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Dear Investor,

The price of oil is turning up again, surging last week by more than 9% and blasting back over \$50 per barrel.

Watch it carefully over the next few weeks. If last week's rise is sustained, it will re-ignite recent fears of inflation ... push long-term interest rates back up ... light a fire under the gold market ... and put the kibosh on the stock market rally.

No matter what, do everything you can to better understand the powerful, fundamental forces likely to drive oil prices higher this summer and beyond.

One person who's got his finger on the pulse of these forces is my associate, Larry Edelson, contributing editor to my [Safe Money Report](#) and editor of his *Real Wealth Report*.

It was based primarily on Larry's fundamental insights that we forecast \$50 oil three years ago. It was also Larry who urged me to recommend energy stocks to subscribers, delivering stellar appreciation and high, steady yields.

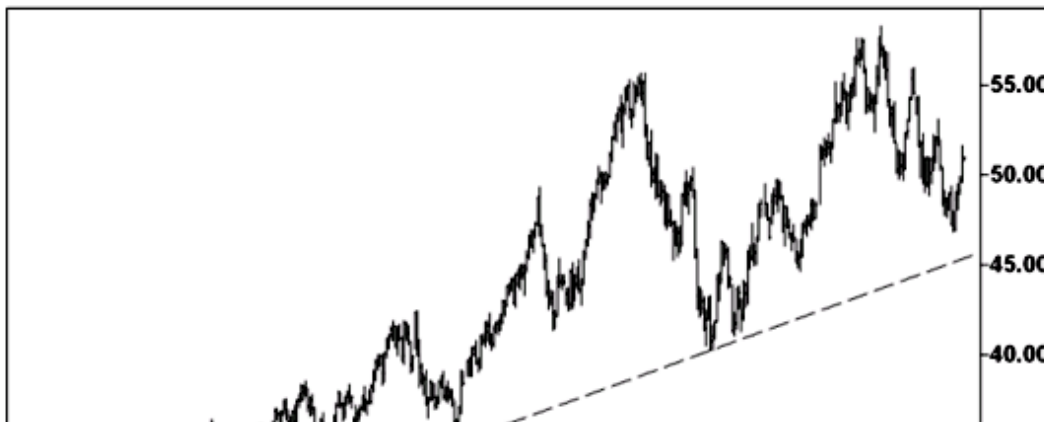
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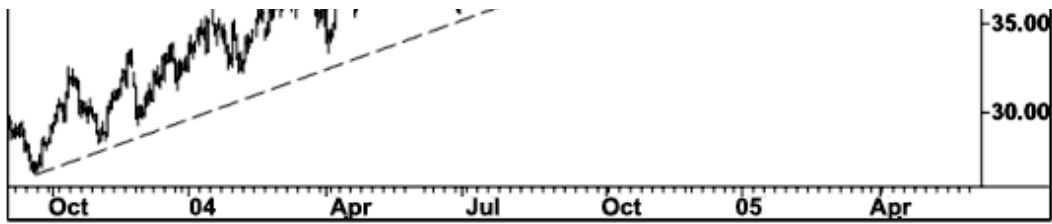
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My Interview With Larry Edelson

Martin: Some observers are saying that last week's surge in oil was a fluke. They say it was just an over-reaction to a report from the U.S. Energy Department showing an unexpected drop in the nation's oil stockpiles.

Larry: Maybe. But anyone who gets hung up on the short-term fluctuations in oil needs to have their brain reprogrammed. If any market is being driven by long-term megatrends, it's this one.





The long-term, virtually unstoppable surge in oil you see in this oil price chart is no fluke.

The acceleration in the price rises that began around July of last year is no fluke.

And although nothing can be absolutely certain, last week's surge that you see at the very right of the chart is also consistent with the long-term, no-fluke pattern.

Martin: The long-term picture is clear. But tell us what you think is going on right here and now.

Larry: Let me sum up recent events: Oil jumps to \$58. There's some profit-taking and it falls back to \$50, a perfectly normal correction in a major bull market. Then, it dips a bit below \$50, and suddenly people think the surge is all over!?

That's baseless. Right now, oil is within 10% of all-time highs. Just a week or two more of the kind of price rises we saw last week and you'd be back up there again ... or beyond.

Martin: What's driving this?

Larry: Exactly the same thing that's been driving it all along -- China and India. Over two billion people. Nearly a third of the world's population.

Martin: You were there recently. What did you see?

Larry: First let me tell you what I *didn't* see. I didn't see any signs whatsoever of a slowdown. And believe me, I looked hard. I talked to central bankers, business entrepreneurs, and people on the street. Back in the U.S., there's plenty of talk about threats to the Asian boom, and there are some. But they're just not a factor right now.

China's GDP came in at 9.5% for 2004. The Chinese authorities tried to cool it off a bit. But they failed to do so.

Martin: Some people say it's a bubble. Do you agree?

Larry: In some aspects, perhaps. But at the core of this is the phenomenally rapid growth of the middle class in China -- now close to 280 million people. That's almost the same as the ENTIRE U.S. population, all classes included.

Martin: Why such rapid growth? And why do you think it will continue?

Larry: Because of the rapid diffusion of consumer technology -- computers, cell phones, the Internet, cheap automobiles.

You're a cultural anthropologist. So you know what I'm talking about. When new technologies are introduced into a relatively well-educated but low-tech society,

they spread like wildfire. The culture and the economy are transformed. And the transformation gains a life of its own, at a grass-roots level.

This transformation has little or nothing to do with government edicts. The Chinese government didn't start it. And they can't stop it.

Martin: Why so fast?

Larry: Look at it this way. Just a few years ago, the Chinese middle class -- and middle-class buying power -- was isolated to a few pockets here and there. Now, it has spread out and engulfed almost all major urban centers in China.

