



**October 2004**

*As the editor of the Silver Bear Cafe, I spend most of my time researching current events. I explore the markets, the war, precious metals, the Federal Reserve and energy. In this weekly column I will attempt to condense the week's events and examine how the news might affect your pocketbook. JSB*

*Editor's note: The following message is Don Stott's plea for your vote. Don is a precious metals dealer in Colorado. His commentaries are posted all over the web. Although he is not really running for the office, it is the the best platform I have heard discribed so far. If any person, who actually desired the position of President, adopted Mr. Stott's platform, they would surely win...that is if they had about a billion dollars to spend on advertising...JSB*

"Ladies and gentlemen, I am running for President of the United States, and if elected, I will hereby promise to:

- (1) Pull all troops out of Iraq within two weeks, and all troops from everywhere in the world within a month.
- (2) I will declare unconditional neutrality for the United States of America for all time. There will never again be any subsidies, advice, support, or help in any way for any nation in the entire world. We will forever mind our own business. We will sell no arms to anyone, nor ammunition, hand guns, rockets, bombs, or anything capable of killing.
- (3) We will strictly enforce our borders, and allow no 'illegals' into our land again. Those here will be returned to their native lands. We will have no more federal handouts or subsidies of any kind for anyone. If the individual states wish to have welfare systems, that's up to them.
- (4) We will sell off all national forests and so called "public lands" which have been sorely abused by us, to the highest bidders, in an orderly way.
- (5) We promise to eliminate 90% of federal bureaucracy within my four year term of office, and all federal government expenses will be paid with tariffs on imported goods from foreign lands. This is but a brief description of what I would do, but I promise to do the above to the absolute limit of my abilities."

## Financial Markets

Stocks retreated last week with all the major indices skidding to multi-week lows. The dollar slipped as well but remains tightly range-bound, while gold edged up a bit. And crude oil rallied toward \$50 per barrel again while the smart guys running this country and its finances continued to scratch their heads, still bewildered but not bemused about being wrong over and over and over again.

We are almost three full years into the so-called recovery and according to Stephen Roach of Morgan Stanley, we're about 8 million jobs short of where we should be, based on the six most recent recoveries.

Sales gains at U.S. retailers are expected to slow to 4.5 percent this holiday season because of higher gasoline prices and declining wages.

The problems that Fannie Mae is currently experiencing are also occurring throughout the mortgage industry. Most of the mortgages underwritten in the nation today use automated programs designed by Fannie Mae...Fannie Mae is probably not alone in playing fast and loose with financial reality. The system is about to collapse, and, when it does, the American way of life, as we know it, will never be the same.

The price of all commodities is rising, and will continue to rise into the foreseeable future.

This year's wheat crop of 609 million tons is the second largest on record. But wheat stocks - the surplus amount of wheat in storage - are actually at 30-year lows. Price pressures will soon start building, because wheat stocks have not been dramatically rebuilt. In all of the last four years, world grain production has fallen short of consumption, forcing a draw down of stocks in wheat, corn, rice, , and soybeans. Soybean prices recently hit 15-year highs, and wheat and corn 7-year highs.

The World is beginning to abandon the dollar standard and Asian central banks are dumping our debt. This action will surely result in much higher interest rates.

Already, dollar bears warn of the implications of a dollar dump by China or Japan - such action would send the U.S. currency into a hopelessly downward spiral, literally flooding the market with unwanted greenbacks and deeply depressing the dollar. Why would countries that have been shoring up their forex reserves with dollars want to get rid of them? The economic answer: to hedge against a falling dollar by selling forward, and, at the same time, taking some profits due to extremely low short-term U.S. interest rates. The political answer: to deliberately trash the U.S. economy, challenging America's position as a world superpower.

OK, gang. Here's the bad news. Get ready for a depression. A depression is a period of time when most people's standard of living drops significantly. It will occur for the same reasons as the unpleasantness of the 1930s, but not necessarily in the same way. For one thing, it's likely to be inflationary, not deflationary, because the government has far more power today than it did in the '30s. And the amount of debt at all levels of society is much greater, which means there's political advantage in making it disappear through inflation. Inflation is an excellent way of getting rid of the liability represented by a couple trillion dollars held offshore by foreigners. Inflation is also an excellent way for the government to generate revenue for itself, which it will increasingly need to do, with its deficits running \$500 billion a year and, I suspect, headed much higher. And that's not even assuming the various wars the U.S. Government is fighting will heat up, as I expect they will. Throw in an unhealthy dose of trade protectionism as political pabulum for the whining masses who complain about outsourcing, and the stage is well set for the next economic episode...an episode I think will someday be called The Greater Depression.

