GOLD & ENERGY ADVISOR

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"Federal Reserve's Announcement Means That Huge Profits in Resources Are Ahead!"

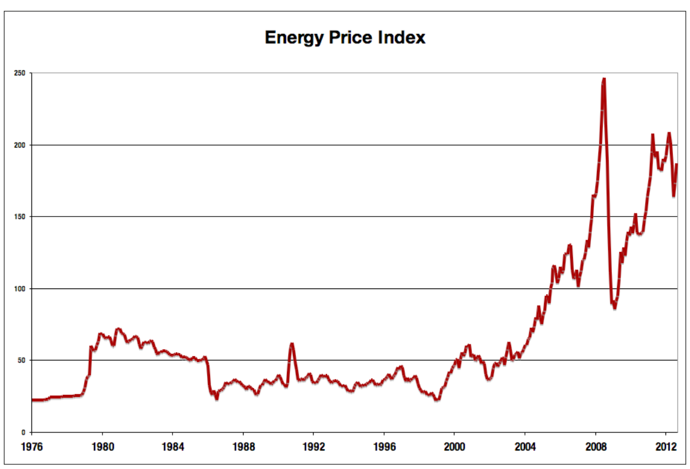
James DiGeorgia, Editor

"The Fed has announced its long-awaited Quantitative Easing 3 program—by far the most inflationary QE yet!

"This, when combined with global population trends and the European financial crisis, means that massive moves in certain markets are coming.

"Here in *Gold & Energy Advisor*, we're getting ready for what might be our most profitable recommendations yet!"

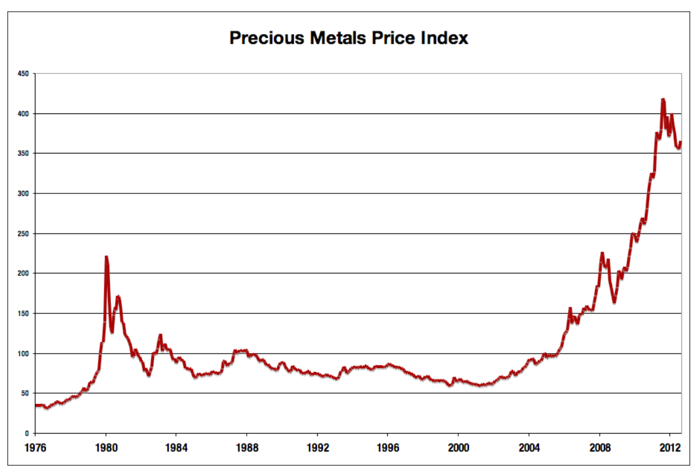
Look at this chart of energy prices, as measured by the World Bank's energy commodity index:



As you can see, energy prices muddled along in a range of 25-75 for several decades. Then, in the early 2000s, they blasted upwards into a new rising trend that hasn't yet abated.

Here in *Gold & Energy Advisor*, we've ridden this trend the entire way. In early 2004, we saw this massive opportunity forming, and started going long energy stocks. When the market fell in 2008, we closed out our portfolio, locking in total gains of 144.33 percent. Then as the market bottomed out, we piled back in again, making a handsome 88.76 percent in a short time.

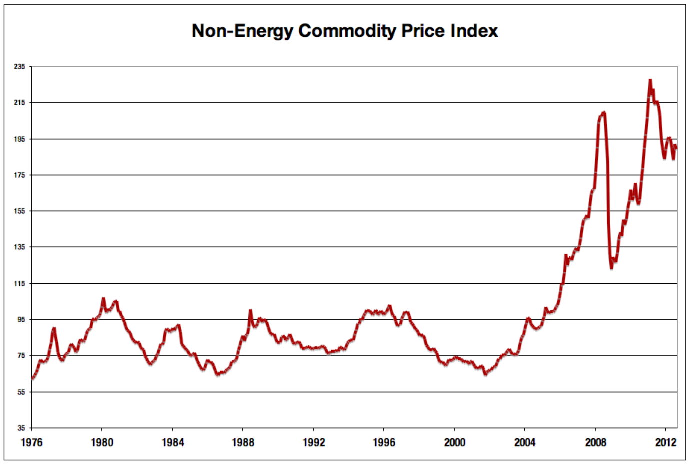
Our precious metal investments have also produced spectacular returns:



I first recommended gold at $398 and silver at $7. Today they're at $1,773 and $35.

