The Little Black Book of Investment Secrets

5th Edition

Stansberry & Associates Investment Research

Stansberry & Associates
Investment Research

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Foreword

By George Rayburn
Publisher, S&A Investment Research

Dear S&A Subscriber,

This book does not contain one single stock recommendation.

Instead, it reveals the fundamental secrets and techniques of becoming a truly successful investor, for the rest of your life.

The Little Black Book of Investment Secrets will show you how smart investors consistently make money safely year after year. and how you can easily do the same.

For example, you'll learn:

- The safest way to maximize the return on every dollar you invest. We'll show you the easy-to-understand "no-risk" fundamentals of stock investing...
- The eight simple strategies and secrets the world's successful investors use to keep their upside unlimited...
- Dozens of valuable (and free) investment tools and resources...
- What to read to become a better investor...
- The real secrets to becoming a millionaire... including options, bonds, gold...
- You'll understand every asset class... what they do and how they work... how much to invest... and most importantly, the right time to buy them.

After reading this book, if the subject of investing comes up, you might even be the most popular person at your next cocktail party.

The ideas in this book – many of which go against conventional investment wisdom – will show you the fundamental secrets of successful long-term investing. In other words, what you need to know *before* you make any investment decision.

In *The Little Black Book of Investment Secrets*, you'll discover how easy and simple it is to keep your investments growing safely year after year... no matter what happens to the economy or the stock market.

Good investing,

George G Rayburn

George Rayburn
Baltimore, Maryland

Chapter 1

Investment Fundamentals

Three Rules for New Investors

By Porter Stansberry
S&A Founder and Editor of *Stansberry's Investment Advisory*

There are three things you can do to greatly increase your chances of success as an individual investor.

First, only invest in companies that pay a substantial dividend (say, at least 3%) and that have a long history of increasing their dividend. You may count money spent on share buybacks when measuring the dividend yield. This will do several things for you. It will narrow your possible choices substantially, giving you an investment "universe" that's more manageable. It will also automatically prevent you from buying stocks that are speculative or overpriced. And finally, it will greatly reduce the odds that your account will ever show a loss. Earning 3% a year isn't much, but it adds up, especially if the company continues to increase its dividend. After a year or two, even if the share price dips, you'll probably show a gain, thanks to the dividend.

Second, out of the companies that are paying a good dividend, only buy companies whose businesses you're able to easily understand *and that you judge to have a solid competitive advantage*. As a test of your understanding, read the company's 10K (annual report) filed with the SEC. You can get a copy online for free. Or you can call the company and they'll send you a copy. If you're not willing to spend an hour or two reading a company's 10K, are you really ready to invest 4%-6% of your life savings in its stock? It baffles me that investors will readily pile money into companies they don't understand... and that they make no effort to understand. (Keep in mind, I'm not talking about trading here. I'm talking about investing – buying a position and keeping it for years.)

Third, only buy stocks when they are very attractively priced, i.e. when there's a substantial margin of safety in the stock. This means waiting to buy until the company's shares are priced so low that it can afford to buy back all of its shares. I perform this test on all of the stocks that make it into my "no risk" portfolio – which is almost always my best performing portfolio every year. This step makes it nearly impossible for you to lose money investing and will ensure you garner the benefits of compounding, because your entry price will be small relative to the company's assets and future earnings.

What I've learned about finance and investing has taught me that it's very hard, nearly impossible, for anyone to beat the compound returns of high-quality common stocks held for the long term. If you follow these three rules – good dividends, understandable businesses with competitive advantages, and buying only at very safe prices – you can achieve world-class investment results.

The Single Most Important Factor in Your Investment Success

By Dr. Steve Sjuggerud
Editor, *True Wealth*

This message is simple. But it is the most important lesson in investing: HOW you divide up your assets among the three classes is infinitely more important than WHICH stocks you choose...

Think of asset allocation as you would your diet. A diet of ALL meat would literally kill you. But a diet of all vegetables, while it may not kill you, would likely lead to inferior overall performance. We all know this. And we know that some balance of these is optimal – hence the phrase "well-balanced" diet.

The same holds for investing. We know that some mix of stocks and bonds over the long run must be the "optimal" mix, to give us healthy gains AND (at the same time) ward off portfolio heart attacks.

Asset Allocation

Now-famous studies (by Gary Brinson in 1986 and 1991) show that more than 90% of portfolio performance and variability can be explained by asset allocation – your mix of stocks, bonds, and cash. The other 10% is made up of factors like market timing and stock selection.

This makes sense. If your asset allocation is 100% stocks and the market falls 20%, chances are you'll be down pretty close to 20%, regardless of the stocks you choose. And if your allocation is 100% bonds and bonds earn 6%, chances are your bond portfolio would have made you 6%.

By far, the most important decision you make is how you divide up your pie of assets. If studies about portfolio performance are even remotely correct (they do intuitively make sense), it means spending your time picking stocks is a waste of time – because a rising tide raises all ships. (And, yes, unfortunately, an outgoing tide has the opposite effect.)

How to Figure Your Own Asset Allocation

The more you read about the topic of asset allocation, the more confusing it often gets. Different "scientific" studies on this topic give strikingly different results. (In fact, many studies said you should be 100% in stocks... but you would have been clobbered in recent years on that advice.) So, while we recommend doing all the homework on asset allocation, never forget the basics:

- The "100 MINUS YOUR AGE RULE" is a great starting point for how much you should have in stocks.
- For example, if you're 30, you should have 70% of your investable funds in stocks. And if you're 70, you should have 30% in stocks.
- The 60/40 mix is a good mix of risk and return for many "set it and forget it" portfolios.
- For best results, you've got to diversify among different types of stocks and bonds as well as among asset classes.

It bears repeating, the truth is there is no one "PERFECT PORTFOLIO." It's different for everyone based on age and risk tolerance. However, if you stick with the basics, you should be more than capable of finding the Perfect Portfolio for you...

How Much to Invest in Any Single Investment

It doesn't matter what you're trading or investing in. You can't put too many eggs in any one basket.

As a rule, I never put more than 5% of my total portfolio in any

single investment idea. And I'm more comfortable never putting more than 4% in any single investment.

And proper position sizing must be used in conjunction with a trailing stop strategy. See "Don't Lose Money: The Most Important Law of Lasting Wealth" on page 18 for more on trailing stops.

The whole purpose of using a trailing stop loss is to prevent what I call a catastrophic loss. A catastrophic loss occurs when any single position in your investment portfolio experiences losses large enough to wipe out your other gains and/or jeopardizes your access to capital.

Using a 25% trailing stop loss will not prevent you from suffering a catastrophic loss if you invest half of your portfolio in a single position.

And speaking of position sizes, one of the biggest differences between professional investors and amateur investors is the size of their positions relative to their total portfolio. Professionals consider a 2%-3% position enormous. Having 5% of your money in any one position is considered "gunslinging" by most professionals.

Meanwhile, at conferences, when I tell investors they should never allocate more than 4% of their portfolio to any stock initially, people look at me as if I'm nuts.

In fact, I would bet that 99 out of 100 individual investors wouldn't even know how much money they can afford to invest in a given stock, limiting the position to only 4% of their portfolio. Instead, almost all individual investors measure their position sizes in terms of shares, typically round numbers, i.e. "I own 50 shares."

When you decide to buy a stock, any stock, I recommend you consider 4% of your portfolio to be your maximum initial allocation. I also recommend you always use a 25% trailing stop loss if you do take a position that large. Why?

Because the combination of a 4% allocation and a 25% stop loss means that, at most, you'll lose 1% of your total portfolio. Almost any investor can afford to suffer setbacks of this magnitude and still beat the market.

Think like a pro – think about your positions as a percent of your portfolio, not as a number of shares. Know the stop loss points of all your positions, at all times. But never enter the stops into the market.

This Is the Greatest Stock Market System Ever Discovered

By Brian Hunt,
Editor in Chief, S&A Investment Research

"*I have some money I want to invest in the stock market. Where should I put it?*"

A good friend recently called to ask this question. He knows I'm in the investment newsletter business and an active investor... which makes his question the financial version of asking a doctor friend, "*Does this look infected to you?*"

The answer I gave him is the same one I give my mother. I urged him to begin using the investment system I use myself... the greatest stock investment system in the world. After I told him how to use the system, I said, "***If you're really greedy, if you want to safely make a ton of money in stocks, use this system exclusively.***"

Before I discuss the system, it's important to note the word "safely." This is big...

You see, with the debt problems in the U.S. and Europe... and with political instability in the Middle East threatening as much as two-thirds of the world's oil reserves... the only investment prediction I'm comfortable making is that **the next five years are going to be darn volatile... and full of risk**.

This leads me to seek out only the safest havens, offering the deepest values, for my long-term "401(k) type" investments. This leads me to the greatest stock investment system in the world. It leads me to be obsessed with my colleague Dan Ferris' idea of "World Dominating Dividend Growers."

Longtime *S&A* readers have heard about this idea before. World Dominating Dividend Growers are the biggest and best companies on the planet... companies like Intel, Microsoft, and Johnson & Johnson. They hold dominant positions in their industries and the best brand names. They have fat profit margins and enormous pricing power. They can use tough times to gain margin share against competitors with less pricing power and greater need for financing.

If the risks I see on the horizon turn into bigger problems, these companies are "armor plated"... and will still crank out cash flows.

For example, let's say we run into another round of trouble with the banks. No problem. Remember, *World Dominating Dividend Growers are the biggest and best*. They have modest or zero levels of debt, so they're not vulnerable to contractions in bank lending. (This type of vulnerability killed a lot of companies in the 2008 credit crisis.)

There are two key things to keep in mind when it comes to World Dominating Dividend Growers...

One, **you have to buy them at the right price**. Like any investment, the *price you pay* to own a slice of a World Dominating Dividend Grower is the key factor in building wealth over the long term. Coca-Cola is a fantastic World Dominating company, but if you buy the stock when it is overpriced, you can still lose a lot of money.

Many folks bought Coca-Cola shares in 1998, when the company traded for more than 40 times earnings. They then watched the value of their shares fall by 50%. This example shows it's plenty easy to lose money in a great company if you don't buy at a good price.

As a rough rule of thumb, I only buy World Dominating Dividend Growers when they're trading for around eight to 10 times earnings. This is a good price to pay for a share in an elite company like Intel or Johnson & Johnson.

The second thing to keep in mind with these companies is that **I am buying them for their dividend growth**. I am buying them to collect safe dividend streams that I will direct towards buying more shares... which will allow me to collect more dividends... which will allow me to buy more shares... which will allow me to collect more dividends.

This is the practice known as "compounding." It's a practice advisory legend Richard Russell calls the "royal road to riches." It's the safest, surest, best way to build wealth in the stock market. Again, if you're greedy... if you like huge long-term returns, you should focus on compounding.

As a longtime fan of investment newsletters, and now as an "industry insider," I know one of the most frequent questions in the back of a reader's mind is, "*Well, they say to do this thing, but what are they telling their friends and family to do? What are they actually doing with their own money*?"

I hope this essay answers that question. Our firm sees plenty of risks on the horizon. So we're telling anyone who will listen to participate in the safest, most profitable long-term investment program known to man. We're telling people to compound their wealth with World Dominating Dividend Growers. And we're doing it ourselves.

These companies are safe. They're dominant. They pay out ever-increasing steams of income. But a warning: Only buy them if you're greedy...

The One Person Who Knows What's Right for Your Financial Situation...

By Dr. Steve Sjuggerud
Editor *True Wealth*

"*People who spend a week choosing a furniture refinisher will sign up with the first [financial planner] who calls. People who circle junkyards for matching hubcaps will buy mutual funds without reading the prospectus. People who check the expiration date on cottage cheese wouldn't think of investigating the background of their broker. They know next to nothing about whether the broker has made or lost money for clients, whether he's been reprimanded or sued, or how long he's been in the investment business.*"

– *A Fool and His Money* by John Rothchild, 1988

"I don't know what to do about my financial situation right now," my computer consultant friend complained to me recently. "I've got to raise some money quickly for taxes. I'm vested with company stock, so I can get money from there."

He was baiting me for advice.

For future reference, Rule No. 1 in the financial advice world is: Don't give your friends and family financial advice. If the advice works out, you don't get any credit – it's what they expected you to do. But if the advice doesn't work out, you'll get all the blame, and worse, you'll quite possibly lose that relationship.

I was taught this on "day one" as a broker a long time ago. But sometimes it's hard to stick to. So I gave my golfing buddy a harmless suggestion...

"You've got a lot of equity in that nice house of yours don't you? And you don't want to take the big tax hit from selling that stock, right? So have you thought about some type of home-equity line instead?"

Right now, though, he's worried about his job. Quite frankly, even though his consulting company is continuing to pay his salary, he hasn't been on a job in weeks. He could open up a line of credit while he still has a job, as it'd be easier to get. No cashing in stock, no tax hit, and he said he has plenty of equity in his home.

After a lot of talking, I figured that even with his job on the line, he's just so averse to anything that smells like debt, he couldn't tap his home equity. He couldn't even consider establishing a line of credit. He wanted to go home and run the numbers. But the answer was obvious to me...

I told him it's more important for him to sleep at night than to run the numbers. While establishing a home-equity line might make FINANCIAL sense, it didn't make EMOTIONAL sense. The only way he could sleep would be to sell his stock.

Ultimately, Only You Know What's Right for Your Financial Situation

One of the early lessons I learned is that EVERYBODY FEELS DIFFERENT ABOUT MONEY. My friend is so afraid of debt that he would rather spend his last penny than open a credit line while he still can. (In some ways, it's admirable. In other ways, it might not be so smart.)

My friend will sell his stock, I'm sure. It's what's right for him, emotionally, to solve his financial issue. He knows this is right for him (which means he's better off than most of us), but I think he just wanted to "talk it out" aloud.

What's the right thing to do? This is the hard part. This is the question you ask yourself every day. Unfortunately, to do it right, there are no short cuts. This means that you can't just hand your life over to a financial planner and tell him to "make it OK."

It means you'll have to do a little homework (which, if you're

reading this, is exactly what you're doing).

Do You Know Enough About Your Financial Planner?

Speaking of your financial planner, what qualifications, if any, does he or she have? Did you know that to become a financial planner, all you need to do is hang a shingle? I'm not making this up! No different than a used-car salesman. There's no test, no skills, and no experience necessary. All you need is the ability to get somebody to hand over all of his or her money. And as John Rothchild shares his own embarrassing tale in his book *A Fool and His Money*, you can see this is easy:

> *In the past, my wife and I had chosen our various brokers as follows.*
>
> *At a party, we'd run into friends who'd be bragging about the money they'd made in the stock market, and we'd get the name of their broker. The next business day, we'd drive to Dean Witter or whatever firm their broker represented, to tell him or her the sad stories of our previous brokers and how we deserved better. The new broker would nod sympathetically. After a 15-minute chat, we'd hand over all our money. That's the truth, and I doubt it's unusual.*

Folks, this is your life. This is your future. And ultimately, only you know what's best for you and what allows you to sleep at night. Not me, not some financial planner, and not anyone else.

I can give you every pearl of investment wisdom I know to make you a better investor. But in order for you to achieve your greatest success, you've got to remain in the driver's seat. Like my friend, you've got to make the decisions that make sense for you.

The Best Stock Tip I Ever Received

By Dr. Steve Sjuggerud
Editor, *True Wealth*

When it comes to hot tips, it's either a bum insider tip (which could cost you a bundle) or it's a good insider tip... In which case, you're guilty of insider trading. Either way, you really come out a big loser.

I once wrote in my newsletter about my one and only experience with what I believed was a "hot tip." I called it, "True Confessions: How I Lost It All In A Day." It details the story of one of my first experiences in the financial world, as I started out at a brokerage firm...

"Psst... we know IBM's earnings numbers are going to be bad tomorrow... so we're all buying put options to capitalize as it crashes." I caved in to the pressure and bought as well... and soon after I did, I was dreaming of where I would spend the money.

The whispers were right – IBM's numbers were horrible. AND my tipster was wrong. The share price soared as Wall Street cheered IBM's restructuring plans. I'd never seen a pile of my own money vanish so quickly in my life. And it was a great lesson for me.

I learned that there is no such thing as a "hot tip" from an insider. I also learned that these guys at my brokerage firm really didn't know anything. Oh, sure they talked big... but they were just guessing. Time and again, they had a great story... And time and again, they lost money.

Even the Good Ones Aren't Worth It...

Then, not long after, some guys in the brokerage office got taken in for insider trading. They actually KNEW something for

once! (It was very similar to the Martha Stewart case.) And what did it get them? A TON of trouble!

What a great lesson for me to see firsthand. And – fortunately – it didn't cost me too much in the grand scheme of things.

The first lesson was – no matter how "inside" the story sounds, most hot tips just don't pan out. The second lesson was – your life gets turned upside down in a hurry if an insider tip you acted on actually turns out to be true.

Ultimately, I formulated my own idea of the best investment tip:

There's No Such Thing as a Hot Tip

Either you lose money or go to jail... Those are the only two possible outcomes. So the next time someone passes along a hot tip that smells of insider information, politely thank him. But please, don't trade on it.

Mistakes Made by "Get Poor Quick" Investors

By Dr. Steve Sjuggerud
Editor, *True Wealth*

Here are some of the things that have consistently proven themselves to be part of the "GET POOR QUICK" approach.

- Buying and selling options as a "novice." Getting lucky and hitting a big winner in options is the worst thing for a new options trader. It almost ensures he'll eventually lose everything by going back for more, always looking for that big score, until all his money is gone. Options can be traded successfully – with the right tools, the right knowledge, and the right advice.
- Buying and selling futures. Same story as options.

- Buying an expensive computer trading program and trading with it blindly. (If someone truly figured out the Holy Grail, why would he sell it to anyone who wanted it for just $2,000?)
- Putting all your eggs in one risky basket. Like options, if you happened to get lucky once and make a zillion dollars, you'd lose it the second time around (or the third). Eventually, it will all be gone.
- Throwing good money after bad – buying more as the price falls. This is nearly always what investors do after the stock they've put all their eggs in starts to go down. Instead of getting out – or lowering their risk – they mortgage the house, the car, the family cat, whatever, just so they're not proven wrong. And if they ultimately are right (which is very rare), they'll do it again the next time around. Then they'll definitely lose it all.
- Speaking of mortgaging... leveraging up, using margins, or any type of borrowing money for stock trading is generally a bad idea. It's not that the debt is bad in itself. But it's generally a sign of people who are gambling. And if they lose it all, they're still responsible for paying back the money they borrowed.

Then there are a lot of just generally bad investments...

"Get Poor Quick" Investments

- In general, private placements are incredibly risky. If you're throwing $50,000 into a mining startup, you should be prepared to mentally write that money off. If it happens to turn into millions, be thankful. But don't buy that yacht just yet...
- Thinly traded stocks are generally bad investments. The share price may go up as you're buying, but you'll never get out when it's falling. Look for minimum average daily volume of at least 200,000 shares in stocks you're considering. But if you do get in under that volume, again, mentally write off that investment. If it turns into a big winner, be thankful.

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- Secretive investments. There have been tons of frauds here – think Bernie Madoff and Allan Stanford's massive investor ponzi scams – all promising things like a "guaranteed" 10% a month or more. Folks, it's just not possible. All that secretive stuff, saying that "this is what the big banks really do with their money" is B.S. If you compound $10,000 at 10% a month for 10 years, it would turn into $1 billion.. even Warren Buffett can't touch that.
- Wiring money offshore. Generally, these secretive investments require you to wire money to strange lands. I saw one once promising 8% a month. It was a Panama-based corporation with a P.O. Box in Costa Rica, asking you to wire your money to Latvia. Who do you go to when your money disappears?

How to Avoid the "Get Poor Quick" Approach

The list of bad investments and investment mistakes is far longer than the list of smart investments. But these things described above are the major ones to avoid to keep you off the "GET POOR QUICK" track.

Below, I've included a checklist for you to follow to avoid making major mistakes in your investments.

Common Sense Investment Checklist

– Is the source of this recommendation trustworthy? (Do I know this for sure?)

– Have I taken the necessary steps (like trailing stop losses, etc.) to prevent a major loss in this investment?

– Where does this stock trade? Is it widely traded enough that I will be able to sell when I need to?

– Have I verified the claims made about this stock's performance? (Do NOT rely on what a broker's research department tells you!)

– Am I sending my money offshore to people I do not know to be reputable?

– Have I done enough of my own research to know all I need to know about this company?

How to Read a Financial Report

By S&A Investment Research

We've found a great online tutorial.

The tutorial is free, and produced by the folks at Yahoo Finance. It will show you the basics of fundamental vs. technical analysis, how to read annual reports, and how to evaluate expenses. Plus, it will give you an understanding and a simple method to analyze balance sheets, income statements, and company earnings.

Go to www.finance.yahoo.com/education/stocks

The Best Stock Investing Strategy Since 1965

By Dr. Steve Sjuggerud
Editor, *True Wealth*

What's the best strategy for investing in stocks? James O'Shaughnessy was determined to find out...

O'Shaughnessy tested literally *hundreds* of stock investing strategies in the updated version of his book, *What Works on*

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Wall Street.

The most successful investing strategy (the one that had the highest return relative to the risk taken) was what O'Shaughnessy called the "trending value" strategy.

When I read about the "trending value" strategy, I woke up my wife at 11:30 p.m. to show her. (What kind of husband am I, waking her up then?)

"What's the big deal?" she said.

"This is EXACTLY what I've been writing in *True Wealth* for years," I told her. "*We look for value, and we wait for the uptrend. And this is what O'Shaughnessy discovered that works best over the last half century!*"

Specifically, investing in stocks with the "trending value" returned 21% a year since 1965. If you had invested $10,000 in the trending value strategy in 1965, it would have turned into $48 million.

It was right there. Page 625. No. 1 out of hundreds of strategies. I loved it. While we don't do "trending" or "value" exactly like O'Shaughnessy does in the book, it still validates our *True Wealth* principles of looking for opportunities that are **cheap and hated, and in an uptrend**.

It's interesting to me because "trending value" is what I do... but this leaves me with no friends in the investment world...

You see, the world has two types of investors: value investors and trend followers. Behind closed doors, the two groups don't like each other. They each think the other group is full of fools.

Me? I have no friends in either group. The fact that I could believe in using both value AND the uptrend doesn't allow me in either club. I am a fool to both groups...

But it turns out, I get the last laugh... Trending value is the best risk-adjusted strategy out of hundreds of strategies tested back to 1965, according to this excellent book.

So while I have no "friends," it turns out, we're doing what's proven to work.

"Trending value" is what works in investing. Stick with it...

Don't Lose Money: The Most Important Law of Lasting Wealth

By Dr. Steve Sjuggerud
Editor, *True Wealth*

Let's face it – most people don't know when to sell a falling stock. So they're frozen into inactivity, saying, "Should I just keep holding and hoping, or should I cut my losses now?" This state of indecision is usually permanent, and often continues until you hear this: "Well, it's too late to sell now."

One of my good friends lost it all following the "it's too late to sell now" principle. He bought a ton of shares of a cable stock based on his friend's recommendation. The shares soon tumbled in half, and his friend, who knows about the cable business, told him to buy more, so he did. The shares tumbled in half again, and he bought even more. He finally stopped buying when the shares hit a dollar a share. Now they trade for pennies – he would have to pay more in commissions than those shares are worth. He was uncertain about everything, and soon it was all over.

After you've read this section – if you follow the advice here – your constant state of indecision will be gone. You'll never lose another night's sleep worrying about which way your investments will go tomorrow. Because, unlike most investors, you'll have a plan – knowing when to get out and when to stay in for the biggest possible profits.

Buying stocks is easy. There are thousands of theories out there on why and when to buy. But buying is only the first half of the

equation when it comes to making money.

Nobody ever talks about the hard part – knowing when to sell.

We've all made expensive mistakes – either missing the full upside by selling too soon or taking a huge loss by holding a falling stock too long. But it's time to make big losses a thing of the past.

In order to invest successfully, you need to put as much thought into planning your exit strategy as you put into the research that motivates you to buy the investment in the first place. So please read closely here, and think about each point…

The Trailing Stop Strategy

In stocks (and in business), you must have and use an exit strategy – one that makes you methodically cut your losses and let your winners ride. If you follow this rule, you have the best chance of outperforming the markets. If you don't, your retirement is in trouble.

You'll Never Recover

Percent fall in share price	Percent gain required to get you back to even
10%	11%
20%	25%
25%	33%
50%	100%
75%	300%
90%	900%

The exit strategy I advocate is simple. I ride my stocks as high as I can, but if they head for a crash, I have my exit strategy in place to protect me from damage. Though I have many levels of defense and many reasons I could sell a stock, if my reasons don't appear before the crash, the trailing stop strategy is my last ditch measure to save my hard-earned dollars. And it works.

The main element to the trailing stop strategy is a 25% rule. I will sell any and all positions at 25% off their highs. For example, if I buy a stock at $50, and it rises to $100, when do I sell it? If it closes below $75 – no matter what.

Don't Let Your Losers Become Big Losers

What's so magical about the 25% figure? Nothing in particular – it's the discipline that matters. Many professional traders actually use much tighter stops – the *Investor's Business Daily* newspaper, for example, recommends an 8% stop. Ultimately, the point is, you never want to be in the position where a stock has fallen by 50% or more. This means that stock has to rise by 100% or more just to get you back to where it was when you bought it. By using this trailing stop strategy, chances are you'll never be in this position again.

I use end-of-day prices for all my calculations, not intraday prices. You should too. This makes things easier. If a stock has gone to $100, put at least a mental stop at $75. If, subsequently, the stock closes at or below that $75 level, sell your shares the next day.

We do this because we think that PLACING ACTUAL STOP ORDERS IS A BAD IDEA. We do not recommend placing stop orders at all. The dirty NYSE traders will pile up all the stop orders, and then execute them all at a horrible price. Interestingly, stocks often close higher the very same day, after the NYSE traders make a mint executing stop orders. DON'T put a stop order in the market. Simply sell the day after you hit your stop.

I have to admit, it took me three years to truly follow my own advice on this one. I would always come up with some excuse for why I should keep holding some dud stocks. Nearly every time with those losers, if I'd practiced what I preached, I'd have been better off.

Now I always cut my losses. And once you get into the habit, and commit to doing it, it is not hard.

One thing in life is certain: The future is uncertain. Nobody – not even the most astute analyst or investment advisor – can know

enough about a particular company, industry, or the nuances of the market, to anticipate future prices with 100% certainty.

But common sense dictates two fundamentals: 1) taking small losses is much better than taking big losses and 2) letting your profits run is much better than cutting them off prematurely.

By following this simple plan accordingly, I strongly believe your investment results will start to improve immediately and dramatically.

Frequently Asked Questions About Trailing Stops

By Dr. Steve Sjuggerud
Editor, *True Wealth*

QUESTION: *What's the rule for getting back into something that you were stopped out of?*

ANSWER: Ah, yes. The six-month "cooling off" period. That's the answer you're looking for. You are not allowed to consider going back into a stock you've stopped out of until a six-month "cooling off" period has passed.

"What's so magical about six months?" you may ask. And the answer is "absolutely nothing." There is no scientific basis for it (just as there is no scientific basis for using 25% for your trailing stop). But it's not portfolio science we're concerned with… it is emotions.

The whole purpose of a trailing stop is to get you out of a losing position… a stock that you like. Six months should hopefully give you enough time to let your emotions about the stock cool, and let you see it rationally again. Maybe it won't look so great the second time around.

The other rule, in addition to the six-month cooling off period, is to determine whether the stock has begun an uptrend.

The simplest rule here is to make sure the stock is above its 200-day (or 40-week) moving average.

Those two rules should keep you from getting into trouble with stocks you're passionate about.

The last rule, which trumps the above rules, is if the stock hits a new high, then you are allowed to consider buying it again. This is based on the rough idea that if a stock hits a new high after you stopped out of it, whatever caused the stock to fall by 25% in the first place is now water under the bridge. Whether you want to buy it at a new high or not is a different question. But you are ALLOWED to consider buying it again at a new high.

QUESTION: *Steve, I have stop orders in with my broker, and…*

ANSWER: Wait! Stop right there! I don't recommend having a stop with your broker, in particular on smaller stocks. *True Wealth* readers have been punished in the past for doing this… A large group of subscribers must have all had stops on a small stock with their brokers at the same price. The trader promptly drove the price down by about 10%, took out all the stops, and then increased the price by 10%. All in less than an hour.

In particular, stocks that are smaller than $500 million deserve special attention. You should never have stops in the market in stocks this size – the trader WILL take you out. Chances are, you'll never have a problem with really big stocks. So you can use a stop order there if you prefer. But I think that, even up to the $1 billion size, it's still smarter not to show your hand.

QUESTION: *I was wondering how I should handle stops in stocks with large dividends and "income" investments…*

ANSWER: The stops are based on the total return. So of course you need to include any type of income. Yahoo Finance has a column called "Adjusted Close" in its historical quotes section, that provides the closing price adjusted for all splits and income as well.

You can easily import prices from Yahoo into your financial program or Excel.

Editor's Note: The next idea is called "position sizing." It's another way to NOT lose money. To help you understand it, we recommend you read the following interview with Stansberry & Associates' Editor in Chief, Brian Hunt. It was published by S&A's news and insight aggregator, *The Daily Crux,* in November 2011.

One of the Most Important Ideas Any Investor Can Learn

***The Daily Crux* Interview with**
Brian Hunt, Editor in Chief

The Daily Crux: Brian, one of the most important things any new investor can learn is correct position sizing. Can you define the idea for us?

Brian Hunt: Sure... Position sizing is an incredibly important part of your investment or trading strategy. If you don't know the basics of this concept, it's unlikely you'll ever succeed in the market. Fortunately, it's an easy concept to grasp.

Position sizing is the part of your investment or trading strategy that tells you how much money to place into a given trade.

For example, suppose an investor has a $100,000 account. If this investor buys $1,000 worth of shares in company ABC, his position size would be 1% of his total capital. If the investor bought $3,000 worth of stock, his position size is 3% of his total capital.

Many folks think of position size in terms of how many shares they own of a particular stock. But the successful investor thinks in terms of what percentage of their total account is in a particular stock.

C**rux:** Why is position sizing so important?

Hunt: Position sizing is the first and probably most important way investors can protect themselves from what's known as the "catastrophic loss."

The catastrophic loss is the kind of loss that erases a large chunk of your investment account. It's the kind of loss that ends careers... and even marriages.

The catastrophic loss typically occurs when a trader or investor takes a much larger position size than he should. He'll find a stock, commodity, or option trade he's really excited about, start dreaming of all the profits he could make, and then make a huge bet.

He'll place 20%, 30%, 40% or more of his account in that one idea. He'll "swing for the fences" and buy 2,000 shares of a stock instead of a more sensible 300 shares. He'll buy 20 option contracts when he should buy three.

The obvious damage from the catastrophic loss is financial. Maybe that investor who starts with $100,000 suffers a catastrophic 80% loss and is left with $20,000. It takes most folks years to make back that kind of money from their job.

But the less obvious damage is worse than losing money... It's the mental trauma that many people never recover from. They can get knocked out of investing forever. They just stick their money in the bank and stop trying. They consider themselves failures. They see years of hard work – as represented by the money they accumulated from their job or business – flushed down the toilet. It's a tough "life pill" to swallow. Their confidence gets shattered.

So clearly, you want to avoid the catastrophic loss at all costs... And your first line of defense is to size your positions correctly.

Crux: What are the guidelines for choosing a position size?

Hunt: Most great investors will tell you to never put more than 4% or 5% of your account into any one position. Some professionals won't put more than 3% in one position. One percent, which is a much lower risk per position, is better for most folks.

~ The Little Black Book of Investment Secrets ~

Seasoned investors may vary position size depending on the particular investment. For example, when buying a safe, cheap dividend stock, a position size of up to 5% may be suitable. Some managers who have done a ton of homework on an idea and believe the risk of a significant drop is nearly non-existent will even go as high as 10% or 20% – but that's more risk than the average investor should take on.

When dealing with more volatile vehicles – like speculating on junior resource stocks or trading options – position sizes should be much smaller... like a half a percent... or 1%.

Unfortunately, most novices will risk three, five, or 10 times as much as they should. It's a recipe for disaster if the company or commodity they own suffers a big, unforeseen move... or when the market in general suffers a big unforeseen move. These big, unforeseen moves happen with much greater frequency than most folks realize.

Crux: Can you explain how the math works with position sizing?

Hunt: Yes... But first I need to explain a concept that goes hand in hand with determining correct position sizing: protective stop losses.

A protective stop loss is a predetermined price at which you will exit a position if it moves against you. It's your "uncle" point where you say, "Well, I'm wrong about this one, time to cut my losses and move on."

Most people use stop losses that are a certain percentage of their purchase price. For example, if a trader purchases a stock at $10 per share, he could consider using a 10% stop loss. If the stock goes against him, he would exit the position at $9 per share... or 10% lower than his purchase price.

If that same trader uses a stop loss of 25%, he would sell his position if it declined to $7.50 per share, which is 25% less than $10.

Generally speaking, a stop loss of 5% is considered a "tight stop"– that is close to your purchase price – and a 50% stop loss is considered a "wide stop" – that is a long way from your purchase price.

Combining intelligent position sizing with stop losses will ensure the trader or investor a lifetime of success. To do this, we need to get familiar with the concept many people call "R."

Crux: Please explain...

Hunt: "R" is the value you will "risk" on any one given investment. It is the foundation of all your position-sizing strategies.

For example, let's return to the example of the investor with a $100,000 account. We'll call him Joe.

Joe believes company ABC is a great investment, and decides to buy it at $20 per share.

But how many shares should he buy? If he buys too many, he could suffer a catastrophic loss if an accounting scandal strikes the company. If he buys too little, he's not capitalizing on his great idea.

