this would encourage banks to start lending out their excess cash and juice the economy.

In practice, nothing would happen. The IOER is already at 0.25 percent. Reducing it to zero would make no difference.

Ditto for the Federal Funds Rate, which under normal circumstances is the Fed's biggest 'bazooka'. Since the Fed has already promised to keep rates at rock-bottom "through late 2014," that weapon has already been fired.

Plus, interest rates are already at historic lows anyway. Thirty-year fixed-rate mortgages are currently averaging 3.62 percent. Do you think that lowering them a little further would ignite a massive boom in US real estate? Hardly.

That leaves the Fed's "nuclear option": another round of Quantitative Easing (QE). But even here, Bernanke's gun is running out of ammo.

The first round of QE hit the markets when lending rates were high. It was a big surprise, greeted with wild enthusiasm. It lowered overall rates by an estimated 100 basis points.

But even though the Fed's balance sheet expanded by a staggering $1.4 trillion, QE still didn't resuscitate the ailing US economy. So QE2 was announced.

This time, it wasn't a surprise. Not only that, everybody now knew that QE was obviously far less powerful than everybody had expected, since the first round hadn't pulled our economy out of the dumps.

QE2 only lowered rates by an estimated 13 basis points. In economic terms, that represents the difference between 0 percent growth and a mere 0.13 percent growth.

In other words, for QE2 the Fed created and spent $600 billion to achieve "growth" that was little more than a statistical rounding error.

When the total costs are included, many analysts dispute whether QE actually did anything positive—including perhaps the most authoritative voice of all.

Former Fed Chairman Alan Greenspan said that as of July 2012, QE had had "very little impact on the economy."

He confessed to being "very surprised at the data"—including being "shocked" at how badly our exploding federal deficits are crowding out private-sector investing.

That last point is crucial. Greenspan discovered that when you add up ballooning federal spending, massive bailouts, multiple rounds of QE, and everything else, "the data are showing that it's <u>negative</u>" for the economy on a net basis.

Despite this, I expect Chairman Bernanke to announce another round of QE sometime soon. The political pressure for it has been building for some time.

But it won't work.

Greenspan knows this. Bernanke does too. But Washington will require him to do *some-*

thing, and this is the only tool left in his economic toolbox.

(This is something out of an ancient Greek tragedy. Bernanke built his academic career and public reputation around the idea that you could always print your way out of a recession. Now he's being forced to try it again and again, even after he himself has proven it to be a failure. Pity the man who is forced to humiliate himself like this.)

Anyway, what will happen once QE3 comes along? My prediction: we might get a small pop in the economy, but it won't last.

What *will* last is a plunge in the value of the dollar.

The US economy is extremely fragile right now. (More on this in a moment.) Any more QE or other forms of monetary intervention will push the dollar over the edge, and take our economy with it.

A weaker dollar means ballooning costs for imports and raw materials. This pummels profit margins for US businesses.

Falling profits means that businesses will reduce capacity, lay off workers, and raise prices. Now you have unemployment growing, while inflation rises.

Meanwhile, the government will collect less in tax revenue. At the same time, it will be spending more. This means the federal deficit will soar. (It's already at $1 trillion per year.)

Interest rates will shoot up. This means that debtors have to spend more just to service their existing debts. This will take a terrible toll on businesses and consumers.

For the US government, owing $15.7 trillion, this will be catastrophic.

Thus begins a downward spiral, where Washington's likely "solution" will be **more** QE. And the economy will swirl down the toilet bowl.

Peter Schiff believes that at that point, "We're going to have to slash, I mean <u>slash</u>, government spending, massively across the board, and restructure our debts." This includes:

- A partial default on US Treasuries, and "not paying 100 cents on the dollar" on outstanding US debt.
- "Being honest with people who are on entitlements like Social Security and Medicare—they're not going to get the benefits they've been promised."
- Slashing payrolls for government workers.

Even with all this, Schiff predicts a massive wave of bank failures. Investors and depositors alike are going to lose money.

Also, "the housing market is going to fall again. We're going to have to allow Fannie and Freddie to go bankrupt next time as well as the FHA and not bail them out."

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Some might say Schiff is too pessimistic, but if anything, the opposite is true. Here's why:

He assumes that Washington could actually have the political courage to implement steep spending reductions.

But I think our government is far too dysfunctional for this. I expect we'll see Schiff's other scenario instead:

"Alternatively we can bail everybody out and pretend that we can print our way out of the crisis, and instead we'll have runaway inflation or hyperinflation. [This] is going to be far worse than the collapse we would have if we did the right thing and just let it all implode."

This is the most likely outcome, because...