Right now, there are about 2 trillion U.S. dollars floating around outside the country. That's problematical because, unlike U.S. citizens dealing within the U.S., foreigners aren't constrained by "legal tender" laws that force acceptance of our currency. At some point, foreigners will realize that the dollar is nothing but a floating abstraction, an "IOU Nothing" issued by a bankrupt government. The convenience of the dollar will be outweighed by the fear of its losing value quickly, and the world will start dumping it. When that happens, it's going to be the biggest financial tidal wave in world history, because the dollar is the de facto currency in dozens of countries. For example, it's reported that there are more \$100 bills circulating in Russia than in the U.S. itself. Even scarier is the fact that every central bank in the world holds dollars as their reserve currency. At some point they'll realize – more or less at the same time – that they're sitting on an asset that itself rests on nothing but confidence. And confidence can blow away like a pile of feathers in a hurricane. They'll start unloading dollars by the scores of billions, and the dollar will collapse. For that reason, at some point the U.S. will become one of the cheapest countries in the world to live in – if you have purchasing media other than dollars. Cheap in terms of gold and strong foreign currencies, but hugely expensive in dollars, as hundreds of billions of the things suddenly flood into the country, and real wealth is shipped out. Just the opposite of what's kept the American standard of living at artificially high levels for the last 15 years: shipping dollars off to foreigners (keeping domestic inflation down), while importing vast amounts of real wealth (evidenced by the trade deficit, currently running at over \$600 billion annually).

The fate of the dollar is probably the most serious single economic reality confronting the average American, simply because everyone owns them, is paid in them, and uses them. My own view is that the main reason Rome fell wasn't declining morality, Christianity, or barbarian invasions (among the many reasons put forward), but simple economic stagnation. And the destruction of its currency was as much a cause as a symptom of that.

Are foreign currencies a good alternative to the dollar? There are many reasons you should have a bank account outside of the U.S.; a couple of years ago, the Argentines who survived their crisis – which included draconian foreign exchange controls, limits on the withdrawal of funds from accounts, and very severe inflation – were those who had substantial funds out of the country, in a sounder currency.

It seems to me the epicenter of the next crisis will be the U.S. Dollar.

Once the elections are over the White House and Congress will have to deal with the deteriorating budget situation, and the fiscal area will become an outright negative for the economy and markets, rather than the positive it has been for the last three years. Combined with the record trade deficit, the extremely low consumer savings rate, record consumer debt, the huge decline in mortgage refinancing, any fiscal tightening can only exacerbate the economic soft spot and create strong headwinds against ongoing growth. Although the current high energy prices are another key factor in working against growth, it seems clear that even if energy prices were to fall, the economy would still be burdened with some major structural imbalances not susceptible to easy solutions. Thus the post-election period, rather than relieving the current uncertainties, may result in a renewed emphasis on the sacrifices involved in trying to solve the coming fiscal crisis that nobody wanted to face before Election Day.

The dollar is tanking.

## On the war front

You can wave goodbye to the naïve idea that democracy would take root in Iraq and then spread like the flowers of spring throughout the Middle East. That was never going to happen.

So what is America there for, other than to establish a permanent military stronghold in the region and control the flow of Iraqi oil? The insurgency in Iraq will never end as long as the United States is occupying the country. And America's Iraqi "allies" will never fight their Iraqi brethren with the kind of intensity the United States would like, any more than the South Vietnamese would fight their fellow Vietnamese with the fury and effectiveness demanded by the hawks in the Johnson administration.

The Iraqi insurgents - whether one agrees with them or not - believe they are fighting for their homeland, their religion and their families. They are not unlike the Texans, fighting Santa Anna at the Alamo. The Americans, unlike the Mexicans, are not at all clear what they're fighting for. Saddam is gone. There were no weapons of mass destruction. The link between Saddam and the atrocities of Sept. 11, 2001 was always in doubt and has been proven so. At some point, as in Vietnam, the American public will balk at the continued hemorrhaging of resources and lives, and this tragic and dark circus will become politically unsustainable. Meanwhile, the death toll mounts.

One of the reasons the U.S. effort in Iraq is unsustainable is that the American people know very little about the Iraqi people and their culture and, in most cases, couldn't care less. We seem to be getting very tired of this altercation. The war in Iraq was sold to us as a response to 9-11. As it slowly dawns on a majority of Americans that the link was bogus, and that the motive was always the oil, the political support will all but vanish.

The troops who are fighting and dying deserve better.

The Iranians are about to commit an offense far greater than Saddam Hussein's conversion to the euro for his oil exports back in the fall of 2000. In March 2005 Iran is going to start competing with New York's NYMEX and London's IPE with respect to international oil trades - using a euro-based international oil-trading mechanism. What does that mean? It means that without some sort of US intervention (likely covert, but possibly overt), the euro is going to establish a firm foothold in the international oil trade in 2005 - which given U.S. debt levels and the neoconservative desire for U.S. global domination - provides a rather problematic situation. Indeed, numerous articles have revealed Pentagon planning for operations against Iran in 2005. The publicly stated reasons will be over Iran's nuclear ambitions, but the unspoken macroeconomic issues explain the Real Reasons regarding the 2nd stage of petrodollar warfare - Iran's upcoming oil Bourse.

China has deployed up to 150,000 troops on its border with North Korea to deter Pyongyang's nuclear build-up and to stifle mounting violence from rogue North Korean soldiers, a report said Sunday. Hong Kong's Sunday Morning Post cited an unidentified security source in China as saying five divisions of Chinese People's Liberation Army (PLA) troops had been deployed in Yanbian Korean Autonomous Prefecture, bordering North Korea, since last month.

The single greatest danger to national (and global, I presume) security is the prospect of nuclear weapons in the hands of terrorists and detonated in a major population center.