Here's where intelligent position sizing comes into play. Here's where the investor must calculate his R.

R is calculated from two other numbers. One is total account size. In this case, it's $100,000. The other number is the percentage of the total account you'll risk on any given position.

Let's say Joe decides to risk 1% of his $100,000 account on the position. In this case his R is $1,000. If he decided to dial-up his risk to 2% of his entire account, his R would be $2,000. If he was a novice or extremely conservative, he might go with 0.5%, or an R of $500.

Joe is going to place a 25% protective stop loss on his ABC position. With these two pieces of information, he can now work backwards and determine how many shares he should buy.

Remember... Joe's R is $1,000, and he's using a 25% stop loss.

To calculate how large the position will be, the first step is to *always* divide 100 by his stop loss.

In Joe's case, 100 divided by 25 results in four. Now, he performs the next step in figuring his position size. He then takes that number – four – and multiplies it by his R of $1,000.

Four times $1,000 is $4,000, which means Joe can buy $4,000 worth of ABC stock... or 200 shares at $20 per share.

If ABC declines 25%, he'll lose $1,000 – 25% of his $4,000 – and exit the position.

That's it. That's all it takes to practice intelligent position sizing.

Here's the calculation again:

100 divided by your stop loss equals "A."

"A" multiplied by "R" equals position size.

Finally, position size divided by share price equals the number of shares to buy.

Now... what if Joe wants to use a tighter stop loss – say 10% – on his ABC position? Let's do the math...

100 divided by 10 equals 10.

10 multiplied by $1,000 equals $10,000.

$10,000 divided by the same $20 share price equals 500 shares.

So you can see that using a tighter stop loss with the same R allows Joe to buy a larger number of shares, while risking the same amount of his total account... $1,000.

Next, let's say Joe wants to use a super-tight stop loss of just 5% on his position. In this case, if ABC declines just 5% to $19 per share, he's out of the trade.

This tighter stop loss means he can buy even more shares. Let's do the math again...

100 divided by 5 equals 20.

20 multiplied by $1000 equals $20,000.

$20,000 divided by the $20 share price equals 1,000 shares.

Again, a tighter stop loss with the same R of $1,000 means he can buy twice as many shares and still risk the same amount of his total account.

As you can see, you can use the concepts of position sizing and stop losses to determine how much of any asset to buy... from crude oil futures to currencies to microcaps to Microsoft.

If you're trading a riskier, more volatile asset, the stop-loss percentage should typically increase and the position size should decrease.

If you're investing in a safer, less volatile asset, the stop-loss percentage should decrease and the position size should increase.

And like I mentioned earlier, a good, "middle of the road" R that will work for anyone is 1% of your total account. Folks new to the trading game would be smart to start with half of one percent of their account. This way, you can be wrong 10 times in a row and lose just 5% of your account.

Crux: Any closing thoughts?

Hunt: Again, the biggest thing intelligent position sizing does is keep you from suffering the catastrophic loss. The golden rule of investing or trading is, "Don't lose money." Intelligent position sizing ensures you always follow rule number one.

Crux: Thanks for talking with us.

Hunt: My pleasure.

The Ultimate Way to Protect Your Money from Wall Street Scams

By Dr. David Eifrig, Jr., MD, MBA
Editor, *Retirement Millionaire*

"Dividends don't lie."

It's one of my favorite Wall Street sayings. Accountants can mess with a company's books in all kinds of ways, but they can't fake a cash payment. And if a company can pay a dividend, it's almost always making money.

In the past 20 years, we've seen Merrill Lynch's Henry Blodgett touting stocks he privately dismissed as crap (actually, his term was worse)... Bernie Madoff mailing phony account statements to hoodwink clients out of $18 billion... Corrupt lenders building a multibillion-dollar firm based on worthless "liar" loans... And that's just a sample. There's nothing new about accounting fraud.

The irony is, protecting yourself from these convoluted shell games is simple... **Demand a cash dividend from your investments.** It's hard to pay shareholders year after year if you're cooking the books.

A dividend is money a company pays its shareholders. Every quarter, the company counts its earnings and pays out some portion to its owners (the shareholders). Essentially, it's your cut of the profits.

Focusing on dividend-paying stocks is one of the great secrets to building wealth. And fortunately, *the market is giving us a rare chance to load up on some of the world's greatest dividend payers at good prices*.

Most investors dismiss dividends. In fact, some alleged professional stock-pickers refuse to even consider companies that pay a dividend. After all, they argue, the company should be plowing all the money back into the growing business. If the company reinvests the cash in itself, the company can grow even bigger, right? Wrong.

Here's what investors who only focus on capital gains are missing: **Nearly half of your total long-term returns from investing in stocks come from dividends.**

Sure, you want the company to use some of its earnings to grow, but you also want to get your money back along the way. In fact, among the most important rules to investing (along with asset allocation and position sizing) is defining your exit strategy – how will you get your money back?

When you invest in a small startup, you're happy to let your money grow as the business grows. But what happens when the growth slows? Do you sell the stock?

Not if it's still a good business. You don't want to lose out on reaping the success of the business as it evolves into a larger, steadier company.

Dividends are a simple way to pay back owners who've invested in the business. By keeping some of the money and paying the rest to shareholders, dividend-paying companies can continue their growth while rewarding shareholders at the same time.

For example, a couple years ago, I recommended pharmaceutical company Eli Lilly (LLY) to readers of my *Retirement Millionaire* advisory. We locked in a 5.6% annual payout. Lilly's paid a dividend for 125 consecutive years and increased it 42 years in a row. It's almost impossible to have a business better managed than that.

When companies like LLY establish a decades-long history of paying out money to shareholders, it reflects their commitment to managing the value of the business through down times and up times.

The No. 1 fear of retirees is that inflation will erode the value of their money. If you're on a fixed income like Social Security, it's

imperative to own securities that will keep up with future prices and pass some of that growth back to investors. Dividend growers are your best answer here. And as I mentioned, they have a built-in safety mechanism...

In the past 30 years, I've seen Wall Street lie and cheat... from Blodgett to Madoff. The simplest, most effective way to fight back is to demand a dividend. Companies that pay dividends are sending you real money – and dividends don't lie.

An Income Investment Secret Wall Street Doesn't Want You to Learn

By Dan Ferris
Editor, *The 12% Letter*

The 2008 credit crisis offers a tremendous lesson for folks interested in generating income from their investments.

You're not going to hear this from your broker. **He doesn't want you to know.**

But if you learn this lesson, you'll find it indispensable in the years to come...

The lesson is that chasing income through stock in highly leveraged companies – like most finance and real estate vehicles – can be a killer.

Many finance companies and real estate firms take on lots of debt to conduct business. They are such low profit margin businesses that they have to "lever up" in order to achieve good returns on capital. They can only exist with continuous debt financing. If this debt financing seizes up, as it did in 2008, it's like the oxygen leaving a room for these guys. If they don't have that constant financing, their share prices collapse. No amount of income will allow your portfolio to recover from a near-total loss.

There is an income investment where you never have to worry about that. Ever. These investments sailed through the crisis, paying... and raising... their dividends the whole way. **If you're tired of getting killed by every ludicrous, leveraged sham Wall Street thinks up, this investment is where you want to be.**

Before I get to that, though, let me back up and show you how poorly traditional income investments are set up to withstand trouble...

Thornburg Mortgage was a real estate investment trust (REIT). It was great company. It never lost a penny investing in mortgages since the day it started up in 1993. Thornburg returned an average of about 14% a year to investors, most of it in dividends, from 2000 to 2007.

Thornburg's stock carried a double-digit yield. But in 2008, Thornburg was hit with $600 million in "margin calls." Its mortgage assets were falling in value due to the ongoing mortgage crisis. Thornburg's lenders needed $600 million in additional cash – which it didn't have. It sold its high-quality mortgages for less than it paid so it could stay in business. Thornburg's problems worsened, and it eventually declared bankruptcy and ceased all operations.

Thornburg knew what it was doing. The business performed well for over a decade. Its only problem was that it carried $13 billion in debt. Shareholders saw the stock drop from $140 a share to less than $1.40.

You'll find similar stories with many master limited partnerships (MLPs), another popular income vehicle. At the beginning of 2009, for example, Atlas Pipeline yielded more than 30%. Ignorant income investors thought they were in hog heaven. But that year, it cut its dividend from $0.96 a share to $0.15. The share price fell more than 90%.

The problem was, it had over $1.5 billion in debt, more than

three times its equity. Atlas' profit margins shrunk as natural gas prices fell... making it impossible to properly service its debt. The company almost went bankrupt.

I hope you see what I'm getting at here. Investors eager for high current yields often buy leveraged junk – junk dreamed up by Wall Street. When trouble hits, junk gets exposed and the investors suffer.

But there was one group of stocks that raised its dividends in 2008 and 2009: World Dominating Dividend Growers.

As long-time S&A readers know, World Dominators are big companies that are No. 1 in their industries. They dominate their markets, obliterate competition, gush cash, pay rising dividends year after year, and – since they don't yield double digits right this second – are generally underappreciated by the average income investor.

But in a crisis, your income investment couldn't be safer. Remember, these are the biggest, strongest companies in the world... and their fortress-like balance sheets allow them to march through tough times.

Take dominant software company Microsoft, for example. It carries very little debt, less than $10 billion versus a $219 billion market cap. And in the depths of the crisis, with companies like Thornburg struggling to borrow money, Microsoft had no trouble getting another $2 billion in short-term debt.

More important for income investors, on September 22, 2008 – with global financial markets in a panic – Microsoft raised its quarterly dividend 18%.

The same thing is true of other World Dominating Dividend Growers...

Wal-Mart – the world's biggest retailer – issued $1 billion of new debt in January 2009, at rates as low as 3%. And in March 2009, when the world looked like it was coming to an end, the company raised its dividend almost 15%.

Now... you might argue, World Dominating Dividend Growers' share prices fell along with others in 2008 and 2009. But unlike most other stocks, **the World Dominators were never in any financial danger**.

They just became better investments during the crisis. Investors were able to buy them more cheaply. (The amazing thing is many of them are STILL cheap relative to their earnings today.)

By far the best, safest stocks to buy today are World Dominating Dividend Growers. Yes, their share prices can drop, just like any other stock. You don't have control over that. But even if their share prices suffer, they'll still be safe, financially strong companies that raise their dividends year after year. **They'll still be great businesses that will prosper for years to come.**

Wall Street would rather you not invest in those companies. It wants you to buy the leveraged stuff so they can collect banking fees...

That leveraged stuff usually sounds new and exciting. But great investors avoid "new" and "exciting." They prefer "been around a long time, through everything" and "safe and steady cash flow." They prefer "sleep at night" income investing.

They prefer World Dominating Dividend Growers.

Universal Disdain – The Path to Easy Money

By Dr. Steve Sjuggerud
Editor, *True Wealth*

"*I just wait until there is money lying in the corner, and all I have to do is go over there and pick it up.*"

– Jim Rogers in *Market Wizards*

Sometimes it's too easy...

Sometimes everything just lines up. If you're open enough to listen, the profits are right there in the corner, just waiting to be picked up. I try to listen, even when the message is extremely uncomfortable and doesn't seem to make sense...

I find my biggest winners are often the most "uncomfortable" trades... I started in this business as a broker specializing in international stocks and bonds. My dad was kind enough to be one of my first and biggest accounts. (To this day, I don't know if he had faith in me, even as a newbie, or if he just plain didn't have any better place to put that money.)

Of course, I wanted my dad's account to grow the most, with the least risk. But other clients' accounts were simply rising faster. After a year or so, I realized the problem. Being so careful not to lose any of dad's money, I would only share an idea with my dad once it was "comfortable." That often meant after the good, safe stock I was buying for other clients had risen steadily for weeks. In other words, we bought too late.

The lesson there was, when all the stars are fully aligned and yet I'm still uncomfortable, chances are, it's going to be a good trade.

In short, the more "uncomfortable" an investment feels… the more unpopular it is… the more everyone hates it… that's exactly when you should consider buying.

Chapter 2

Investment Strategies

The Completely Risk-Free Way to Buy Stocks

By Porter Stansberry
S&A Founder and Editor of *Stansberry's Investment Advisory*

This technique should change the way you invest for the rest of your life.

It's a way to buy stocks that eliminates *all* of the downside risk. Not some of the risk – all of the risk. Not in "theory," either – in fact. Using this simple technique, you can arrange your portfolio so it will be impossible for you to lose another penny, ever, in stocks.

Using this strategy, no matter what happens in the future, the value of your portfolio cannot fall. You will have a one-way bet. If your stocks go up, you will make 100% of the capital gains. If your stocks go down, you can't lose a penny. And, done right, positioning yourself this way shouldn't cost you a cent.

In short, you get a risk-free investment in common stocks – *for free*.

This is the perfect setup for long-term investors who are seeking capital gains, but can't afford to lose any money.

You have two choices. You can keep on investing like you have in the past – winning sometimes and losing sometimes. Or... you can adopt this strategy, buy all of the most promising businesses you find, whether they're risky or not, and never worry, ever again, about losing a single penny.

How is this possible? Simple. All you have to do is buy long-term put options on the stocks you buy. Doing so allows you to insure the value of your stocks – up to every single penny. Normally buying put options is expensive. But...

I can show you how to arrange for the companies you've invested in to pick up the entire cost of the insurance (put options) you buy.

It's a great technique to use at times like now, when there is uncertainty in the market and dozens of high-quality, blue-chip stocks trade for extremely attractive prices.

There's only one catch...

Finding the Right Setup

The strategy for making risk-free profits in stocks is very straightforward: *All you have to do is find a stock whose dividends will cover the cost of buying put options at close to the current price of the stock.*

Here's the catch: At any given time, few stocks have both high dividend yields and relatively low put-option prices. But, it does occasionally occur.

This dividend-financed put option strategy works when high-quality, blue-chip companies become absurdly cheap relative to their dividend payments. Put options on these companies are typically cheap because the market doesn't think it's likely share prices will fall much farther, and because, historically, high-quality, blue-chip companies don't have volatile stock prices. (The formula traders use to value options puts a lot of weight on historic volatility.)

The Real, Secret Benefit of this Strategy: It Forces You to Be a Contrarian

Using this strategy has the obvious benefit of protecting you from all, or nearly all, of the downside risk – for free.

It also has another, less obvious benefit that I believe is just as

important. Following this strategy forces you to look for and invest in high-quality, high-yielding businesses when they become unusually cheap.

The Lost Secret of No-Risk Investing

By Porter Stansberry
S&A Founder and Editor of *Stansberry's Investment Advisory*

The main reason almost all investors lose money in stocks over long periods of time is because **most investors believe risk-taking is rewarded in the stock market**.

After all, that's what they teach in finance classes at major universities. That's what the brochures printed up by the Wall Street firms say. And so, that's the advice that gets passed along to clients. One of the first questions a broker will ask you when you sit down with him to open an account is, "*What's your risk tolerance*?" Then they show you a chart, to convince you that only by buying very risky stocks and mutual funds can you achieve a high rate of return in common stocks. Given this advice, most investors chose mutual funds labeled "aggressive growth." When they lose money, the broker explains solemnly, "*I'm sorry it didn't work out this time, but you've got to take big risks to make big bucks.*" And so even more money goes into the high-risk fund or the risky stock.

The most important point to remember is that *risk does not equal return* in the stock market. In fact, the size of your genuine average results is largely determined by the type of stocks you buy. The lower the risk characteristics are, the higher your likely return will be.

To earn truly large returns in the stock market, the key is eliminating the risks you take.

Here, I'll show you the simple, single secret of discerning which growth stocks are actually "no risk" opportunities in disguise.

For more than a decade, I've worked closely with hundreds of thousands of individual investors all over the world in my capacity as an investment newsletter editor and now publisher. I've had the opportunity to interview dozens of the world's top investors and many of the most successful businessmen in many different industries. I've been on the podium at the country's top investment conferences with the country's biggest money managers. I've traveled the world alongside self-made millionaires. And I've worked for small investors who were carefully managing as little as $10,000.

I can tell you what most people won't admit, not even to their spouse: Everyone who invests money, sooner or later, suffers the big hit, the wipeout. It's not just the poor folks who get suckered into a penny stock scam. It's everyone, eventually.

Talk to any experienced broker, in any town in America, and, in a moment of honesty, he'll tell you the same thing: The vast majority of his clients, if left to their own devices, would go broke very quickly. And the rest? They're going broke slowly.

The reason? A total ignorance of passive investment risk and, therefore, a complete lack of strategies to manage it successfully.

However, there is a way to invest in stocks that eliminates the risk of a wipeout and provides overwhelmingly positive odds of success. I call it the "*NO RISK*" investment strategy. By eliminating the risk of catastrophic loss and by focusing your investment selection criteria on risk, not reward, you can become a very successful investor.

In short, there is a "no risk" way to buy stocks.

Recognizing Risk – and Avoiding It at all Costs

Let's turn back the clock to February 2002… In the middle of the worst time to buy stocks in 20 years, our "no risk" approach to investing allowed us to make outstanding gains – while sleeping soundly at night.

The popular stock market averages, like the S&P 500, the Dow Jones Industrial, and the Nasdaq 100 had all fallen between 10% and 50% from their highs in 2000. In addition, the terrorist attacks of September 11, 2001, had instilled a kind of fear in Americans not seen since the attack on Pearl Harbor in December 1941.

For many investors, the bear market that began in the spring of 2000 was something they'd never seen before: Stocks were falling and then falling more. Between 1981 and 2001 – a 20-year period – stocks on the major averages hadn't finished a year lower than where they started. Not even the crash of 1987 proved strong enough to hold stocks down. As soon as "Black Monday" passed, they rallied again.

The reality of a falling stock market cost many investors a substantial portion of their life's savings. And September 11, for many, marked their point of panic. Investors sold in droves when the market reopened on September 18, a week after the attacks.

After this frenzy of selling, stocks rallied in January. But the rising prices couldn't hold. And soon, stocks were hitting new lows.

Many investors simply threw in the towel. *But, for "no risk" investors, the actions of the market as a whole don't matter…*

A Tale of Two Stocks

The first rule of "no risk" investing is: *Opportunity is infinite, but capital is finite*.

There is a limitless number of future opportunities, but every investor's capital is strictly limited. Therefore, unless there's a truly great opportunity to do something, you should do nothing. This is the hardest thing for most investors to learn – especially investors who have made their wealth from their own businesses. In your own business, action is always necessary for reward. But in passive investing, doing nothing often creates better opportunities.

In February 2002, I saw two outstanding opportunities – two of the best investments I've ever seen in my entire career. Unlike most investors, though, I wasn't looking only to buy a stock. "No risk" investing implies protecting yourself first and always. The best way to protect yourself from a runaway bear market is to put some money on the "short side" of the stock market, which allows you to profit as stocks fall.

The first opportunity was in Bristol-Myers (NYSE: BMY), a stock well known on Wall Street and well respected all over the world. In February 2002, BMY was one of only eight "triple A" credit risks in the United States. That is, the credit rating agencies judged Bristol-Myers to be one of the best companies in the world to lend money to. A "triple A" rating implies there's less than one chance in 1,000 that BMY would default on its loans.

In Wall Street's eyes, Bristol-Myers was one of the safest stocks you could buy. The company had a 100-year track record of success and a new CEO, Peter Dolan, who was well liked on Wall Street.

By February 2002, the bear market in stocks caused many investors to shift their assets into "safe" stocks like BMY. As a result, its share price had remained largely stable while the market as a whole fell. The stock had a strong balance sheet and paid a reliable, and substantial, dividend.

For most investors – and many mutual funds – Bristol-Myers was the perfect place to put money to ride out the storm of the bear market.

The other opportunity was one Wall Street – and most investors – had never heard about: Blair Corp. (AMEX: BL) of Warrenton, Pennsylvania.

Blair was an old, family business, essentially a cheap knock-off of Sears. For nearly 100 years, the company turned a small profit by selling moderately priced clothes, in catalogs, through the mail. Although, like BMY, Blair did have a strong balance sheet, there were numerous threats to its business, including falling textile

prices, foreign competition, soaring direct-mail costs, and – most importantly – the Internet, which allowed many garment makers to compete directly for Blair's customers.

When you own a business outright, you're in control, which allows you to mitigate risks through operational decisions: You decide what marketing to buy, you decide how many employees to hire, you decide what new lines of business to pursue. When you buy stocks, you give up this control, which puts you in jeopardy. If management pursues a high-risk business strategy, you might not even know about it.

On the flipside, though, there are a few advantages to passive investing (buying stocks rather than buying an entire business). One of the most important advantages is liquidity: You can almost always sell all of your shares in any stock you hold in less than one day's time. More often than not, you can liquidate your entire position in only a few seconds. If you own an entire business outright, selling it can take years.

The other advantage to passive investing is even more important: disclosure.

Companies whose shares trade on the major stock exchanges in the United States are regulated by the SEC and by the rules of the stock exchanges. The primary rule is disclosure. Publicly held companies must tell investors all of the key facts about their business: the risks to their business, the financing of their business, and the track record of their management team. They also have to tell investors who owns any large blocks of stock and whether or not the managers of the business have been buying or selling shares in the company. Using SEC documents, you can learn more about public companies than most private business owners know about the businesses they own outright.

Each year, companies must file two documents with the SEC, a so-called 10-K report and a so-called 14-KA. The former is the annual report and the latter is a proxy statement. Most of the due diligence you will have to do to become a "no risk" investor can be done using only these two documents. The 10-K, the annual report, will show you the company's results over the last five years and, in surprising detail, will explain the business model, the marketing strategy, and the financial status. It will also give you biographies on the management team and give you a lot of information about the sector the business is in.

The proxy statement will show you how many shares management and large outside investors own and will detail how much money management is being paid, including all the bonuses and perks.

When you combine these two reports with the most recent quarterly report, called a 10-Q, you can, in only a day or two, build a very complete picture of the business – including, all of the likely risks to the business.

This is where you should always begin. Use the biggest advantage of passive investing – disclosure – to learn everything you can about what could go wrong in a stock you're considering buying. Although this isn't difficult to do, it does take a considerable amount of time – typically about two days of research, which is one reason why "no risk" investing isn't more popular with the great majority of individual investors. Nevertheless, the "no risk" strategy of investing starts with identifying all the possible risks to any given investment and writing them down.

Bristol-Myers: Profit Risk

Before investing in an operating company, the most important kind of risk to analyze is risk to profits. The question to ask yourself is, what is the likelihood that Bristol-Myers' profits and its profit margins will remain at least as large as they are now for the next 10 years?

If you can't answer the question with confidence, or if the answer is "not very likely," then you shouldn't consider buying the stock. And with Bristol-Myers, it was easy to see that there was no

chance its profits or profit margins would remain as robust over the next 10 years.

It was all there in the 10-K for any investor who bothered to look.

In 2000, Bristol-Myers was bringing in nearly $5 billion in sales (25% of the company's total revenue) from only three drugs: Glucophage, Taxol, and Buspar.

Taxol was the chemotherapy of choice for cancer hospitals, Glucophage was the leading oral drug for type II diabetes, and Buspar was a highly regarded anti-anxiety pill. All three medicines had lost their patent protection. At the time, the most recent to go "off patent" was Bristol-Myers' top selling drug, Glucophage. On January 25, 2002, the FDA approved a generic version made by several of the largest generic-drug makers. Prices for generic drugs are up to 80% lower than what Bristol-Myers had been getting for the product. These drugs were the most profitable in the company's catalog. These rich revenues wouldn't exist by the end of 2002.

With its best drugs moving off patent and with essentially nothing in the pipeline to replace these large revenue streams, it would be impossible for BMY to continue producing as much profit. This made Bristol-Myers a very easy stock for "no risk" investors to analyze. Just by reading the 10-K, you could see clearly that BMY was a stock with an obvious investment risk. Investors should have avoided the stock at all costs. But they didn't. Instead, many investors were buying the stock because of its credit rating and reputation.

Bristol-Myers: Technology Risk

The next kind of risk you have to look for before you buy an operating company is technology risk. Are there new technologies disrupting the company's existing business model? Will these new technologies lead to higher or lower profit margins? Where your answers are negative, you simply refuse to invest.

And in Bristol-Myers' case, technology was causing tremendous problems.

New medical technologies led to a radical expansion in the number and character of drug discovery tools. There were so many new ways of designing therapies in the 1990s, large drug companies like Bristol-Myers had to invest in small companies that were specializing in one or two particular new technologies. No one company could keep all of its research and development in-house, because there were too many new opportunities, thanks to inventions like PCR (polymerase chain reaction), the sequenced human genome, xeno-mice, and fully human monoclonal antibodies.

Investors didn't need to understand all of these technologies to see that they'd probably lead to lower profit margins for BMY because, for the first time ever, BMY was having to pay billions of dollars for new drug candidates and it wasn't able to buy complete ownership rights – not even for $2 billon. More and more of the profits from drugs were being siphoned off by the discovery firms – which meant less profits for BMY.

All of this should have been obvious to investors by February 2002. By then, BMY had written off (subtracted from earnings) $785 million of its $2 billion investment into a small drug discovery company, ImClone Systems. ImClone became famous during 2001. Unfortunately, its fame didn't stem from a great drug it discovered, but instead from the antics of its founder and CEO, Sam Waksal, who sold his shares in the company immediately after he learned the FDA would not approve its lead drug, Erbitux. In 2000, BMY invested $2 billion to buy a 20% stake in ImClone. As part of the deal, it also got the marketing rights to Erbitux in the United States, a deal that could have generated substantial revenes, had Erbitux been accepted by the FDA in 2001. But that's not what happened, illustrating the risks of this research and development strategy.

Meanwhile, BMY's in-house R&D efforts were also coming

up empty. The company had spent hundreds of millions to develop a longer-lasting version of Glucophage. Instead of taking a pill once a day, patients would take a pill once a week. Nobody thought to ask who in the world would pay a sharp premium for the once-a-week pill when Medicare and private insurance wouldn't reimburse any of these costs in favor of the far cheaper generic versions that were available.

Besides these pitiful knock-offs of its own products, the only truly new drug BMY brought to market between 1999 and 2002 was a hair removal cream marketed in partnership with Gillette. Not exactly cutting edge medicine.

Thus, by early 2002, investors didn't have to wonder about the impact of technology on BMY's bottom line: The negative impact was there to see, for anyone who bothered to look.

With two strikes against it (profit risk, technology risk) there is no way any risk-averse investor should have been willing to buy Bristol-Myers. But many did.

Bristol-Myers: Management Risk

The most important quality for managers of a public company to have is integrity. They must inspire it throughout the organization.

There are three simple litmus tests all risk-averse investors should give to management.

First, is the compensation they are awarding themselves reasonable, fair, and commensurate with the company's success? Microsoft changed its compensation policies in a way that provides a good baseline for what you want to see. For one, Microsoft did away with huge stock options awards, which pay employees at the investors' expense and reward employees for share price performance, not company performance. Also, the company tied cash bonuses and restricted stock awards to specific company performance metrics – stuff like profit margins, pieces of software sold, etc. In this way, Microsoft has removed the incentive for managers to take great risks with the company, while rewarding them for consistent performance improvement.

Second, have there been any ethical lapses in the public or private lives of the management team? A man who will lie to his wife will also lie to his investors. Although it's unlikely that you'll be able to readily identify managers who cheat on their wives, the SEC forms I mentioned earlier will tell you if they've been involved in a corporate bankruptcy in the past. Another obvious sign of trouble is a management team that regularly takes big charges against earnings or is targeted by the SEC for earnings manipulation.

Third, you must look to see how the management team is spending the company's money. Are they investing their cash flow wisely? Most investors like to see a company buying back its own stock… but if these buybacks happen at the same time that management itself is selling stock or if these buybacks occur when the shares are trading at a very high price, this can be a horrible use of capital. Likewise, nine out of 10 corporate mergers or acquisitions turn out to be complete wastes of money. Risk-averse investors look for management teams that are focused on investing in smaller, similar businesses and that have a consistent track record of returning capital to investors, either in the form of a dividend or share buybacks that occur when the stock price becomes very low.

There's another category of risk you have to look for – and write down – before you're ready to buy a stock in the "no risk" way. There's credit risk too. Bristol-Myers was also suffering in this category... but I want to come back to this issue later.

So, let move onto Blair Corp. and quickly cover the issues we've already considered with BMY: price risk, technology risk, and management risk.

Blair: Profit Risk

Blair made money by selling low-priced clothing to predominantly retired, older women.

~ The Little Black Book of Investment Secrets ~

As such, its business was low margin (it made a small amount of money on each item it sold) and high volume. It had been very successful over time: In 90 years, the company had never had a losing year. In 2002, Blair was on track to sell more than $600 million worth of goods, almost exactly the same amount it had sold over the previous 10 years. In February 2002, we could be sure of these numbers because the company's track record proved what we could guess about its business: Blair's retired customers on a *fixed income* tended to buy the same amount of apparel, regardless of the economy, each year. There was no risk of Blair's profits suddenly drying up.

And, in fact, there was an indication that profits would soon surge: a beneficial new technology.

Blair: Technology Risk

Where in BMY we found technology was wreaking havoc on the company's business model – adding costs and taking away revenues – Blair's business was enjoying significantly falling marketing costs, due to digitizing its customer database and using the Internet to deliver catalogs.

In 2000, Blair spent $12 million on new computers and a database system that helped it analyze its mailing lists and find customers who were most likely to buy. The result was a huge increase in the productivity of its marketing efforts – a surge in profitability. Specifically, in the first year after the new database was installed, revenue per advertising dollar went up 16% in 2002, while provisions for returns fell.

By the second half of 2001, Blair was making a fortune off of its investment in new technology. It's major costs – advertising, catalog mailings, letter mailings, and co-op media programs – all fell substantially. Advertising dropped 18.8%. The total number of catalogs mailed fell 9% (85.4 million vs. 93.9 million). Letters sent dropped further – down by 33% (32.6 million vs. 48.5 million). In all, the total cost of the company's advertising and co-op media fell by 39%!

Despite these dramatic cuts, net income soared – to over $12.6 million in the second half of 2001, from just $2.6 million the year before.

Information technology allowed Blair to cut its costs dramatically, without substantially reducing revenues. Overall, the company's operating costs would fall 12.5%, while sales only dipped 5%. What Blair lost in volume, it more than made up for in profitability.

By early 2002, it should have been obvious to any investor who read Blair's SEC filings that its business was on very solid ground. The company was earning roughly $25 million per year in profits on sales of around $600 million. Thus, its profit margins were small: 4.1%. But the profit margins Blair was earning on its e-commerce business were more than 20%. If, after 10 years, Blair could derive half of its future sales from the Internet, the firm could make $60 million on its Internet sales alone, even without any increase to sales overall. *By shifting just 10% of its sales to the Internet, Blair has already made six times more money, while spending 39% less on advertising.*

Also, the demographic trends were strongly in Blair's favor: The number of computer-savvy women over the age of 60 was set to grow strongly.

Blair's own projections forecast that its sales would reach $1 billion a year after 10 years, implying that profits should reach $100 million a year. Any reasonable analysis of the company's profit and technology risk would be bullish. Chances were overwhelmingly good that Blair would continue to make money – and even make a lot more of it.

Blair: Management Risk

Blair's management made it easy to give them a stamp of approval. First, 5% of the stock was still held by the Blair family,

giving it a big incentive to keep the business running on an even keel. As such, the company had never made a big acquisition and paid a substantial cash dividend each year.

The "No Risk" Formula: No Red Flags and a Great Price

From this brief analysis alone (we didn't cover credit risk and dilution risk yet), you can see the differences between Bristol-Myers and Blair for *passive* investors. In every way Blair seemed safe. In every way BMY seemed risky.

Now, could BMY produce another new blockbuster drug in a year or two and get its business back on track? And wouldn't that mean more to investors than bad managers and technological risks?

Yes, of course. That *could* happen. BMY could turn things around and end up being a great business to own. But the lessons I've learned in the stock market and from working with individual investors is that *you can't make money by investing in the risks that Bristol-Myers was facing*. It's a trap. Either BMY won't be able to crawl out of the hole it's digging for itself; or, sometime before the bottom, you'll lose confidence in BMY, resulting in you selling at a much lower price.

For "no risk" investors then, the rule is very simple: If you see a red flag, you don't invest. Period.

On the other hand, with a situation like Blair, where there were no red flags at all and a significant reason to expect the company to succeed, you only invest if you can do so *at an exceptionally good price.*

What's a Great Price?

When it comes to getting a good share price, we stand on the shoulders of giants.

There has been so much good thinking done in the past 100 years about the pricing of common stock it is amazing that most investors still have no idea how much to pay for a share of stock. People know far more about the pricing of automobiles than they do about the pricing of shares – despite the fact that typically their life savings aren't on the line at the auto shop.

The best work on securities pricing can be found in the most famous investment book of all time, *Security Analysis* by Benjamin Graham and David Dodd.

I happen to have a Second Edition of that work (1940) on my desk. It's almost a thousand pages long and literally requires *at least* a master's degree in finance – or the equivalent – to read. Not that anyone would want to...

Because, at the heart of Graham and Dodd's book, and also at the heart of the "*no risk*" investment strategy, lies a remarkably simple concept: *the margin of safety*.

There's a huge margin of safety in most of your life's activities. Most of us don't take any significant risks in the course of our regular activities, and, when we must, we insist on a substantial margin of safety. Like airbags and seat belts in our cars and strict rules about who is allowed to drive next to us. It's strange then, that we often invest without any caution at all...

To ensure a margin of safety in every investment – even in the stocks that don't have any red flags – what Graham and Dodd and other "no risk" investors do is simply make sure that, in every stock they buy, the company could easily afford to buy itself.