The US Economy Is Headed Off a Cliff

Just look at what we're facing today:

- **Unemployment is at Depression-era levels.** Officially, unemployment is at 8.3 percent—which is terrible enough. But the official statistics don't include the underemployed, like engineers working at McDonald's because they can't find real work. They also don't include those who have been unemployed for a long time, because these people are presumed to not want any work. When you include these people too, actual unemployment is at 22.8 percent.
- **Americans are growing poorer at an alarming rate.** According to the Fed's Survey of Consumer Finances, median household net worth has fallen more than 38 percent since 2007.
- **A shocking 46.4 million Americans are now on food stamps.** That's one out of seven. (It used to be 1 out of 50.)

And this is before we reach our "fiscal cliff"—the Financial Doomsday that will arrive on January 1, 2013.

On that day, here's what's going to happen:

- The Bush tax cuts automatically expire.
- The 2% payroll-tax reduction expires.
- The extension of unemployment compensation benefits will expire.

Added together, these represent a massive $440 billion tax hike.

That's about 3.1 percent of our economy, And this will arrive even as GDP is struggling to grow by even 2 percent. These expirations will drive the US economy deep into a recession.

But wait, there's more. In addition to all this, President Obama is also pushing for a bunch of new taxes, including boosting the top marginal rates up to 36 and 39.6 percent, limiting itemized deductions, taxing dividends as ordinary income, boosting capital gains tax up to 20 percent, raising the Medicare tax, and creating a new 3.8 percent tax on investment and business income.

According to a new analysis by accounting firm Ernst & Young…

Obama's Proposals Would Be Devastating to Our Economy

These new proposals are aimed precisely at the most productive sector of the economy—small business owners.

These taxes would simultaneously discourage saving, reduce capital investment into business ventures, and make labor more expensive for the business owner. This is a "perfect storm" for pounding the American economy down into deep recession.

The Ernst & Young analysis found that if Obama gets his way, we'll see:

- A 1.3 percent reduction in GDP
- A loss of 710,000 jobs
- A fall in capital stock and investment of 1.4% and 2.4%, respectively
- A fall in real after-tax wages of 1.8%, reducing workers' standard of living.

I've gone on record stating that the US government needs to increase revenue. But Obama's proposals are deeply flawed.

Meanwhile, Congress is too dysfunctional to produce real solutions to the financial crisis.

As JP Morgan recently said, unless Washington acts fast, we're going "head first into the fiscal meat grinder."

Despite all this, we shouldn't despair. I firmly believe our approach in *Gold & Energy Advisor* is one of the best possible ways to profit from market turmoil. We've done it before, and we'll do it again.

Which brings up a major new announcement...

A New Direction for *Gold & Energy Advisor*

As our name says, the purpose of *Gold & Energy Advisor* is to help you make high profits from precious metals and energy.

In a sense though, this is merely our secondary purpose. Our primary purpose is to help you make high profits from the biggest investment trends affecting the world, whatever they may be.

When I started *GEA* in 2004, gold and energy were among the biggest trends. They still are today. And so we will continue to focus on them, with the goal of maintaining or even surpassing our long-term average gain of 29.1 percent per year.

However, we're also going to add an additional focus. Along with precious metals and energy, I plan to address…

Portfolio Update

In Update #1359, we took quick profits on our short put on Conocophillips (symbol COP). We bought to close the August $52.50 short put (symbol OP120818P52.50). Our profit was $101.

In Special Report #098, we opened new positions on Magellan Midstream Partners (MMP) and Pengrowth Energy Trust (PGH). For MMP, we sold the $70 Sept. put (MMP120922P70). On PGH, we sold 2 contracts of the Oct. $6 puts (PGH121020P6).

In Update #1368, we took profits on our Apache Corp. (APA) short put. We bought to close the Aug. $90 put (APA120818P90). Our profit was $105.

In Update #1370, we hedged our position on Forest Oil (FST). We sold to open the Nov. $8 call (FST121117C8).

In Update #1372, we took profits on our MMP position. We bought to close the $70 Sept. put (MMP120922P70). Our profit was $80.

In Update #1375, we hedged Stone Energy (SGY) by selling the Oct. $26 call (SGY121020C26).

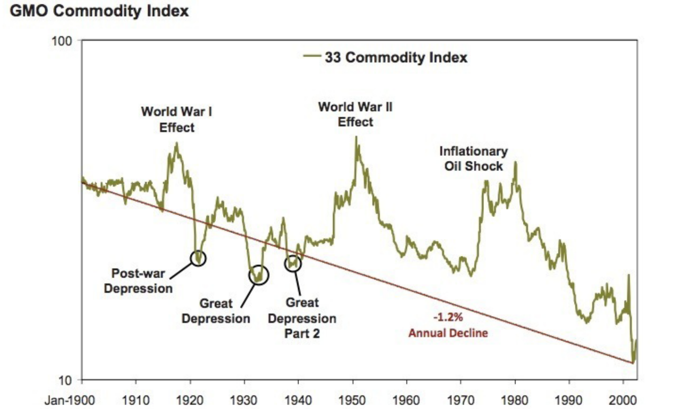
In Update #1377, we opened a new position on Devon Energy (DVN). We sold to open the Oct. $57.50 put (DVN121020P57.50).