Of course, those price movements are history now. What awaits us in the future?

The answer can be found in this chart:



That's the World Bank index for non-energy and non-precious metal commodities. Things like coffee, tea, and soybeans. Corn, rice, and wheat. Cotton, rubber, and lumber. Aluminum, copper, and steel.

As you can see, the average prices for all these resources have rocketed upward right along with energy.

Yes, this is a chart of what happened in the past, not the future. But it helps us to anticipate what's coming, because it shows that all resources have been skyrocketing, not just energy and precious metals.

As the name of our service (*Gold & Energy Advisor*) implies, in the past we've focused on energy and precious metals. That's because these were the biggest opportunities from the early 2000s up through the present.

There are still huge opportunities in these markets, and we'll continue to focus on them. However, several other resource opportunities have now grown too big to ignore.

Last month I announced that I'm broadening our scope here in *GEA*. Along with energy and precious metals, we'll also start including the highest-potential investments in other resource categories. This month, let's explore this idea a bit further, and discuss…

Seven Reasons Why We Have Huge Opportunities Ahead

Trends come, and trends go. But the biggest trends can last for many years—far longer than most people expect.

These mega-trends are where the big money can be made. As the saying goes, a rising tide floats all boats—and when you're riding a monster trend, it's far easier to rake in monster amounts of cash.

I believe that soaring resource prices are a mega-trend today. Since 2004, we've focused on oil and precious metals, because that's where the biggest money has been. Now the trend is broadening to include other commodities as well.

There are seven primary forces driving this mega-trend—seven reasons why I believe we have massive opportunities ahead of us.

Reason #1: Our Soaring Global Population

"I was born in a world with 2.5 billion [people]. And I'm seeing it almost triple in my lifetime." So said Hania Zlotnik, former Director of the United Nations' Population Division, to the BBC recently.

In 2011, the global population hit 7 billion. The United Nations projects that this number will soar to over 9 billion by mid-century.

This increase represents more people than today's population of North America, South America, Australia, and Europe… combined.

The Earth's human population increases by two people every second. That's 200,000 every day—nearly 80 million more people per year.

And each additional person needs food, water, shelter, and energy. This alone is a massively bullish force driving commodity prices upward. In fact, the Earth's swelling population is already overwhelming the supply of many vital resources.

We see this especially in...

Reason #2: The Global Food Crisis

Dr. Molly Brown is a Senior Research Scientist at the NASA Goddard Space Flight Center. Her work focuses on predictions of global famine by satellite monitoring of crop growth, forecasts of drought conditions, and so on.

As she recently told the BBC:

"We need to double the amount of food we have available to us, as soon as possible."

Dr. Brown explained that the Earth's rapidly growing population is causing a food shortage that will be extremely difficult to solve. In the past, global food production has easily met, or even exceeded, population growth—but those days are over.

For example, in the 20th century, wheat production grew about fivefold. During the first half of the century, this was mostly driven by the increases in area devoted to wheat crops. Then starting in the 1950s, agricultural scientists made large breakthroughs in nitrogen fertilizers, irrigation techniques, and disease-resistant wheat breeding. This resulted in large increases of wheat yields per acre.

But these types of gains are no longer available. Although there's still unfarmed land remaining in the world, the most desirable land is already being worked. The rest of it will not be very productive. As Dr. Brown explained in an interview, "We're using almost all the highly-productive land [for agriculture]: 30-40 percent of the world surface."

Nor can we rely on major increases in yield. Yes, such things might still happen—but it's unlikely. The major important breakthroughs, like Dr. Norman Borlaug's "Green Revolution" (which increased wheat production fivefold in developing countries) have already occurred. There's a limit to how productive a food-producing plant can be, and agricultural scientists aren't expecting large yield increases anymore for many crops.

Reason #3: Political Unrest from Resource Shortages

Political turmoil can cripple the production of resources on a national level.