It's a wonderful concept: If a company is strong enough financially for you to consider buying as a *passive* investor, it must be strong enough to buy itself. Don't take on risks that the company itself cannot afford to tackle. When you buy a stock that's strong enough financially to buy itself, you're buying equity – you're an owner – but you only have to assume the risk of a bondholder. And that, in a nutshell, is the entire advantage of being a "no risk" investor: getting more from your investments without accepting any risk in return.

This is the most important secret of "no risk" investing.

Take Blair back in February 2002. At the time, the stock was trading for $16 per share, which represents a total market value of $120 million. That is, every day on the stock market, shares in Blair were changing hands at $16. At the time, there were 7.5 million shares of Blair Corp. stock outstanding. Therefore, the total market value, *the market cap* as it is called, was $120 million. If you wanted to buy the whole company, you'd have to slowly buy up all the shares outstanding. Assuming you could get them all for around $16, it would cost you $120 million.

I mentioned that we'd discuss credit risk later in this report. The reason we didn't have to discuss credit risk in regard to Blair is because the company didn't have any debt outstanding in February 2002. It did have nearly $50 million in cash. In other words, there was no risk of bankruptcy with these shares. Furthermore, the company, because it was so old, had acquired a lot of property and equipment. It also held a lot of inventory. The result was a very rich balance sheet. Specifically, in February 2002, Blair had more than $31 per share in "net" assets. Net assets means that if you liquidated the company – if you took everything it owed and sold it and then paid off all of the company's short-term obligations, you'd be left with $31.60 per share, according to Blair's auditors.

One way we knew buying Blair in February 2002 at $16 was a great price is because the company's net assets were worth nearly twice as much. Or, in other words, if we set out to build a company to compete with Blair, it would have cost us at least twice as much as simply buying Blair outright. Specifically, the company had net assets of $237 million, but a market cap of only $120 million.

Blair Corp., back in 2002, was a steal.

You rarely find companies trading for so little on the public stock markets. For obvious reasons, there are not very many good companies that you can buy for less than net assets. "No risk" investing doesn't require buying for less than replacement cost. It does require having a substantial margin of safety, namely that the company in question is strong enough financially to buy all of its shares outstanding.

In February 2002, Blair had no long-term obligations and a market cap of $120 million. It also had $50 million in cash. Thus, for it to buy itself, it would need to borrow $70 million. It could have done so easily, using its property and its inventory as collateral. Assuming the company had gone forward with such a plan, it would have to cover the interest on $70 million in debt. Prevailing interest rates on such a fully collateralized loan were around 8%. Doing the math ($70 million times 8%), you see that Blair would need to come up with $5.6 million in profit each year to make its "mortgage" payment. It could buy itself easily, in other words.

The last way to measure whether or not a company is reasonably priced is to consider how much money it is earning, relative to its total market cap. Blair was earning around $25 million per year. And you could buy the whole company for only $120 million – less than five years' worth of earnings. This, again, was an extraordinarily good price.

To give you an idea of how cheap Blair was compared to other stocks, at the time I was researching Blair Corp., Target was immensely popular with "growth" investors – otherwise known as risk takers. Target, like Blair, also sold to mid- and low-price shoppers. But, in February 2002, it would have taken 20 years worth of Target's earnings to cover Target's share price. A lot can go wrong in 20 years. (Woolworth was the top American retailer over 20 years ago. Do you even remember Woolworth?) And, in those 20 years, you would earn less than 1% a year in dividends on Target stock. Worst of all, because the company was only able to grow by opening expensive new stores, Target carried lots of debt. In fact, the amount of debt it held was larger than the combined value of its entire equity. (That's like owing more on your house than it's worth.) If anything bad happened to Target, its shareholders would get nothing.

Target was the kind of stock Wall Street wanted you to buy…

so they could get rid of it.

Target did go up in price somewhat over the last few years. True. But… you can only see this in hindsight. Had you bought Target in February 2002, you would have suffered a 30% decline in share price before things improved. Not many investors would have been able to withstand that kind of volatility. And they certainly wouldn't have been rewarded with a suitable compensation: you could have made four times as much money buying the "risk free" Blair.

By the time I had the opportunity to publish my research on Blair widely, it had risen in price, to about $20 per share or a $160 million in total market cap. That was still a great price.

My prediction was that the share price of Blair would rise by five times over the next 10 years. In my opinion, this was a "no risk" way to invest in a business that would make you more money than just about anything else you could possibly do with your savings – including start your own business. Earning five times your money in 10 years is the equivalent of making 40% a year on your capital. Very few businesses earn capital gains at such a high rate.

I made my prediction in 2002. Four years later, Blair had gone from $16 to $40, an increase of 1.5 times, or 150%. Investors earned more than 30% on their capital, per year, which is a far higher return than would have been possible even in most high-risk investments. Early in 2007, Blair was bought out by Appleseed, which makes women's apparel, for more than $42 a share.

In any case, putting money into Blair in early 2002 was certainly better than investing in any of the major stock market averages. Best of all, the largest total drawdown in the share price since February 2002 was 20% – not enough volatility to keep anyone awake at night.

Why "No-Risk" Works

I know almost all individual investors are driven by emotions and an instinct to gamble. Talk to investors. They say, "*I had a* *feeling this one would pop…*" Or, I dumped this stock because "*I didn't have a good feeling about it…*"

The truth is, when you're holding a stock that's risky, it's simply a matter of time before you lose your nerve and sell. "No risk" investing works because by analyzing and writing down all of the risk factors *before* you invest, you will develop the fortitude to hang on to your position when the market has a bad day, or a bad week, or a bad month.

The way I see it, for most Americans, financial security will remain out of reach until they learn how to invest in the right, cheap stocks and hold them for the long term. The only way to actually do this, I believe, is the "no risk" way. No investor I've ever met could stomach holding a stock for 10 years that suffers 50% drawdowns every other year.

Luckily, you don't have to suffer volatility like this to be a successful investor.

In other words, when you focus on the stocks most likely to provide you with the highest actual returns over time, you will end up buying stocks that are the least volatile.

When you combine these average tendencies with our "no risk" criteria, you will acquire a portfolio of stocks that offer you the very highest possible returns, which will also be safe enough to allow you to *comfortably* hold for a long period of time.

And… as we saw above, your ability to hold over a long period of time will mostly determine your actual results.

Once you understand that, for passive investors, the most likely way for you to accomplish your investment goals is to buy and hold cheap stocks for long periods of time, you'll see why "no risk" is the only way to really make money investing in common stocks. What you're looking for then is not what your stock broker is most likely to want to sell you, a business that's promising great things.

Instead, you need to find businesses that you can buy so cheaply, that nothing has to happen for you to do very well over time.

Size Up Any Stock – Quickly and Easily

By Dan Ferris
Editor, *Extreme Value*

The old way to size up a stock doesn't seem to be very valuable anymore, so it's time to take a different look at things...

Introducing... the Price-to-Sales Ratio

The price-to-sales (P/S) ratio simply compares the price of a stock to the company's sales for that year. But this is why it may be a better guide to determining the "true" value of a company: It's much harder to fudge the top line (sales) than the bottom line (earnings).

And perhaps even more important, since most analysts and investors don't look as closely at the top line, chances are it's a "cleaner" number for us to consider.

How the Price-to-Sales Ratio Measures Up

Crunching the numbers, the P/S ratio turns out to be a very valuable indicator. Not surprisingly, if you buy stocks when they are "cheap" – based on this ratio – you do much better than if you buy when stocks are expensive.

Specifically, if you buy the S&P 500 index when the P/S ratio is below 0.9, history tells us that five years later, you'd be up an average of 81%. This works out to an annualized return of 12.6%. However, if you buy when the P/S ratio is above 0.9, five years later, your average annualized return would be 4.7%. (A "buy and hold" strategy for the S&P 500 over the last 50 years would have produced about 6.7% a year.)

Looked at another way, your returns would have been 50%

BETTER than "buy and hold" if you bought "on the cheap." And your returns would have been 25% worse if you bought when things were expensive.

The easy rule of thumb to remember as a rough "fair value" of a business is "one times sales." (A price-to-sales ratio of one.) Again, this is just a rough gauge for whether or not you're paying too little or too much to invest. This ratio is easy to find. It's listed on finance.yahoo.com for each stock.

Now I'm not saying you should avoid all stocks that trade above one times sales. What I am saying is, the price-to-sales ratio is easy to understand. It's easy to find. And it's an easy way to gauge – one that you don't have to be an accounting expert to use – if a particular company is dramatically overpriced.

The S&A Guide to Options Trading

By S&A Investment Research

This article has all you need to know about options, and nothing you don't. It is short, but it is complete. How can it be short and complete? We'll explain below. But first… here are a few things you must keep in mind:

Truth No. 1: Buying and selling options is about the riskiest and potentially most rewarding game on Wall Street.

Options master Victor Sperandeo racked up a nominal rate of return of 70.7% without a losing year between 1978 and 1989. With his astounding track record, we'd be foolish not to pay attention to what he has to say:

> *"Options are, many say, the riskiest game in town. Certainly they are by far the most challenging, flexible, and potentially profitable financial instruments available. But if you trade them prudently, if you apply sound principles of money management, trade only when the risk/reward ratio is highly in your favor, and execute your trades with diligence and patience, then in all likelihood you will be profitable over the long term. I can say, conservatively, that at least 40 percent of all the returns I've made in my life have been with options."*

~ The Little Black Book of Investment Secrets ~

Truth No. 2: Want to be a winner? Watch your losers!

To succeed in trading options, you really need to limit your trading to opportunities that have at least a 3-to-1 payout. A 5-to-1 reward-to-risk ratio, of course, is better. But at minimum, you want to have the potential to pocket $3 in return for every dollar you risk.

You accomplish many things by forcing a minimum 3-to-1 discipline on yourself. For one, it forces you to think in terms of reward and risk, which is extremely important. Most failed options traders, even ones that may have had good trading systems, fail because they didn't pay enough attention to risk.

If you're willing to lose 50% on a position, you'd better be expecting a gain of 150% or more – at minimum. That's a tall order. If you're willing to lose it all (meaning have the potential for a negative 100% return on a position), then you'd better be expecting a 300% to 500% or more gain in that position.

When you see it in those terms, and you realize that 500% winners don't come along every day, you can see "risking it all" is a bad bet, in terms of risk versus reward.

Options are a lot like poker. Your hand is only a small portion of the battle. Betting appropriately for the entire game is really what's important, which leads us to…

Truth No. 3: Big winners make small bets

You've got to know when to hold 'em, and know when to fold 'em. But you'd sure hate to fold 'em and take a total loss with a big bet on the table… so don't ever put yourself in that boat. Limit the size of your positions. You should only have 2%-3% of the money you've set aside for trading at risk on any one trade. We really can't imagine any combination of circumstances where you should consider putting more than 10% of your trading money on one play. Don't do it!

To end up like Vic Sperandeo over the long run, you've got to stick to the program. Limit the size of your positions. And limit your downside by never allowing a small loss to turn into a big loss. Traders who follow this have a chance of being winners in options over the long run. Those who don't do this will be quickly drummed out of the club, taken for every penny.

The Easy Way to Understand Calls and Puts

By Dr. Steve Sjuggerud
Editor, *True Wealth*

There's a piece of land on the beach that I have my eye on. Empty lots on the water are hard to come by around here – they rarely go on the market. And when they do, they're snapped up pretty fast.

I drive by it around dusk one day on my way to a dinner party and see an old man on the property. I get out of my car and strike up a conversation, looking over the water. It turns out he's the owner. I ask him if he'd ever consider selling the property. "Sure," he says. "A million firm."

Right on the spot, I try to work a deal. I think a million is actually a good price for oceanfront around here, but I don't want to tell him that. And I need a little time to do my homework and get my finances together.

Here's the deal I offer: "I'll give you $10,000 right now – that you can keep – if you can give me a piece of paper giving me the

right to buy this property for $1 million anytime in the next 30 days. If I decide not to buy it, you keep the money."

"You've got yourself a deal right there," he says, happy to pocket the no-risk $10,000.

I head out to the dinner party. At the party, I meet some folks who've been looking to buy on the ocean for months, but nothing has come on the market. They mention that they'll snap up the first thing available, even at more than $1 million.

Long story short, I sell them the old man's oceanfront lot for $1,050,000.

I made a 400% profit in a few hours, by selling an asset that I controlled, but didn't own.

I could have completed the transaction two ways:

1) I could have exercised my right to buy the land, and gone through all the paperwork hassles and documents, taxes, and fees, only to turn around and go through all that again with the sale. Or...

2) I could have simply sold my "right to buy" piece of paper to the couple for $50,000.

For $10,000, I had the "option" to buy this land over the next 30 days. I could either buy the land or sell my right to buy. That's exactly what an option is…

OK, I confess, this isn't a true story. But it is a perfect example of buying a call option.

A **call option** is the right (but not the obligation) to buy something at a particular price. That's pretty much it. I paid $10,000 to the old man for the option to buy his property. I paid $10,000 for a call option.

A call option has an **expiration date**. In this case, in 30 days, my call option would have expired – worthless. Options are worthless after their expiration date. You'd better either **exercise the option** by buying the property or **sell the option** to somebody else before it expires.

With stock options, you have the same choices as I did. You can either exercise the right to buy the stock at a certain price (like the $1 million figure), which is called the strike price. Or you can sell the option to somebody else through the options market, basically just like the New York Stock Exchange. Only it's the options exchange. And it's in Chicago.

The reality is, nobody goes through the hassle of exercising their right to buy, just like I didn't when it came to the land. I didn't want the land transferred to me before I sold it to the couple. And the same is true for stock options. Because there is an options exchange, people are trading these options all the time.

Those are the basics of a call option. Now let me cover the basics of a put option…

Using Your Homeowner's Policy to Understand Puts

Every time you buy an insurance policy, you are essentially buying a put option.

Take your homeowner's policy as an example. When you sign on the dotted line and write your check, you are essentially buying the right to sell your house back to the insurance company for a certain value, under certain conditions, for a limited period of time. By accepting your money, the insurance company has taken on an obligation to buy your house back from you under the same terms. The longer your policy has to run, the more the insurance company will charge you. A six-month policy costs less than a 12-month policy. It works exactly the same way with put options. The longer it's good for, the more it costs.

As put-option buyers, we have two big advantages over insurance-policy holders. First of all, most options are not subject to the terms and conditions of many insurance policies. A disaster is not necessary for them to "pay up." In the case of put options, the

stock has to go down. That's it.

Secondly, unlike the insurance-policy holder, buyers and sellers of options are free to change their minds about a position for any reason. You can always exit or add to your position by simply buying more or selling it in the market.

For the most part, options are as easy to buy and sell as stocks. This makes them an ideal investment for those who wish to take advantage of big moves, because it can be done without the expense and risk of buying or selling huge chunks of stock.

In short:

Buyers of call options want the stock to go up. They only make money if the stock goes up.

Buyers of put options want the stock to go down. They only make money if the stock falls.

A Brief Options Glossary

Underlying Instrument: The stock, stock index, or any other financial instrument that you have the right to buy and sell.

Premium: The price of the option.

Expiration Date: Options expire on the third Friday of the month. You must sell on or before the expiration date.

Exercise: You can either sell your option, or exercise your right to buy (in the case of a call) or sell (in the case of a put) the underlying instrument at the strike price.

Strike Price: The price at which you can "exercise" your option. This price is based on the underlying instrument. Call-option buyers have the right to buy the underlying instrument at the strike price. Put-option buyers have the right to sell at the strike price.

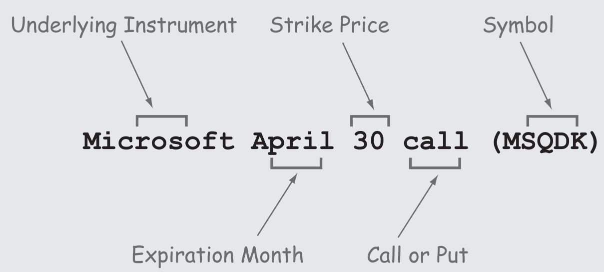
In the Money: Calls are "in the money" if the price of the underlying instrument is HIGHER than the strike price. Puts are "in the money" if the price of the underlying instrument is

LOWER than the strike price. (A put with a $20 strike price is "in the money" with the stock at $19.)

At the Money: When the price of the underlying instrument is identical to the strike price. Same for both puts and calls.

Out of the Money: Calls are "out of the money" if the price of the underlying instrument is LOWER than the strike price. Puts are "out of the money" if the price of the underlying instrument is HIGHER than the strike price. (A crude-oil call with a strike price of $25 is "out of the money" if crude is at $20.)

Anatomy of an Option



This option is betting that Microsoft's share price will be above $30 on option-expiration day in April, which is the third Friday of the month.

Three Major Factors Determine the Price of Options

1. **Distance of the Strike Price from the Market Price:** For out-of-the-money options, the closer the market is to the option's strike price (the closer the option is to being "in the money"), the more expensive the option will be.
2. **Time Until Expiration:** The longer an option has to work, the more expensive it will be. Extra time simply gives the stock more time to make the move. An option is known as a "wasting asset." It loses value with the passage of time, also known as "time decay."
3. **Volatility:** The more volatile the stock, the more expensive the option will be. Because volatile stocks have greater potential for large price moves, there's a higher probability that an out of the money option will at some point be in the money.

Figuring Profit Potential

Profit potential for both buying and selling options is typically figured at expiration. At expiration, hard-to-figure pricing variables, like time and volatility, drop from the equation, making profit calculations much easier.

However, that doesn't mean that you need to hold an option until expiration, and you do not need to exercise your option in order to profit from a position. To take a profit on a put or call, simply sell it. You can also cut losses in losing positions by doing the same thing.

The vast majority of options are not carried through until expiration at all. Rather, they are sold on the options-exchange market.

On the following page, there are some simple formulas for figuring risk and profit potential, based on the market price of the underlying instrument at expiration.

Nuts and Bolts: Some Final Questions

Can I buy options through my regular broker?

Once you complete an extra "options agreement," most brokers will allow you to buy calls and puts and to sell covered calls (sell calls on stocks that you own) without any problem.

More complicated trades, like spreading options or selling naked options, require additional paperwork. Usually, investors have to have at least two years of options-trading experience and at least $25,000 in an account. These requirements vary by broker.

Where can I find quotes?

You can get option quotes on Yahoo Finance... First, look up the stock of the options you're trading. Then click on "option" on the left side of the page. To search directly for the option add ".X" to the end of the option ticker.

Option prices on Yahoo Finance are 15 minutes delayed, so they're basically worthless for trading purposes. Most online brokerage firms give you a certain number of free real-time quotes, and you can pay for more real-time access.

Another choice is to buy simple market-data services like MyTrack (www.mytrack.com) for $99 per month.

How many options should I buy?

The common mistake option buyers make is that they over-leverage. In other words, they buy far more options than their account size justifies.

Options are purchased in blocks of 100. So if the Microsoft April 30 calls are priced at $2.30, you'll pay $230 for one contract, a call option on 100 shares of Microsoft.

Traders should use options as a substitute for the underlying shares. In other words, if you typically buy 1,000 shares, then you should buy 10 contracts. If you trade in lots of 500 shares, then you should buy just five contracts.

Of course, most people don't think that way. Most people think, "I can deposit $10,000 and sell short 1,000 shares of Company X at $10 a share, or I can purchase $10,000 worth of put options." This type of thinking is foolish. Foolish because, rather than using options to reduce risk, they've actually increased their potential maximum loss. Instead of substituting 10 puts for their normal trade of 1,000 shares, they've overleveraged and bought 100 puts, which cover 10,000 shares.

One of the annoying characteristics of options is that they have this nasty habit of expiring worthless. Consequently, you have to be willing to accept the potential loss of 100% of the capital you put at risk in options. So you should never, never, NEVER buy more put options than necessary to control the number of shares you normally trade.

Buying a call:

Let's say you think Company X, now at $29.50, has a rosy future. You expect the stock to hit $35 in the next six months, so you buy the Company X April 30 calls at $1.20. Here's how to figure what you would need to break even and what your profit would be on expiration day if Company X moved in the right direction…

	Strike Price	$30.00
+	Amount Paid for Option	+ $ 1.20
	Breakeven Price	$31.20

The market price of the stock needs to be above the breakeven price at expiration for a call to be profitable.

	Market Price of the Stock	$33.86 (Company X's price at expiration)
-	Strike Price	-$30.00
-	Amount Paid for Option	-$ 1.20
	Your Net Profit	$ 2.66 (222% profit)

Buying a put:

Let's say, conversely, you think Company X is going downhill. You expect the stock to sink to $25 in the next six months, so you buy the Company X April 30 puts at $1.50. Here's how to figure what you would need to break even and what your profit would be on expiration day if the stock took a turn for the worse:

	Strike Price	$30.00
-	Amount Paid for Option	-$ 1.50
	Breakeven Price	$28.50

The market price of the stock needs to be below the breakeven price at expiration for a put to be profitable.

	Strike Price	$30.00
-	Market Price of the Stock	- $26.20 (Company X's price at expiration)
-	Amount Paid for Option	- $ 1.50
	Your Net Profit	$ 2.30 (153% profit)

The Greatest Opportunity Ever Is Just About to Pass You By

By Dr. Steve Sjuggerud
Editor, *True Wealth*

You are foolish if you don't do everything you can to take advantage of this.

It is probably the greatest opportunity for you for the next 10 years.

And it is here now.

Time's "a-wasting" actually... You're about to miss the best moment, if you don't get on it, right now. The "V" bottom (as I call it) – where you can get the very best prices – is passing you by as I type.

I can't know this for certain, of course... But I'm more convinced of what I'm saying here than I have been about any other investment in my two decades of studying investments.

My friend, the time has come. It is time for you to buy a house, preferably a primary residence.

No excuses. No delays. Just figure out how to make it work.

Already have a house? Go get another, and rent out the one you're in.

Upside-down in what you've got? Do what Karen Farley did...

Farley was upside-down by $200,000 in her house and hadn't made a mortgage payment in a year. Her mortgage company sent her a letter, saying "*You could sell your home, owe nothing more on your mortgage, and get $30,000.*"

Farley told Bloomberg news, "*I wondered, why would they offer me something, and why wouldn't they just give me the boot? Instead, I'm getting money.*" According to Bloomberg, Farley is "*also approved

for an additional $3,000 through a Federal incentive program.*"

Farley gets her $30,000 check today. She'll use the money to cover moving costs and a deposit on the next place she lives in. No joke.

It's not just Farley, of course... Literally millions of upside-down homeowners are eligible for these deals.

Banks desperately want to get rid of these properties, at any cost, NOW. And the government desperately wants to help homeowners, NOW. It's doing everything from passing out checks to reducing mortgages and more.

Yes, you can sit back and complain that these people who lived beyond their means are getting off way too easy... But the smarter thing to do is to go out and take advantage of this situation...

The deals happening right now are ridiculous.

A friend of mine just bought a five-bedroom, three-bath house in a decent neighborhood for $70,000. He bought it in a foreclosure auction. He's going to put a coat of paint on it and price it below market value for a quick sale at $129,000.

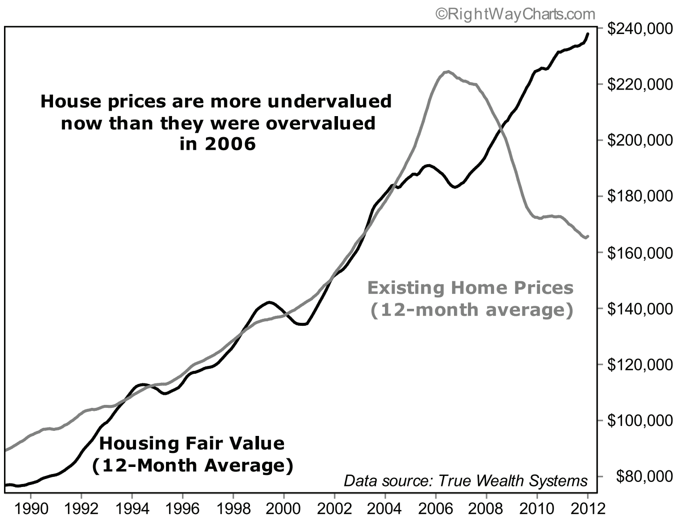
This is just one example. The point is, banks are finally willing to get rid of stuff. And investors (like my friend) are willing to step up. Buyers and sellers are finally seeing eye-to-eye. **This is it. This is your moment. The opportunity for the really great deal is just about to end.**

I believe this is the greatest opportunity you will have in the next 10 years in investing – as far as risk versus reward...

You see, your downside risk is extremely low, as houses are selling way below their replacement cost and you're essentially getting the earth itself "for free."

With homes dramatically below replacement cost AND with mortgage rates at record lows (below 4% for a 30-year mortgage), houses in the U.S. are more affordable than they've ever been.

We all know the recent housing bubble was the greatest in American history. But what most people don't understand is that houses are more *undervalued* right this second than they were *overvalued* during the bubble.



The median home price is about $165,000 in the U.S. right now. In order for homes to return to "normal" values, they'd have to rise 55% to $256,000. (I'm assuming mortgage rates and incomes stay flat, and that affordability returns to "normal" at 130 on the affordability index.)

That's a gain of $91,000. If you'd bought that home with a 20% down payment, you'd have put down $33,000 to make a gain of $91,000. Not counting any other costs, that's a profit of 175%.

This gain will happen. I have no doubt in my mind. The only question is when. Will it take three years... five years... or 10 years? I don't know. But it will happen.

Even better, if you buy this property as your primary residence, you basically have nothing to lose. Even if I'm completely wrong, and home prices go nowhere, you at least lived there "rent free"

for a few years.

But if I'm right, as your primary residence, this 175% profit would be completely tax-free. (Gains on your primary residence are basically the last legitimate tax-free shelter.)

I actually believe you should do better than this...

If you buy right now – I mean RIGHT NOW – you should still be able to get in at "below market" prices. You could get a property from a desperate seller, likely a bank. The better value you get up front, the higher your return percentage will be when things return to "normal."

And yes, **things will return to "normal" in housing**...

Housing is cyclical – we go through periods of overbuilding and underbuilding. Now is the time in the cycle when you want to buy.

When will things return to normal? Again, I don't have that answer... Nobody does. But it will happen.

How much louder can I say this? **This moment is the greatest opportunity ever to be an American homebuyer. It is the best moment in history. We may never see opportunity this great in our lifetimes.**

You can buy a home and make a 175% tax-free gain by simply assuming things return to "normal." If I'm wrong, and prices go nowhere, you got to live rent-free for a couple years. As far as risk versus reward, I don't know how you can beat that today.

The thing is, YOU have to do it. YOU have to get out there. YOU have to roll up your sleeves and make it happen.

People WILL do it... and soon. But they're not doing it yet. GO BEAT 'EM TO IT.

Best of luck to you... I know it's nerve-wracking and exciting at the same time to consider doing this. But your downside really is limited, and your upside potential is definitely there... it's just a question of when. I strongly believe it'll be worth it.

Now go! Get on it!

Here's How to Get the Best Deal Possible on Housing

By Brett Eversole
Analyst, *True Wealth Systems*

I recently made an offer on my first foreclosure.

In my hunt for a good buy, I've learned something shocking about the bank-owned real estate market.

Here's how one real estate veteran explained it to me...

> *"Look Brett," he said. "Banks aren't real estate companies. They're using clearing houses to move the properties. These clearing houses are a few guys in a room trying to move hundreds of properties as soon as possible. They don't answer the phones or return e-mails. They just list the properties. If they don't get offers, they lower the price."*

I've experienced this firsthand...

I just put in an offer on a property. It's been on the market for about two months. The original list price was $223,900. After a month, the price dropped to $213,900. And at the time of my offer, it dropped again... down to $199,900.

In just two months, the list price on this home fell 11%. Today, it's listed for $97 a square foot. To put that in perspective... a similar house down the street sold for over $180 a square foot in 2005. That's almost double today's price.

And this isn't an isolated case...

In March, I saw the same thing happen with a similar foreclosure I was considering. That home was listed for $249,900 in December. The price fell three times in the next three months. It finally sold for $214,900... 14% below the original list price. The selling price was just $93 a square foot.

It's clear to me... The foreclosure market is saturated. **The banks are willing to clear these properties for ANY price.**

That means you could get an outrageous deal if you buy right now...

The average American family could afford a $200,000 Florida home selling for roughly $100 a foot. As the housing market recovers over the next few years, this house could easily sell for closer to $300,000, or $150 per square foot.

That's a 50% tax-free gain, if it's your primary residence.

And it gets better...

The particular property I'm looking at is being sold through Fannie Mae. Fannie Mae apparently never learned its lesson in the mortgage debacle. It's willing to finance this property with just a 3% down payment. In short, you could put $6,000 down... and make a $100,000 gain as the market recovers. Not bad!

Could the housing market fall farther? And could my price projections be wrong? Of course, both of my assumptions could be wrong.

But today's price is so low, I'm certain I can make money on my housing "trade."

If you aren't in the market for a home... maybe you should be. This is one of the best times in history to buy.

Start with your local foreclosure listings. You can easily view them here: http://realestate.yahoo.com/Foreclosures. And you can find properties like the one I'm looking at – where you don't need a big down payment – here: http://homepath.com/.

From my experience, foreclosures are a minefield. But you only need to find one gem to get an unbelievable deal. Get out there and find it today.

That's what I'm doing, as we speak...

The Art of the Short Sale

By Jeff Clark
Editor, *S&A Short Report*

"Psst, hey Jeff. What's a good stock to buy now?"

For the past 20 years, I've been in the investment business. Quite simply, I trade stocks for a living. I have to tell you that the average public investor is often fascinated by that. In fact, I'm quite certain that at every social engagement I've ever attended, whether it was a holiday party, a high school reunion, a summer barbeque, or a PTA meeting, once people found out what I did for a living they always wanted to know, "What's a good stock to buy now?"

Curiously, never once, ever, did anyone ask me, "What's a good stock to sell?"

I find this strange because in every successful investment, there are two required transactions, a buy and a sell. Most folks understand the "buy" part of the trade, but I am constantly amazed at how few understand the "sell."

For the past 20 years I've had my share of successful "buy" stories. After all, for the majority of that time period, we were in a raging bull market. But I have to tell you that I have made far, far more money on the "sell" side. The "short sell" side to be specific.

I can almost hear the collective "GASP."

"Oh my goodness. He sells stocks short? Isn't that risky? Isn't that unpatriotic? Isn't that, well, INSANE?"

The simple answer is, "None of the above."

The fact of the matter is intelligent short selling has a place in EVERY portfolio.

I'll show you exactly how short selling works (it's easier than you think). And most importantly, after 20 years of doing it, I'll show you specifically what I've found works to consistently generate profits from overpriced stocks.

The THREE Secret Keys to Finding the Perfect Trade

If you look at the stock market from a historical perspective, you'll notice that, generally speaking, stocks spend about two-thirds of the time moving higher and one-third of the time moving lower. So if you're only buying stocks, then you're only seeing about two-thirds of the opportunities available. That's like watching only the first six innings of a baseball game, or turning the television off midway through the third quarter of the Super Bowl.

Think about what you're missing.

What I happen to find most interesting is that when stocks are moving, whether higher or lower, they tend to move lower at a much faster pace. Think about it. I mean, you rarely hear of a "buying panic." Consequently, profits on short sales tend to come much faster than on purchases. In fact, my average holding period on short sales is less than three months.

How Bad Ideas Create Great Profit Opportunities

Before we get to my basic strategy for successful short selling, let's deal with a few of the misconceptions surrounding this form of investment…

- The most common misconception is that short selling is a complicated strategy. It's not.

We're all familiar with the old Wall Street adage "Buy low/Sell high," in which we look to buy stocks when they're cheap and unloved, and then sell them when they're expensive and the darlings of the investment community. Simple, right?

Well, short selling is the exact same thing… only in reverse order.

Just as we look for ridiculously cheap valuations and an air of pessimism surrounding a stock in order to consider it for purchase, we look for ridiculously expensive valuations and extreme popularity in order to consider a stock a viable short-sale candidate.

It really is as simple as that. Not very complicated at all.

- Another very common misconception is that short selling is risky because it exposes the investor to unlimited potential losses. This concept is just silly.

Honestly, I have been short selling stocks for years and not once, ever, have I lost an unlimited amount of money. Yes, I've taken my share of losses on the short side of the market, but I've lost money buying stocks, too. There is no more inherent risk in short selling than there is in buying stocks. And just as there are ways to mitigate the risks of buying stocks, there are similar methods of reducing risk for short selling.

The secret to making money in stocks, whether buying or selling, centers around two factors…

1. The entry price of the trade
2. The timing of the trade

Let me explain…

When buying stocks, if you pay too high a price, or you get the timing wrong, then you're likely to lose money. The same is true in short selling. If you short a stock at too cheap a price, or get the timing wrong, then you're likely to lose money. Same thing.

The strategy we use for short selling is designed to make sure that we only short sell stocks that are trading at absurd valuations, and that we get the timing right.

Now let's look at our strategy…

Strategy for Successful Short Selling

When I first started trading stocks, I did so almost exclusively from the long side. Through a series of trials and errors, I developed a three-pronged approach for what constituted a good stock to buy…

1. Ridiculously cheap valuation.
2. High degree of pessimism or even hatred surrounding the shares.
3. Price action that had just turned up following a long period of steady decline.

As simple as this buying strategy might seem, it has produced superior returns.

Logically, then, it makes sense to use a similar three-pronged approach to shorting stocks…

1. Ridiculously high valuation.
2. High degree of optimism surrounding the shares.
3. Price action that has just turned down following a period of steady incline or parabolic rise.