In Update #1378, we hedged Total SA (TOT). We sold to open the Nov. $52.50 call (TOT121117C52.5).

Global Resource and Commodity Shortages

During the 20th century, worldwide commodity prices fell steadily. Except for temporary interruptions from war, oil shocks, and the like, commodity prices fell lower and lower by an average of about 1.2 percent per year.

GMO Commodity Index



Note: The GMO commodity index is an index comprised of the following 33 commodities, equally weighted at initiation: aluminum, coal, coconut oil, coffee, copper, corn, cotton, diammonium phosphate, flaxseed, gold, iron ore, jute, lard, lead, natural gas, nickel, oil, palladium, palm oil, pepper, platinum, plywood, rubber, silver, sorghum, soybeans, sugar, tin, tobacco, uranium, wheat, wool, zinc.

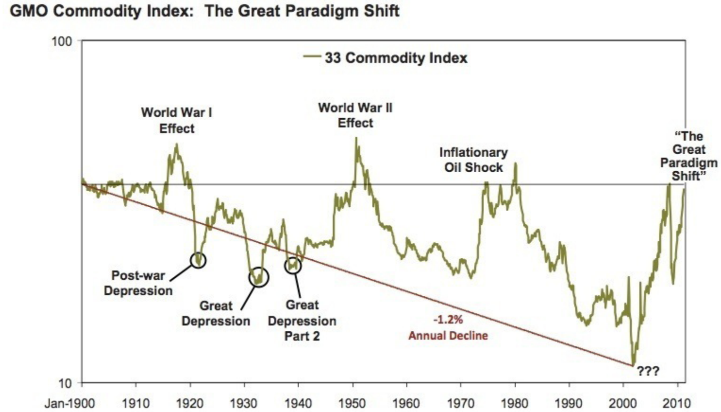
Source: GMO

This is all the more remarkable when you realize that world population grew from about 1.7 billion in 1900 to over 7 billion today—and demand for commodities grew accordingly.

This means technological advancements and increasing abundance of cheap energy made commodity production costs fall even more quickly than commodity demand was rising.

Then this trend was suddenly shattered:

GMO Commodity Index: The Great Paradigm Shift



Source: GMO

As you can see, a decade ago commodity prices reversed sharply and shot upward.

What happened? Several things.

Much of the reversal was politically driven. The collapse of the Soviet Union triggered the emergence of free-market economies in China and India. These two countries alone account for over one-third of the entire world's population. And they've both been growing explosively, sending world commodity prices skyrocketing.

In addition to politics, there are physical factors. Commodity prices are directly related to the cost of production, which in turn is directly related to the price of energy. Starting from the early 2000s, the price of crude oil more than quadrupled in less than a decade.

There are other factors as well. Add them up, and we see why commodities have soared.

Unfortunately for many people, this includes the prices of the most essential food commodities. Prices of staples like grains and legumes have shot up.

Most people in well-fed America are oblivious to this, but for the last five years or so, much of the world has been in a food crisis. Poorer nations are having difficulty getting sufficient food for their populations.

We're seeing the fallout from this already. Many analysts believe food shortages were a key reason for the unrest in the Middle East that resulted in the "Arab Spring" and the toppling of several governments.

For example, food now accounts for about 40 percent of the average household budget in Egypt. Situations like this create extreme social pressures. (Small wonder that Mubarak got overthrown.)

As a result, more and more analysts are making grim predictions about the world's future supply of food.

Things are likely to get worse instead of better—much worse.

There are several reasons for this.

The most obvious reason is the ballooning global population. In the last ten years, world population has grown by <u>one billion.</u> Every day, more people are added to our planet.

Second, rising energy costs will continue to drive up the costs of producing and transporting foodstuffs to market.

Third, modern farming methods have greatly increased the amount of food produced per acre, but we're now at a point of steeply diminishing returns. For example, grain productivity growth in the early 1970s was at 3.5%. It's fallen steadily since then, and is now only 1.5%. If we want more food, we'll have to farm more land. But the amount of arable land that's not already being worked is low.

Fourth, fresh water is growing increasingly scarce in many places.