This is most obvious in times of war. Of course, we aren't (yet) at the point where there are large-scale wars over specific resources. But some sociopolitical analysts are predicting that overt wars for food, water, and other resources will be a growing phenomenon over the next century.

Meanwhile, political unrest is spreading. Few people in America think about this, because as a nation we have an abundance of resources, not a shortage. But people elsewhere don't have the abundance that we do.

Already, more than 1 billion people in the world today lack reliable access to clean water. One-third the world's population lives in regions with water shortages. According to a McKinsey study, by 2030 global water requirements will be 40 percent higher than the current supply. Wars for water are a growing possibility.

Global food shortages are equally acute. Last year, tens of thousands died from famine in East Africa alone.

The world's poor spend 60-80 percent of their limited incomes on food, and live at subsistence levels. Even small price rises can make food unaffordable. That's why in 2007 and 2008, rising food prices caused riots in more than 30 countries.

Food scarcity and rising prices were also a large factor in the Arab Spring revolutions across the Middle East. Even harsh political oppression can be tolerated, but when people are starving, they have nothing more to lose.

Famed investor Jeremy Grantham has written a lot about this. Grantham is Co-Founder and Chief Investment Strategist of Grantham Mayo Van Otterloo (GMO), one of the largest financial firms in the world (with $97 billion in assets under management). This summer he issued a warning that the food crisis would threaten global political stability, and this was being "badly underestimated by almost everybody and all institutions, with the possible exception of some military establishments."

Along with unrest within specific countries, there's also growing friction between nations—especially from...

Reason #4: "Land Grabs"

Land grabs occur when industrialized nations or corporations acquire farmland in the Third World. These deals—sometimes as leases, sometimes as outright purchases—are usually made with corrupt local officials, at terms exceedingly unfavorable to the local population. The purchasers then grow food on the land, and export it out.

United Nations are alarmed at how quickly this practice is spreading. For example, China has acquired arable land in Angola, Cameroon, Zimbabwe, Mozambique, Sudan, Kazakhstan, Brazil, and Mexico. Saudi Arabia has acquired land in Sudan. Great Britain has acquired land in Angola, Malawi, and Ukraine.

The list goes on and on. It includes land sales in Egypt, Congo, Zambia, Mali, Sierra Leone, Tanzania, Kenya, Madagascar, Liberia, Ghana, and more.

At first, land grabs don't seem like a big deal. But a closer look reveals that they distort the global food market, reduce food production in the short term, and have the potential to cripple production growth in the long term.

To understand the distortion, consider Ethiopia. This African nation is heavily dependent on external food aid to keep its people alive. According to current government statistics, 3.7 million of its citizens will require international food aid between now and December to avoid starvation.

At the same time, the 36 nations and corporations that have "grabbed" land in Ethiopia are exporting food out of the country.

This isn't an isolated example. Millions of people in the Democratic Republic of the Congo are also dependent on international food aid, while China produces palm oil for its own use on 7 million hectares of land.

In Cambodia, about fifteen percent of all land has been signed over to private companies. Much of this land was not owned by the government, which signed it over anyway. Now the new plantation owners are burning down the homes of people who have refused to leave their property, and then chasing them out with hired military units.

These deals are being made all over the world. Many of them are being done secretly. It's impossible to know the full scale of what's going on.

But one thing is clear. As an article in the UK's *Guardian* noted, we're headed for a "dystopian future in which millions of the hungry are excluded from the land of their forefathers by barbed wire fences and security guards as food is exported to feed the rich world."

Why Land Grabs Will Cripple Food Production

On the surface, land grabs don't seem alarming. Some of the local governments that have made these agreements even claim that they are a boon for food production, since high-tech international organizations can use the land more efficiently than the local population could.

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PUBLISHER

Finest Known, LLC

EDITORIAL STAFF

James DiGeorgia — *Editor*
Spiros Psarris — *Associate Editor*

PUBLISHING STAFF

Jon Longo — *Subscriber Services*
Sharol Dell'Amico — *Marketing Manager*

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But in truth, land grabs are a dangerous trend for global food supplies. There are several reasons for this.