Let's look at each element individually…

Ridiculously High Valuation

We all understand that, ultimately, earnings drive stock prices. Consequently, the price/earnings ratio is the best gauge with which to measure the ridiculousness of a stock's valuation. But at what level does a P/E ratio signal that a stock may be overvalued? I have three general conditions…

1. The P/E ratio is more than twice that of the company's earnings growth rate.
2. The P/E ratio is 50% higher than the industry average, or more than 50% higher than the company's historic P/E ratio.
3. The P/E ratio is higher than my life expectancy.

The first condition makes perfect sense. A company with a high earnings growth rate can sustain a high P/E ratio. But there is a point at which the valuation becomes unsustainable, and where the valuation does not properly discount the potential for the earnings growth to slow. In my experience, that point has been when the P/E ratio is more than two times the growth rate.

Simply stated, the price/earnings ratio tells an investor how many years it will take for the company to pay back his original investment at the current level of earnings. For example, it would take 10 years for an investor to recover his original investment in a stock with a P/E of 10. A stock with a P/E of 100 requires the investor to wait 100 years.

Before I put a nickel into any investment opportunity, I want to make sure that there's a reasonable chance that I'll see my money again within my lifetime. Seems like a reasonable goal, doesn't it?

High Degree of Optimism Surrounding the Shares

If every analyst on Wall Street loves the stock…

If the anchors on CNBC seem to be mentioning the stock every hour…

If all of your friends are talking about the fortunes to be made by owning the stock…

Then it's probably on my list of short-sale candidates.

This concept is really quite easy to understand. If the whole world is in love with a stock, and if everyone who wants to own the stock already does, then who is left to buy the stock and push the price higher? And if there is no one left to buy and to push the stock higher, then it only takes one seller to shift the momentum in the other direction.

It's All Meaningless Until the Third Condition is Met

A high valuation, in and of itself, is not a reason to short a stock. Stocks can stay ridiculously overvalued for long periods of time.

And, few things in life are more uncomfortable than being on the wrong side of a stock as it goes from ridiculously overvalued to absolutely moronically absurdly overvalued.

Short selling stocks that are insanely hyped and where it is evident that the average public investor (a.k.a. "the dumb money") is involved can also be a profitable endeavor. However, even the dumb money can win out once in a while.

So while there are plenty of companies whose shares fit into these first two categories, it is not until the third category is satisfied that I feel confident in recommending shares be sold short. Once the price action turns negative on one of these ridiculously overvalued, overhyped stocks then, and only then, is it time to initiate a short position.

Price Action that Has Just Turned Down Following a Period of Steady Incline or Parabolic Rise

Just as it doesn't make a whole lot of sense to jump in front of a moving train, it also doesn't make a whole lot of sense to try to short a stock as it's moving higher. Yes, there is a certain thrill to shorting a stock at its absolute peak, just as there might be a certain adrenaline rush to jumping over the railroad tracks right in front of a speeding train. But if you're not successful, the results can be disastrous.

Rather than trying to pick a top in a stock, it makes far more sense to wait until the price action has turned lower and is in the early stages of confirming that the momentum has shifted from bullish to bearish. For me, that confirmation occurs when the stock trades below its 50-day moving average.

Stocks in which the upside momentum is strong will hold above their 50-day moving average lines. Failing to hold above that line is an excellent early indication that the momentum is shifting to the bearish camp. Most of my short sale recommendations will fall into this category.

Alternatively, if a stock has been moving nearly straight up (parabolic), then its 50-day moving average line will be too far below the current stock price to justify waiting until a violation of the line to go short. Since parabolic rises typically occur during a time of intense hype, then we'll look to short a stock when we sense that the hype has peaked.

The Mechanics of Short Selling

Since short selling involves selling stocks that you don't currently own, it is necessary to borrow the shares from your broker. To do this, you'll need to open a margin account and deposit 50% of the value of the shares you're borrowing. Once your broker approves your request to borrow the shares, then you may go ahead and sell the shares short. The entire sales proceeds are credited to your account, and you will be obligated at some point in the future to buy the shares back to replace those that you originally borrowed. If you are able to buy the shares back at a lower price, then you keep the difference. On the other hand, if you have to pay more for the shares than you originally received, then the loss is deducted from the funds you originally deposited in the account.

Since the shares are termed "borrowed," any dividends or stock splits paid by the company are the obligation of the short seller. In other words, if a stock you've sold short pays a $0.75 dividend, then that amount is deducted from your brokerage account. Similarly, if a stock you've sold short declares a two-for-one stock split, then you'll be liable to return twice as many shares to your lending broker. Keep in mind, none of this actually affects you financially as both the dividends paid and the stock splits are reflected in an automatically lowered price per share. Nonetheless, short sellers need to be aware of these obligations.

Let's revisit the misconception that short selling may subject the investor to unlimited losses.

When short selling, an investor loses money as the stock moves higher. Since, in theory, there is no limit as to how high a stock can climb, then, in theory, there is no limit as to how much a

short seller can lose. Of course, theories are one thing and practical reality is quite another.

The truth is that as a short sale moves against the investor (the stock climbs higher), the brokerage firm will eventually require the investor to either deposit additional funds to secure the position, or to buy the shares back and close the position completely. This is known as a "margin call," and generally occurs on short sales with a move of just 20% in the wrong direction. In this manner, a margin call serves as an almost automatic stop-loss on ill-conceived short sales. Granted, a loss of 20% on a position is no walk in the park, but it is infinitely more acceptable than an unlimited loss.

How to Get Paid in the Next 24 Hours

By Jeff Clark
Editor, *Advanced Income*

I want to introduce you to an income secret that could easily give you all the money you need for the rest of your life.

Over the past 25 years of managing money for wealthy folks in California, I've used this secret to help people make a small fortune.

I can remember one client, for example, who started out with 2,000 shares of a company called Siebel Systems. By using this strategy, we were able to generate an incredible HALF-MILLION dollars in income in a single year.

This guy bought a vacation home in Tahoe with his earnings.

I had another client who simply needed to generate about $2,500 a month in income to cover his monthly expenses. We were easily able to do that for him using the income strategy I'm going to show you today.

Another client sold a piece of real estate and wanted to get more income than she could by putting the money in the bank. We were able to help her generate an amazing $150,000+ per year.

You get the point.

This is a way to generate income. Serious income.

I have used and continue to use this strategy myself, for my own account. For example, I used it to generate about $4,000 in free income on a stock called Devon Energy Corp.

The strategy I'm talking about is an "options" strategy – but completely different from any risky options trading you've ever heard about or tried before. In fact, what I'm going to show you is actually LESS risky than owning ordinary stocks.

The technique is called "selling covered calls," which is sometimes referred to as "covered call writing."

In short, covered call writing is the only income-producing idea that offers high returns and low risks when interest rates are rising. It's probably the best way to add extra income to your portfolio. And I'm not the only one saying this:

- Brian Workman, a senior vice president at *Citigroup* says: "This was a definite eye-opener… it makes you wonder what else Wall Street has been keeping from us."
- Financial author Ronald Groenke says: "This really is 'new money.'"
- Paul Kadavy, a member of the American Institute of Banking, says: "You get your 12% or greater return paid up front immediately the day after you make your investment trade… no waiting as with other investments. And you can take that money and use it right away for your personal expenses or use it to reinvest and make even more money."

So what is covered call writing, and how does it work?

Although covered call writing involves the use of options, it is

really quite simple. **In a nutshell, the strategy involves buying a stock and then selling someone else the right to buy it from you in the future.**

That's it.

Think of it in terms of real estate…

Let's say you buy a piece of property for $200,000. You then turn around and sell someone the right to buy it from you anytime in the next three months for $210,000. For that right, you charge a premium of 4%, or $8,000.

You pocket the $8,000 immediately. It's your money now. You are also obliged to sell the property for $210,000 if the buyer chooses to exercise his right.

This scenario has three possible outcomes…

1) The property goes up in value, and the buyer exercises his right to buy. In this case, you've pocketed the $8,000 premium, and you'll be selling the property for $210,000. Here, you'll have an $18,000 gain (9%) in three months, and you'll have to find another investment property to buy in order to continue the strategy.

2) The property remains worth $200,000. In this case, you keep the $8,000 premium. Since the buyer won't be willing to pay $210,000 for a property that's only worth $200,000, you'll keep the property, too. You've made 4% over three months, and you can sell the right to someone else for another three months, repeating the process.

3) The property falls in value. In this case, the $8,000 premium you received helps to offset the loss on the property. The buyer walks away when the right expires, and you're free to sell another right for another time period.

So if the investment goes up, then we sell it for a gain. If the investment stays the same, then we profit off of the premium. And if the investment drops in value, then the premium helps offset the loss.

I know it sounds like a terrific strategy, but there are two major pitfalls…

First of all, if the investment collapses, the small premium you received by selling the option won't do much to alleviate the loss on your "safe" money. ***So you have to make sure your investments are absolute bargains.***

If a stock drops 10%-20%, you can make up for the loss by selling the premium a few times. But you will not recover from a 50% loss with this strategy.

Unfortunately, a lot of people who try selling covered calls get sucked into buying expensive stocks because the call premiums are quite large and the theoretical returns can be huge. But that strategy carries a lot of risk, and it's not a good place for "safe" money.

We have plenty of opportunities to generate 15%-20% annual returns by selling calls on safe, cheap stocks. So we have no need to try to juice the returns even more by taking on large risks.

The other pitfall to covered call writing is that you sell off your potential for enormous gains.

Take our previous property investment, for example. We are obligated to sell the property for $210,000. That's a good gain, especially considering the extra $8,000 premium. But if the property jumps to $300,000, then we'll be kicking ourselves for selling at such a cheap price.

But here's the thing… The purpose of covered call writing is to generate income, not capital gains. It's the difference between buying a bond and buying a stock. Stock buyers look for capital gains. Income is secondary. Bond buyers want the income, and any gains are a bonus.

Folks who write covered calls are bond buyers.

If you like the prospects of a stock and believe it could easily double or triple, then you shouldn't sell options against it. All

~ The Little Black Book of Investment Secrets ~

you're doing is capping your profit potential and guaranteeing you'll be out of the trade before it explodes higher.

To put it another way, you should only sell calls against stocks that you wouldn't mind selling at the agreed upon price. If it moves higher after you're out, then who cares? You met your objective and moved on.

Let's look at an example…

In August 2007, I recommended a covered call position on Sun Microsystems (Nasdaq: JAVA). The company had just reported stellar earnings – the third time in three quarters that it trounced analyst's expectations. It was sitting on a pile of cash, and the fundamentals were all quite favorable.

So at a little less than $5 per share, JAVA qualified as a safe, cheap stock. And the option premiums were also quite large. For example, the January 5 call options were bidding 55¢.

Here's the trade I recommended…

Buy shares of Sun Microsystems (Nasdaq: JAVA) at about $5 per share, and Sell the SUNW January 5 calls (SUQAA) at about $0.55.

Quite simply, we bought the stock at $5 per share and then sold to someone else the right to buy the stock from us at $5. For that right, we got 55¢ per share. So our net cost of this trade was $4.45 per share ($5 for the stock less 55¢ received from selling the call).

These options expired on January 18, 2008 – which was just a bit more than five months from the date of the recommendation.

If JAVA had traded for more than $5 per share at that time, then we would have been required to sell the shares for $5. Since we're into the trade at a net cost of $4.45, we would have pocketed a 55¢ gain, which would have worked out to a little better than 12% in a little more than five months.

In fact, the stock traded for less than $5 per share when the options expired, then we held on to the stock (and the 55¢ premium) and continued to sell options against it.

The only way we could have lost money on this trade was if JAVA was trading for less than $4.45 on option-expiration day in January. JAVA reached its low point of the preceding 52 weeks when it hit $4.40 per share, and that occurred almost exactly one year earlier – well before the turnaround. So the odds of losing money on this trade were fairly remote.

This was an excellent opportunity to write a covered call. It was a low-risk way to generate a 12% return in a little more than five months. You won't find a bond with that combination.

If it sounds confusing, I hope you'll stick with it to try a few of these simple trades on your own.

I think you'll be amazed at how easy it is for you to collect thousands of extra dollars of income a year, with very little risk.

Understand that this is different than the way in which most people approach covered call writing. Most people start by looking for options that carry the fattest premiums and then find a way to justify owning the stock. That's why most people have a tough time generating consistent income through covered call writing.

I know this sounds like a tall order, but I've been doing it for years. The opportunities were somewhat limited back in 2005 and 2006. But with the recent increase in stock market volatility, the call option premium is higher now than at any time in the past four years. That gives us an ideal environment for covered call writing.

To take advantage of this situation, all you need to do is contact your broker and make sure that your account is approved for covered call writing. In most cases, you'll just need to fill out and sign a one-page form called an "Options Disclosure Document."

Remember, we're not buying options here. That's a strategy for traders and speculators. Most options expire worthless – so we're taking the other side of the typical options investment. We're *selling* covered calls. This is the lowest-risk form of options trading. In fact, it's less risky than just buying stocks outright.

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A professor named Robert Whaley from Duke University conducted a 16-year study, beginning on June 1, 1988. The results were startling. Even during a period that included one of the biggest bull markets of the past 100 years, the strategy of writing covered calls beat the stock market as a whole… with less risk… and with much, much bigger dividends.

For more information on the covered call positions I'm recommending right now, go to www.stansberryresearch.com and click on "*Advanced Income*".

The Clearest, Simplest Explanation of Selling Puts You'll Find Anywhere

By Porter Stansberry
S&A Founder and Editor of *Stansberry's Investment Advisory*

I urge you to become familiar with one of the greatest money-making strategies you'll ever find in the stock market.

I'm referring to selling put options.

In fact, once you learn how to sell puts, you may never execute a conventional stock purchase again.

I realize most people will probably never get involved in options... just like most people will probably never buy bonds. That's fine with me. You have to do what you're comfortable with... and do what you understand. But know this: You can make 5%-10% every few months, nearly risk-free, in the options markets. You do this by *selling* options, not buying them.

Buying options is incredibly risky. It's a strategy that should be used mostly by professional investors to hedge against losses – insurance, essentially. Buying options is a cost of doing business for professional fund managers. Selling those options is an easy way for us to generate large amounts of safe income.

How safe is selling options? My colleague Dr. David Eifrig, who has been showing readers of his *Retirement Trader* advisory how to use options to generate safe income, recently closed 61 consecutive trades for a profit with this strategy.

With this sort of track record, it's no surprise that our firm **has received more positive feedback about this technique than any other technique we've ever shared**.

That's why I'm sharing a portion of Dr. Eifrig's "how to sell puts" educational material. Dr. Eifrig is a phenomenal educator. The explanation below is the clearest, simplest explanation of selling puts you'll find anywhere. (**Please note**… this presentation is from late 2011, and the numbers cited are from that time.)

THE BASICS OF SELLING PUTS

Excerpted from a presentation by
Dr. David Eifrig Jr., MD, MBA, Editor, Retirement Trader

When most folks hear the words "stock options," they think of risky bets on volatile moves in the stock market. And the way most folks use options, that's a reasonable thought.

But as I'll show you in a moment, there's a way to use stock options *to drastically reduce your risk in the market... while increasing your returns*.

Keep in mind, a stock option is a contract between two parties that gives the buyer of the option the right – but not the obligation – to buy (or even sell) a security at a given price, in a given time period out into the future to some expiration date.

When it comes to stock options that allow you to buy a stock at a given price in the future, we name these **call options**.

And when it comes to options that allow you to sell a stock at a given price in the future, these are called **put options**.

In my option guides, I cover both of these subjects in depth. But for the purposes of this presentation, we're going to be dealing exclusively with **selling put options**.

And while many investors and traders ignorantly use stock options to increase their risks, you can use put options to *decrease* your risks. You see, done properly, selling put options is one of the greatest moneymaking strategies ever created. It's a simple low-risk way to make thousands of extra dollars per month... while taking on less risk than conventional stock investors.

Most people learn about put options the best by thinking of them with a simple housing example...

Remember, an option is a contract between two parties. The acquirer of the put option – the buyer – is purchasing a contract that allows him to sell an asset at a given price in the future.

The seller of the put option contract is taking the other side of the trade. He is agreeing to buy an asset at a given price in the future.

I know at first this can sound complicated, so let's go over it one more time. The BUYER of a put option gets the right, but not the obligation, to SELL an asset at a given price in the future.

The SELLER of a put option agrees to BUY an asset at a given price in the future.

Now... let's look at how a put option works with a story about a house. Let's say you're familiar with a particular neighborhood and the values of the homes in it. You see an attractive little house that you think is worth $200,000. Paying $200,000 for it would be a good deal in your opinion.

But you're not interested in a "good" deal on that house. You're interested in a great deal. You'd love to buy the house for $170,000... or 15% ($30,000) below the market price.

Here's where a put option contract come in...

You approach the owner of the house and start talking. He's a nervous sort. You learn the homeowner – like most homeowners – is concerned about the economy, skyrocketing gas prices, the upcoming elections, and the world in general. He's nervous something bad could happen to the country, which could cause the price of his home to sink below $150,000. He's even worried the house is only worth $180,000 to begin with.

You tell the homeowner: "Well, you never know what will happen in the world. But I think I can help you out. If you give me $1,000, I'll agree to buy your house for $170,000 if you want to get it off your hands. That offer is good any time for the next 12 months, no matter what happens."

The nervous homeowner agrees to your offer. You draw up a contract, you both sign it, and he gives you $1,000 cash.

This is generally how selling a put option works. You (the put option seller) enter into a contract with the homeowner (the put option buyer) that gives the buyer the right, but not the obligation, to sell that house to you for $170,000 sometime in the next 12 months.

The outcome can work out several different ways...

If the "calamity" the homeowner is worried about does not arrive in the next 12 months, and home prices in the neighborhood remain robust, then he won't be interested in selling his house to you for $170,000. You keep the $1,000... and the transaction is finished... over... done.

If the homeowner decides, for whatever reason, that he wants to sell you his house for $170,000 in the next 12 months, then you are on the hook to buy it for that amount. (Remember, you believe it is worth $200,000, so you're thrilled with a $30,000 discount).

Realize... this isn't a "one side loses, one side wins" transaction. This is win-win.

And like most transactions, it involves different parties, each with their own goals and needs.

The homeowner (the put buyer) "wins" in this contract because he's buying a bit of insurance against a big downturn in housing... or against some big calamity.

You (the put seller) "win" because you collect upfront cash, and enter into a contract that will allow you to purchase the house for $170,000, should the buyer want to sell it for that much.

While some folks do sell put contracts on homes, in *Retirement Trader*, we're interested in a much easier way to make "low ball" offers on assets we'd love to own...

In fact, we're interested in making hundreds and thousands of dollars per month by selling puts on the world's best, most stable companies. Take Intel for instance...

Technically, you'd describe Intel as a $100 billion computer-chip maker. But that description shortchanges how marvelous this business is.

Intel (INTC) is a moneymaking machine. It is the dominant manufacturer of the most essential component used in computers.

All of the name-brand computer makers – Microsoft, Dell, even Apple – rely on its processors. And electronics makers use its chips to improve the brainpower of everything from ovens to garage door openers.

To get a sense of how dominant Intel is, realize it controls 80% of the global market for microprocessors. Its nearest competitor, AMD, accounts for just 10% of the market. Intel made $4.3 billion in net income in 2010. AMD, on the other hand, is struggling to barely break even, regularly losing hundreds of millions a quarter.

AMD is dying a slow death. Its cash flows are barely positive – only once in the past three years and twice in the past four quarters. This means more market share for INTC. Other competitors exist, but they can't match INTC for quality, price, or brand loyalty.

For all practical purposes, Intel has no competition. It's a virtual monopoly. And Intel treats its shareholders well. It pays an annual cash dividend of 4%... plus it buys back billions of dollars of stock every year... which increases the value of the individual shares remaining outstanding.

And yet, the stock is currently trading for just 3.1 times book value, 2.7 times sales, and less than its growth rate at a price-to-earnings (P/E) ratio of 12.4. The company has margins at the levels of some of the best businesses ever... Profit margins of 23%, operating margins of 33%.

Going back to our home analogy for a second, it's safe to say Intel is a beautiful, hurricane-proof, beachfront mansion. It's one of the world's ultimate blue-chip companies.

Today, Intel trades for around $20 per share. For Intel shares, this price is a good deal. But remember... just as in the house analogy, we're not interested in a "good deal" on Intel. I'll let the other guy settle for a "good" deal.

I want a great deal.

I want to put in a "lowball" offer on Intel by selling put options.

Today, you can sell a put option contract on Intel that obligates you to buy shares for $17 in April 2012. This is less than a year away.

This contract is priced at approximately $1 per share right now. And since one option contract represents 100 shares, you'll receive $100 by selling this put. Let's go over the math as if we were willing to buy 300 shares of Intel at the dirt cheap $17 a share...

If we wanted to buy 300 shares of Intel, we would simply enter the market and sell three put contracts. This would obligate us to buy Intel for $17 per share in April 2012. And as I mentioned, we'd receive $1 per share for taking on this obligation.

Since each contract represents 100 shares, we would receive $100 per contract. And remember, we want to buy 300 shares, so we will sell three contracts and receive $300.

~ The Little Black Book of Investment Secrets ~

Keep in mind... in the next video, I'm going to show you exactly what to tell your broker to make this sort of trade, but we'll keep things short and simple for right now.

If we sell three put contracts that obligate us to buy Intel for $17 per share in April 2012, it can work out a handful of different ways...

One possibility, Intel stock chugs along... and advances from $20 per share to $22 per share. Since no Intel shareholder will sell us shares for $17 they could sell on the open market for $22, we simply pocket the $300 we received for selling the puts.

A second possibility, Intel stock doesn't move at all. It remains at $20 per share on April 2012. Since no Intel shareholder will sell us shares that are trading on the open market for $20 for $17, again, we pocket the $300 we received for selling the puts.

Another possibility: Intel declines 10%... from $20 per share to $18. Since no Intel shareholder will sell us shares that are trading on the open market for $18 for $17, we pocket the $300 we received for selling the puts. This situation is worth noting: *We make money even if the stock declines*.

A fourth possibility, Intel declines 20%... down to $16 per share. Since nearly any Intel shareholder would be willing to sell shares trading for $16 on the open market for $17, we are "put" the stock. We are obligated to buy 300 shares of Intel at $17 per share... a $5,100 outlay.

But remember... we were paid $300 to enter into the put contracts. Therefore, our "real" cost is $4,800 for those 300 shares. That means our price is actually $16.

This is the beauty of selling put options. By only selling puts on companies we'd be happy to own, we're not bothered when we're forced to buy the shares.

This is how we get huge discounts on blue-chip stocks like Intel. As I write, if you could buy Intel for $16 per share, and the dividend remains the same, it'd be like buying a stock that pays a super safe dividend yield of 5.2%.

In our example, if Intel sunk below $16, we'd end up losing money on the initial purchase, but we'd still own one of the world's best businesses for a very cheap price, and be holding a company now paying us 5% a year.

If you are worried that all of this sounds too complicated for you to do, don't worry. I promise you it's pretty simple once you've done a few of these trades on your own.

Over the years, I've taught a lot of people how to do this – everyone from accountants and chemists to car dealers, construction workers, and U.S. military personnel. One fellow, a mechanical engineer for the energy industry recently told me he's made $60,000 trading this way – just in the past 10 months.

Doctors are notoriously bad at investing. I know this from my time in medical school and residency. But I've even taught by my count a dozen or so doctors how to do this.

The point is, once you do a few of these trades on your own, you'll have a much better understanding of how it all works.

Bond Investing Basics

By S&A Investment Research

What is a bond?

A bond is a loan. There are three kinds: short, medium, and long term. A short-term loan (less than two years) is called a bill. A loan for two to five years is called a note. All loans for a longer term are bonds. These terms are often used interchangeably. We will not be investing in bills in *True Income*. So for convenience, I will use the term bond for both notes and bonds.

In the bond world, there are three different types of borrowers:

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governments, municipalities, and corporations. We will be making loans to corporations.

A key difference between stocks and bonds is that stocks make no promises about dividends or returns. The company is under no obligation to pay you.

However, when a company issues a bond, it guarantees it will pay back your principal (the face value) plus interest. If you buy the bond and hold it to maturity (when the loan expires), you know exactly how much you're going to get back. Bonds are traded in $1,000 increments. So for each bond you buy, you'll receive $1,000 at maturity.

When we make a loan we want to know four things:

- What is the amount of the loan?
- Who is the borrower?
- How much interest do we earn?
- When do we get paid?

Let's use the **Goodyear Tire and Rubber 7.86% bond due 8/15/2011** to illustrate how this works.

You decide the answer to the first question… The "par value" or "face amount" of each bond is $1,000. But that's generally not what you pay to buy a bond. For example, if the Goodyear bond was selling for $740, and you wanted to invest $10,000, you would buy 13 bonds ($740 per bond = 13 bonds).

The next three questions are answered in the description of the bond.

Goodyear (borrower) **7.86%** (coupon) **bond due 8/15/2011** (repayment date).

Goodyear Tire and Rubber Company is the borrower. That's easy. The next question – how much interest do we earn – is a little tougher…

The "coupon" is 7.86%. This is the interest the borrower pays on the loan… but it's not necessarily the interest you earn. The borrower calculates the interest payment by multiplying the coupon (7.86%) times the par value ($1,000)… 7.86% times $1,000 equals $78.60. This is the annual interest amount paid in two equal installments of $39.20 on February 15 and August 15.

This coupon will not change. Bondholders are guaranteed payments equaling $78.60 a year per bond. But the price of the bond can change. Here's what it looks like for the Goodyear bond:

Current Price of the bond	$740
Annual Interest payments	$78.60
Yield (7.86%/$740)	10.6%

So if you pay $740 for this bond, you'll actually receive a 10.6% yield – much higher than the original coupon.

The last part of the bond description is the maturity date. This is the date the loan will be repaid. The borrower borrowed $1,000 and will repay $1,000. So you'll receive $1,000 for every bond you hold.

What is my return?

When you buy a bond, you will get the interest payments, plus you will be repaid the full amount of the bond at the end of the loan. Your return is the combination of the interest payments plus the capital gain.

When will I get paid?

Most corporate bonds pay interest twice a year. The borrower pays the interest to the bond trustee, who sends the interest payments to you. The bond trustee will be an independent company – selected by the borrower – that takes care of bookkeeping.

Do I have to pay taxes on the interest?

Yes. Unlike municipal bonds, which are exempt from federal (and sometimes state) taxes, corporate bonds pay taxable interest to bondholders. You can get around this by holding the bonds we buy in True Income in a tax-exempt retirement account (like an IRA).

What are the risks?

A bond manager faces many risks: interest-rate risk, event risk, default risk, credit risk, downgrade risk, prepayment risk, duration risk, and more.

We, on the other hand, don't have to worry about most of these. We'll be buying debt that's already been downgraded. And because we will hold these bonds until they mature, we eliminate interest-rate risk, duration risk, and prepayment risk.

In fact, we face only two risks (and they're related)… credit risk and default risk.

If the issuer's credit deteriorates, we face the prospect of a default. If the issuer defaults, we may lose all or part of our capital. But my analysis in *True Income* is designed to find high yields while ensuring that default is as remote a risk as possible.

How do I buy a bond?

There is no central place or exchange for bond trading, as there is for publicly-traded stocks. Bonds are traded through bond dealers, more specifically, the bond-trading desks of major investment dealers, like Lehman Brothers or Goldman Sachs. These dealers buy and sell huge volumes of bonds. They know all about a particular bond and are prepared to quote a price to buy or to sell.

When you want to buy a bond, you call your broker and he calls one of the dealers to arrange the trade. You need to give your broker this information about the bond you want to buy:

- How many bonds
- The name of the borrower, the coupon, and the maturity date
- The CUSIP number

A CUSIP is a number assigned by Standard & Poor's to every traded security. So using the CUSIP along with the description eliminates any possibility of error, and I'll always provide the CUSIP number when I make a recommendation in True Income.

Your broker will arrange the trade and credit the bonds to your account. Bonds are "book traded," which means your ownership is accounted for and maintained by the bond trustee, an independent company – selected by the borrower – that takes care of bookkeeping. A certificate is not issued.

Where can I learn more about bonds?

- PIMCO, the world's largest bond investor, covers the basics of corporate bonds here: http://www.pimco.com:80/LeftNav/Bond+Basics/2007/Corporate+Bond+Basics.htm
- Investing in Bonds, an industry website, offers calculators, a market overview, and other resources here: http://www.investinginbonds.com:80/.
- Yahoo Finance has a bond screener here: http://screen.yahoo.com:80/bonds.html
- FINRA (the Financial Industry Regulatory Authority) has some tips on how to choose a broker here: http://apps.finra.org:80/Investor_Information/Smart/Bonds/406000.asp.

Bond Glossary

Bond

A bond is a long-term loan to the government, a municipality, a corporation, or even an individual. The terms of the loan are contained in an agreement between the borrower and the bond trustee, who represents the interests of the bondholders.

Bond Trustee

An independent third party selected by the borrower to handle bookkeeping on a bond. The trustee represents the interests of the bondholders.

Note

A note is a medium-term loan to the government, a municipality, or a corporation. The terms of the loan are contained in an agreement between the borrower and the note trustee, who represents the interests of the noteholders. (Also called a bond.)

~ The Little Black Book of Investment Secrets ~

Debt Instrument

Debt instrument is the general term used to describe both a note and a bond.

Fixed-Income

Bonds and notes pay a specified amount of interest. The dollar amount of the interest payments is fixed and does not change for the life of the loan. Bonds and notes are therefore called fixed-income investments.

Issuer

The issuer is the name of the borrower.

Principal

Principal is the amount of each bond or note. It is the amount of the loan. Principal, par value, and face value are interchangeable terms.

Par Value

Par value is the denomination of the note or bond. It is the original amount of the loan. Generally, it is $1,000.

Face Value

Face value is the same as par value. It is the denomination amount of the note or bond. Generally, it is $1,000.

Coupon

Coupon is the specified amount of interest on the bond. It is fixed for the term of the loan.

Maturity Date

Maturity date is the date the bond will be repaid in full.

Accrued Interest

Accrued interest is the amount of interest that has been earned on the bond since the last payment date. Interest is earned every day, but only paid twice a year. So the accrued interest amount increases every day until it is paid.

Interest Rate

Interest rate is the cost of the loan to the borrower. The coupon and interest rate are the same. It does not change for the term of the loan.

Yield

Yield is the relationship between the coupon of the bond and its current price. The coupon does not change, but the price of the bond does. The yield changes as the price of the bond changes. If the bond price declines, the yield increases, and vice versa.

Yield to Maturity

Yield to maturity is the amount we earn on a bond every year until it is paid. This takes into account the interest paid and the discount or premium of the bond price to its par value.

Municipal Bonds

Municipal bonds are loans to a municipality. The loan is usually to establish or improve facilities or services that benefit residents. The bondholder does not have to pay tax on the interest payments. Therefore, the interest rates on municipal bonds are generally lower than on corporate bonds.

Corporate Bonds

Corporate bonds are loans made to corporations. Unless the bonds are held in a tax-exempt account (like an IRA), bondholders pay taxes on the interest.

Credit Rating

A credit rating is a report issued by a credit rating agency – like Moody's or Standard and Poor's. It estimates the chances of default. Credit ratings are important because they determine the interest rate the borrower has to pay. The higher the chance of default, the higher the interest rate.

High-Yield Bonds

High-yield bonds are a part of the corporate bond markets. Issuers in this market are more likely to default and therefore, pay more to borrow.

Junk Bonds

Junk bonds is a nickname for high-yield bonds.

Call

Call is a prepayment right given to the borrower by the bondholders. The borrower may "call" the bond for early repayment at a specified date, the call date, and for a specified amount, usually at a premium to the par value.

Basis Point

Basis point is one hundredth of one percent. There are 100 basis points in each 1%. The differences in bonds are often quoted in basis points. For example, an investment-grade bond pays 60 basis points (0.6%) less than a non-investment grade bond.

Default

Default occurs when the borrower cannot make either principal or interest payments as agreed. The borrower is in violation of the loan agreement and may be forced into bankruptcy.

~ The Little Black Book of Investment Secrets ~

Why You Must Buy Gold or Silver Now

By Porter Stansberry
S&A Founder and Editor of *Stansberry's Investment Advisory*

Many investors believe gold is a hedge against inflation. And that's true... but that's not the real secret of gold...

The real purpose of gold is to hedge against government hubris.

I won't get into a political analysis today – you get enough of that in the paper and on TV. But surely you can see that, around the world, the role of government is at the top of a huge period of expansion.

In Europe, governments have launched an enormous economic experiment: a paper currency that's not even backed by a single political force. In the United States, the government believes it can spend money it doesn't have *eternally* without consequences.

In Latin America, two governments – Bolivia and Venezuela – have decided they're entitled to steal billions in assets from private investors, break contracts, and takeover the most important sectors of their economies. In Russia, although it's not really a break from the past, the government has stolen the biggest energy company and staged a show trial of its CEO.

And, perhaps most dangerously of all, governments around the world have promised their citizens a level of economic security in the form of pensions and health benefits that they cannot possibly afford.

Not very many people understand the fallacy of these actions... or their inevitable collapse. But... over time... more and more people will begin to doubt the solvency of their governments and the practicality of their schemes. *If the government can't pay its bills... why am I saving its dollars? If I can't depend on the government to protect me and*

my family, how will I pay for protection... for health care... for energy?

When people have tangible evidence that something has gone wrong with the economy, they begin to hedge against it. They hoard real assets. Rich people hoard gold and silver.

Hedging is like buying life insurance. You don't buy life insurance as an investment, except maybe as a tax strategy... but that goes beyond this metaphor. In general terms, you buy insurance so that, if something terrible happens, your family will have something to live on. Likewise, you should have some exposure to gold and silver in your portfolio. And no, it's not too late to buy some – far from it.