The chances of that happening sooner rather than later are pretty close to a hundred percent and you'd better get ready for it - and I don't mean get ready for a "dirty bomb" filled with radioactive waste. That sort of bomb might kill someone if it dropped right on his head, some more people might be killed in the ensuing

panic, and the cleanup would be a pain and take a while. The real threat is the real thing - a nuclear-fission device in the kiloton range capable of killing tens if not hundreds of thousands.

A recent reminder of that was the August 23 admission by South Korea that in 2000 it had enriched uranium in the course of atomic vapor laser isotope separation (AVLIS) experiments that had not been declared to the International Atomic Energy Agency (IAEA).

The nuclear Non-Proliferation Treaty (NPT) was opened for signature on July 1, 1968, and came into force on March 5, 1970. After that, at least five nations - Israel, India, Pakistan, South Africa, North Korea - engaged in clandestine nuclear-weapons programs and actually succeeded in developing nukes. Many others tried - Taiwan, South Korea, Argentina, Brazil, Iraq, Iran, Libya, to name just the best-known cases. Still others - Japan, Germany, Canada, Sweden, and so on - have the certain capability and have proliferated nuclear or dual-use technology.

Beyond that, there are thousands of eminently capable nuclear scientists of the nations of the former Soviet Union and other countries who are for hire at the right price, not to speak of the tons of nuclear materials that vanished when the Soviet Union collapsed.

All this makes for a noxious mix. The long and the short of it is that 60 years after the detonation of the first nuclear device by the US Manhattan project in World War II, nuclear-weapons know-how, technology and materials are widespread, relatively inexpensive, and largely uncontrollable. Vast technological advances and the spread of civilian nuclear technology (some 450 reactors in 31 countries) make control and detection of diversion of dual-use technologies to weapons development virtually impossible.

Iran is continuing to ready itself for conflict.

Hassan Abasi, a senior member of Iran's Revolutionary Guards, has boasted that Iran has "a strategy drawn up for the destruction of Anglo-Saxon civilization."

That sounds serious to me. The interesting thing to consider is that Iran is in the cat bird's seat and could deal a devastating blow to the United States economically - without touching Israel or even fomenting chaos in Iraq.

The Middle East is home to nearly 70% of the world's proved oil reserves. The United States imports 20% of its oil from the Middle East. Nearly all of the oil that comes from the Persian Gulf must pass through the Strait of Hormuz, which Iran has already trained a host of missiles on. With supplies in the United States already so tight...the sinking of just one oil tanker in the Strait of Hormuz would cause the price of oil to spike out of control. The simple threat of civil war in Nigeria was enough to drive oil futures prices over \$50.

The slightest hint of an act of hostility by Iran will send the markets reeling and push the price of a barrel of crude over \$100.

## Precious Metals

Uranium is the fuel nuclear reactors use to generate electricity. More than 400 nuclear reactors operate in 31 countries and account for about 17% of the world's electricity. In parts of Asia and Europe, nuclear capacity supplies up to 80% of the electricity demand. Nuclear power is the only fully developed non-fossil fuel electricity generating option with the potential for large-scale expansion.

Countries around the world are going to have to find alternative sources of energy. It is in their best interest to find sources of energy that are not located in parts of the world dominated by war and politics. The 2 sources of mass energy that can be used with current technology are coal and nuclear. There is a lot of coal in the world, probably a few hundred years of cheap coal is available. But there is one small problem with coal, It's an environmental nightmare (Coal-fired plants world wide release over 9 billion tones of greenhouse gases into the atmosphere each year) and given the choice most countries would rather have a brand new state of the art nuclear facility with Redundant and automatic safety systems that releases little more than a bit of steam (of course the world still has to figure out what to do with all the nuclear waste being stored at plant sites).

As the world starts to run out of oil and gas all the talk about how environmentally unfriendly nuclear energy is will be put to the back burner until better energy alternatives come to the fore front, but that is decades away from happening.

The current world political crisis, with its inherent threat to world energy supplies and prices underscores the need for domestically produced, non-petroleum based electricity. The recent power crises in California and Ontario have sharpened the focus on the fact that North American power usage continues to rise, as it does throughout the world. These factors in conjunction with pressures to dramatically reduce greenhouse gas emissions have prompted the Bush administration to actively support new reactor construction and development in the U.S.

In Europe, it has become apparent that plans to phase out nuclear power plants are unworkable and so, new reactor developments have been begun once again. In Asia, nuclear power development continues to proceed apace. The development of new simplified reactor designs and the improvement in efficiencies of currently operating reactors have dramatically improved the economics of nuclear power and have actually increased the demand for uranium.

So in my personal opinion there will be a mad rush by countries to get their hands on steady supply of uranium needed to power the many nuclear reactors around the world (440 currently in operation and 30 under construction world wide). In North America alone, rapidly growing demand for power and electricity has reached a point where the grid is increasingly vulnerable to massive failures (everyone knows what happened in California and New York). In the years to come as china and India seek to attain 1st world living standards, what is going to happen when hundreds of millions of people in china and India want to turn the lights on!

As of today nuclear power contributes about 20% of the electricity in the U.S up from 4.5% in 1973 making it the second most used fuel source for producing electricity (after coal). In china, after experiencing electricity demand grow by 15% per year, the country plans to increase its nuclear generating capacity by a factor of 5 by 2020. This means 32 new reactors, or 2 per year. But even then nuclear will only account for 4% of its power generation. If china were to attain the same nuclear share as the U.S (20%) it would require 200 new reactors, or half of today's globally installed nuclear base.