Fifth, modern farming is very expensive. Most regions of the world cannot afford to use modern agricultural techniques and fertilizers. They're limited to older methods that are far less productive.

Sixth, many regions of the world are experiencing declining soil quality. In some cases, this is reversible, although it will take several years (and an expensive switch from chemical-based farming to organic methods). In other cases, soils are growing increasingly saline, which is not reversible in the short term.

Lastly, as the middle class grows in developing countries (especially China and India), demand for meats is soaring. This means an exponential increase in demand for grain. (It takes 16 pounds of grain to produce 1 pound of beef.)

These are all long-term trends. And it's possible that some of them will be lessened by advances in crop genetics. (Agricultural scientists are especially interested in transferring high-productivity "C4" genes from plants like corn into the less-efficient "C3" plants such as rice and wheat. This will boost crop yields substantially.) But these advances are projected to take 20-30 years. Meanwhile, the global food crisis remains.

Here in the United States, we're unlikely to have food shortages. The productivity of our Midwest means we'll remain net exporters for years to come. Nevertheless…

Malnutrition and starvation are already serious problems around the world. These will grow more severe in the years to come.

This has implications for us as investors.

First, with a trend this large, we should profit from it. This doesn't mean we're profiteering from starvation. After all, the trend will occur whether we invest in it or not.

It does mean that we have a responsibility to care for ourselves and our loved ones as best we can. That includes positioning ourselves in front of whatever trends we see.

(And if this still bothers you, the answer is simple. Make as much money as you can in the markets, then use some of it to help the hungry here in America.)

Second, food shortages can topple governments. This can cause large geopolitical changes in short periods of time. Obviously, this can affect your portfolio.

Third, as the food crisis grows more severe, some sectors and companies could be spectacular investments. For example, a growing concern in the agricultural industry is that Morocco has over 70 percent of the world's low-cost, high-quality deposits of phosphorus—which is a vital ingredient in fertilizer, among many other things.

There's still a lot of phosphorus in the world. But much of it is expensive to mine, or is laced with contaminants like uranium isotopes. As a result, <u>Morocco owns a larger percentage of the world's high-quality phosphate salts than OPEC does of the global oil supply</u>**.** And advisors to Morocco's King Mohammed VI are openly recommending that he exploit his near-monopoly and drive prices up.

Therefore, Western mining companies that can lock in access to good phosphate reserves should do very well in the future.

That's just an example of the type of opportunities that resource shortages will create. Looking forward, I expect to add some of the best of these to the *GEA* model portfolio.

So as I said, we'll be broadening our scope a bit in *Gold & Energy Advisor*. We'll still be covering gold and energy, but I'm also looking for other lucrative resource plays.

Meanwhile, let's wrap up by returning to our discussion of…

America's Financial Judgment Day

Global resource shortages are a long-term trend. But the United States is facing a clear and present danger right now.

Congress will accomplish little until after the November elections are done. Meanwhile, we're rushing toward the 2013 fiscal cliff.

It's doubtful Washington will be able to fend it off completely in the last few weeks of 2012.

Few things are certain in life, but here's one thing that is. You need to structure your investment portfolio around the assumption that the US government is going to borrow, spend, and "quantitatively ease" until the dollar is ruined.

At the same time, Europe is rushing towards its own version of the fiscal cliff. This muddies the water a bit. Many financial analysts are predicting that the dollar will rise, and gold will fall, as investors flee the trainwreck of the euro.

Yes, the dollar will probably rise temporarily.

But this doesn't mean gold is going to fall like the analysts say. The dollar only looks good because other currencies are turning into toilet paper. Once Washington starts doing the same to the dollar, all bets are off.

Sooner or later, investors will remember that for thousands of years, gold has been the epitome of wealth. It can't be printed, inflated, or "quantitatively eased." And when competitive currency devaluations begin around the world, global capital will start rushing into the yellow metal. Silver will leap up as well.

Even though it's only August, traders are already starting to mutter about January's fiscal cliff. Once the full implications sink in, precious metals could spike up just from this alone.

You've probably heard the old adage to "buy the rumor and sell the news." In other words, he who gets in ahead of the broader market, wins. He who waits, loses.

The smart money always gets into an investment long before the talking heads on CNN start yapping about it. By that time, it's too late.

That's why I'm telling my clients to add more gold and silver to their portfolios now. Whether or not Congress avoids the fiscal cliff in January, Europe is still on the brink of financial meltdown, the US is still running trillion-dollar deficits, and we're still in serious trouble for 2013 and beyond, regardless of who wins the elections in November.

As all these trends continue, can you imagine anybody in the future saying, "I wish I didn't own so much gold and silver"? I certainly can't! So draw your own conclusions, and do what you need to do to protect yourself.