What you want in a hedge is a lot different than what you want in an investment. With an investment, you need something that's stable, which hopefully provides a yield, and isn't going to drive you crazy with volatility.

Gold and silver are none of these things. But they are a perfect hedge, because, when things go wrong economically – when there's a crisis – the price of silver and gold goes bananas.

The Easy Way to Buy Real Gold

By Dan Ferris
Editor, *Extreme Value*

As with stocks, it's not necessary to buy all your gold at once.

Think of gold as savings. The way to save effectively is to start immediately, never stop, and save a little every week or month. Make the amount small enough to be painless. That way, it's easier to establish as a habit. Start today.

I buy South African Krugerrands. Any decent bullion coin will do. Some people prefer gold bars. That's fine, too. Whether coins or bars, just go out and buy yourself some plain, ordinary gold.

For example, In January of 1980, nobody trusted the government to do anything. Gold hit a record (at the time) $850 an ounce. After a decade of dumb ideas from our political leaders (including Nixon's price controls), the Vietnam War, and the OPEC oil embargo, we were stuck with drastic inflation, high unemployment, and no signs of economic growth. Everything the government touched turned to stone. So people wanted out of government, and they especially didn't want the government to have control over their wealth.

Sound familiar?

Gold rises during times of fear and panic. Gold rises during real wars. Gold rises when faith in public officials falls. And gold rises as real interest rates fall to zero. Right now, we are seeing many of these things. That's why at least a small part of your portfolio should be dedicated to precious metals.

How to Buy Collectible Gold Coins

By Dr. Steve Sjuggerud
Editor, *True Wealth*

You can make an astounding amount of money in gold coins – 348%… 1,195%… 665%…

And these numbers don't represent "getting lucky" on one coin investment. These numbers are the percentage gain in the entire CU3000 coin index (www.coinuniverse.com) over the last three coin bull markets (1972-74, 1976-80, and 1987-89).

I've been recommending buying collectible coins for years now in my letter *True Wealth*. To make a smart investment, there are only a few things you need to know:

How to Find the Real Value of Gold Coins

Most people are not familiar with coin terms, like "PCGS" and "MS65." But they should be, especially if they want to be one of the investors who score triple-digit gains.

So I'd like to explain the basics of the coin industry's lingo… specifically how to size up the real value of a gold coin.

It really comes down to intrinsic value (gold content) and collector's premium.

Intrinsic Value: If you melted a gold coin down, this is the value of the gold content.

Before 1933, when gold coins were in circulation, the price of gold was set at $20.67 an ounce. So if you think about it, a gold coin from that time, called a "$20 gold piece," contained nearly an ounce of gold. A $10 gold piece contained nearly half an ounce of gold, a $5 gold piece contained nearly a quarter ounce of gold... and so on.

So, as a rough rule of thumb, if gold is about $1,600 an ounce, then you can talk about the intrinsic value of a gold coin like this:

- A $20 gold piece has about $1,600 in intrinsic value.
- A $10 gold piece has about $800 in intrinsic value.
- A $5 gold piece has about $400 in intrinsic value.
- A $2.50 gold piece has about $200 in intrinsic value.
- A $1 gold piece has about $100 in intrinsic value.

So let's take a random U.S. gold coin – a $5 Liberty from the late 1800s and early 1900s. If it sells for $700 right now, how much of that is real gold value, and how much of that is something else?

Well, at current gold prices (around $1,600), and according to the table above, a $5 gold coin has about $400 of intrinsic or *real* gold value. That leaves about $300 in another type of value. That's what's known as the collector's premium.

Collector's Premium: This is the value of the coin's quality.

At $700, our hypothetical $5 Liberty is a good-quality coin. By that I mean that it has been graded by one of the two major coin-grading agencies – **Professional Coin Grading Service (PCGS)** or **Numismatic Guaranty Corporation (NGC)** – and it has been sealed in a clear plastic case (so you can't hold this coin in your hand).

If this particular coin was a "raw" coin and hadn't been graded for quality and sealed, it might cost you $525 or so.

At a price of $700, this particular $5 Liberty gold piece is graded at "MS61" on the grading scale. "MS" simply means "Mint State," and a range of "60" to "65" is assigned, with 65 being the top or pristine quality. So MS61 denotes that this particular coin is a lower-quality, mint-state coin.

To give you an idea of how prices can differ, if that $5 Liberty graded at MS63 could fetch $1,200, an MS64 quality coin could fetch $2,000. And a pristine quality (MS65) coin could go for over $5,000.

Why the big price differences? It comes down to rarity and popularity...

Rarity and Popularity: Rarity pertains to how many of each coin (in a specific condition) exist. Popularity refers to how a particular coin is viewed by collectors.

To give you an idea what constitutes rarity in the coin world, NGC and PCGS have only graded 3,800 of these $5 Liberty gold coins at the highest-quality grade (MS65), while they've graded more than 60,000 at MS62. So the highest-quality $5 Liberty coins are somewhat rare.

But this is a tough category to call. As a rough rule, the rarer the gold coin, the more it is worth. However, popularity among collectors plays a part as well, and these fads can change. We can't mathematically track beauty. But we can track the population of a coin... how rare it is in a certain quality...

Both grading services, PCGS and NGC, offer "Population Reports" or "Census Reports" to tell us how many coins they've graded of each type in a particular grade. NGC's census report is free at www.ngccoin.com. So it is relatively easy to check on the popularity/rarity of a coin.

Many sources also list the quantity of a coin minted, including the popular "Red Book" (*A Guide Book of United States Coins* by R.S. Yeoman), which is cheap on Amazon.

How Coin Pricing Works... Or Works You

Buying a rare coin or an "investment grade" coin is not like buying a stock.

You can't click your computer mouse and have it in your account a few moments later. In my experience, the transaction process can take weeks, even once you've settled on a price.

Ah, price. Unlike the stock market, there is no easy price quote in rare coins...

There are many price guides available out there. For free retail coin prices online, you can visit www.pcgs.com and click on "PCGS Price Guide." These are "retail" prices, but after a little homework, you'll find that nobody pays retail. You should easily beat these listed prices by at least 10%.

For an "inside" look on the prices coin dealers are charging each other, spend four bucks and buy a Greysheet (www.greysheet.com). This will give you the ballpark price for a coin.

If you're buying a semi-numismatic gold coin (one less than $1,000), add 10% to the Greysheet price. If you're buying a prized rare coin (more than $1,000), take the Greysheet dealer price and add 25% to it. That should give a rough indication. If a dealer is way off that price, get a quote from another dealer.

Chapter 3

Profitable Resources

Free Money Without Working or Investing

By Dr. David Eifrig Jr., MD, MBA
Editor, *Retirement Millionaire*

I love loopholes.

I used to think only attorneys, politicians, or investment bankers could take advantage of the sorts of things I'm about to share with you – things like tax avoidance, early IRA withdrawals, and interest-free loans.

But after years on Wall Street and befriending some of the top bankers, lawyers, and investment advisors in America, I can tell you that the world is full of loopholes... opportunities to take money back from the government or even tap some of the value of your home while you live in it.

Don't worry... you won't be obliged to any Wall Street scam artist or Washington scum by following my advice.

Your only obligations will be to your own financial freedom... You see, by following the herd, most folks miss out on these "free money" opportunities.

My associates and I have found ways for you to extract free money out of your home... and start withdrawing your money from your IRA today, without penalty. And how about converting plain old air into cash?

I'll show you how to do all this and more.

None of these opportunities require the help of a lawyer. But they are true loopholes in a system designed to screw the little guy. So please don't tell anyone else. The more folks find out about these loopholes, the more likely they'll be shut down by Washington.

Here are the details...

If You Own a Home, These Next Two Techniques Are for You...

The first two opportunities show you how to use your home to raise a substantial amount of extra cash.

Both allow you to live in your home until you die. Of course, everyone's situation is different, but if you're one of the thousands of retirees who is running low on cash, these could be perfect for you...

No. 1 – Share Your Future Wealth and Get Cash Today

I've discovered a remarkable company in San Diego, called EquityKey, that can help you live your retirement dream. It actually has patents pending on its products and services. The patents let it do something unique with your home. It actually offers large sums of cash in exchange for an option on your real estate. Let me explain...

If you are between 65 and 85, EquityKey will pay you a lump sum today in exchange for a share of the future appreciation of your property. Essentially, in exchange for its cash today, you agree to share the future gains in your property's value with EquityKey when you sell your house. The upfront cash is like the premium you get for selling an option. You can do whatever you want with the cash, and the home remains yours forever.

Whether you live in or rent out your home or commercial property, these folks can help you.

From a recent article in *U.S. News and World Report*:

> *Gladys Tully, 72, got $106,000, and used the money to pay down part of the principal of her mortgage and remodel her bedroom and bathroom, without giving up her passions: painting, the large garden and orchard on her property, and a hiking trip to Europe every year.*

I'm not talking about a first or second loan on the property. In fact, it's not a loan at all. So you owe EquityKey nothing – no monthly payments or interest charges – and it has zero control over what you do with the house *until you sell it*. Only at the end of the transaction is EquityKey entitled to a payment and even then, only if the value of your home has increased.

Again, you're essentially selling an option to share between 50%-100% of the future appreciation on your home. In exchange for this option, EquityKey pays you a lump sum.

The best part is that you get to keep all the current equity you have in your home. EquityKey takes some of the risk of owning real estate from you. It recoups the money it pays you now through future long-term growth in the property.

The company will pay between 8% and 16% of current property value in exchange for 50%-100% of the future increase in value of the property as measured by the Standard & Poor's/Case-Shiller Index.

EquityKey has partnered with Standard & Poor's to use its monthly index for 20 of the largest metropolitan areas across the country to independently measure and report changes in residential home values. This gives homeowners and investors transparency and confidence in changes in home values up and until the property is sold and the transaction ends. If your property ends up selling for more than what the index suggests, you keep the entire surplus.

The application and underwriting is really quick and easy. If you have at least 25% equity in your home today (meaning if you have a $600,000 home, your current loans cannot exceed

$450,000) and are current on your payments, you can close the transaction and receive a lump sum payment in as little as two weeks. The company is currently taking applications for homes in the major counties surrounding San Francisco, Los Angeles, San Diego, New York, Boston, Connecticut, and New Jersey.

I recommend looking at their website www.equitykey.com or talking to:

Jeffrey Nash
4747 Executive Drive, Suite 450
San Diego, CA 92121
Direct: 619-400-8960

If you live in a state where EquityKey does not do business – or if you don't want to give away the future upside in your real estate – you can use my second free-money tip to get cash from the home you live in.

No. 2 – Cash-Out Your Home Now

This next free-money technique was once thought to be dangerous for the elderly. In truth, the problems have been cleaned up and it's now a perfectly safe tool. Most people of retirement age still scoff at the idea of a reverse mortgage because of the stories from the early 1980s.

But not my friend Loretta in Minneapolis. She told me her story a few summers ago:

Loretta had just turned 69, and her three boys were concerned. She had told them over and over what she wanted to do, but they just didn't believe it was true.

At the time, Loretta felt trapped. She had lived alone in her house for 16 years. Between the interest-only mortgage and her car loan, she felt "smothered." So Loretta was literally tapping into her personal goldmine.

It turns out the Federal Housing Administration gave her

money that she will never have to pay back while she's alive. You can do the same. And depending on where you live there may be a fortune waiting for you to tap. If you live in an average home, you can easily get $200,000. If you are in a "major" city, $362,790 awaits you.

The money she got "gave her a new life," Loretta said.

Today, Loretta loves life. She works part time for a small, boutique company called Gentle Transitions. The job involves packing up elderly people as they move to smaller living spaces. She then helps them unpack in their new place on the second day. A big smile came across her face as she told me how happy and peaceful her life is.

The best part: She can live in her house until she dies, without ever paying a penny to the bank.

If you feel like Loretta once did – stuck financially, but with a home almost paid off – the reverse mortgage will help you safely tap into that wealth. Here's how it works:

In a typical mortgage, you obtain a loan for the purchased real estate and then slowly over the life of the loan pay it back to the bank. The reverse mortgage works exactly the opposite. We get the bank to pay us while our health is good, and we don't have to pay it back until we die. This is the sort of deal I like to uncover for readers.

Most lenders offer four types of reverse mortgages, but the Home Equity Conversion Mortgage (HECM) and the Proprietary (aka Home-Keeper) are the two I recommend. They are both insured by federal agencies and thus have lower costs.

Before you apply for these loans, the U.S. government requires you to meet with an approved independent counselor. The counselor explains all the costs, features, and the pros and cons of receiving these loans. This law stems from unscrupulous practices back in the late 1970s and early 1980s when some lenders took advantage of the elderly.

Today, these practices are outlawed. The lender can't kick you out, and he certainly can't own equity.

Who Can Get These Loans?

The loan requirements are simple and easily met.

You must:

- Be at least 62 years old.
- Own the property with little or no balance on your mortgage.
- Live in the home as your primary residence.
- Receive approval from a reverse mortgage counselor (that simple face-to-face meeting where they make sure you understand what you're doing).

The amount you can get from your home is based on your age, the value of your home, current interest rates, and whether you "roll" your closing costs into the loan.

Generally, the older you are, the more valuable your home, and the lower the interest rates, the more money you receive. For example, if your house is worth $400,000 and you're 65, you can get $168,000. If you are 85, you can get $300,000.

Once you are approved, you can receive your loan money in several ways. You can take the money as a lump sum, a stream of payments, a line of credit, or a combination of the three.

If you establish a line of credit, the available credit grows automatically over time. In fact, it grows at 0.5% over the interest rate you're charged.

For example, you can get a reverse loan for $200,000 today, but take out only $100,000 now. Over 10 years, your $100,000 remaining line of credit could grow again to $200,000.

Then guess what? You take out another $100,000 at age 78 to

pay for, say, a world cruise with your wife and family. This again leaves the same $100,000 to grow some more... Can you imagine another cruise at age 88? I can!

Of course, interest accrues on the first and second $100,000 payments, but you don't have to pay them back while you're living in your home. Isn't this amazing? So whatever you do, don't tap the full line of credit initially and watch your credit line grow over time.

If you decide to do a reverse mortgage, your heirs might protest at first, but explain to them that all you're doing is borrowing against money you've already saved over your lifetime.

It's your money. And you can do anything with it you wish.

Is the Reverse Mortgage for You?

If you are older than 62 and own your home, then you absolutely must look at how a reverse mortgage improves your lifestyle. The questions you must ask are simple ones:

- Is there a special trip or large ticket item I've waited my lifetime to have?
- Could I face cash flow problems in the next few years?
- Am I worried about inflation and not having enough money 15 years from now?

If the answer is yes to one or more of these questions, then a reverse mortgage will give you peace of mind.

How to Tap Your IRA Right Now

Sitting on a pile of IRA money? Want to buy your dream piece of real estate, but don't have a job or enough cash flow? This secret is for you. Some of you may want to retire today, but aren't yet 59.5 years old. Well, using this little known secret in the IRS code, I can show you how to get your money right now without paying any IRS penalties or fines.

Your broker probably doesn't want you to know about this either. If you start taking your money out of your account, his fees to manage your IRA get smaller. But through an IRS loophole, you can retire today and begin your "Early IRA Distribution" tomorrow. Our method is perfectly legal and simple to do. Even the rationale behind the loophole makes sense.

And you can start taking the money out, pay taxes on it (but no fines or early withdrawal penalties), use whatever you need, AND still make regular contributions to a separate IRA if you'd like. Here's how...

No. 3 – One IRS Loophole We Can Be Grateful for

The IRS has a rule called the 72(t)(1) which provides for a 10% tax on early distributions from an IRA before the age of 59.5. But if you take out your IRA money in what the IRS calls "substantially equal periodic payments" for at least five years or until you reach 59.5 years, then you pay no penalty. All you do is pay regular income tax rates on the income (which you would eventually have to pay anyway).

The IRS allows you to determine the amount using one of three different methods:

- Required Minimum Distribution method (RMD)
- Fixed Amortization method
- Fixed Annuitization method

Essentially, the methods look at tables to estimate your life expectancy and apply an interest rate to the IRA balance. The methods provide a dollar amount that you may pull out every year.

Take this *Forbes* article as and example:It shows how a chiropractor, Alfonse DeMaria, took $700,000 in his IRA and converted it to a $3,000-a-month income stream. He bought himself a six-bedroom home with 269 acres in rural New York to enjoy now with his family. "My kids and I can start enjoying the house now rather than 25 years from now, and it will still be here then, too," he said.

The different IRS methods give slightly different amounts, so

the best choice may vary depending on your needs. Here's an example straight from the IRS, although I've simplified it a bit (that IRS code is kind of dense in places):

Mr. B is 50 years old and has $400,000. In the first year:

- The RMD method will give him $11,695.91.
- The Fixed Amortization method would allow $23,134.27.
- The Fixed Annuitization method allows for $22,906.88.

As you can see, the amounts vary. Please carefully consider each method. If you take out more earlier, you'll have less later and vice versa. By the way, the IRS tables and math are not that difficult. Regardless, I urge you to seek more advice from a tax accountant or financial planner if you are unsure about what to do.

And don't worry about changing your mind. Say you start with one method, the RMD, and find you need more money later, the IRS allows you to change your method one time. So you could switch to one of the fixed methods in later years and take out more when you're older.

One of the questions I always hear is "How long do I do this?" The answer is five years, or until you turn 59.5, whichever comes last. So if you start this at age 48, you must continue for another 11.5 years. If you started at age 57, you would need to continue until 62 years of age.

If you just lost your job and are thinking about an early retirement, this secret really helps provide a source of income. If you have a large sum of money in your 401(k) and looking for another job isn't appealing, consider retiring early. It's quite simple to do. Just roll the money over to a self-directed IRA and start taking it out using this method. Perhaps you don't need that much income? Consider rolling your 401(k) into two different IRAs. Keep one growing and start the 72(t) withdrawal process in the other. Again, this is perfectly legal and simple. Happy retirement!

More Free Money from the Government

My friend Paul has some land in Maine. He is one of the few doctors I know who understands investing well. For years, he has taken his extra cash and bought land in North Carolina and Maine. His plan has always been to harvest trees – beautiful old hardwoods. He sells some of them and makes gorgeous furniture from the others. But his latest venture intrigued me the most...

No. 4 – Let the Wind Provide Free Money for Your Retirement

I couldn't believe what I was hearing. Paul was putting up a wind turbine on a ridge on his land and was going to sell it back to the utility company. The numbers looked great.

The turbine cost about $1 million installed. But most states offer rebates and incentives to do this sort of green energy project, and Maine is no exception. A state rebate of $100,000 plus a 35% rebate of total project cost cut Paul's costs to $550,000. A small business loan financed the deal for 15 years at 3%, for a monthly cost of $3,800. Let's add some other maintenance and insurance and round it up to $4,000 per month. Now, let's look at the income.

The windmill generates about 1 million kilowatt-hours (kWh) per year, and the utility will pay him about 6 cents per kWh. This brings in about $60,000 a year, or $5,000 per month. But it gets better. The IRS allows for a tax credit of 1.8 cents per year for wind-powered energy. This is a tax credit of $18,000, or $1,500 per month.

With the tax benefit of the credit and the positive cash flow from the wind-power, he'll net about $2,500 per month cash from the one windmill. If the neighbors don't mind, I think he'll put up several of these over the next few years. Not bad income for his coming retirement: $30,000 per year tax-free on land that was basically worthless.

Notice that what makes the math work for him is the tax incentives and benefits. It's not often the various government agencies come together and present great investment opportunities like this one. My guess is the government will hatch more of these unique opportunities in the future. I plan to watch for them and promise to share what I find with you so you can improve the quality of your retirement and live a richer life.

A Quick Way to Save on Your Insurance Costs

By S&A Investment Research

If you're looking for insurance policies for a new property you're in the process of buying, we've found two good websites that let you shop for the best rates. 1) **www.insweb.com**, and 2) **www.insure.com**.

After you find the best rate, we recommend you check out the company's overall rating at AM Best (**www.ambest.com**), an independent group that rates insurance companies. The service is free.

Where We Get Our Ideas: The Best Online Investment Resources

By Dr. Steve Sjuggerud
Editor, *True Wealth*

"So... where do you come up with your investment ideas?"

I never have a good answer for this question.

My Magic 8-Ball? A secret website? A guy on the inside at a big hedge fund? Those things would all fail you sooner than later.

The truth is, I read a lot, looking for a little tiny nugget of something... a little road to go down and research. And then I dig...

When I'm on the trail of something new, whether it's Icelandic bonds, rare coins, timberland in Argentina, or something a little more straight-ahead, I don't have a specific process... I simply learn as much as I can, and then I get on a plane and go talk to the experts.

But that doesn't answer where the idea comes from in the first place... **My investment ideas simply come from reading and thinking actively about what I read, trying to find an investment angle.**

Today, I'll share with you where I get my investment ideas and how I follow them. I'll stick with things that are either free or very inexpensive, so you can use them and get your money's worth out of them. (We have outrageously expensive tools at our fingertips in the office... including Thomson Datastream and a Bloomberg terminal... but at home you don't need these.)

Investor news: No surprises here... I read the *Financial Times* (the world's best financial newspaper), I thumb through the *Wall Street Journal*, and Bloomberg. Most everything here is free online. If I could read just one financial magazine each month, it would be the *Economist*. I also like *Barron's*, *Forbes*, *Fortune*, and one you probably haven't read, but should: *Bloomberg Markets*.

Stock charts: For quick stock charts, we actually use Yahoo and stockcharts.com. We have the fancy tools, but these freebies are quick. We use stockcharts.com for most of the charts in *DailyWealth*. This site offers a ton of technical indicators, if you're into them.

Stock data: To quickly look up price history for a stock and balance-sheet information, once again, we use Yahoo. Ten years ago, this info would have cost you tens of thousands of dollars a year. I probably use Yahoo Finance more than any other site. Sometimes, you've got to double-check the balance-sheet data though.

When I'm doing detailed historical research, I'll use the Federal Reserve Bank of St. Louis' website: http://stlouisfed.org/default.cfm.

Precious metals: For precious metals investors, Kitco provides the most detailed news and commentary on gold and silver. It occasionally features essays by your editors as well. Casey Research and John Doody's *Gold Stock Analyst* also do excellent work on metals and mining stock analysis.

ETFs: For information on exchange-traded funds, I use etfconnect.com. It's the most comprehensive free ETF database out there. You can use its "Fund Sorter" to search for just about any kind of ETF.

Foreign stocks: To look up foreign stocks, you can use adr.com. ADR stands for "American Depository Receipt." They are simply foreign stocks traded on the U.S. exchange. This site also has a nice search function. For instance, let's say you want to invest in Argentina. You can use its screen to find every Argentine stock traded here in the States.

Independent stock research: There's an incredible amount of independent research out there. Of course, I'm biased toward my publisher, Stansberry & Associates Investment Research. I can only tell you that if Stansberry wasn't my publisher, I would still subscribe to its publications. Morningstar and Value Line are also worth the price.

Trailing stop services: Tracking your stops can be a pain... but I've found two excellent ways to keep track of them – TradeStops and XLQ.

Tradestops.com was actually started by a *True Wealth* subscriber with a Ph.D. in math, Richard Smith. It's a simple, web-based way to track your stops. It sends you an e-mail when one of your stops is hit. Couldn't get much easier. You ought to give it a try.

XLQ is a full-blown Excel interface that automatically brings stock quotes and company data into an excel spreadsheet for you.

With XLQ Companion, you can easily track your stops. It is free to try for 45 days. Visit qmatix.com for details. Leo, the creator of QMatix, is very helpful. Both Richard and Leo do a great job.

That's a lot to keep you busy, and a lot of things to check out. The Internet revolution has given us an absolutely amazing amount of free (or inexpensive) stuff to help us with our investments.

Chapter 4

Secrets of the World's Most Successful Investors

What to Read to Become a Better Investor

By Dr. Steve Sjuggerud
Editor, *True Wealth*

Someone once said to me, "If your mouth is moving, you can't be learning." I couldn't agree more – being a voracious reader is one of the few ways you can get a leg up on the competition.

I present you with a small list of my most recommended books for you to get a leg up in your investing. I chose this list based both on the value of the information as well as the ease/entertainment of reading, since investment books generally bore most people to tears.

For newcomers, I always recommend the best, most fun-to-read version of exactly how economic freedom creates wealth: *Eat the Rich*, by humorist P.J. O'Rourke. Beginners and experts alike can learn from this little gem. It is the first of the seven books I consider essential reading for all market watchers. The other six are included below.

When it comes to trading and investing, here's what I believe is the best $90 you can spend today. Together, these six books (plus *Eat the Rich*, above) explain how the world works and how to profit from it:

1. *Reminiscences of a Stock Operator* by Edwin Lefèvre, 1923

You will undoubtedly become a more profitable trader by reading this book. It's the highly entertaining tale of Jesse Livermore, one of the most successful traders in history, told in first person – in a swashbuckling style. You're having so much fun as you read this book, you don't even realize you end up learning many of the infallible trading secrets that 99% of traders never learn. If you only read one book about trading, read this one. It is ESSENTIAL.

2. *Economics in One Lesson*
by Henry Hazlitt, 1946

Want to know how the world REALLY works? This book explains how, using easy-to-understand examples. Starting with a simple story about a broken window, Hazlitt explains the One Lesson of Economics. It is all you need to know. After reading this heavily-Austrian-influenced book, you'll quickly be able to punch holes in most government schemes. At around $10, you can buy copies for your local political leaders, too.

3. Martin Zweig's *Winning on Wall Street*, 1986

Who do the world's most successful traders and money managers look to for advice? Wall Street's most famous number cruncher, Martin Zweig. It's amazing such a great mind could boil his life's work down into terms stock market beginners can understand. Perfect for beginners and experts alike. You'll know what to buy, when to buy, and when to sell. What more can you ask for?

4. *Market Wizards: Interviews With Top Traders*
by Jack Schwager, 1989

If you want to learn how to be successful in trading, learn from the best. This book has in-depth interviews with 17 of the world's top traders. These folks all turned pittances into many millions of dollars in their careers. One of the top traders interviewed is Dr. Van K. Tharp – the only trading coach interviewed. Buy it.

5. *Trader Vic II – Principles of Professional Speculation*
by Victor Sperandeo, 1994

This book ties it all together... and was written by a trader whose documented 12-year track record was more than 70% a year – without a losing year in that period. This book is a bit denser than the rest – with four sections (Economic Fundamentals, Technical Analysis, Options Trading, and Trading Psychology). From a free-market perspective, Vic clearly explains how he's made a pile of money... and how you can, too!

6. *Trade Your Way to Financial Freedom*
by Van Tharp, 1999

Van has personally influenced my trading style. There's an old saying, "There's nothing worse than making the right call and losing money on it." I'd venture to say Van's teachings could help you make the wrong call and still make money. This book is essential to market success.

The Top 10 Books About Value Investing

By Porter Stansberry
S&A Founder and Editor of *Stansberry's Investment Advisory*

This list only includes books that deal, nearly exclusively, with common stock long-term investing.

If you read these 10 books (one isn't even a book, it's an essay) and you follow the basic precepts (buy value, buy safety, buy businesses with a durable competitive advantage, allow your investments to compound over many years), I have no doubt you can easily earn 15%-30% per year, after tax.

Your investing shouldn't require more than 10 hours per week.

If you make more than two to three investments per year, you're working way too hard.

You can buy all of the books on this list easily and cheaply (except for Seth Klarman's book, which is out of print). If you study them all carefully, it might take you six months. Your total tuition wouldn't equal $1,000 – and you'd know far more about how to be a successful investor than 99% of the world's top MBA graduates.

Being a successful investor takes a little bit more than just knowledge. You've also got to master the traits listed in the very first "book" on my list. It's an essay written by Richard Russell. It contains the only real secret to becoming wealthy: the power of compound interest. It also demonstrates the key emotional distinction between wealthy people and everyone else.

With this emphasis, here are my personal top 10 books on common stock investing.

1. Richard Russell, "Rich Man, Poor Man." Richard was kind enough to let us reprint his famous essay at the end of this book – see page 127. For more information on Richard's excellent *Dow Theory Letters* advisory – which he's been writing for over 50 years – go to http://www.dowtheoryletters.com.
2. Ben Graham, *The Intelligent Investor* (especially chapters 8 and 20).
3. Warren Buffett, the letters of Warren Buffett (available free at www.berkshirehathaway.com).
4. Mohnish Pabrai, *The Dhandho Investor.*
5. Tweedy, Browne, "What Has Worked in Investing" (available free at www.tweedy.com, under "Research & Reports").
6. David Dreman, *Contrarian Investment Strategies.*
7. Joel Greenblatt, *You Can Be a Stock Market Genius.*

8. Martin J. Whitman, the letters of Marty Whitman (available free at www.thirdavenuefunds.com, under "Shareholder Letters").
9. Martin J. Whitman, *Value Investing.*
10. Seth Klarman, *Margin of Safety.*

The Secret of a Man Richer than Buffett and Gates... Combined

By Dr. Steve Sjuggerud
Editor, *True Wealth*

Bill Gates and Warren Buffett aren't as rich as you might think...

Sure, with fortunes in excess of $50 billion each, Gates and Buffett are the richest Americans today... by far. But a new book about the rich shows their wealth doesn't stack up to the greatest fortunes in American history.

In fact, John D. Rockefeller tops the "All-Time Richest Americans" list. (This list appears in a book called *All the Money in the World*, edited by Peter Bernstein and Annalyn Swan.) At his peak, in today's dollars, Rockefeller's oil fortune would have been worth more than $300 billion.

Next on the list is steel magnate Andrew Carnegie, at $280 billion, followed by Cornelius Vanderbilt, at $168 billion. While a true apples-to-apples comparison is difficult, it's clear these industrialists were far richer back then than the richest men today.

One big difference between now and back then is, today you can live very much like the ultra-rich, without actually being ultra-rich.

Back in the 19th century, a flush toilet or a daily hot bath might be an unimaginable luxury, available only to the super wealthy. But today, the "regular" rich can live very much like billionaires...

For example, the ultra-rich might take a private jet to their Caribbean vacation villas. The regular rich can fly first-class, stay in a five-star resort, and have a similar experience.

But can money buy you happiness? And if you're ultra-rich, can you make yourself happier than everyone else? Daniel Gilbert, a Harvard University professor, actually tried to figure this out.

He concluded: "*Wealth increases human happiness when it lifts people out of abject poverty and into the middle class. But it does little to increase happiness thereafter.*"

He said, "*Americans who earn $50,000 per year are much happier than Americans who earn $10,000 per year. But Americans who earn $5 million per year are not much happier than those who earn $100,000 per year.*"

You may find it hard to believe. Or not. Ross Perot found this out firsthand. "*Right after my company got successful, as a young man I met some of the wealthiest people in the world. I found that they were such unhappy, lonely people... I learned that money and happiness are unrelated.*"

You may think that reading about making money is crass. I personally find it interesting...

I've learned about making money in school (I took education as far as you can). And I've learned about making money from reading and meeting with extremely wealthy people. I can tell you, **I've learned far more from the stories of people who made it on their own than I have from any finance textbook**.

From *All the Money In the World*, I learned Bill Gates and Warren Buffett aren't the richest Americans in history... living rich is more in reach than it's ever been... and lastly, being rich won't necessarily make you happy.

If you're looking to increase your wealth, I've found the best

way is to learn from those who have done it themselves. Check out *All the Money in The World*... and other books on investors and entrepreneurs who made it on their own.

Those books are better than textbooks on how to safely grow your wealth.

What America's Millionaires Have in Common

By S&A Investment Research

You should read *The Millionaire Mind* – how millionaires in America REALLY think – so you can size yourself up in relation to America's most financially successful.

After interviewing more than 1,300 millionaires, the following are the author's conclusions:

The Eight Important Elements of Economic Success

Take a moment and consider your own opinions on each of these points, and how you size up to the millionaire's perspective. And think about whether or not you need to start making some changes in your life...

1. Understand the key success factors that our economy rewards: being honest with all people, hard work, integrity, and focus. [We were amazed to learn that the top of the list was "being honest with all people" – even above hard work!]
2. Never allow a lackluster academic record to stand in the way of becoming economically productive. [Can you believe the average millionaire graduated college with a 2.9 GPA – and that's if he even graduated!]

3. Have the courage to take some financial risk. And learn how to overcome defeat. [Handling defeat is a big key in investing. The most important – and toughest – thing to do is to CUT YOUR LOSERS.]
4. Select a job that is not only unique and profitable; pick one you love.
5. Be careful in selecting a spouse. [People who are economically productive married men or women who shared the characteristics that are most compatible with success.]
6. Operate an economically productive household. [Many millionaires prefer to repair or refinish rather than buy new.]
7. Follow the lead of millionaires when selecting a home – study, search, and negotiate aggressively.
8. Adopt a balanced lifestyle. Many millionaires are "cheap dates." It does not take a lot of money to enjoy the company of your family and friends.

Contrary to the popular wisdom about the "rich," we were pleased to find that millionaires in America are generally honest people. They value their marriages. And they value the company of their family and friends over expensive "stuff." What a refreshing revelation – that these are the core values of achieving true wealth.

If you're interested in learning more about how America's most financially successful people think, check out the book *The Millionaire Mind* by Thomas Stanley.

The Secret to 26% a Year for Two Decades:

It's OK to Do Nothing Sometimes… Or for as Long as It Takes

By Dr. Steve Sjuggerud
Editor, *True Wealth*

You may not have heard of Paul Tudor Jones... but his investment track record is among the best in all of history...

He's returned 26% a year for his investors since the start of his fund nearly two decades ago. Said another way, $10,000 invested at 26% a year for two decades would turn into MORE THAN A MILLION DOLLARS.

What's his secret? Surely you have to take on a ton of risk to make returns like that, right? Wrong...