There is a little-known way to hold gold and other precious metals overseas, privately. It's called the Perth Mint Certificate Program (PMCP), and it is an excellent way to ensure your wealth securely, discreetly, flexibly and inexpensively.

When you buy precious metals in the PMCP, you get a certificate of ownership. The certificate represents a specific item -- the bullion or coins you purchased. The document simply shows "ounce for ounce" what you own that the Perth Mint is holding for you.

The PMCP is an extremely private way to own precious metals. The PMCP is not considered a monetary instrument, since it is non-negotiable and does not provide a payment of a "sum certain" in dollars. Your assets and any related documents are stored offshore (in Perth). You retain the ownership certificates, which are transferable but non-negotiable.

In case of an economic catastrophe, you simply use the documents to request delivery from Perth to any number of major financial centers, such as Zurich, London, or Singapore.

Some countries have restrictions on gold ownership, but you may remove your assets from the Perth Mint whenever you wish. There are no import or export duties on precious metals in Australia. Coins purchased in the PMCP enjoy worldwide recognition you can liquidate them in any major financial market (subject to import restrictions).

The program also allows you your choice of gold, silver, platinum and palladium. No other certificate program we've researched offers all four metals. And, you can sell all or part of your holdings and receive your proceeds in a variety of currencies: U.S. dollars, Australian dollars, Swiss francs, or other major foreign currencies.

The PMCP's products the highest quality and purity Australian semi-numismatic coins come in various sizes, ranging from 1/20 oz. to 1 kilo (gold, platinum, and silver are available in the 1 kilo size). The PMCP offers low premiums, low storage charges and a \$50 certificate charge (per transaction). The bigger the transaction the bigger the savings. Of all the available precious metal buy-and-store programs, the PMCP offers the most inexpensive way to buy precious metals, privately, in a convenient form. Now there's an easy way to hold part of your portfolio in precious metals, and get the benefits of global diversification.

Silver stockpiles are dwindling and newly mined silver is failing to meet worldwide demand. The lackluster performance of silver during the past few years seemed to leave the general public disinterested, and even make some skeptics question its status as a precious metal. Everyone that is except for one shrewd investor with billions of dollars and a proven track record for picking undervalued stocks and other investments.

On July 16, 1997, silver reached a low of \$4.16 an ounce, a price that apparently attracted the attention of billionaire investor extraordinaire Warren Buffet. His company, Berkshire Hathaway Inc., began quietly purchasing large quantities of silver at the \$4.30 an ounce level, testing his idea that the metal was undervalued in relation to supply and demand dynamics. When silver broke the \$6 an ounce barrier, it became obvious to Buffet that his theory was proving true - the drying up of the silver stockpile was indeed forcing an increase in the price of silver.

Buffet, 72, is arguably the world's most successful investor, with a self-made net worth exceeding \$30 billion. Throughout his 46-year career, he has sought out fundamentally sound but undervalued stocks and other investments, purchased them, and held them for years or even decades before selling. This simple philosophy helped to make him the richest man in America by 1993, and it took software billionaire Bill Gates to bump him into second place.

I would look for silver to be \$7.50-\$8 an ounce by the end of the year. By the end of 2005, I expect the price to exceed \$10.00.

Protect yourself. Buy silver.

With all the attention on the latest high-tech stocks, the price declines in gold have been attributed to lack of demand. Surprisingly though, gold, has experienced supply deficits for more than a decade amounting to over 22,000 tonnes.

How can the price of a commodity decline in the presence of a supply deficit?

Basic economics tells us that a supply deficit causes prices to rise, but that hasn't happened in the case of precious metals. The fanfare that always accompanies central banks sales gives the impression that these sales have made up the deficits. However, net central bank sales only account for a small part of the deficit. The balance of the deficit has been made up through the practice of leasing, creating an artificial supply that acts to suppress prices.

Central banks lease out gold to bullion banks at low interest rates. Bullion banks, in turn, lease the gold to mining companies and hedge funds that sell the bullion and invest the proceeds in higher yielding investments. Calling this practice leasing is a major misnomer. In the case of the mining companies, it is more accurate to refer the practice as "covered short selling" and in the case of the hedge funds, it should be called "naked short selling". In both cases, the artificial supply that suppresses prices will be a major contributor to the coming price increases as these entities are forced to buy bullion at market price to mitigate escalating losses and cover their short positions.

Although there is some controversy about the total amount of leased gold, the estimates are between 192 million and 800 million ounces. Any sharp price rise in either metal will have a slingshot effect, caused by a massive short-covering demand that cannot be filled with even several years' worth of mine production. This will greatly magnify any increased investor demand and put extreme upward pressure on prices.

For 3,000 years precious metals have maintained their purchasing power and have been the most liquid, universal form of money throughout the world. Since 1971, both the Canadian and US dollar have lost approximately 80 percent of their purchasing power while gold has enjoyed an increase. In 1971, for example, a new car could be purchased for \$3,500 ( 100 ounces of gold ) and a starter house in the suburbs for \$35,000 ( 1,000 ounces of gold ). Today, 100 ounces would buy two new cars and 1,000 ounces would buy two houses or an estate in the country.