First, they create destructive economic incentives. Fertile land is being signed over to international corporations at ridiculously cheap rates—as little as $1 per acre. This encourages the acquiring governments/organizations to treat the land as a disposable commodity, to be used up and thrown away—and that's exactly what's going on, especially when the land is being leased rather than purchased.

Slash-and-burn agricultural practices are being used on a large scale. The international groups are using large amounts of pesticides, draining wetlands, and cutting and burning woodlands. Fertile soils, which took a generation to accumulate, are being rapidly depleted and exhausted.

Also, the international groups use different agricultural techniques than the local population would. This means that far more global resources are consumed to produce food than would otherwise be the case.

For example, while local farmers would fertilize with manure, the international land grabbers are using petroleum-based fertilizers instead. This is very resource-intensive: in the US, it takes 42 gallons of oil to produce a metric ton of corn. And about three-quarters of the cost of nitrogen fertilizer comes from the cost of natural gas. Thus, the grabbers are creating additional price pressure in the energy markets.

Also, while local farmers would consume most of the food they produce, and sell the rest to other consumers, international groups are often shipping the food to biofuel manufacturers instead.

As I've covered before in *GEA*, biofuels like ethanol do little to reduce global oil consumption. When you factor in the oil used to produce them (in fertilizers and so on), and account for the <u>reduction</u> in automotive fuel efficiency that they cause, many analysts calculate that ethanol and other biofuels don't reduce global oil consumption at all. They're popular merely because of political grandstanding, not because they're good fuels.

So when international organizations grab land from poor regions to produce biofuels, they're taking food from the mouths of local families and pouring it into Western fuel tanks—with no benefit other than the profits they make.

Even when the food is sold internationally for consumption, it's used less efficiently than if locals had produced it. First of all, not all of it arrives to the market. International land grabbers can't tend the crops as attentively as locals can, and they usually pay slave-level wages to the workers that harvest and transport the crop. Thus, according to the *Journal of Humanitarian Assistance,* "Up to twenty-five percent of crops are lost due to pests and diseases and the developing world loses up to an additional thirty-seven percent of harvested foods due to problems in storage and transportation."

Also, local production would ensure that most of the crops would be eaten by people. Conversely, international grabbers sell much of it to be used as animal feed for meat production.

This is much less efficient use of the foodstuffs. On average, it takes up to <u>16 pounds of grain</u> to produce <u>one pound</u> of meat.

It's one thing for feedlots in Texas to do this with surplus corn from Iowa. It's quite another to export grain from starving local populations in Africa, and use it to produce filet mignon for fine restaurants in Paris.

Lastly, international organizations often grab fertile land and use it for non-food purposes. One infamous example occurred in Cambodia earlier this year, where the government granted a 70-year concession of 9,000 hectares to a large corporation—<u>against</u> the will of the local villagers who owned the land. (The case gained international attention when the villagers resisted the bulldozing of their property, to the point of taking several hostages during their standoff with military and police units.) Here the land was not being cleared for crops, but for a rubber plantation.

Overall, land grabs are a dangerous and ominous trend for global food supplies.

Reason #5: Soaring Oil Prices

As we saw at the beginning of this issue, energy costs have roughly tripled in the last decade.

Despite this long run, there are many reasons why this trend still has years more to go. Since I discuss these frequently here in *GEA*, we won't spend time on them this month. Instead, let's talk about their implications.

Oil is one of the world's most important commodities. As such, it is heavily weighted in commodity indices. For example, 70.5 percent of Standard & Poor's GSCI index is made up of energy.

Thus, as oil continues to rise, it alone can have a strong upwards influence on global commodity markets.

But there's more going on here than just technical price indicators. The price of oil has a direct impact on the cost of many other things.

In agriculture, fuel prices are a significant part of food production costs. Therefore, high oil prices drive up the prices of agricultural products.

In manufacturing, petroleum and natural gas are the primary feedstocks for plastics. Obviously, plastic is found in most other products. Thus, rising petroleum means rising costs in other markets as well.