Paul Tudor Jones revealed his "secret" in *Bloomberg Markets* magazine... "If you don't see anything, you don't trade... You take risk only when you see an opportunity."

Instead of taking on a ton of risk, as most people would think, his driving belief could be summed up as: Don't lose money. "You get so you really want to avoid drawdowns because they are so painful," he said.

I loved reading all of his quotes... because I believe Paul Tudor Jones is right... you should take risk only when you see an opportunity. And I believe his advice is particularly important right now, when you might not have the opportunity but you do have the urge to "put your money to work" and ultimately make a bad investment. Just wait instead. Save it for the "no-brainers..."

The worst thing to do is buy something because you feel you have to put that money to work. Remember: If you don't see anything, you don't trade. The urge to do something is strong.

Resist it if you have nothing compelling to buy.

If you want to end up like Paul Tudor Jones, then only take risk when you see an opportunity. If you don't see anything, stand pat – it sure has worked for Mr. Jones.

Secrets of the World's Richest Woman

By S&A Investment Research

"There is no great secret in fortune-making. All you do is buy cheap and sell dear, act with thrift and shrewdness and be persistent."

– Hetty Green, in the late 1800s

Hetty Green was 82 when she died in 1916, leaving an estate that, in today's dollars, was worth about $2.5 billion.

She became the richest woman in the world without any help from anyone. She was eccentric and tough as nails, both of which contributed to her nickname "The Wicked Witch of Wall Street."

Green's road to wealth was always an uphill battle. You've got to remember, this was a WOMAN on Wall Street in the 1800s. Women had few rights back then – even voting was still decades away. Green was quoted as saying, "I wish women had more rights in business. I find men will take advantage of women in business in ways they would not attempt with men. I have found this particularly so in the courts, where I have been fighting all my life." But she didn't let the fact that she was a woman stand in the way of becoming a billionaire...

Four Secrets of Hetty Green's Success

There are four "secrets" to Hetty's success that we can learn

from. First is her "Millionaire Next Door" miserliness. The traditional view of billionaires is probably something like Donald Trump – living the high life. Well, Hetty Green in her day was WEALTHIER than Trump is today. But unlike Trump, Hetty lived on the cheap, often in a $14-a-month apartment in Hoboken. (She had no permanent residence.) She didn't even have an office – she regularly sat on the floor at Chemical Bank during the business day – for 25 years. Instead of the finest fabrics, she generally dressed in black, often wearing hand-me-downs. Hardly Donald Trump.

Second is her investment strategy. It wasn't anything novel – she bought quality assets on the cheap. "There is no great secret in fortune-making. All you do is buy cheap and sell dear, act with thrift and shrewdness and be persistent," she said. "When I see a thing going cheap because nobody wants it, I buy a lot of it and tuck it away. Then when the time comes, they have to hunt me up and pay me a good price for my holdings." Warren Buffett isn't doing anything new – he's only doing what Hetty Green did 100 years ago.

Third, Hetty was unbelievably shrewd about minimizing her taxes. In a time before the Federal income tax (imagine that!), Hetty was able to slide around state tax laws with remarkable ease. With no permanent address, she shuffled between New York, New Jersey, and Vermont. This was only one of her many tax tricks: In an unspoken agreement with the NYC comptroller, Hetty acted as the bank for the city of New York. She would hold New York bonds, allowing the city to pay her less than market interest rates, effectively giving the city cheap loans in exchange for the New York taxman looking the other way.

Fourth, hard assets were key. She bought real estate and railroads on the cheap, and rarely sold. She didn't want mansions. She wanted paying properties and rails in the boomtowns – which at the time included Denver, St. Louis, and Cincinnati. A typical move was to buy on the outskirts of town, and wait for the city to grow to her – a seemingly sound investment strategy throughout the history of the United States.

Four Questions the World's Greatest Investor Asks – Before He Invests…

By Dan Ferris
Editor, *Extreme Value*

Warren Buffett and Charlie Munger of Berkshire Hathaway have decided on their list of the right questions to ask before investing. The following is from an interview with Buffett and Munger:

Interviewer: Could you please explain the filter process you go through in making an investment?

Buffett: Look, it is just this simple – there are four things we look for. Can we understand it? Does it have a sustainable long-term competitive advantage? Are the management people we admire and trust? And do we think it's selling at an attractive price? It is as simple as that. If it gets through all four filters, then I sign my name to the check.

Hetty's Four "Simple Secrets"... Taken to the Extreme

Here's a quick review of Hetty Green's secrets:

1. Live miserly
2. Buy what nobody else wants
3. Minimize your taxes
4. Overweight your holdings in hard assets that pay

None of Hetty Green's secrets sound very novel. Yet her real "secret" appears to be that she took all of these to the extreme.

As a woman on Wall Street in the late 1800s, the cards were truly stacked against her. But by following these four secrets, Hetty Green became three times as wealthy as Oprah Winfrey – the wealthiest self-made woman – is today.

We sure don't have the obstacles in front of us today that Hetty faced back then. So if we follow her secrets, we shouldn't have a problem achieving her success... right?

What's the Point of Investing?

By Dr. Steve Sjuggerud
Editor, *True Wealth*

"*Nice to meet you... Hang on a sec... Let me text my husband.*"

My wife and I stand there waiting. The girl busily taps out a text message on her new iPhone.

She's not so quick with the typing, but we know what's going on... She's just showing off that she owns a $500 phone – hot stuff in rural Georgia.

We saw her arrive at the hotel where we were staying... She drove a black Suburban, with enough chrome to make a Detroit drug dealer blush.

She and her husband are young... probably in their late twenties. He's apparently a builder in Georgia. Of course, homebuilding in Georgia died about two years ago... But even though their income must be down, their spending hasn't changed.

Me? I don't have an iPhone... Or a blingy Suburban... But I probably have one thing these conspicuous consumers don't: The house I live in is fully paid for.

I handle my money differently. I *could* buy an iPhone or a Suburban tomorrow. I wouldn't need a penny of debt to do it. But I won't... Why? Because I know those things won't make me the slightest bit happier. I'd be the same dolt I was before... only now, I'd be $50,000 poorer!

I don't try to keep up with the Joneses. I'm doing the opposite, actually. I'm downsizing. I'm reducing my "stuff."

Think about this... What good is all this stuff, really? You can't take it with you. Doug Casey, the legendary newsletter writer, says it best:

"*I've never seen a hearse with luggage racks.*"

Doug is extremely wealthy, and has been for a while. My friend Bob Bishop is a wealthy guy like Doug. Bob wrote the excellent *Gold Mining Stock Report* newsletter for a few decades. He recently retired. Bob decided to sell some of his extraordinary possessions... for no particular reason I could see. He didn't need the money. And they weren't really taking up space. I asked him why he was selling. He said:

> *"After a while, you don't own your stuff... Your stuff owns you. Steve, you're young... so you're probably in the accumulation phase. Me? I've been there. Now I want to downsize and simplify. I don't need all this stuff."*

Bob can buy anything he wants. But, like Doug, he doesn't drive a blingy Suburban, and I doubt he's got an iPhone. It's just stuff!

This brings me to the point of this essay... **What's the point of saving money anyway? What's the point of investing?**

When you get older (if you're not already older!), just what are you going to buy with that money you've saved?

Jonathan Clements gave a good answer to this in his farewell column for the *Wall Street Journal* (Clements has written more than 1,000 columns for the *Wall Street Journal*).

Clements says your savings "*can deliver three key benefits*." Even better, he says, "*You can enjoy this trio of benefits even if you don't have great wads of cash*." Here's how:

1. If you have money, you don't have to worry about it.
2. Money can give you the freedom to pursue your passions.
3. Money can buy you time with friends and family.

When I think about it, these three things are exactly what

Doug and Bob are doing with their lives. The great thing is, it doesn't (usually) take millions to spend time with friends and family or pursue your passions. **You don't need a fortune to live well**... even if you don't have many millions in the bank.

Rich Man, Poor Man

By Richard Russell
Founder, *Dow Theory Letters*

Making money entails a lot more than predicting which way the stock or bond markets are heading or trying to figure which stock or fund will double over the next few years.

For the great majority of investors, making money requires a plan, self-discipline and desire. I say, "for the great majority of people" because if you're a Steven Spielberg or a Bill Gates you don't have to know about the Dow or the markets or about yields or price/earnings ratios. You're a phenomenon in your own field, and you're going to make big money as a by-product of your talent and ability. But this kind of genius is rare.

For the average investor, you and me, we're not geniuses so we have to have a **financial plan**. In view of this, I offer below a few items that we must be aware of if we are serious about making money.

Rule 1: COMPOUNDING: One of the most important lessons for living in the modern world is that to survive you've got to have money. But to live (survive) happily, you must have love, health (mental and physical), freedom, intellectual stimulation – and money. When I taught my kids about money, the first thing I taught them was the use of the "money bible." What's the money bible? Simple, it's a volume of the compounding interest tables.

Compounding is the royal road to riches. Compounding is the safe road, the sure road, and fortunately, anybody can do it. To compound successfully you need the following: **perseverance** in order to keep you firmly on the savings path. You need **intelligence** in order to understand what you are doing and why. And you need a **knowledge** of the mathematics tables in order to comprehend the amazing rewards that will come to you if you faithfully follow the compounding road. And, of course, you need **time**, time to allow the power of compounding to work for you. Remember, compounding only works through time.

But there are two catches in the compounding process. The first is obvious – compounding may involve sacrifice (you can't spend it and still save it). Second, compounding is boring – b-o-r-i-n-g. Or I should say it's boring until (after seven or eight years) the money starts to pour in. Then, believe me, compounding becomes very interesting. In fact, it becomes downright fascinating!

In order to emphasize the power of compounding, I am including this extraordinary study, located on the following page, courtesy of *Market Logic*, of Ft. Lauderdale, FL 33306. In this study we assume that investor (B) opens an IRA at age 19. For seven consecutive periods he puts $2,000 in his IRA at an average growth rate of 10% (7% interest plus growth). After seven years this fellow makes NO MORE contributions – he's finished.

A second investor (A) makes no contributions until age 26 (this is the age when investor B was finished with his contributions). Then A continues faithfully to contribute $2,000 every year until he's 65 (at the same theoretical 10% rate).

Now study the incredible results. B, who made his contributions earlier and who made only seven contributions, ends up with MORE money than A, who made 40 contributions but at a LATER TIME. The difference in the two is that B had seven more early years of compounding than A. Those seven early years were worth more than all of A's 33 additional contributions.

This is a study that I suggest you show to your kids. It's a study I've lived by, and I can tell you, "It works." You can work your

	Investor A		Investor B	
Age	Contribution	Year-EndValue	Contribution	Year-EndValue
17	0	0	0	0
18	0	0	0	0
19	0	0	2,000	2,200
20	0	0	2,000	4,620
21	0	0	2,000	7,282
22	0	0	2,000	10,210
23	0	0	2,000	13,431
24	0	0	2,000	16,974
25	0	0	2,000	20,872
26	2,000	2,200	0	22,959
27	2,000	4,620	0	25,255
28	2,000	7,282	0	27,780
29	2,000	10,210	0	30,558
30	2,000	13,431	0	33,614
31	2,000	16,974	0	36,976
32	2,000	20,872	0	40,673
33	2,000	25,159	0	44,741
34	2,000	29,875	0	49,215
35	2,000	35,062	0	54,136
36	2,000	40,769	0	59,550
37	2,000	47,045	0	65,505
38	2,000	53,950	0	72,055
39	2,000	61,545	0	79,261
40	2,000	69,899	0	87,187
41	2,000	79,089	0	95,905
42	2,000	89,198	0	105,496
43	2,000	100,318	0	116,045
44	2,000	112,550	0	127,650
45	2,000	126,005	0	140,415
46	2,000	140,805	0	154,456
47	2,000	157,086	0	169,902
48	2,000	174,995	0	186,892
49	2,000	194,694	0	205,581
50	2,000	216,364	0	226,140
51	2,000	240,200	0	248,754
52	2,000	266,420	0	273,629
53	2,000	295,262	0	300,992
54	2,000	326,988	0	331,091
55	2,000	361,887	0	364,200
56	2,000	400,276	0	400,620
57	2,000	442,503	0	440,682
58	2,000	488,953	0	484,750
59	2,000	540,049	0	533,225
60	2,000	596,254	0	586,548
61	2,000	658,079	0	645,203
62	2,000	726,087	0	709,723
63	2,000	800,896	0	780,695
64	2,000	883,185	0	858,765
65	2,000	973,704	0	944,641
Less Total Invested:		(80,000)		(14,000)
Equals Net Earnings:		**$893,704**		**$930,641**
Money Grew:		**11-fold**		**66-fold**

compounding with muni-bonds, with a good money market fund, with T-bills or say with five-year T-notes.

Rule 2: DON'T LOSE MONEY: This may sound naive, but believe me it isn't. If you want to be wealthy, you must not lose money, or I should say must not lose BIG money. Absurd rule, silly rule? Maybe, but MOST PEOPLE LOSE MONEY in disastrous investments, gambling, rotten business deals, greed, poor timing. Yes, after almost five decades of investing and talking to investors, I can tell you that most people definitely DO lose money, lose big time – in the stock market, in options and futures, in real estate, in bad loans, in mindless gambling, and in their own business.

Rule 3: RICH MAN, POOR MAN: In the investment world the wealthy investor has one major advantage over the little guy, the stock market amateur and the neophyte trader. The advantage that the wealthy investor enjoys is that HE DOESN'T NEED THE MARKETS. I can't begin to tell you what a difference that makes, both in one's mental attitude and in the way one actually handles one's money.

The wealthy investor doesn't need the markets, because **he already has all the income he needs**. He has money coming in via bonds, T-bills, money market funds, stocks and real estate. In other words, the wealthy investor *never feels pressured* to "make money" in the market.

The wealthy investor tends to be an expert on values. When bonds are cheap and bond yields are irresistibly high, he buys bonds. When stocks are on the bargain table and stock yields are attractive, he buys stocks. When real estate is a great value, he buys real estate. When great art or fine jewelry or gold is on the "give away" table, he buys art or diamonds or gold. In other words, the wealthy investor puts his money where the great values are.

And if no outstanding values are available, the wealthy investors waits. He can afford to wait. He has money coming in daily, weekly, monthly. The wealthy investor knows what he is looking for,

~ The Little Black Book of Investment Secrets ~

and he doesn't mind waiting months or even years for his next investment (they call that **patience**).

But what about the little guy? This fellow always feels pressured to "make money." And in return he's always pressuring the market to "do something" for him. But sadly, the market isn't interested. When the little guy isn't buying stocks offering 1% or 2% yields, he's off to Las Vegas or Atlantic City trying to beat the house at roulette. Or he's spending 20 bucks a week on lottery tickets, or he's "investing" in some crackpot scheme that his neighbor told him about (in strictest confidence, of course).

And because the little guy is trying to force the market to do something for him, he's a guaranteed loser. The little guy doesn't understand values so he constantly overpays. He doesn't comprehend the power of compounding, and he doesn't understand money. He's never heard the adage, *"He who understands interest – earns it. He who doesn't understand interest – pays it."* The little guy is the typical American, and he's deeply in debt.

The little guy is in hock up to his ears. As a result, he's always sweating — sweating to make payments on his house, his refrigerator, his car or his lawn mower. He's impatient, and he feels perpetually put upon. He tells himself that he has to make money — fast. And he dreams of those "big, juicy mega-bucks." In the end, the little guy wastes his money in the market, or he loses his money gambling, or he dribbles it away on senseless schemes. In short, this "money-nerd" spends his life dashing up the financial down-escalator.

But here's the ironic part of it. If, from the beginning, the little guy had adopted a strict policy of never spending more than he made, if he had taken his extra savings and compounded it in intelligent, income-producing securities, then in due time he'd have money coming in daily, weekly, monthly, just like the rich man. The little guy would have become a financial winner, instead of a pathetic loser.

Rule 4: VALUES: The only time the average investor should stray outside the basic compounding system is when a given market offers outstanding value. I judge an investment to be a great value when it offers (a) safety; (b) an attractive return; and (c) a good chance of appreciating in price. At all other times, the compounding route is safer and probably a lot more profitable, at least in the long run.

For more on Richard Russell's Dow Theory Letters, go to **www.dowtheoryletters.com.**

Bonus Chapter

The "End of America"… And How to Safeguard Your Finances

The Corruption of America

By Porter Stansberry
S&A Founder and Editor of *Stansberry's Investment Advisory*

I've written hundreds of research reports in my career as a financial analyst.

I'm very proud of these reports… and I've earned a lot of respect because of the controversial calls I've made (like my prediction that General Motors would go bankrupt… and my prediction that U.S. mortgage giants Fannie Mae and Freddie Mac would collapse).

But I believe "The Corruption of America" is the single most important report I've ever written.

With this report, I set out to categorize, document, and examine in detail some of the major culture, moral, and social problems America is facing.

For years, I've been warning about "The End of America"... the looming financial disaster we face because of out-of-control debts and a currency that's based on nothing more than the hollow promises of a bankrupt government.

Many Americans have seen and felt the decline of our country over the past several decades. What I've tried to do in "The Corruption of America" is document these facts... to show you what's happened to our country in terms of the actual numbers.

More importantly, I've tried to start the discussion about why this decline has occurred.

As we stumble farther and farther into a global sovereign debt crisis, the life most Americans have come to expect and depend on will likely come crashing down. The choices we make during this period will determine the future of the next several generations of Americans.

If we take the time to understand how we ended up in this position... I believe we're capable of making better and wiser choices about our future. And I believe we will.

Whatever your opinion is, I guarantee you'll learn some shocking things about America.

(**Please note**… this report was published in December 2011, and the numbers cited are from that time.)

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The numbers tell us America is in decline... if not outright collapse.

I say "*the numbers tell us*" because I've become very sensitive to the impact this kind of statement has on people. When I warned about the impending bankruptcy of General Motors in 2006 and 2007, readers actually blamed me for the company's problems – as if my warnings to the public were the real problem, rather than GM's $400 billion in debt.

The claim was absurd. But the resentment my work engendered was real.

So please... before you read this issue, which makes several arresting claims about the future of our country... understand I am only writing about the facts as I find them today. I am only drawing conclusions based on the situation as it stands. I am not saying that these conditions can't improve. Or that they won't improve.

~ The Little Black Book of Investment Secrets ~

The truth is, I am optimistic. I believe our country is heading into a crisis. But I also believe that... sooner or later... Americans will make the right choices and put our country back on sound footing.

Please pay careful attention to the data I cite. And please send me corrections to the facts. I will happily publish any correction that can be substantiated. But please don't send me threats, accusations against my character, or baseless claims about my lack of patriotism. If I didn't love our country, none of these facts would bother me. I wouldn't have bothered writing this letter.

I know this is a politically charged and emotional issue. My conclusions will not be easy for most readers to accept. Likewise, many of the things I am writing about this month will challenge my subscribers to re-examine what they believe about their country. *The facts about America today tell a painful story about a country in a steep decline, beset by problems of its own making.*

One last point, before we begin... I realize that this kind of macro-economic/political analysis is not, primarily, what you pay me for. You rightly expect me to provide you with investment opportunities – whether bull market, bear market, or total societal collapse. And that's what I've done every month for more than 15 years.

But that's not what I've done this month. You won't find any investment ideas at all in these pages. This issue is unlike any other I have ever written.

I'm sure it will spark a wave of cancellations – costing me hundreds of thousands of dollars. I fear it will spark a tremendous amount of controversy. Many people will surely accuse me of deliberately writing inflammatory things in order to stir the pot and gain attention. That's not my intention. The truth is, I've gone to great lengths throughout my career to protect my privacy.

I am speaking out now because I believe someone must. And I have the resources to do it. *I am sharing these ideas with my subscribers because I know we have arrived at the moment of a long-*

brewing crisis.

Our political leaders, our business leaders, and our cultural leaders have made a series of catastrophic choices. The result has been a long decline in America's standard of living.

For decades, we have papered over these problems with massive amounts of borrowing. But now, our debts total close to 400% of GDP, and America is the world's largest borrower (after being the world's largest creditor only 40 years ago)... And the holes in our society can no longer be hidden...

We've reached the point where we will have to fix what lies at the heart of America's decline... or be satisfied with a vastly lower standard of living in the future.

How do I know? How do I statistically define the decline of America?

The broadest measure of national wealth is per-capita gross domestic product (GDP). Economists use this figure to judge standards of living around the world. It shows the value of the country's annual production divided by the number of its citizens. No, the production isn't actually divided among all the citizens, but this measure provides us with a fair benchmark to compare different economies around the world. Likewise, this measure shows the growth (or the decline) in wealth in societies across time.

So... is America growing richer or poorer based on per-capita GDP? Seems like a simple enough question, doesn't it? Is our economy growing faster than our population? Are we, as individuals, becoming more affluent? Or is the pie, measured on a per-person basis, growing smaller?

This is the most fundamental measure of the success or the failure of any political system or culture. Are the legal and social rules we live under aiding our economic development or holding us back? What do the numbers say?

Unfortunately, it's a harder question to answer than it should be. The problem is, we don't have a sound currency with which to

measure GDP through time. Until 1971, the U.S. dollar was defined as a certain amount of gold. And the price of gold was fixed by international agreement. It didn't actually begin to trade freely until 1975. Therefore, the value of the U.S. dollar (and thus the value of U.S. production, which is measured in dollars) was manipulated higher for many years.

Even today, our government's nominal GDP figures are greatly influenced by inflation. The influence of inflation is particularly pernicious in GDP studies. You see, inflation, which actually reduces our standard of living, drives up the amount of nominal GDP. So it creates the appearance of a wealthier country... while the nation is actually getting poorer.

The only real way to accurately measure per-capita GDP is to build our own model. The need to build our own tools tells you something important – the government doesn't want anyone to know the answer to this question. It could easily publish data far more accurate than the indexes it puts out. But government doesn't want anyone to know. And it wants to be able to say "those aren't the real data" when studies like ours produce bad news.

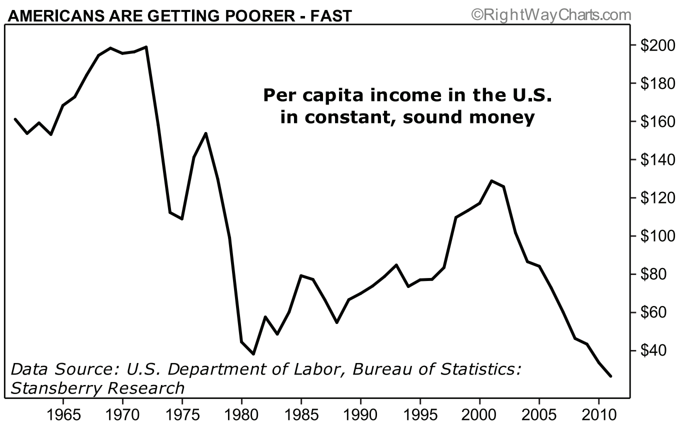
So pay attention to how we built our charts. You can see for yourself that our data are far more accurate than the government's figures. Our data are based on the real purchasing power of the currency, not the nominal numbers, which are completely meaningless in the real world.

The question we are trying to answer is: What would per-capita GDP numbers look like, if we used a real-world currency, like gold, or a basket of commodity prices, instead of the paper-based U.S. dollar? What would the figures be if we measured GDP in sound money instead of the government's funny money?

Here's how we figured it out. We took the government numbers for nominal GDP and measured them first against commodity prices, and later (after it began to trade freely) gold. We used a standard commodity index (the CRB) up to 1975 and gold post-1975. The result of this analysis shows you the *real* trend in U.S. per-capita GDP, as measured on a real-world purchasing power basis.

Our analysis shows you what's actually happened to our real standard of living. The results, we suspect, will surprise even the most bearish among you.

America is in a steep decline.



Americans Are Getting Poorer – Fast

Let me anticipate the "official" criticism of our study. Many people will claim that our numbers aren't "real." They will say that we "mined" the data to produce a chart that showed a steep decline.

That's simply not so. All we've done is convert the government's nominal GDP stats into a fixed currency value that's based on real-world purchasing power. The fact is, our data are far more accurate than the government's because they represent the real-world experience. *That's why our data are far more closely correlated to other real-world studies of wealth in America.*

Consider, for example, annual sales of automobiles. Auto sales peaked in 1985 (11 million) and have been declining at a fairly steady rate since 1999. In 2009, Americans bought just 5.4 million passenger cars. As a result, the median age of a registered

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vehicle in the U.S. is almost 10 years.

Our data shows that real per-capita wealth peaked in the late 1960s. Guess when we find the absolutely lowest median age of the U.S. fleet? In 1969. At the end of the 1960s, the median age of all the cars on the road in the U.S. was only 5.1 years. Even as recently as 1990, the median age was only 6.5 years.

Rich people buy new cars. Poor people do not.

Most important, our data "proves" something I know many of you have felt or perceived for many years. You've seen the decline of your neighborhoods. You've gone years without being able to earn more money in your job. Or you've seen your purchasing power decrease to the point where you're now substituting lower-quality products on your grocery list for the brand-name products you used to buy.

You can see how much harder it is on your children to find good jobs, to buy good housing or a new car. As a result, few people under the age of 40 have the same kind of "life story" as their parents.

And because they can't "*make it*," many have decided to "*fake it*." The average college student now graduates with $24,000 in debt... and by his late 20s has racked up more than $6,000 in credit card debt. Meanwhile, median earnings for Americans aged 25-34 equals $34,000-$38,000. (Source: Demos.org, "The Economic State of Young America," November 2011.)

Can you imagine starting your life out as an adult with a personal debt-to-income level at close to 100%? What does this say about the state of our economy? What does this say about the state of our culture?

Who Suffers Most

It's not only the young that are having trouble in America. It is also the old.

Debt levels among households headed by people older than 62 have been rising for *two decades.* The average mortgage size for this population is now $71,000 – five times larger than it was in 1987 (adjusted for inflation), according to William Apgar of Harvard's Joint Center for Housing Studies.

Older Americans are also more reliant on credit card debt than ever before... *credit card debt*. From 1992 through 2007 (which is the latest data available) older Americans took on credit card debt at a faster pace than the population as a whole. According to *USA Today*, lower- and middle-income Americans aged 65 and older now carry an average of more than $10,000 in credit card debt, up 26% since only 2005.

Given average interest rates of 20% for these debts, it's a fair bet that these obligations will never be repaid. But they will have a terrible impact on the standard of living of these older Americans.

What in the heck is going on? Don't Americans pay off their mortgages before they retire? Don't they work hard during their careers, save, and invest, so they can move to Florida and spend their retirement in comfort?

Older Americans living with credit card debt! This doesn't sound like America, does it? Or maybe it does.

My bet is that most of my subscribers know that something has gone terribly wrong with America. It's not easy to figure out how all of this happened... but you know from your own experiences that these numbers aren't wrong. It might not be pleasant to think about... but these figures paint a sad but accurate picture: *America is not the country it was 40 years ago. These changes are warping our economy, politics, and culture.*

In this month's issue, I'd like to try to define a few of the core reasons we're in this situation. I can't possibly analyze all the factors that have led to this decline. But I want to document the growth of graft in politics. I want to demonstrate – with real facts and examples – how public company leadership has deteriorated. And I want to document some of the things that are occurring in

the broader society, all of which I believe are linked to this fundamental decline in our standard of living.

You see, I believe the decline of our country is primarily a decline of our culture.

We have lost our sense of honor, humility, and the dedication to personal responsibility that, for more than 200 years, made our country the greatest hope for mankind. I want to detail some of the factors that gave rise to the current entitlement society. We have become a country of people who believe their well-being is someone else's responsibility.

I've labeled these problems: **The Corruption of America.**

These problems manifest themselves in different ways across institutions in all parts of our society. But at their root, they are simply facets of the same stone. They are all part of the same essential problem.

The corruption of America isn't happening in one part of our country... or in one type of institution. It is happening across the landscape of our society, in almost every institution. It's a kind of moral decay... a kind of greed... a kind of desperate grasp for power... And it's destroying our nation.

The Ethos of 'Getting Yours'

Americans know, in their bones, that something terrible is happening. Maybe you can't articulate it. Maybe you don't have the statistics to understand exactly what's going on. But my bet is, you think about it a lot.

For me, a poignant moment of recognition came this month.

Bloomberg news published an article based on confidential sources about how Henry Paulson, the former CEO of Goldman Sachs and the Republican U.S. Treasury secretary during the financial crisis, held a secret meeting with the top 20 hedge-fund managers in New York City in late July 2008. This was about two weeks after he testified to Congress that Fannie Mae and Freddie Mac were "*well-capitalized*."

I knew for a fact that what Paulson told Congress wasn't true. I wrote my entire June 2008 newsletter detailing exactly why Fannie and Freddie certainly had billions in losses that they had not yet revealed to investors – $500 billion in losses, at least. There was no question in my mind, both companies were insolvent – "zeros," as I explained.

And yet, in front of Congress, the U.S. Treasury secretary was saying exactly the opposite. Either I was a liar... or he was.

Then... only a few days later... what did Paulson tell those hedge-fund managers?

He told them the same thing I had written in my newsletter. He told them the *opposite* of what he'd said publicly to Congress. He told these billionaire investors that Fannie and Freddie were a disaster... They would require an enormous, multibillion-dollar bailout... The U.S. government would have to take them over... And their shareholders would be completely wiped out.

Here you had a high-government official, explicitly lying to Congress (and by extension, the general public), while giving the real facts to a group of people who represented the financial interests of the world's wealthiest folks. The story didn't come to the public's attention *for two years.*

This was the most outrageous example of graft and corruption I have ever seen. Certainly it involves more billions of dollars in misappropriated value than any other similar story I can recall. These managers had the risk-free ability to make tens of billions of dollars, if not hundreds of billions, by using derivatives to capitalize on what they knew was the imminent collapse of the world's largest mortgage bank. Who picked up the tab? You know perfectly well. It was you and me, the taxpayers.

(One of the investment managers present at this meeting was

Steve Rattner, who by that point was already deeply involved in another bit of graft, his efforts to bribe New York state pension-fund managers for large investments into his hedge fund, from which he earned perhaps as much as $100 million. He later settled the charges for a mere $10 million shortly after Andrew Cuomo was elected governor of New York.)

The Bloomberg story... about a crooked Treasury secretary handing a room full of crooked billionaires inside information worth billions of dollars... hardly caused a ripple. As far as I know, no actions are being planned against Henry Paulson or any of the hedge-fund managers involved. No other major media outlet picked up the story. I saw nothing about it from the Department of Justice or the Securities and Exchange Commission.

What does that say about our country when even the most egregious kind of corruption – involving hundreds of billions of dollars – is simply ignored?

It seems like everyone in our country has lost his moral bearing, from the highest government officials and senior corporate leaders all the way down to schoolteachers and local community leaders. The ethos of my fellow Americans seems to have changed from one of personal integrity and responsibility to "getting yours" – the all-out attempt, by any means possible, to get the most amount of benefits with the least amount of work.

You can see this in everything from the lowering of school standards (revising the SAT) to the widespread use of performance-enhancing drugs in professional, college, and high school sports. Cheating has become a way of life in America.

I have an idea about how this happened... about the root cause of this kind of corruption and why it was inevitable, given some of the basic facts regarding how we've organized our government and our corporations.

Let me show you the numbers – the hard facts – behind what's happened to our country...

The Corruption of Politics

I'll start with one of the biggest factors in the decline of our civilization – the link between welfare, education, crime, and politics.

It is routinely alleged in national political debates that something is fundamentally unfair and un-American about the huge "wealth gap" between the poorest Americans and the wealthiest. Some politicians like to argue that the poor never have a real shot at the American dream, and as a nation, we owe them more and more of our resources to correct this injustice. Most important, it is alleged that only the government has the resources to correct this inequality.

This is a dangerous notion...

First, it promotes the idea of entitlement. Entitlement is a fairly new idea in the American political lexicon – perhaps because most of our nation's wealth is still fairly new. The American idea of entitlement argues that because you were born into a rich society, other people owe you something. The idea has become pervasive in our culture. It underlies the basic assumptions behind the idea of a "wealth gap." Implicit is the assumption that successful Americans haven't rightfully earned their wealth... that in one way or another, they've taken advantage of the society and have an obligation to give back most of what they've "taken."

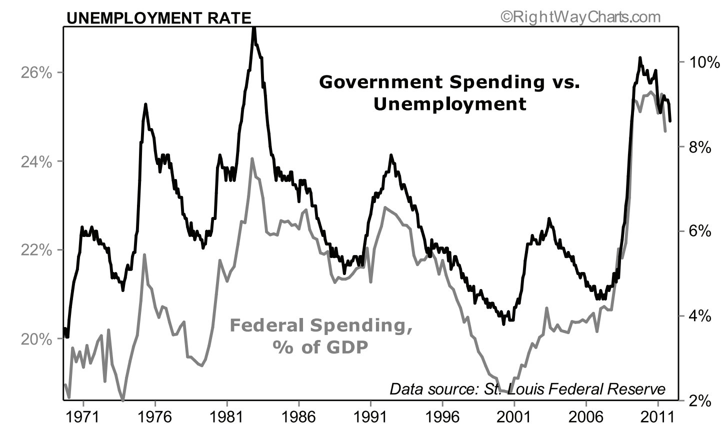
As you'll see, I believe the idea of entitlement lies at the root of many of our most serious cultural problems.

The more obvious problem is the idea that the government is responsible for fixing the "wealth gap." But the government has proved wholly ineffective at dealing with poverty in America. The data is nearly conclusive that government efforts are far more likely to be the *cause* of the wealth gap than the *solution*.

The simple fact is, the government has to take resources from someone before it can dole them out to others. And this act of taking turns out to be economically destructive. It reduces the market's

incentives for entrepreneurs. The more you take from the productive members of society, the less productive they become. That's the primary lesson of the history of socialism. Yet... many of our political leaders seem oblivious to this iron law of human nature.