If investors take the time to examine why they have a negative bias towards gold, and can accept that what they believe to be true may be myth or misconception, even the naysayers may realize the important contribution precious metals can make to a portfolio and how they can both increase and preserve their wealth in the coming decade.

China has one of the highest savings rate in the world, and in recognition has liberalized the ownership of gold. China's central bank governor estimated that Chinese citizens currently have 1.2 trillion yuan or \$145 billion of savings, which contrasts sharply with the spent savings of the Americans. Historically, the Chinese have an affinity to gold and the government's recent move to allow individual ownership has prompted the World Gold Council to predict "the rise in demand for gold in China from the current 200 tonnes to an annual 600 tonnes over the next few years."

I believe Chinese demand will surprise even the World Gold Council. Already five banks jumped the gun and queues were formed, similar to the long lineups outside the Bank of Nova Scotia in the late 1970s. The Chinese have one of the lowest grams per capita usage, at 0.1 grams per capita in contrast to 0.73 in India and 1.41 in the United States. China's official gold reserves are less than 2 percent at only 600 tonnes. The central bank is expected to boost its holdings in line with the more industrialized nations. To achieve a level of the Europeans at 15 percent of reserves, China would need to consume all of the gold produced in the next two years.

Gold just recently tested \$430, a level that has been resistance for gold all year. Gold is likely to pullback or consolidate before it breaks \$430. This would give us a consolidation period in gold stocks and, more than likely, a final buying opportunity. This scenario is also in line with the dollar bouncing off of 84 support for a few weeks. The action in the gold stocks is giving us important clues to which stocks are likely to go up the most during the next gold bull run."

Protect yourself. Buy gold.

## Speaking of Energy

Last week, the oil price touched \$50 per barrel for the first time, not because of terrorism in the Middle East but because of gangsterism in Nigeria. A combination of past under-investment and current political strife has left producers struggling to keep up with demand

Oil currently accounts for 40% of the world's energy consumption, and world oil consumption is projected to increase 2.3% per year for the next 16 years - driving the demand to 120 million barrels per day in 2020. Against that consumption, the world is currently producing on the order of 77.5 million barrels a day, but the threats to supplies coming out of the Middle East, Nigeria, Venezuela and elsewhere (for instance, the Strait of Malacca) are growing... and due to reserve depletion, are only going to get more difficult and costly to recover.

To be sure, oil more than doubled in price between 1979 and 1980 and almost quadrupled in 1973, meaning that today's oil shock may not rank among the most dramatic in history.

However, keep in mind that oil has surged more than 300% since 1998. More important, today's lofty price could easily prove to be the most resilient.

This year, global demand for oil — currently at more than 80 million barrels per day and climbing — has come closer than ever to exceeding the world's known production capacity. Disruptions in oil supply — due to wars or market forces like OPEC embargoes — are nothing new. But with producers pumping as fast as they can, there is little cushion for temporary supply interruptions or heightened demand from industrializing countries like China and India.

The price of natural gas futures surged last week, rising by nearly 9 percent in a runup that traders said was driven more by technical factors than supply-demand fundamentals. Natural gas for November delivery rose 56 cents to settle at \$6.911 per 1,000 cubic feet.

“We really are close enough to the edge to have no excess capacity. Demand growth shows no sign of slowing and now it seems to be accelerating,” said Matt Simmons, a Houston-based investment banker. “It’s really important to know what the real story is — as bad as it may be.”

How long will the world's oil last?

Production has peaked, and the economic impacts will be dire.

When the modern oil industry was born 145 years ago in Titusville, Pa., few people worried about just how long petroleum would keep flowing out of the ground. But since production peaked in the United States in 1970, a growing number of geologists, economists and industry analysts have been pondering the question of just how long worldwide supplies will keep up with growing demand. And some are predicting that global production may peak as soon as next year.

The outlook is muddled by the data. Estimating oil reserves, how much is left in the ground, is a notoriously perilous endeavor. The task is complicated by the secrecy of OPEC producers, who are reluctant to disclose just how much oil they've found.

This year, global demand for oil, currently at more than 80 million barrels per day and climbing, has come closer than ever to exceeding the world's known production capacity. Disruptions in oil supply due to wars or market forces like OPEC embargoes, are nothing new. But with producers pumping as fast as they can, there is little cushion for temporary supply interruptions or heightened demand from industrializing countries like China and India.

"We really are close enough to the edge to have no excess capacity. Demand growth shows no sign of slowing and now it seems to be accelerating," said Matt Simmons, a Houston-based investment banker. "It's really important to know what the real story is, as bad as it may be."

No one is suggesting that the world oil industry is close to pumping its last drop. But the question now being raised is whether new reserves can be discovered fast enough to both replace depleted oil fields and keep up with growing demand. Some argue that the world is rapidly approaching the point where the pace of oil depletion overtakes the growth in new supplies.

"The worry is whether there is something worse than the Great Depression of the 1930s waiting for us, particularly that the United States gets heavily hurt because we burn a quarter of the world's oil," said Princeton University geologist Kenneth Deffeyes.

Deffeyes is perhaps the leading proponent of the work of the late M. King Hubbert, a Shell Oil geologist who accurately predicted, in a controversial 1956 paper, that U.S. oil production would peak in 1970. Deffeyes has applied Hubbert's work to global oil supplies and has come up with his own projection for peak global production. He expects world production to peak around Thanksgiving of 2005, give or take a few weeks.