In transportation, fuel prices are obviously a primary driver of costs. Since transportation costs affect the delivery of everything else to markets and consumers, rising oil means rising costs for everything else.

Oil prices are a significant factor in most other markets. Therefore, as oil continues to rise, resource markets overall will also be driven up.

Portfolio Update

In Update #1385, we issued a new recommendation for Whiting Petroleum (symbol WLL). We sold short the Oct. $47 puts (symbol WLL121020P47).

In Update #1388, we took profits on our short puts on Devon Energy (DVN) and Pengrowth Energy Corp. (PGH). On DVN, we bought to close the Oct. $57.50 puts (DVN121010P57.50). Our profit was $100 per contract. On PGH, we bought to close two contracts of the Sep. $6 puts (PGH120922P6). Our profit was $100 for both contracts.

In Update #1392, we noted that we would let our Sep. $30 short puts on Bill Barrett Corp. (BBG) be assigned.

Reason #6: The Fall of the Euro

Earlier this month, the European Central Bank announced its "conditionally unlimited" bond-buying program.

In a nutshell, ECB officials said this: they will now print mountains of money and lend it to failing Eurozone countries.

The announcement included the usual jawboning about how the recipients must adhere to strict financial measures. But as Greece has proven several times, this is just empty talk.

ECB officials portrayed this as a bold, decisive move. In reality, they didn't have a choice. If the failing Eurozone nations (Greece, Italy, and Spain) weren't propped up, one or (most likely) all of them would have defaulted on their bonds.

And then several major European banks, having massive exposure to those bonds, would have blown up. Most likely, the entire European financial system would have melted down along with them.

The ECB acted just in time. Spain in particular was right on the brink of failure. According to the *Financial Times*, cash has been draining out of Spain at a catastrophic rate. Panicked investors were dumping Spanish securities, while panicked depositors yanked their money out of Spanish banks (and transferred it into foreign ones). During the most recent quarter, the total capital outflow was more than 50 percent of GDP.

Now it's the ECB to the rescue, ready to print an "unlimited" amount of money to back up these bonds. The markets cheered at this announcement, because the European banking system now has a hope of surviving.

But this comes at a terrible cost: the long-term value of the euro as an international currency.

The only question now is how far it will fall.

In the best case, the euro will only be devalued as much as any currency would be, when printed in potentially "unlimited" amounts.

(In other words, it will turn into toilet paper—but it will be respectable toilet paper, backed by the full faith and credit of the combined Eurozone nations.)

In the worst case, Spain and/or Italy comply with the ECB's austerity requirements for a while, and then renege. (In other words, they'll "pull a Greece.") If that happens, ECB officials will have a horrible choice: do they stop buying Spanish/Italian bonds, or do they continue?

If they stopped, the bonds would implode, and then Europe's financial system would collapse—the exact disaster the ECB is trying to prevent.

If they continued, then the ECB's previous reputation as a respectable, hard-money institution would be destroyed. The euro would become not just toilet paper, but an international laughingstock.

And I haven't even discussed the waves of economic 'stimulus' that the Europeans will probably unleash, to pump up the sagging Eurozone economies. The German high court just gave a green light to this, by granting its blessing to the so-called European Stability Mechanism (ESM). The ESM provides a permanent legal basis for the ongoing Eurozone bailouts. Now the European monetary base expansion can be kicked into overdrive.

However this all works out, it's difficult to imagine a scenario where the euro makes it through the current crisis unscathed.

So how will this affect global resource markets? Actually, there are two main ways.

First of all, the Eurozone economy is going to be in the dumps for a long time. This will reduce demand for commodities, and create downward pressure on prices.

But this won't be a major effect. Demand for basic commodities like food can't decrease that much, even in a financial crisis. As for non-basic commodities, demand could decrease substantially, but this won't affect markets on a large scale.

Europe is past the point where its demand drove world markets. Its total population is only 11 percent of the world's, down from 25 percent a century ago. Each year its influence decreases—the population of its most important economy (Germany) is shrinking, as are the populations of most Eastern European countries.

To summarize the first effect of the falling euro: it will reduce global resource demand, although probably not by much.