Consider a simple analysis that compares the unemployment rate with the size of the federal government's spending, as measured against GDP. (We created this chart after reading a similar analysis at Mark Perry's excellent financial blog, Carpe Diem.)



As you can see in this chart, the larger the government grows as a percentage of our economy, the higher unemployment rises. *The more government, the less opportunity.* These figures are similar when studied comparatively across many different countries.

We also know from decades of experience that little of the government's funding for the poor will ever reach those who are actually in need. Instead, these kinds of socialist policies end up sending billions of dollars into the hands of unions, "community organizers," and other sponsors of the Democratic Party. This tightens their political control of America's inner cities, which have become the source of our country's most intractable social problems.

Believe me, I have reams of data and decades of case studies for these conclusions. But before we get to my proof, I want you to simply assume that what I'm saying is 100% correct. Assume most of the government's social spending ends up corrupting the politics of the inner city. Assume these efforts actually make the "wealth gap" larger. Assume these policies and the politicians who sponsor them are actually creating a society of complete dependence, where the spread of ignorance has created entire generations of people who aren't educated enough to know they've been enslaved by their own leaders.

If these things are true, if my conclusions are exactly right, what would America's poorest communities look like today?

It has now been almost 50 years since the start of the War on Poverty, President Lyndon Johnson's program to radically increase domestic welfare spending. These programs and their various spin-offs have been at the center of Democratic politics ever since. In fact, if you compare speeches about these programs from the mid-1960s until today, you will find the verbiage never changes. Obama is merely echoing the same calls for "social justice" that Robert Kennedy used in his ill-fated 1968 campaign for president.

But besides the soaring rhetoric, besides the promise of a "chicken in every pot," what have these programs actually achieved? The wholesale destruction of urban communities across America, communities that are overwhelmingly African American. If the intention of these programs had been to destroy black communities, you could have hardly done more damage than the last 50 years of Democratic policy.

I don't think most Americans realize how dangerous these communities have become or the toll they take on our country as a whole. That's primarily because talking about this problem is seen as racist. That's complete nonsense. The victims of these policies are primarily black people. Trying to help them restore dignity and independence to their communities isn't a racist goal. It's humanitarian.

And let me offer a prediction... Sooner or later, the people in

these communities are going to finally point their finger at the politicians who've lied and pandered to them for decades, all while stealing from them at every turn. When that moment comes, having a track record of correctly speaking out about the real nature of these problems will be a valuable political asset.

No, I'm not running for office... I'm just trying to buck-up the politicians who I know read this letter. They need to get out in front of this issue.

Let me give you some of the numbers that define the enormous scope of these problems.

According to the NAACP, Texas taxpayers spent $175 million in 2009 to imprison residents from a small part of Houston – only 10 zip codes out of 75. Thus, people from neighborhoods that are home to only about 10% of the city's population account for more than 33% of the state's entire $500 million annual prison spending. These neighborhoods are overwhelmingly poor and African American.

In Pennsylvania, taxpayers will spend $290 million in 2009 to imprison residents from just 11 of Philadelphia's neighborhoods, representing about 25% of the city population. On this relatively small urban area, the state will spend roughly *half* its $500 million prison budget. These neighborhoods are overwhelmingly poor and African American.

In New York, taxpayers will spend $539 million to imprison residents from only 24 of New York City's 200 different neighborhoods. Only 16% of the city's population lives in these areas, but they will account for nearly half of the state's $1.1 billion prison budget. These neighborhoods are overwhelmingly poor and African American.

America has many problems... but these neighborhoods represent more than a society in decline. **Life in these places reflects a complete collapse of Western civilization.** What's happening in these communities? A breakdown of the family and the resulting collapse of the school system. What you have left is crime – violent and political.

In Detroit, only 27% of the black male students in the school system graduate from high school. *This is not a racial problem*: Only 19% of the white male students graduate from those same schools. What's causing this problem? A complete breakdown of society. When communities can no longer teach their children the most basic academic skills, such as reading, math, history, literature, and economics... what future can we expect? And what kind of society do you expect after several generations of total ignorance?

These problems are still found primarily in urban areas, but they are spreading across the country. In Pinellas County, Florida, only 21% of black male students graduate from high school. In Palm Beach County, Florida, you find a similar number. Likewise Duval County, Florida... and Jefferson Parish, Louisiana... and Charleston County, South Carolina. In Nebraska, only 40% of black male students graduate from high school. In Nevada, only 45%. In New York state, only 25%.

What opportunities are available in America to people without even a basic education? The *New York Times* reports almost 70% of black males without a high school diploma are unemployed in the United States.

In many predominantly black, urban communities, the actual unemployment rate is close to 100% for young dropouts. Given these figures, it isn't surprising that many of these people end up in jail.

According to various studies, black males who dropped out of school by age 16 are four times more likely to end up in jail than those who remained in school. Crime is literally all they know. Likewise, a black youth whose mother was a high school dropout is 88% more likely to end up in jail. These are the two primary reasons nearly one in 11 adult black men are either in jail or on parole.

How did this all happen? How did we end up with expensive schools that can't teach? How did we end up with young mothers who aren't married? How did we end up with entire generations

of people who won't – and probably can't – work in the labor force? How did we end up with a skyrocketing prison population? The prison population in America has soared from less than half a million people in 1980 to more than 2.5 million people today. More than 7 million adults are in prison or on parole in the United States. *We have an incarceration rate that's seven times higher than any other industrialized nation.*

The land of the free?

Let's ask the most basic question: What has the gigantic increase in welfare spending and education spending done for the underclass of America? It seems apparent that growth in federal spending has caused far more harm than good. When you study these neighborhoods, what you find is a horrifying story that's been repeated, generation after generation since the early 1960s. It's a story of families who have been destroyed by their dependency on the state.

The truly extraordinary part is that all these things happened *after* these neighborhoods began voting and electing their own (typically black and Democratic) leadership. The socialism they voted for themselves led most directly to the destruction of their communities. It was their own mayors, ward leaders, and congressmen who chose this path for these communities.

Let me show you one case study – Detroit.

How Socialism Came to America... and Destroyed Detroit

In 1961, the last Republican mayor of Detroit, Louis C. Miriani, lost his re-election bid. He probably would have lost to anyone who ran against him because he was known to be a crook. He later served 10 years in prison for tax evasion.

The man who defeated him, Jerome Cavanagh, was a Democrat. He ushered in a new kind of politics in Detroit. Cavanagh, who was white, got elected by promising to give

Detroit's African American population the civil rights they deserved. But he didn't stop there. Seeing the political advantage to serving this community's interests, he did all he could to bring government benefits and government spending to Detroit's black community.

Cavanagh brought socialism to Detroit.

Mayor Cavanagh was the only elected official to serve on President Johnson's Model Cities task force. The program was modeled after Soviet efforts to rebuild whole urban areas in Eastern Europe. At the time, this centralized approach to urban development was proclaimed as an advantage to the Soviet system, something that could give them an edge in the Cold War.

Detroit received widespread acclaim for its leadership in the program, which attempted to turn a nine-square-mile section of the city (with 134,000 inhabitants) into a "Model City." To help finance the effort, Cavanagh pushed a new income tax through the state legislature and a "commuter tax" on city workers. He promised the mostly poor and black residents of the Model City area that the rich would pay for all of these benefits. He bought their votes with taxes they didn't have to pay.

It was classic American socialism.

More than $400 million was spent on the program – and that was back when quarters still had actual silver in them. The feds and Democratic city mayors were soon telling people where to live, what to build, and what businesses to open or close. In return, the people received cash, training, education, and health care.

But they didn't like being told what to do... or how to live. Not surprisingly, the Model Cities program was a disaster for Detroit. Within five years, it had helped trigger a complete breakdown of civil order and the city's population began to rapidly decline.

On July 23, 1967, police attempted to break up a notorious "blind pig" in the heart of the new Model City. Blind pigs were after-hours clubs that featured gambling and prostitution. They

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were part of the black culture of Detroit, with many having been in operation since the Prohibition period. The community tolerated these establishments – but the political leadership didn't want any blind pigs in the new Model City area.

On this particular night, at this particular club, the community was celebrating the return of two Vietnam War veterans. More than 80 people had packed into the club. The police decided to arrest everyone present, including the two war vets. This outraged the entire neighborhood, which began to riot. The scene turned into the worst race riot of the 1960s.

As my friend Doug Casey likes to say about the War on Poverty, "The poor lost." The violence killed more than 40 people and left more than 5,000 people homeless. One of the first stores to be looted was a black-owned pharmacy. The largest black-owned clothing store in the city was also burned to the ground. Cavanagh did nothing to stop the riots. (He claimed a large police presence would make matters worse.) Five days later, President Johnson sent in two divisions of paratroopers to put down the insurrection.

The situation destabilized the entire city. Most of the people who could afford to leave did. Over the next 18 months, 140,000 upper- and middle-class residents – almost all of them white – left the city.

And so, you might ask... after five years of centralized planning, higher taxes, and a fleeing population, what did the government decide to do with its grand experiment? You'll never guess...

Seeing it had accomplished nothing but failure... The government expanded the Model City program with 1974's Community Development Block Grant Program. Here again, politicians would decide which groups (and even individuals) would receive state funds for various "renewal" schemes. Later, big business was brought into the fold. In exchange for various concessions, the Big Three automakers "gave" $488 million to the city for use in still more redevelopment schemes in the mid-1990s.

What happened? Even with all of their power and all of the money, centralized planners couldn't succeed with any of their plans. Nearly all of the upper- and middle-class citizens left Detroit. The poor fled, too. The Model City area lost 63% of its population and 45% of its housing units from the inception of the program through 1990.

Even today, the crisis continues. At a recent auction of nearly 9,000 seized homes and lots, less than one-fifth of the available properties sold, even with bidding starting at $500. You literally can't give away most of the property in Model City areas today. The properties put up for sale represented an area the size of New York's Central Park. Total vacant land in Detroit now occupies an area the size of Boston. Detroit properties in foreclosure have more than tripled since 2007.

None of this is surprising. It's exactly what you'd expect to see given the implementation of a socialist scheme like a Model Cities' program. Quite simply, coercion doesn't work for economic development. You cannot tax yourself into prosperity.

It might buy votes... but sooner or later the voters will realize all that's been promised was a lie. Won't they?... Maybe not.

You see, the failure of the Model Cities program and of the War on Poverty wasn't surprising. What is surprising is that *every single mayor of Detroit since 1961 has been a Democrat*. And extremely liberal, black politicians have filled almost every major political office in the city since the mid-1960s.

For example, John Conyers, Jr. has represented most of Detroit's worst neighborhoods *since 1965*. Today, Conyers is the second-longest serving congressman in the House. And his election track record could be described as "Putin-esque." *Conyers doesn't merely win all of his election campaigns... He wins by margins that aren't explainable in a normal, two-party system.*

He defeated Republican Robert Blackwell in 1964, getting 84% of the vote. He was re-elected 13 times in a row from that district, *all with a greater margin of victory than 85%*. Ironically, the district was so ill-served by his socialistic policies that about

half of the people moved away. The population losses led to redistricting. From then on, his margin of victory has fallen... to "only" around 80%.

These election results don't seem reasonable, do they? They aren't. By controlling the state legislature in Michigan, the Democrats are able to draw the congressional districts in a way that guarantees them almost permanent control. It's no different than what despots do all over the world. They hold an "election." But it's only for show.

And what do the Democrats do with this power? They push a form of American socialism. This political system features transfer payments, government jobs, and lucrative government contracts to voters in exchange for political support – and in many cases, outright bribes. They do all of these things under the cover of "progressive" politics and "social justice."

But if you brush away the veneer, what you find is a history of abuse of power, corruption, and outright bribery. Conyers himself was found guilty of several minor ethical violations in 2006 – mainly of using his staff as personal servants, forcing them to babysit and chauffer his children. In 1992, he was one of the most egregious abusers of the House Banking scandal. He wrote 273 bad checks and left his account overdrawn for nine months. But that's all small-time graft compared to how things really work in his office and in his district.

How do I know? Well... just ask yourself where Conyers' wife sleeps today.

Monica Conyers, the wife of the second-longest tenured congressman in the United States, sleeps in a federal prison in West Virginia. She pled guilty to bribery in June 2009. *She is serving a 37-month sentence for accepting $60,000 in bribes as the president pro tempore of the Detroit City Council*. And yet... and yet... Conyers won re-election handily in 2010.

How is that possible?

These kinds of people and their political philosophy have destroyed what was once America's fourth-largest city. There is almost nothing left of what was the capital of America's industrial heartland. It's not hard to understand what has happened. When you start taxing people at extremely progressive rates to pay for socialist "benefits"... when you start telling them which schools their children must attend... when you start giving jobs away to people based on political patronage, race, or anything other than ability... you quash human freedom, you create dependency. And you deter capital and investment... which bogs down productivity and economic growth. If continued for long enough, it leads to social collapse.

And Conyers is hardly an anomaly. Just look at those same blighted districts in Houston and Philadelphia...

In Houston, most of the city's worst neighborhoods in terms of high-school graduation rates and crime are found in Texas Congressional District 18, where Democrats have won every election since the district was created through re-zoning in 1972. In 1994, Sheila Jackson Lee won the seat by promising to deliver more federal benefits to her constituents...

To appreciate the sterling representation the Honorable Ms. Jackson Lee provides, consider this... In 2010 in bizarre remarks before Congress, she demanded the government recognize victory in Vietnam. You can try to figure out what she's talking about here: http://www.cbsnews.com/8301-503544_162-20010824-503544.html. She also alleged racism on the part of her *fellow members of Congress* who were voting against raising the debt ceiling. Don't believe it? View for yourself: http://www.youtube.com/watch?v=PRyqOg709fw.

In Philadelphia, Chaka Fattah represents the worst parts of the city, Pennsylvania's 2nd Congressional District. The 2nd District is the fifth-most Democratic Congressional District out of the 435 in Congress (and the most Democratic outside of New York) based on the consistency and margin of Democratic victories. A

black Democrat has held the seat since 1963.

Among Chaka Fattah's political highlights is his economically illiterate plan to implement a 1% surcharge on all financial transactions and transfers in lieu of all other forms of tax. This ill-fated plan, which hasn't gotten a single co-sponsor, ignores everything we know about actual human behavior. (If you implemented such a cost to financial transactions, the viability of those transactions would be destroyed and they wouldn't occur.)

Fattah's other notable political position is his support for convicted cop killer Mumia Abu-Jamal. Mumia's case has been a *cause célèbre* for years. The details of his endless appeals are tedious... just know the evidence presented against him is overwhelming. And the Fraternal Order of Police has consistently campaigned against Fattah's re-election over his support of Mumia.

The larger point is... These districts are among the most blighted in our nation. Society has broken down there to a horrible degree. Opportunity has vanished... Crime is rampant... Dependency on the state is the norm. The leadership in these communities should be the most scrutinized, their elected positions among the most contested. And yet, they are the safest seats in Congress. The officials dominance goes unchallenged.

Why haven't these policies and these leaders been dropped – even after they've pled guilty to outright bribery? You would think having experienced enough failure, having lived through horrible riots, terrible crime, total economic collapse, brazen corruption... that sooner or later, the voters in Detroit (and many other cities in America) would come to their senses. But that's not what happened. Instead, these systems have continued to fail up to the point of total collapse. It is as if one part of our society decided to run off the cliff... and then continued to do so *for decades.*

Why? Why did this happen? Why does it continue to happen?

Government Employee Unions: Organized Corruption

A big part of the answer lies in understanding the key mechanism in the Democratic Party's funding system. (Don't worry... so far, we've been talking about Democratic Party failures, but I'll get to the Republicans next. The corruption of America is a bipartisan problem.)

We can trace the origins of these ultraliberal politicians and the beginnings of America's severe urban decline to the early 1960s. Yes, that was when the civil rights movement inspired the black community to take political power. But that wouldn't have necessarily led them to embrace socialism. Americans of all races largely rejected socialism for decades.

That all changed in the mid-1960s. Facing tough mid-term elections, the Democratic Party convinced President John F. Kennedy to allow the federal workforce to unionize. Executive order 10988 – signed on January 17, 1962 – permitted federal employees to organize unions and bargain collectively for higher wages and benefits. This set the stage for similar measures in cities and states across the country and led to a transformation of the union workforce. (Technically, Wisconsin became the first state to allow collective bargaining from state employees in 1959. But that's an outlier. Most states followed the federal lead.)

This represented a major change in both Democratic Party strategy and a major revolution in American politics. Even Franklin Delano Roosevelt, who was the most liberal president in history prior to Barack Obama, recognized that allowing collective bargaining on behalf of government workers was incompatible with a free democratic system of government...

> *All Government employees should realize that the process of collective bargaining, as usually understood, cannot be transplanted into the public service. It has its distinct and insurmountable limitations when applied to public*

~ The Little Black Book of Investment Secrets ~

> *personnel management.* – President Franklin Roosevelt in a letter to Luther Steward, president of the National Federation of Federal Employees, August 16, 1937.

A government union turns the public servant into the public's master. It is a means of using the government's own spending to organize control of that government. And that is exactly what's happened. The government, unlike private companies, isn't limited by normal economics because the government controls the monopoly on force and has the power to levy taxes.

The power of unions had long been held in check by market forces. Companies that gave too much to the unions in terms of pay or benefits soon found themselves driven out of the market because of high costs or poor products. Except in cases of government bailouts (like GM), these companies soon went out of work and their union members were left unemployed.

Nobody could reliably adopt truly socialistic policies because eventually, the costs of those bad ideas limited the power of the people promoting them. The growth of unions stalled in the 1950s, and they began to shrink in the 1960s. This caused a crisis in the Democratic Party (among the principal beneficiaries of union dues). Something had to be done.

Organizing unions made up of state employees completely eliminated the ability of market forces to temper their power. After all, taxes aren't subject to the demands of consumers. Following Kennedy's executive order, membership in public employee unions – The American Federal of State, County and Municipal Employees (AFSCME), the Service Employees International Union (SEIU), and the Teachers' National Education Association (NEA) – boomed. So did their contributions to liberal, Democratic politicians.

These socialist organizations now had access to funding that wasn't limited by market forces. They could control entire generations of politicians. And they did. From 1989 to 2004, AFSCME was the largest single donor to federal political campaigns in the country. **More than 98% of its donations went to Democratic candidates.**

To see the damage the heavy involvement of these unions has on the community, consider one government service – education.

The Democrats largely control all the areas plagued by the worst schools in the United States – the inner city schools of America's big cities. A voucher system that would empower parents to send their children to better schools and introduce competition for government funding is a simple and proven way to improve both the results and cost-effectiveness.

If the Democratic Party were truly interested in the actual well-being of the communities it serves, supporting voucher plans and charter schools is among the first things you'd expect them to pass. But in fact, it is the last thing they would ever voluntarily do. It is the Democratic Party that stands firmly against any significant changes to the public school system – despite its obvious failure – because of lobbying by the NEA.

This is so clearly an example of graft and corruption that you must doubt the ability of the system to function.

Besides this obvious problem, there is a *tremendous* amount of corruption in the various direct transfer payment programs that have been organized and supported by the Democrats and their union backers, which have created an entire subculture of people who live and trade in various forms of welfare. If you don't believe me, spend a few days shopping in your nearest ghetto. Look for the "Use EBT Here" and "We Accept WIC" signs... They're essentially gift tags... demonstrating your compulsory largesse to the good folks of that neighborhood.

And people addicted to transfer payments will never see how their dependency is destroying their community. That's exactly what happened in Detroit.

Today, we have a black, Democratic president, who came to power in the most corrupt state in the union – Illinois. Right

~ The Little Black Book of Investment Secrets ~

now, two former Illinois governors have been convicted for corruption. One for blatantly trying to sell the Senate seat Obama vacated when he became president.

And realize... not a single member of Obama's cabinet has any kind of private-sector experience.

On the other hand, he has extremely close ties to the unions. He had the most liberal voting record of any senator during his tenure in Congress. His agenda is explicitly socialist: "I think we should spread the wealth around a little bit."

The likelihood America will become more and more like Detroit is growing – rapidly. Politicians now control the banking sector, most of the manufacturing sector (including autos), and a large amount of media. They are threatening to take over health care and the production of electricity via cap-and-trade rules and subsidies promoting solar power. These are major threats to the wealth and well-being of America. America is under siege by corrupt socialists.

And the big problem is... these kinds of political systems can't be reformed because their power base is the government itself, thanks to the creation of government employee unions. That sets the stage for a collapse...

Look around... Taxes can no longer be raised without people actively fleeing states. This has happened in several places – New York, New Jersey, and California, to name a few.

In Maryland – where my company is headquartered – the Democratic state government couldn't balance the budget in 2009, so it decided to double the income tax rate on citizens with more than $1 million in annual income. That left the rich facing a 9.45% marginal state and local income tax. Put that on top of a 36% federal rate, throw in another 6% for Social Security and Medicare, and you're looking at a top marginal rate in excess of 50%. What kind of smart, hard-working citizen is going to give the government more than *half* his income if he can move somewhere else and pay substantially less?

The liberal editorial board at the *Baltimore Sun* happily praised the measure and predicted Maryland's top earners would "grin and bear it."

What a bunch of fools.

Instead, the rich left town. The number of million-dollar incomes in the state of Maryland declined by more than 30%, from 3,000 filers to only 2,000. Rather than gaining the predicted $106 million in income from these filers, Maryland collected $100 million *less* than it did the year before.

Do you think Maryland will rescind such stupidly progressive taxes? No way. It's good politics to promise the voters that only the rich will pay. No, it doesn't work. But that doesn't matter – not until the entire system collapses. And that's why such a collapse is inevitable. It happens all the time. The political promises expand and expand. The rate of marginal tax goes higher and higher. The tax base narrows and tax collection declines. Government debts soar, until... sooner or later... the interest rate soars because lenders realize there is no way they will ever get their money back.

That's what's happening now all over Europe.

And it will happen here next.

The states and their union employees have reached the inevitable endgame. The numbers in many states are mind-numbing. Illinois' pension liability now exceeds $100 billion. Roughly half is unfunded. In California, the pension liability is $50 billion. Another 10 states have unfunded pension liabilities in excess of $10 billion.

The Pew Foundation estimates when retiree health care benefits are included, the total unfunded liabilities of the state governments currently exceed $1 trillion.

These debts are not currently on the books of any institution in America. They're merely promises made by our state and local governments. But these promises add up to a bill we cannot possibly pay – not if we plan to honor the $20 trillion the federal government currently owes (which includes all of the debts of Fannie Mae and Freddie Mac).

~ The Little Black Book of Investment Secrets ~

What does this mean for the future of America? I'm sorry... But it's not good.

Everyone knows what happens to socialist countries. They eventually collapse for the simple reason that everyone cannot live at the expensive of his neighbor – not for long.

And if you want to see what socialism will do to our country, don't go to the Eastern-bloc countries of the former Soviet Union. They got rid of that kind of government 20 years ago. Now they've got low, flat taxes and booming economies. You might visit Cuba or spend time in Venezuela. You'll find socialism there, certainly. But you don't have to go that far...

All you really have to do is visit Detroit.

You can drop Congressman Conyers a Thank You note after your visit.

Welfare for the Rich, Too

Our country's core problems are not found in only one political party.

There is just as much corruption, if not more, on the Republican side of the aisle. It was, for example, as I pointed out earlier, a white, Republican-appointed Treasury secretary (Henry Paulson) who tipped off 20 top hedge-fund managers about Fannie Mae and Freddie Mac's imminent collapse after assuring the public that it wouldn't happen.

For big business, the powerful role of government in our society is simply too valuable to ignore. And the amount of corruption it inspires is stunning. Few politicians even bother trying to hide the fact that they're bought and sold like furniture.

Take Newt Gingrich. The white, Republican former House speaker was paid $1.6 million for "consulting" by Fannie Mae and

Freddie Mac during a period of time the two firms were under constant attack by Newt's fellow Republicans. Were the attacks efforts to truly reform a major threat to our financial system... or were they merely shakedowns? All we know for certain is Fannie and Freddie collapsed, just as many Republicans warned they would. The Republican effort to reform the firms failed. Newt collected $1.6 million.

Fannie and Freddie could end up costing taxpayers as much as $500 billion. No, I'm not ignoring the *colossal* role the Democrats played in staffing Fannie and Freddie, lobbying Congress for the companies, etc. I'm simply pointing out that, in Washington, everything and everyone seems to be for sale, on both sides of the aisle.

I realize that's nothing new. What is new is the scope of the corruption and how brazenly our leaders have embraced it.

Think about the new prescription drug benefit – 2003's Medicare Modernization Act. The law provided public funding for both public and private prescription drug benefits. (IBM, for example, estimated it would save $400 million over 10 years on retiree benefits thanks to the law.) At the same time, the law *banned* the federal government from negotiating with pharmaceutical companies. In summary, the law basically requires the federal government to pay for the prescription drugs of just about anyone over the age of 65 and requires the government to pay full retail prices.

There are now around 25 million beneficiaries of this law (not including the pharmaceutical companies). The average annual benefit is currently about $1,500. The total cost of the legislation over the next decade is expected to be around $1 trillion. This represents the largest expansion of Medicare in the history of the U.S.

The benefit was approved by a Republican-dominated Congress, in a midnight vote. Louisiana Republican Billy Tauzin, then chairman of the Committee on Energy and Commerce, which oversees the pharmaceutical industry, organized the vote. Two months later, Tauzin resigned his seat and took a job paying $2.5 million per year as a lobbyist for the Pharmaceutical

Research and Manufacturers of America. The pharmaceutical industry continues to spend $100 million per year on campaign contributions and lobbying.

Americans are left paying the world's highest prices for drugs. Worse, we have extended the entitlement sentiment into the one area of the economy where personal responsibility is crucial. For most people, good health can be achieved by maintaining a disciplined diet and simple exercise. Offering free pills in lieu of such steps will only further the serious problem of diabetes and obesity we face.

And remember... this law was passed by Republicans and signed into law by a Republican president.

I could go on and on here...

There is a *tremendous* amount of corruption between the federal government and big business. There's even more corruption at the state and local level. Here's one simple expression of what's happening...

As late as 1969, the U.S. tax code required "only" 16,500 pages. By 2007, the code grew to 67,506 pages. The current form 1040 instruction booklet is 155 pages long. Obviously none of this is necessary for the collection of taxes. The code has been shaped by the corruption of our government, which in turn was shaped by the corruption of our society.

Here's another simple measure. Look at how much of federal spending goes directly to millionaires and big business.

Republican Sen. Tom Coburn, of Oklahoma, recently published a report on the subject entitled "Subsidies of the Rich and Famous." According to the study, the feds are now spending around $200 billion annually on direct transfer payments to the very rich.

Given the state of our national finances, this is patently absurd. Merely getting rid of these payments would result in a substantial reduction (almost 15%) of our annual federal deficit.

And yet... despite the collapsing dollar, our soaring debt loads, and the lowest civilian employment levels since the Great Depression... everything seems to be business as usual in Washington D.C.

Doesn't that make you sick? There's simply no excuse for this kind of governance. None. Americans deserve a vastly better and more ethical federal government. But we will never get it unless we can find a way to hold our leaders personally accountable for what's happening.

Here's a simple solution. Hold the senators and congressmen personally liable for any deficit, each year. We elected these people to be our leaders. We did not elect them to spend us into bankruptcy. We did not elect them to feather their own nests with unlimited public spending. We did not elect them to buy votes. The only way to stop what's happening is to make them personally responsible for their actions. Either they will balance the budget or face personal financial ruin.

Demanding personal accountability for fiduciary responsibilities would have an immediate and profound impact on our society. It would wipe out the entitlement mentality that's destroying our society – almost overnight.

Restoring personal accountability is also crucial if we hope to restore confidence in our public corporations and capital markets, which were once the broadest, most efficient, and most trusted in the world.

The Corruption of the Corporation

If you think I'm exaggerating the problems we face or the far-reaching impact of the entitlement culture we've allowed to develop in America... then explain the following fact...

The 10 largest American bankruptcies in history have all occurred in the last decade: Lehman Brothers ($691 billion), Washington Mutual ($327 billion), WorldCom ($103 billion),

General Motors ($91 billion), CIT ($80.4 billion), Enron ($65 billion), Conseco ($61.4 billion), MF Global ($41 billion), Chrysler ($39.3 billion), and Thornburg Mortgage ($36.5 billion).

All of these failures have a few things in common: extremely well-compensated CEOs with long tenures (which suggests the board of directors was asleep at the wheel), vast amounts of debt that would seem completely unsafe by any reasonable standard, and accounting policies that deliberately misled investors. Most tellingly, in the majority of these cases, *board members and the executive management have no material investment in the company*.

In every single case, the financial jeopardy was apparent – for years. In fact, at Stansberry & Associates, we accurately predicted several of these bankruptcies and warned about nearly all of them. (Several others we accurately forecast were narrowly avoided thanks to the TARP program and other federal bailouts.) We are far from the best-connected or the smartest financial analysts in the world. Yet... almost every single Wall Street firm remained silent… *and so did the ratings agencies*.

You never saw most of these problems revealed to the public, either in the *Wall Street Journal* or other mainstream news sources. What was almost common knowledge in financial circles was never shared with the public, which continued to buy these stocks (and many others in a similar situation) all the way down. Most Americans' 401(k)s were eviscerated. But the bonuses on Wall Street never fell.

I can't name a single major Wall Street firm that hasn't engaged in massive fraud over the last decade. Not one. They have all paid massive fines to the SEC. But in only one of these cases was any firm held criminally responsible. And that firm was Arthur Anderson – Enron's accountant! What about the bankers who actually lent the firm money against collateral they knew was bogus? What about the investment bankers who sold Enron's stock to the public, even though it knew the earnings were fraudulent? And what happened to the huge corporations whose depositors, executives, and lawyers were full, active partners in the fraud that bankrupted Enron – namely Citigroup and JPMorgan, the two largest banks on Wall Street?

The Senate subcommittee investigating Enron's collapse had this to say about Citigroup and JPMorgan: "*The evidence... demonstrates that Citigroup and JPMorgan actively aided Enron in executing transactions, despite knowing the transactions utilized deceptive accounting or tax strategies, in return for substantial fees or favorable consideration in other business dealings*."

So what happened? Almost nothing. In August 2003, the banks settled with the SEC for a *combined* $255 million. They did not admit guilt. Nor did they stop committing fraud.

The very next year, in 2004, Citigroup settled for $2.65 billion (yes, billion) to get out of charges it had defrauded lenders and investors in the collapse of WorldCom.

(Ironically, the plaintiff who brought this case was New York State Comptroller Alan Hevesi. Hevesi, like Monica Conyers, is currently in jail, for corruption charges. Yes, really. In April, he was sentenced to up to four years in prison in the Steve Rattner-related bribery case I also mentioned earlier. In America today, even the people who are going after the banks for fraud are themselves corrupt.)

AIG paid $800 million in a settlement in 2006 – just two years before its collapse nearly triggered a global financial catastrophe, requiring a $125 billion federal bailout. Fannie Mae paid $400 million to settle accounting charges in 2006, just two years before its collapse cost taxpayers more than $100 billion. Its CEO, Franklin Raines, walked away with close to $100 million in compensation and was never criminally charged.

Goldman Sachs paid $550 million in 2010 related to fraudulent mortgage securities. Citigroup paid $400 million in 2003 for bogus equity research. Invesco paid $325 million in 2004, after it admitting to ripping off its own mutual-fund investors via a late-trading scheme. Prudential was also "dinged" $270 million in the

same scandal.

I could go on... but you surely get the point. Nearly every major financial fiduciary in the United States has been involved in serious malfeasance in the last decade. The sums of these settlements indicate transgressions that should rise to the level of criminal indictments...

The Rigas family, for example, was thrown into prison after defrauding investors in Adelphia Communications. Their settlement with the government was "only" $715 million. Citigroup, on the other hand, has paid settlements close to five times that amount over the last decade... but not a single criminal charge has been filed. Adelphia Cable didn't owe their subscribers a fiduciary duty. All of the Wall Street firms I mentioned did.

If that's not corruption, what is? And if all of this doesn't make you sick, what will?

We've written volumes about the other major corporate scandals over the past decade. We broke the executive options abuse story, for example, in 2002, showing how companies like Broadcom, Juniper Networks, and Apple Computer were ripping off shareholders by printing massive amounts of employee stock options (most of which went to executives) and then re-pricing them when their stock prices fell.

Under the system, all of the company's cash flows (and more) would have to go to share buybacks in order to prevent massive dilution. Thus, the employees were actually stealing the company's earnings. Most people on Wall Street knew this and were shorting the companies whose abuses were the most egregious. But the scheme wasn't revealed to the public (outside of our newsletter) until 2006 when the *Wall Street Journal* finally wrote about the issue.

Steve Jobs, who was one of the most flagrant options abusers at both Apple and Pixar, got off the hook by naming Al Gore to the board of directors... and giving him millions in options grants. To this date, Apple Computer has not paid out a single penny in dividends to its rightful owners (its shareholders). Yet over the last decade, it has increased its outstanding share count via options issuance by 47%.

What can you do about the corruption of America's public companies? Here's a very simple solution: *Make the board of directors personally liable for fraud, negligence, and depositor losses.* If you're on the board of MF Global, for example, and your firm fails because your CEO bet $6.3 billion in Italian bonds… your depositors – who are still missing more than $1 billion – ought to be allowed to sue you personally. Currently, a combination of legal liability limits and insurance (so-called D&O policies), paid for by the corporation, prevent any real personal liability – even in clear cases of fraud.

Franklin Raines, for example, who had Fannie Mae's accounting set up to maximize his annual bonuses in violation of accounting standards was fined $2 million in a settlement with regulators. An insurance company paid the fine. The company paid the premiums on that policy.