But with a surge to record oil prices in recent weeks and gasoline consistently selling in the \$2 a gallon range for most of the summer, energy issues have played a surprisingly low profile in the presidential campaign. The reason, experts say, are clear: There are no simple solutions.

The presidential candidates aren't going to stand up and say 'I've got bad news. They don't want to promise you blood, sweat and tears. So it's not being debated as an issue on the presidential campaign.

Oil industry officials say there are still promising regions that have not been fully developed, including areas of Alaska and the Atlantic and Pacific coasts of the U.S. that are currently off limits. But they generally agree that the days of major new finds of cheap oil are over.

New spending has been constrained, in part, by political instability in parts of the world believed to hold vast potential, such as Venezuela, Iran, Iraq and parts of Africa. But Big Oil is gun shy for other reasons. The sting is still fresh from a major investment boom in the 1990s, when the industry lost heavily when it bet on an oil price run-up that collapsed following a global recession. By 1998, the price of a barrel of oil had fallen to \$12.

The debate over oil reserve estimates and demand-production trends is not just academic; at stake is nothing less than the economic well-being of the world over the next few decades. There are numerous scenarios describing the transition from a global economy based on fossil fuels to whatever energy sources ultimately replace them. The most extreme pessimists foresee a kind of global return to the Stone Age as a world deprived of energy is beset by anarchy and starvation.

And even the most optimistic scientists who believe world oil production will soon peak warn that the transition to a post-petroleum world will require an enormous undertaking involving breakthrough technologies and massive amounts of capital.

In the meantime, many scientists are looking for those alternatives sources. Some have suggested that technologies promoting cleaner-burning coal, still in plentiful supply in the U.S., will help bridge the oil gap. Others have suggested that nuclear power will become more attractive if oil production declines too rapidly. Wind power, more widely used outside the U.S., has a proven track record. More advanced technologies, like the conversion of coal to hydrogen, also show promise, but are years from commercial production.

At some stage, someone is going to have to stand up and say, 'We have a problem here and I think we ought to go out and solve it.' But at the present moment neither of the people involved in our presidential race have found the words or the motivation to do this.

The recent "spike" in the price of oil is no spike at all, but the start of a long-term trend. I believe that the price of a barrel of oil will surpass \$100 by the end of 2006.

I predict skyrocketing prices. I am not alone in my prognostication. I am joined by, among others, Matthew Simmons, chairman of Simmons & Company International, an energy banking firm in Houston. Simmons speaks of a phenomenon called "Peak Oil" and says it is "as inevitable as death," though, like death, predicting its precise timing is not easy. Simmons points out that, unlike the oil crisis of the late 1970s and early 1980s, which was a political phenomenon, the current price increases are fueled by supply and demand, which are less transitory than politics.

What is the scenario in which oil hits \$100 per barrel in the next two years?

Just as the current price increases are said to be fueled in part by rising demand from China and India, those countries will also play a large role in the long term. China and India now consume energy (not just oil, but all forms of power) at a per capita rate that is one half the world average. Compared to the rich nations like the U.S. and Western Europe, their per capita consumption is one-seventh as large. If these two countries become wealthy, as everyone expects they will, and merely start to consume like the rest of the world (forget about their consuming like the U.S.), that rise in demand will have a dramatic impact on world energy markets.

To meet such demand, the world would have to raise output by 25% by 2006.

Is such an increase plausible? Simmons points out that, while new discoveries are certainly possible, even likely, 70% of the world's daily supply comes from fields that have been drilled for 30 years or more. Even Saudi Arabia, despite a stagnant economy, consumes 24% of the oil it drills. In order for it to boost production, it will have to consume a higher percentage of what it makes. As for the world's second largest oil exporter, Russia, if its economy weren't a basket case, it might be using its entire output internally.

During the last oil crisis, the world was producing at 70% capacity. Now it's at 99%. Because there is no slack in the system, every time there is a trial in Russia, a strike in Venezuela, a hurricane off Louisiana or a surge in violence in the Middle East, the oil markets react dramatically. The good news is that we are more efficient than in the 1980s, and we spend a much smaller share of gross domestic product on energy. But while demand may slack off short term due to slower growth, the longer term provides the potential for a catastrophe regardless of new production technology or far better conservation.

Oil and gas analysts are generally using the old their old ways of valuing oil and gas companies .. i.e. asset values based upon some notion of reserves and pricing of the same with consideration as to cash flow.

Investors are only giving oil and natural gas stocks credit for commodity prices at far lower levels than current pricing, as many analysts have noted in recent months. CIBC World Markets Inc. ran some numbers to see what sort of stock price gains could occur if investors start valuing energy stocks using higher commodity prices -- and the increases could be quite spectacular, which is even more impressive given that energy stocks are already about a record high.

According to CIBC World Markets and others, investors are valuing energy stocks using rough figures of \$30 (U.S.) a barrel for oil and \$5 for 1,000 cubic feet for gas. Should these numbers rise to \$35 for oil and \$5.75 for gas, big-name energy stocks on average could rise more than 50 per cent.