The second effect is much more important. Before the euro's woes began, it was the dollar's primary competitor for the role of global trade currency. But those days are over.

Today, there's no viable alternative to the dollar for global trade. Nor will there be for years to come. (Long-term, China wants to supplant the dollar with the yuan, but the current Chinese economic slowdown has set this back.)

This means that world resource prices will be a direct reflection of the dollar's value. Even if supply/demand remain the same, resource prices will go up if the dollar's value goes down.

And that's exactly what's going to happen, thanks to...

Reason #7: The Falling Dollar

The United States has run deficits of over $1 trillion per year for the last three years.

The total federal debt is already at $139,000 per household, and it's increasing by about $8,700 per household each year.

And this will continue for the foreseeable future, regardless of who wins the US Presidential elections in November.

Long-term, this debt can't be paid back—not with the dollar at its current value, anyway. The only way Washington can repay this debt is to devalue the dollar, and reduce the purchasing power that the debt represents. Therefore, the long-term outlook for the dollar is grim.

The short term isn't any better.

For one thing, the Federal Reserve has just announced its third Quantitative Easing program. This wasn't much of a surprise. It's been obvious for a while that another QE program was coming.

What was surprising is that QE3 is **unlimited**. Previous rounds of QE had a definite end date—but not QE3.

The Fed will print $40 billion each month (and buy securities with the money) for as long as Fed Chairman Bernanke wants to do so.

More specifically, QE3 will continue until the labor market turns around "substantially." But Bernanke himself has admitted, "We don't have tools that are strong enough to solve the unemployment problem." Sounds like he's planning to write $40,000,000,000 checks each month for a long time.

Obviously, money-printing reduces the value of the currency—especially when it's unlimited. And as time goes on, Washington is going to be pressured to print more and more money, because of the ongoing financial train-wreck in Europe.

Here's why. In currency markets, the US dollar is basically the inverse of Europe's financial health. The dollar index is comprised of 58 percent euros and 29 percent other European currencies. (The remaining 13 percent is the Japanese yen—the only part of the index not directly affected by the European crisis.)

So, as the euro and other European currencies sink, the dollar index will go up. This means that US exports will fall (because they'll get more expensive for other nations to buy). As a result, US stock values will fall, and domestic jobs will start to evaporate.

To avoid all this, Washington will devalue the dollar, to keep it in line with the falling European currencies. (We don't know if Bernanke was already planning for this in his 'unlimited' QE3, but this doesn't matter. It will be driving his actions soon enough anyway.)

To summarize: there are multiple reasons for Washington to devalue the dollar. And Bernanke is already hard at work doing it.

As the dollar falls, its purchasing power will fall too. This means that more dollars will be required to buy the same amount of stuff—like global commodities.

And since most global resources are priced in dollars, this means that resource prices will be driven up in direct proportion to the dollar's fall—all in addition to the effects of the other trends like the swelling global population.

Also note that the US stock market is priced in dollars too. All else being equal, dollar devaluations will bring big stock market rallies—especially in resource stocks, where the underlying assets are themselves being driven up.

Summary: Great Price Moves Are Ahead—And That Means Great Profits For Us!

Global resource prices are in a mega-trend that's still young. I anticipate big price moves—and big profits—in our future.

Obviously, I'm painting with a broad brush here. "Resources" are a huge category. Among them, some will be spectacularly profitable, while others won't do as well.

This makes our job as investors more challenging, but also more rewarding.

There are opportunities in global resource companies that are among the most compelling I've ever seen. I fully expect that many of them will exceed our historical average gain in *GEA*, which is already among the highest in the industry. (Few other advisory services can boast of recommendations that produced an average return of 29.1% over the last eight years, including some of the most brutal market conditions in living memory.)

So I hope this explains our new direction. After last month's issue, some readers were concerned that we were abandoning precious metals and energy stocks. Not at all!

In fact, I expect that precious metals and energy will continue to be among the most profitable and lucrative resource categories. And we'll continue to recommend the best among them.

At the same time, we'll also be including the highest-potential stocks in other categories.

I expect global resources to be a monster bull trend—maybe the biggest trend we'll see in our lifetimes. Hang on for a wild ride!