The concept of the corporate shield for legal liability was created so that limited partners (like common-stock holders) couldn't be held liable for the damages caused by the general partner's actions or misdeeds. Over time, that shield has been extended to the general partners of public companies – the board of directors and the executive management team. But these people are paid to run the company. If they engage in fraud or are negligent in their duties, they ought to be held liable.

If you were to simply make that one legal change, the conduct of America's corporations – especially those with fiduciary responsibilities to depositors – would change overnight. Confidence in America's public companies and capital markets would soar. But... as long as the idea of entitlement remains ascendant, dictating that executives keep most of the profit but none of the risk... our capital markets will continue to suffer and the management of our public companies will be rife with negligence and fraud.

Is This Fascism?

Earlier this year, in my June issue, I tried to define the unique blend of socialism for the poor, corporate welfare for the rich, paper money for the government, and credit excess for the middle class that has shaped America for most of the last 40 years. I wrote...

> *You can't just call our economic system "socialism." It's not. There's a profit motive and private ownership of nearly all assets. Socialism has neither of these. Besides, far too many people have become far too rich in our system to simply label it "socialism"...*
>
> *Our system isn't truly capitalism either, though. The State intervenes in almost every industry, often in a big and expensive way. With government at all levels making up more than 40% of GDP, it's fair to say we live in a State-dominated society...*
>
> *A certain class of people has the power to not only protect itself from these policies but to profit as well. These people have used the last 40 years to produce massive amounts of paper wealth. And they are now desperately trying to convert those paper accounts into real wealth, which explains the exploding price of farmland and precious metals.*
>
> *This explosion of wealth at the top of the "food chain" is the main feature of what I call New American Socialism. It's a system fueled by paper money, the constant expansion of debt, and a kind of corruption that's hard to police because it occurs within the boundaries of the law...*
>
> *In the New American Socialism, the power of the system produces private profits. In this way, it provides a huge incentive to entrepreneurs and politicians to work together on behalf of the system. This is what keeps the system going. This is what keeps it from collapsing upon itself. And this, unfortunately, is why the imbalances in*

the world economy will continue to grow until the entire global monetary system itself implodes.

I continue to believe that's a very accurate description of what's happening to our country. But... many subscribers wrote in and complained that what I was calling "New American Socialism" was nothing new at all – it was actually fascism.

Webster's defines fascism as...

a political philosophy, movement, or regime that exalts nation and often race above the individual and that stands for a centralized autocratic government headed by a dictatorial leader, severe economic and social regimentation, and forcible suppression of opposition.

That's not what's happening in America – at least, not yet. To this point, there's little direct forcible suppression of opposition and little exultation of the federal government. And while certain congressional districts have become socially regimented and politically repressive, that's not a widespread phenomenon.

Many people fear this is where we're heading... that as conditions deteriorate and the currency collapses, the government will move to take still more power. I don't think that's likely – at least, not for long...

I do agree that the nation will soon face a choice between heading down the path towards fascism... or turning back the power of government and restoring the limited Republic that was our birthright. I continue to believe Americans will choose personal liberty.

I believe they will choose more freedom rather than more totalitarian rule. I don't believe Americans will tolerate martial law for long – even in the advent of a real emergency, which I do believe will occur.

What gives me confidence for the future? Gun sales, for one thing. U.S. citizens legally own around 270 million firearms – about 88 guns per 100 citizens (including children) today.

That's a hard population to police without its consent. America is the No. 1 country in the world as ranked by the number of guns per-capita. That plays a major factor in the kind of government you will see take root in America. Things might go too far in this country for a while... And I'd argue they've been going the wrong way for too long. But the government can only take things so far before they'll be faced with a very angry, well-armed opposition.

If the government attempts to take our guns... my opinion would change immediately. But that's one right the Supreme Court has been strengthening recently. It gives me hope that most people in America still understand that the right to bear arms has little to do with protecting ourselves from crime and everything to do with protecting ourselves from government...

****

I hope you've enjoyed – or at least been challenged to think in new ways – by this report. I've been thinking about the issues for a long time and believe they are important. Whether you agree with my analysis or not, I hope you'll share these ideas with people in your circle of influence. Together, we can certainly draw far more attention to the moral failings of our leaders and the risk we face by the growth of the entitlement culture.

Once again… please realize, I'm not taking a political side here. I'm not saying the Democrats are singularly responsible for the state of our country. I'm not saying the Republicans are all to blame. And I'm not saying this is a black problem or a white problem. The problem is rooted in the corrupt belief that you can live at the expense of your neighbor... that we have become a nation where the vast majority of people believe their well-being is primarily, someone else's responsibility.

This bankrupt belief has taken complete control of our government, educational system, medical industry, and our corporations. And unless we demand better from each other and our political leaders, our society is doomed to collapse under the crushing weight of the Corruption of America.

It's time we got back to our traditions as Americans and started doing more to take care of our families, communities, and ourselves.

One of the Best Trading Opportunities of the Next Two Years

By Porter Stansberry
S&A Founder and Editor of *Stansberry's Investment Advisory*

The stage is set for a global financial reset...

The central bankers in the U.S. and Europe plan to use inflation to wipe away their bad debts. That is their only hope.

They believe that they'll be able to control inflation... that it won't end up getting out of control and destroying the monetary system they've built.

I believe they'll be proven wrong... eventually. But in the meantime, **we have a nearly risk-free way to make huge gains in bank stocks**.

My thesis is simple.

Despite the ongoing financial problems in Europe, both the European Central Bank and the U.S. Federal Reserve have the ability (thanks to the printing press) to stop any run on the banks.

Their previous actions ("quantitative easing") have committed them to an inflationary policy to save the banks and continue the monetary system as it exists today. *And that means the world's largest banks will continue to be bailed out via continuous manipulation of the money supply.*

That's what happened in the U.S. in the fall of 2008 and 2009. And that's what has happened in Europe, starting in December 2011. These policies will cause the value of many assets to rise substantially. Inflation is the salve that heals all financial wounds.

Consider Miami Beach, where I've been living for the past year...

I bought a waterfront property here last February for around $400 per square foot. Those properties are now selling for more than $1,000 per square foot. I've already received one unsolicited offer for the property. That's one small example.

Rising housing prices in Miami (one of the worst-hit areas of the mortgage crisis) will flow through to the balance sheets of these banks. It will take another 18-24 months... but it will happen. And as the bad debts turn into performing loans and the value of the collateral rises... some of the huge write-offs that were taken in 2008 and 2009 will be reversed.

Let's say rising prices lift the average value of Bank of America's assets by 10% over three years. That would increase the bank's equity by $200 billion. That's a *huge* increase for a stock with a $90 billion market cap.

The coming inflation will also cause banks' net interest margin to widen. That's what determines how much cash flow and earnings they generate. It's the difference between what they pay to borrow money and what they collect by lending it. As long-term rates rise because of inflation, banks' profitability should increase substantially because the Federal Reserve (and the European Central Bank) have fixed short-term interest rates near zero.

These two factors – rising asset prices and increasing net interest margin – should cause the share prices of many banks to double (at least) over the next 12 months. And because right now many banks are trading for less than book value, you can capture profits without taking on much risk.

Now believe me... I know what the reaction to this idea will be... Most of my readers will *never* buy these banks – or any others. Some of you will even stop reading because I've suggested what is, in your eyes, heresy.

How could I recommend buying banks when I've been warning of a collapse in the faith of the U.S. dollar... and just last year, was telling people to short banks?

I recommended shorting European banks last July when the European financial crisis threatened to boil over because the European Central Bank (ECB) resisted bailing out the banks as the Fed did here in 2008-2009. I reversed course and covered the short later that year. Then, following the huge ECB bailout of December 21, I changed my global view on stocks...

If the ECB is going to paper over the giant losses these banks face holding sovereign debt that's likely to default, shareholders face little risk and a much greater likelihood that inflation will propel asset values and earnings. Combined with the actions of the U.S. Federal Reserve (which is underwriting much of the ECB actions via swaps), this sets the stage for a global financial reset.

Please understand this... *I am not in favor of these policies.*

The inflationary path we are on will wipe out the middle class. Central-bank-created inflation enables speculators and Wall Street interests. It provides them with more and better ways to increase their wealth – via things like carry trades, leveraged buyouts, and net interest margin – at the expense of the entire nation.

These central bank policies and the resulting inflation will cause a huge rise in income inequality as real wages decrease and financial profits greatly increase. These policies will ultimately cause a severe breakdown in civil society.

This is how the "End of America" (a loss of confidence in our paper money) will develop. It's happened in dozens of other countries over the last few decades. It is the inevitable result of paper money systems and government-led central banks.

But thanks to these policies, you have a nearly risk-free way to

make huge gains in bank stocks.

Note: The only assumption in this analysis is that the central banks continue their inflationary policies. Because the central banks can't risk a global deflation and credit collapse, *they are going to continue printing*. As I said above, that's going to have widespread consequences.

Editor's Note: China is corning the world's gold markets, and it's "one of the biggest and most important financial stories of the day," says S&A founder Porter Stansberry. Understanding China's actions is critical to successfully managing your money over the next few years. Porter explains the situation in the following essays and the huge impact it will have on you and your finances. Even if you don't agree with everything he says, they're worth reading…

How the Chinese Will Establish a New Financial Order

By Porter Stansberry
S&A Founder and Editor of *Stansberry's Investment Advisory*

For many years now, it's been clear that China would soon be pulling the strings in the U.S. financial system.

After all, the American people now owe the Chinese government nearly $1.5 trillion.

I know big numbers don't mean much to most people, but keep in mind... this tab is now hundreds of billions of dollars more than what the U.S. government collects in ALL income taxes (both corporate and individual) each year. It's basically a sum we can never, *ever* hope to repay – at least, not by normal means.

Of course, the Chinese aren't stupid. They realize we are both trapped.

We are stuck with an enormous debt we can never realistically repay... And the Chinese are trapped with an outstanding loan they can neither get rid of, nor hope to collect. So the Chinese government is now taking a secret and somewhat radical approach.

China has recently put into place a covert plan to get back as much of its money as possible – ***by extracting colossal sums from both the United States government and ordinary citizens, like you and me***.

The Chinese "State Administration of Foreign Exchange" (SAFE) is now engaged in a full-fledged currency war with the United States. The ultimate goal – as the Chinese have publicly stated – is to create a new dominant world currency, dislodge the U.S. dollar from its current reserve role, and recover as much of the $1.5 trillion the U.S. government has borrowed as possible.

Lucky for us, we know what's going to happen. And we even have a pretty good idea of how it will all unfold. How do we know so much? Well, this isn't the first time the U.S. has tried to stiff its foreign creditors.

Most Americans probably don't remember this, but our last big currency war took place in the 1960s. Back then, French President Charles de Gaulle denounced the U.S. government policy of printing overvalued U.S. dollars to pay for its trade deficits... which allowed U.S. companies to buy European assets with dollars that were artificially held up in value by a gold peg that was nothing more than an accounting fiction. So de Gaulle took action...

In 1965, he took $150 million of his country's dollar reserves and redeemed the paper currency for U.S. gold from Ft. Knox. De Gaulle even offered to send the French Navy to escort the gold back to France. Today, this gold is worth about $12 billion.

Keep in mind... this occurred during a time when foreign governments could legally redeem their paper dollars for gold, but U.S. citizens could not. And France was not the only nation to do this... Spain soon redeemed $60 million of U.S. dollar reserves for gold, and many other nations followed suit. By March 1968, gold was flowing out of the United States at an alarming rate.

By 1950, U.S. depositories held more gold than had ever been assembled in one place in world history (roughly 702 million ounces). But to manipulate our currency, the U.S. government was willing to give away more than half of the country's gold.

It's estimated that during the 1950s and early 1970s, we essentially gave away about two-thirds of our nation's gold reserves... around 400 million ounces... all because the U.S. government was trying to defend the U.S. dollar at a fixed rate of $35 per ounce of gold.

In short, we gave away 400 million ounces of gold and got $14 billion in exchange. Today, that same gold would be worth $620 billion... a 4,330% difference.

Incredibly stupid, wouldn't you agree? This blunder cost the U.S. much of its gold hoard.

When the history books are finally written, this chapter will go down as one of our nation's most incompetent political blunders. Of course, as is typical with politicians, they managed to make a bad situation even worse...

The root cause of the weakness in the U.S. dollar was easy to understand. Americans were consuming far more than they were producing. You could see this by looking at our government's annual deficits, which were larger than ever and growing... thanks to the gigantic new welfare programs and the Vietnam "police action." You could also see this by looking at our trade deficit, which continued to get bigger and bigger, forecasting a dramatic drop (eventually) in the value of the U.S. dollar.

Of course, economic realities are never foremost on the minds of politicians – especially not Richard Nixon's. On August 15, 1971, he went on live television before the most popular show in America (*Bonanza*) and announced a new plan...

The U.S. gold window would close effective immediately – and no nation or individual anywhere in the world would be allowed to exchange U.S. dollars for gold. The president announced a 10% surtax on ALL imports! Such tariffs never accomplish much in terms of actually altering the balance of trade, as our trading partners simply put matching charges on our exports. So what actually happens is just less trade overall, which slows the whole global economy, making the impact of inflation worse.

Of course, Nixon pitched these moves as patriotic, saying: "I am determined that the American dollar must never again be a hostage in the hands of international speculators."

The "sheeple" cheered, as they always do whenever something is done to "stop the speculators." But the joke was on them. Within two years, America was in its worst recession since WWII... with an oil crisis, skyrocketing unemployment, a 30% drop in the stock market, and soaring inflation. Instead of becoming richer, millions of Americans got a lot poorer, practically overnight.

And that brings us to today...

Roughly 40 years later, the United States is in the middle of another currency war. But this time, our main adversary is not Europe. It's China. And this time, the situation is far more serious. Our nation and our economy are already in an extremely fragile state. In the 1960s, the American economy was growing rapidly, with decades of expansion still to come. That's not the case today.

This new currency war with China will wreak absolute havoc on the lives of millions of ordinary Americans, much sooner than most people think. It's critical over the next few years for you to understand exactly what the Chinese are doing, why they are doing it, and the near-certain outcome.

In the next essay, I'll explain the rest of the story... and what it means for you as an investor.

The Largest Gold-Accumulation Plan of All Time

By Porter Stansberry
S&A Founder and Editor of *Stansberry's Investment Advisory*

For more than 30 years, since the start of the country's "Reform Era" in 1978, China has been selling (exporting) more goods than it has imported.

That's allowed the nation to stockpile trillions of dollars – more money than our entire monetary base totaled before the recent financial crisis.

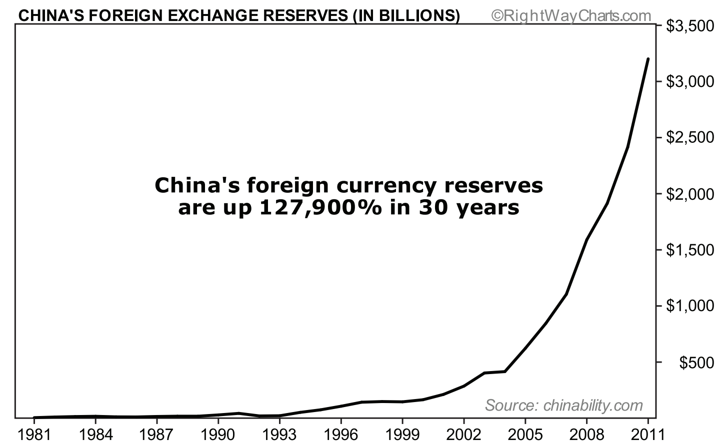
The way it works is simple to understand. When a Chinese business earns dollars by selling overseas, the law requires the company to hand those dollars over to the country's central bank, the People's Bank of China (PBOC). In return, the business gets Chinese currency (called either the "yuan" or the "renminbi") at a fixed rate.

There's nothing fair about this. The Chinese people do all the work, and the Chinese government keeps all of the money. But that's the way it goes.

At first, the dollar inflow was small because trade between the two countries was tiny. In 1980, for example, China's foreign currency reserves stood at approximately $2.5 billion. But since then, the amount of foreign currency reserves held by the Chinese government has gone up nearly every year... and now stands at $3.2 TRILLION. That's a 127,900% increase. It's simply astonishing to look at the chart on the following page of the increase in currency reserves...

As I mentioned in my previous essay, the group in China that manages these foreign reserves is called the State Administration of Foreign Exchange (SAFE). This group is engaged in a full-fledged currency war with the United States. The ultimate goal –

as the Chinese have publicly stated – is to create a new dominant world currency and dislodge the U.S. dollar from its current reserve role.



And for the past few years, SAFE has had one big problem: What to do with so much money?

SAFE decided to use most of these reserves to buy U.S. government securities. As a result, the Chinese have now accumulated a massive pile of U.S. government debt. In fact, about two-thirds of China's reserves remain invested in U.S. Treasury bills, notes, and bonds. The next biggest chunk is in euro. Of course, all this money is basically earning nothing to speak of in terms of interest... because interest rates around the world are close to zero.

And while the Chinese would love to diversify and ditch a significant portion of their U.S. dollar holdings, they are essentially stuck. You see, if the Chinese start selling large amounts of their U.S. government bonds, it would push the value of those bonds (and their remaining holdings) way down. It would be like owning 10 houses on the same block in your neighborhood... and deciding to put five of them up for sale at the same time. Imagine how much that would depress the value of all the properties with so much for sale at one time.

One thing China tried to do in recent years was speculate in the U.S. stock market. But that did not go well... The Chinese government bought large amounts of U.S. equities just before the market began to crash in late 2007. It purchased a nearly 10% stake in the Blackstone Group (an investment firm)... and a similar stake in Morgan Stanley. Blackstone's shares are down about 46% since the middle of 2007, and Morgan Stanley is down about 70% since the Chinese purchase.

The Chinese got burned big time by the U.S. equities markets and received a lot of heat back home. They are not eager to return to the U.S. stock market in a meaningful way. So China's U.S. dollar reserves just keep piling up in various forms of fixed income – U.S. Treasury bonds, Fannie and Freddie mortgage bonds, and other forms of debt backed by the U.S. government. These investments are considered totally safe – except that they're subject to the risk of inflation.

According to a statement by the government: "SAFE will never be a speculator. It mainly seeks to protect the safety of China's foreign exchange reserves and ensure a stable investment return."

If the Chinese won't buy stocks and the only real risk to their existing portfolio is inflation, what do you think they will do to hedge that risk?

They will buy gold... lots and lots of gold.

It was no surprise to us when, in 2011, China became the No. 1 importer of gold. For many people in the gold market, this was a big shock – India has always been the world's leading gold buyer. In India, people traditionally save and display their wealth in gold. Their entire financial culture is based on gold. Historically, silver has played the same role in China... but not anymore.

In fact, not only has China become the world's leading importer of gold, it was already the world's leading producer... by far. According to the most recent figures from the World Gold Council, China produces nearly 50% more gold (about 300 tons

per year) than the second-place country... Australia. And guess what? Every single ounce produced in China – whether it's dug out of the ground by the government or a foreign company – must, by law, be sold directly back to the government.

The Chinese are now clearly on a path to accumulate so much gold that one day soon, they will be able to restore the convertibility of their currency into a precious metal... just as they were able to do a century ago when the country was on the silver standard.

The West wasn't kind to China back then. The country was repeatedly looted and humiliated by Russia, Japan, Britain, and the United States. But today, it is a different story...

Now, China is the fastest-growing country on Earth, with the largest cash reserves on the planet. And as befits a first-rate power, China's currency is on the path to being backed by gold.

China desperately wants to return to its status as one of the world's great powers... with one of the world's great currencies. And China knows that in this day and age – when nearly all governments around the globe are printing massive amounts of currency backed by nothing but an empty promise – it can gain a huge advantage by backing its currency with a precious metal.

As the great financial historian Richard Russell wrote recently: "China wants the renminbi to be backed with a huge percentage of gold, thereby making the renminbi the world's best and most trusted currency."

I know this will all sound crazy to most folks. But most folks don't understand gold, or why it represents real, timeless wealth. The Chinese do. And in my next essay, I'll provide more evidence of how they are carrying out the largest gold accumulation plan of all time.

How and Why China Came to Dominate the Market for Gold

By Porter Stansberry
S&A Founder and Editor of *Stansberry's Investment Advisory*

In some recent essays, I've introduced an idea that I'm sure will earn me jeers and derision from the mainstream press... And probably even worse from the U.S. government.

But my job isn't to fit in with the mindless journalism that passes for the "mainstream press" these days. And it isn't to impress the U.S. government. My job is to study the numbers and report on the most important financial developments that will affect my readers.

One of those ideas is the ongoing and enormous accumulation of gold by China... which will allow it to supplant the United States as the owner of the world's reserve currency.

If you doubt this is what the Chinese are doing, I suggest you take a look at a cable that was leaked on the nonprofit website Wikileaks last year.

This cable was prepared by the U.S. Embassy in Beijing and was sent back to officials in Washington, D.C. The embassy was commenting on a recent report by China's National Foreign Exchanges Administration. The cable quoted the Chinese administration as follows...

> *China's gold reserves have recently increased. Currently, the majority of its gold reserves have been located in the U.S. and European countries. The U.S. and Europe have always suppressed the rising price of gold. [The U.S. and Europe] intend to weaken gold's function as an international reserve currency. They don't want to see other countries turning to gold reserves instead of the U.S. dollar or euro.*

~ The Little Black Book of Investment Secrets ~

> *Therefore, suppressing the price of gold is very beneficial for the U.S. in maintaining the U.S. dollar's role as the international reserve currency. China's increased gold reserves will thus act as a model and lead other countries towards reserving more gold. Large gold reserves are also beneficial in promoting the internationalization of the RMB [China's currency].*

Do you see where this is all heading?

A century ago, China used silver to back its currency. Today, it has chosen gold... And it is basically buying up the world's gold supply. China is essentially attempting to "corner" the gold market.

Just remember... no gold mined in China... not a single ounce... is allowed to leave the country. It all goes to the government's reserves. Yes, the Chinese government allows foreign companies to enter China and form joint ventures with local Chinese firms. And foreign companies are free to mine as much gold as they want in China... But every single ounce must be sold to the Chinese government at current market prices. So the government is piling up every ounce that's mined in China... at least 9.6 million ounces a year (the equivalent of 300 tons).

And that's just the beginning...

I can also say with near-100% certainty that China is secretly buying massive amounts of gold from the International Monetary Fund and other sources. I feel confident about saying this because it's exactly what the Chinese did from 2003 to 2009. If you remember... in 2009, China suddenly announced that its gold holdings had risen by 75% because of secret purchases that took place over six years.

These purchases moved China into sixth position on the list of countries with the most foreign gold reserves. But keep in mind, even with these giant purchases, China's gold holdings still account for less than 2% of its foreign reserves. That's a pittance when you compare it to places like the U.S. and Germany, which hold more than 70% of their reserves in gold.

There's no doubt in my mind that China will continue to buy huge amounts of gold.

In January, news outlet Bloomberg reported mainland China bought 3.6 million ounces of gold from Hong Kong over the past few months... That's 483% more than during the same time the year before. The data come from the Census and Statistics Department of the Hong Kong government. The Chinese government does not make such information public.

In fact, the Chinese have not announced a single gold purchase since 2009. But when you look at the massive amounts of gold "disappearing" from the world markets, it's obvious the Chinese must still be buying. As the newswire Reuters recently suggested in an article that detailed the sale of 150 tons of gold to "unnamed" buyers, "among the most likely candidates is China, which has the largest currency reserves... at $3.2 trillion."

When you are buying this much gold, it's almost impossible to keep the entire thing a secret. That's why many stories of China's secret purchases have been mentioned in the mainstream press. For example, CNN Money interviewed Boris Schlossberg, director of currency research at Global Forex Trading. What follow is an excerpt from that interview…

> *China is considered a stealth buyer of gold... As the world's largest producer of the metal, China often buys gold from its own mines and doesn't report those sales publicly. Analysts suspect the country is continuing to buy gold and could in fact, be the world's largest buyer consistently. It simply doesn't reveal its pro-gold stance…*
>
> *Announcing an aggressive gold buying spree is not in China's best interest because, for one, it might push gold prices higher. Secondly, it could devalue the U.S. dollar, which would subsequently lessen the worth of the country's portfolio of U.S. government bonds.*

This is why the *Mining Journal* said last November that it expects China to amass some 5,000 tons of gold over the next five years. I would not be surprised if it amasses twice that amount. As CNN explained, "The thing to remember here is that if China is going to continue to purchase massive amounts of gold, the last thing they want to do is make this information public, until they really have to. The less they say, the cheaper the price they'll have to pay."

I recently interviewed the most successful gold and silver investor in the world, Eric Sprott, on this subject. Eric is a billionaire, who made much of his fortune in silver. He runs Sprott Resource Management, one of the world's largest resource investment firms. Here's what he told me...

> *I'm sure China's buying gold. I just have no doubt that it's the most logical thing in the world that they would be buying gold. They're seeing their value of their Treasurys declining almost every day now with the weakness of the U.S. dollar. They are losing a lot of money, and they see the gold price essentially go up every day. Well, it's not a difficult decision to say, "Well, we should be buying gold and getting rid of dollars." That's got to be the easiest call in the world.*

Now... while I might not be able to technically prove that the Chinese are buying millions of ounces of gold bars, I can prove they're buying plenty of gold out of the ground. The Chinese government is now in the process of secretly buying up part or all of dozens of the best gold mining companies around the globe.

One of the biggest recent purchases was by the government-owned Shandong Gold Group (the second-biggest producer in China), which made an offer to purchase Jaguar Mining for $785 million in cash – that's 77% more than what Jaguar is now worth in the markets.

Keep in mind... This is the biggest premium EVER paid for a large gold mining firm. Before that, state-owned Zijin Mining

Group (China's biggest gold producer by market value) said it would spend as much as $1.6 billion a year on acquisitions. Last year, the company bought 17% of Australian gold miner Norton Gold Fields and a 60% stake in gold company Altynken.

And these are only the deals the government WANTS to make public.

The government also has kept a slew of investments in the gold markets private and secret. You see, few investors realize the government's China National Gold Group (CNGGC) makes little information public on its most sensitive purchases.

For example, CNGGC has many aliases, including its 40% stake in China Gold Intl. Resources and may have more than 300 secretive investment stakes in various gold mining companies around the globe. With a tremendous amount of digging in recent months, we've been able to locate the Chinese government's significant equity stakes in dozens of junior gold mining stocks.

The point is, when you look at the gold China already has in reserve... and look at what it controls that's still in the ground... **the Chinese might already have more gold than any other nation on Earth**.

But even these resources don't guarantee China control of the market. To really control the market for gold, the Chinese must establish the world's leading exchange – and regulate it honestly. As I'll show you in the next essay, they are doing just that.

It's the next step in China's hidden currency war against the United States.

How China Plans to Change the Way Gold Is Traded

By Porter Stansberry
S&A Founder and Editor of *Stansberry's Investment Advisory*

Today, the global price of gold is largely controlled by just five "bullion banks" in London. These banks establish the price twice a day by offering to buy or sell gold at a fixed price. The world's other markets operate largely off these prices.

Manipulating the price of gold (and thus the value of other major currencies, like the U.S. dollar) is possible by influencing those five bullion banks: Bank of Nova Scotia, Barclays Capital, Deutsche Bank, HSBC, and Societe Generale.

Whether that's happening right now or not, I can't say. But it is a matter of public record that the world's eight leading governments conspired from November 1961 until March 1968 to suppress the price of gold by using their central banks to manipulate the London bullion market. So it has happened before.

Meanwhile, the trading range of the gold price *suggests* that the market continues to be heavily manipulated.

Why do I believe that?

Because as a precious metal with no yield, gold should be a fairly volatile asset – like silver and platinum are. But when you look at how many times the price of gold moves by more than 5% in a day, you find that it *almost* never happens.

Over the last 10 years, the price of gold has moved up or down by more than 5% on only 10 occasions. The same volatility has occurred in silver 80 times. It has happened in oil 137 times.

No explanation other than manipulation can account for gold's exceptionally low volatility. It simply doesn't trade like a free-market commodity.

As I explained in a recent essay, to control the market for gold, the Chinese must not only accumulate massive gold reserves (which it's doing), it must establish the world's leading exchange – and regulate it honestly.

And that's exactly what's happening...

For decades, Chinese citizens were barred from owning physical gold under penalty of imprisonment. Then in September 2009, China became the only country in the world to promote gold ownership to its citizens. The government started a major campaign to encourage all citizens to buy gold. Locals can now buy gold bars, which come in four sizes, at ANY Chinese bank in the country. If you don't think that's unusual, try buying gold at ANY bank in the United States and watch the funny look you get from the teller.

The Chinese government has also set up thousands of gold "stores" around the country... which look like jewelry stores, but instead sell bars of gold.

As *Forbes* recently reported at the scene of one such gold store...

> *The crowds surge shoulder to shoulder inside Beijing's Cai Bai store to buy 5 to 10 gram slivers of gold and jewelry of every size and shape. It's one dramatic example of the gold craze in China, which is officially and unofficially promoted by the Communist government... And it is an integral part of the pro-gold preference by the Chinese public and its government.*

My friend Simon Black – who writes about geopolitical, expatriation, and wealth issues on his Sovereign Man website – also visited one of these Chinese gold stores on a recent trip, and said...

> *On the inside, these gold stores look like jewelry shops – armed guards, glass viewing cases, etc. But instead of diamond crusted earrings and white star sapphires, you see bars. Lots of bars. The government mints bars in sizes ranging from 5 grams (which are so tiny they're actually cute) to 1 kilogram. The prices are updated instantly – they have a Bloomberg screen that tracks the spot price... and the bars are all serialized and [offer] 0.9999 purity, the same as you would get from Switzerland. They are also certified by the gold exchange, which validates the quality.*
>
> *We went into several stores and saw Chinese people buying like crazy... all with cash. The most popular denominations were 10 grams and 50 grams, as well as every piece of jewelry in sight. I'm surprised the mint shops didn't sell out [as] the inventory was flying off the shelf.*

Why would the Chinese government set off a frenzy for gold?

Well, here's one thing to remember... the Chinese government doesn't pay much attention to human rights or property rights. It could demand all of its citizens' gold at any time – just like FDR did in the U.S. back in 1933.

But all of these facts are just hints about what's to come. The real story won't be unveiled until June. That's when China will open something called the Pan Asia Gold Exchange (PAGE). This is a direct competitor to the London Metals Exchange and the COMEX in New York.

The way things work right now, the futures market in London "fixes" the spot price of gold each morning and afternoon, based on trading in London and on America's COMEX market.

But both of these markets back gold contracts with only 10% of the actual metal. The new China PAGE market is expected to have a much larger gold backing and could change the way gold is traded.

As James Turk's GoldMoney site recently reported:

> *The potential effects cannot be underscored enough –*

> *PAGE is clearly preparing the world for a Chinese world reserve currency, and is doing this by bringing gold, and by extension silver, back into the Chinese economy*

Forbes wrote about the development...

> *It means the spot market in gold could be headed for China – and away from London's Metals Exchange or the Comex in New York. It also means that the Chinese currency – not dollars – will for the first time become the ruling currency used in one of the major speculative commodities of our age. All eyes will be on the influence of the gold trade in China rather than New York, London, Switzerland, or South Africa.*

For several years, we've been warning about the loss of world reserve currency status for the U.S. dollar. We have worried about our currency because we understood the propensity of governments to steal from their citizens through inflation.

With roughly half of our national debt held by foreigners, we have long believed efforts to print away our obligations will prove catastrophic for America's leading international position – and most especially for the role of our dollar as the world's leading reserve currency.

But until recently, we were unsure of the exact mechanism by which the dollar would be replaced. **Now, we see how it will unfold...**

The Chinese will slowly hedge their exposure to the dollar by becoming the world's leading gold investors. By taking over the world's gold markets and building a huge stockpile of gold, they will be able to back their currency with the world's traditional form of money.

Once they are ready to make the yuan freely convertible, they will have created tremendous demand for their bonds and bills by making their currency the world's most reliable... and the only one backed with gold.

The impact on the dollar could be catastrophic... And every day the dollar falls, China's gold stockpile will grow more valuable (and more powerful). You can protect you and your family from this potential collapse with a handful of very simple steps... the first one being to own plenty of gold.

A Brief History of Stansberry & Associates

The story of Stansberry & Associates Investment Research begins on a humid afternoon in 1996, during a rained-out yard party in Central Florida.

Dr. Steve Sjuggerud and Porter Stansberry had escaped into the house, and were sitting on cheap, plastic folding chairs in a child's bedroom.

As a tropical downpour raged outside, Steve admitted to Porter that he would soon be leaving his prestigious mutual-fund job – to write investment newsletters.

"Steve, you're crazy," said Porter.

But months later, Porter found himself working with Steve, and even living with him in his small apartment. Two years went by... then, in 1999, Bill Bonner backed Porter's decision to launch his own newsletter, *Porter Stansberry's Investment Advisory*.

Today, Stansberry & Associates Investment Research has subscribers in 127 different countries. Based in Baltimore's historic Mount Vernon neighborhood, it has more than 40 research analysts and assistants at its headquarters, as well as at satellite offices in Florida, California, and Oregon.

Unlike Wall Street investment banks and brokerages, Stansberry & Associates are completely independent – dedicated only to publishing great investment ideas for our subscribers.

To learn more about our products and how to order, please call our Customer Service Department, at 888-261-2693.

~ The Little Black Book of Investment Secrets ~

Appendix

List of Articles

Porter Stansberry,
S&A Founder and Editor of *Stansberry's Investment Advisory*

Dr. Steve Sjuggerud
Editor, *True Wealth* and *True Wealth Systems*

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