In the old days when oil and gas was relatively cheap many companies earned next to nothing if they were lucky. Cash flow considerations were important because it provided a measure of survival. A company with high cash flow could survive until next year when times might be better. The reserve estimates ( and asset values ) were likewise important because they indicated what someone else might pay for the company in a distressed take over for instance.

What these approaches fail to take into account is the recent massive improvement in the financial reward that is now associated with finding oil and gas. Just because there is not enough supply to meet demand does not mean that companies will fail to discover new reserves. Sure it will be harder and harder to do that as the years go by but opportunities will not suddenly dry up.

Thus it seems to me that what we have here is a group of companies with prospects that rival those of the highest growth sectors of the world economy still being priced by methods that might be more appropriate for companies that are candidates for insolvency.

Needless to say looking at the sector from this alternative perspective leads to the conclusion that the sector is enormously under valued.

Buy energy.

## The Fed

Recently, Greenspan speeches center on social programs being scaled back. He recognizes that Social Security, Medicare, Medicaid, and other entrenched programs cannot be funded. He cites a growing federal budget deficit, which causes neither alarm nor desire for reduction. In my opinion, he is actively engaged in a publicity campaign to create an alibi for upcoming failures and systemic shocks. Backroom cleanup efforts must be intense, as the JPMorgan hedgebook and Fanny Mae balance sheet require full-time attention. Such undertakings are kept quiet though, and far from the undiscerning public eye. JPMorgan and Fanny Mae stand as vivid evidence of the failure of the previous two myths.

"Imagine a place where you could spend far more than you earned for years without consequence," writes Gary Duncan in the Times of London. "Imagine a place where you could pay your way by writing cheques that nobody would bother to cash. Welcome to America, today."

Americans have never had it so good. But Nature has her ways of keeping things in balance. We have been acting like a deer frozen in the headlights of an on coming truck.

"Over the past decade or more," Duncan continues, "the United States has been living far beyond even the vast means commanded by the world's largest economy. America's households have spent far more than they earn, borrowing extravagantly against the rising value of their homes and other assets. The U.S. government has been no less profligate, dramatically increasing spending while making hefty cuts in taxes. "

We are witnessing the biggest free lunch in modern economic history. But there's no meal quite as expensive as a free lunch.

The Fed cut rates 13 times after the 2001 recession began. With the key rate as low as 1%, the Fed was willing to lend money at a negative real rate of interest. This ultra-cheap money is what stimulated a consumer-spending binge in the United States and a capital-spending binge in Asia. The effect on Americans is simple: They ruined themselves by spending money they didn't have on things they didn't need. Asians, on the other hand, built factories to produce things for people who didn't have the money to pay for them.

Both trends are doomed, but not exactly in the same way. Americans' standard of living was bound to fall, compared to the rest of the world's, anyway. Wealth still comes, mostly, from producing things. Asians can now produce things more quickly and less expensively. The Fed's artificially low rates merely accelerate the process, giving Americans one last spending spree - like a condemned man's last meal - before the credit card is taken away.

When will the "free lunch" come to an end?

"No one can predict with certainty," writes Duncan. But a revaluation of the yuan might be the dessert course...or the coffee. Then, the bill is sure to come - denominated in yuan!

"It is a tantalizing prospect, although one that will depend on China's ability to preserve political stability as its prosperity grows," Duncan concludes. "However, it is not impossible that, in our lifetimes, markets will hang, not on the words of Alan Greenspan or his successor, but on those of the chairman of China's central bank."

Alan Greenspan does not live in the world you and I do. It's imaginary. He is "Sir" Greenspan. He professes to believe in the principles he wrote in his gold essay. However, in the real world he has betrayed those beliefs. He's like Doctor Robert Stadler in "Atlas Shrugged." Dr. Stadler was a character Ayn Rand wrote to show how corrupt a person could be.

When we hear about inflation and are told that the rate is around 6%, we are being intentionally misled. The Fed uses a system where inflation measured by the Consumer Price Index (the CPI). The CPI does not include food, gas, housing, and other prices out in the real world. Another cost left out are taxes. We would be shocked if all the taxes we paid - visible and hidden - were accounted for. Sure there are "tax-cuts," but as Robert Ringer said: "All tax cuts are illusions! There is no such thing as a tax cut; there is only a change in the manner in which the money is extracted. Were this not true we would be paying less than we were 10 to 20 years ago. Think of all the tax-cuts we have been blessed with."

Taxes, and the intentional left out costs of living, place the Fed's inflation figures in the "hokey category".

When this country's money system collapses and/or there is total chaos, historically that is the time to change the political system. "He who has the gold makes the rules."

The Federal Reserve is successfully overseeing the demise of the U.S. Dollar. If you have accumulated any wealth in your life, and you currently have it stored in Federal Reserve Notes, you must, for your sake and that of your family, convert it into some alternative form. The Fed is out of control. The rules have changed.

Buy gold. Make your own rules.

## Financial Survival

If you think, as I do, that there is a fundamental demand/supply imbalance in oil and the price is heading towards \$US100 a barrel, sell your investment properties. Sell your shares, too, while you're at it, and any bonds yielding less than cash.

Natural gas use will rise anywhere from 5 percent to as much as 15 percent in the coming winter. Prices will rise anywhere from 10 percent to 20 percent depending on your location. You can offset these increases with added insulation and alternative fuels, but the cost of being comfortable is going up.

During the next month, expect violent fluctuations in all markets. These fluctuations will occur as a result of the clash of market manipulators with the natural momentum of a free market. Throughout the month leading up to the elections we will witness an all out attack on the natural order by the Plunge Protection Team, the Fed, through its use of the Repo Pool, COMEX through its use of naked shorts to hold down the price of gold and silver, and whatever any part of the Government can do to put a positive spin on the dire energy market outlook.

The wisest thing to do now would be to watch patiently from the sidelines. No one, but the insiders, will have a prayer of coming out ahead. Profits will turn into losses in the blink of an eye.

Have you ever heard of hyperinflation? In January 1919, one ounce of silver cost 12 German marks. Four short years later, on November 7, the day that Hitler jumped on a table in a beer hall in Munich and shouted "The revolution has begun," the same ounce of silver cost a whopping 543 billion marks!

Think it can't happen here?

American householders are making the biggest financial mistake of their lives.

For half a century, from 1951-2001, house prices kept pace with inflation. Then, following the fastest rate cuts in history, real estate shot up. In certain "hot spots," houses have been gaining 30% per year. Throughout the nation as a whole, the gain has been closer to 10% - still three to four times the rate of inflation.

Americans mistook this increase in house prices for wealth...and began to spend it. Last year, the amount of "equity" they "took out" of their homes came to 6% of their incomes. That, along with tax cuts, is what has allowed them to continue spending money.

It is an elegant little trap, set by our own central bank...and enabled by central bankers in China and Japan. It allows Americans to believe what they want: that they are getting richer. Actually, we get poorer every year it continues; our expenses rise faster than our incomes.

Wealth from house-price increases is phony. Real wealth comes from jobs, earnings, profits and savings. There are no shortcuts. No free lunches. No "adjustments" that turn consumption into savings or expenses into income. You still can't get into heaven without dying.

I generally don't dwell on politics any more than is necessary, as the Silver Bear Cafe is intended to be a financial/economic web site, and concerned with interpreting the news as it relates to your pocket book. This week, however, I feel the need to echo the thoughts of Jim Sinclair. The upcoming election will have a lot to do with your pocketbook, but it will also determine your standard of life in the coming years.

Three Reasons to VOTE.

It is your business who you vote for but nonetheless please vote.

Also, please encourage your young adult children to vote. Let's face it, this may well be the most important election in the history of the USA. Both candidates will see this election as a mandate for their policies and it will certainly be just that.

There are three actions other than economic that hang in the outcome:

1. Patriot 2 which is an oxymoron in its name.

2. A National Identity Card that has already started to take shape via driver's licenses in the Ridgewood section of Brooklyn New York. Under the guise of identifying illegal immigrants, driver's licenses are required to carry significant additional information on the individual including their social security numbers. It was the Patriot Act that identified the 300 who received letters from the New York DMV. Although it is a State initiative, it is in fact what is called raising a flag and seeing who salutes.

3. A US company was cleared last week by the Federal Food & Drug Administration for the implantation of a microchip into humans. The chip implants are said to be a convenient way of quick scanning that could save the need to show passports and/or ID cards. It will prove handier than carrying cash or producing medical records. This clever barcode would let people find you if you are lost or abducted." The microchip is the size of a rice grain which is inserted below the skin and can be read by a scanner or recognized by a specially designed GPS system.

Unfortunately, both the mainstream candidates will back the afore mentioned legislation. Remember, there are alternatives.

A failure to vote in these circumstances is a failure to stand up for what you believe in and even a vote for what you do not believe. Vote as you choose and encourage every American to do the same.

There is an increasing threat of domestic terrorism, heightened materially by the rapidly approaching national election. Considering where the major sentiment measures are at present, the stock market is ill-prepared for such an event. It would melt down!

Keep your eye out for a catastrophic event occurring this weekend. There are people on both sides of the fence that would like to exacerbate chaos in our country next week.

If you are depending on Social Security, stop.

Get out of debt. Figure out ways to conserve. Take up gardening. Sell everything you don't need.

Follow the course opposite to custom and you will almost always do well...

It's not what you don't know that will screw you up, it's what you know that is wrong. The spin you hear from the mainstream media is intended to mislead you. Open your eyes and face the future. If you leave your head in the sand and ignore it, you are only leaving your butt exposed for the world to kick. This all may sound like gloom and doom, but when you get a handle on what is going to happen, you will have a future filled with opportunity. Fortune favors the Informed.

More next month...

If you have not yet joined "the Bear" and/or have questions, please call us, toll-free, at:

1 (877) 389-7626

May the Great Spirit be with you always,

Johnny Silver Bear  
Chief cook and bottle washer, The Silver Bear Cafe

#### *Disclaimer*

*All statements and expressions are the sole opinions of the editor and are subject to change without notice. A profile, description, or other mention of a company in the newsletter is neither an offer nor solicitation to buy or sell any securities mentioned. While we believe all sources of information to be factual and reliable, in no way do we represent or guarantee the accuracy thereof, nor the statements made herein. The staff of Silver Bear Cafe are not registered investment advisors and do not purport to offer personalized investment related advice. The publisher, editor, staff, or anyone associated with, or associated to the Silver Bear Cafe may own securities mentioned in this newsletter and may buy or sell securities without notice.*