A few years from now, it could double in size. And that will still be only about half of the total Chinese population. Suddenly, you'll have the equivalent of TWO U.S. populations driving up the price of oil, industrial metals, precious metals, and raw materials.

And that's just one country -- China. We see a similar (but not identical) pattern in India, which is nearly as large.

This is causing huge demand for natural resources, taxing Mother Earth to the max. Oil -- energy -- is the prime target of that demand.

Will there be recessions and busts in Asia? Of course. But this demand is not going away in your lifetime or mine. It's going to be there for decades.

Martin: I just read about the huge shopping malls in China in the *New York Times*. They say that, already, four shopping malls in China are larger than the Mall of America. Two are even bigger than the West Edmonton Mall in Canada.

People are swarming into the malls. On just one day, one mall in Southern China attracts about 600,000 people. They come by car, by bus, by train. Isn't this the sign of an economic bubble?

Larry: If you told me those shopping malls were being built here, in Europe, or in Australia -- I'd say yes, that's another signal of a bubble in those industrialized countries. But not in China. The living standards of an estimated 400 million people in China have now been raised above the poverty level, and they are just starting to shop.

Martin: Are there any other signs that support your view?

Larry: Many! Take steel production, for example. Steel is at the core of a country's industrial machine. As long as steel production is growing rapidly, you know that a major industrial transformation is still underway and that its momentum is bound to continue.

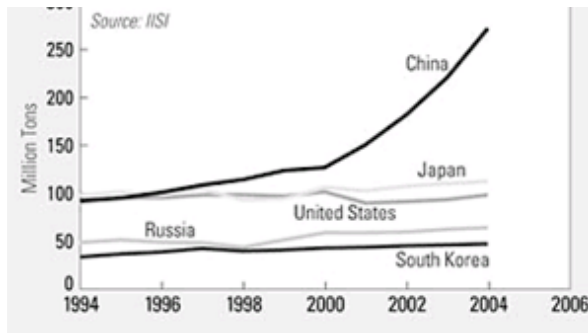
China alone has pushed world steel production up by one-third in the last five years. Last year, China's steel production exceeded the billion-ton threshold for the first time. Overall, China now produces a whopping 27% of the world's steel.

But even that's not enough steel to meet Chinese demand! That's why China's now cutting deals with Australia, Argentina, Brazil and many more countries -- they need those countries' iron ore to make steel.

Top Five Steel-Producing Countries, 1994-2004

300

According to *Vital Signs*, the source of this chart, China's rise is as if all of Europe, Russia, and North and



of Europe, Russia, and North and South America were simultaneously to undertake a century's worth of economic development in a few decades. Add in India and Southeast Asia -- and you're talking double that!

Martin: So you've got massive growth in China and India. Assuming that continues unabated, what does it mean for oil?

Larry: At the very minimum, it means you've established firm underpinnings for a solid floor under the price of oil.

Martin: At what level?

Larry: Close to \$50, give or take a few dollars in either direction.

Martin: \$50? A floor? That's quite amazing. For years, you and I talked about \$50 as the next major *upside target* for a barrel of oil. Now, \$50 is emerging as the floor for a barrel of oil? Unbelievable ... and yet, at the same time, very logical. But suppose it dips to the low \$40s like some people are saying.

Larry: That won't change a thing. The key is: How long will it stay there? A temporary dip means very little. This is a classic "buy-the-dip" market.

Martin: You've talked about the demand. What about supply?

Larry: We're running out! The world is running out of oil.

Martin: What about alternate energy?

Larry: Still decades away from being a viable substitute. The world was complacently coasting along with fossil fuels for decades. Now we're going to pay the price -- a very HIGH price.

Martin: Which alternate technology is closest?

Larry: There are two -- solar and nuclear.

Martin: And windmills?

Larry: A distant third. But the real sin of the supply situation is that in the late 1990s, when everyone was enamored with high tech, when investment bankers and venture capital firms were throwing good money at the dot-bomb companies, they ignored the basics, especially the energy infrastructure. So capital was diverted from necessity to greed.

Right now, China is trying to rectify that by mandating 10% reliance on solar for all energy needs by 2008. That's just a short three years away. So to the degree they can make the mandate stick, it's going to drive up the demand for solar technology.

Martin: Who's going to fulfill that demand?

Larry: I'm looking at two companies right now. They'll be in an upcoming issue of

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Near-Term Outlook

Martin: Let's refocus on the near term. What's going to happen this summer?

Larry: The summer travel season is going to be bigger than expected. We can already see preliminary signs of that -- with an upsurge in airline travel. Higher fuel prices are still not making a dent in travel. They have to go a lot higher before that's going to happen.

But despite all the talk about big shortfalls in refining capacity in this country, we still don't see hardly any movement to add capacity. No new refineries have been built in 25 years! Can you believe that? All those new autos on the road, all those new SUVs and trucks, all that growth over a 25-year time span ... and not one new gasoline refinery!? It's crazy.

Martin: Supply is tight. We know that. But what could change it?

Larry: What could change it is a series of unexpected events that make supply *even tighter* -- that throw us into a panic. Panic shortages. Panic buying. Panicky energy markets driving prices through the roof.

World's Hot Spots

Martin: I know you can't predict this, but name a few. If it doesn't happen, we won't hold it against you.

Larry: Start in the most obvious place -- Iraq. Oil production in Iraq is still far below projections. Their drilling and refining facilities are falling apart. Dilapidated. Dangerous. In disarray.

But their oil ministry is between a rock and a hard place. If they want to rebuild the oil industry infrastructure, they have to stop oil production. But if they stop production, they don't earn the money they need to rebuild infrastructure.

Martin: So what are they doing?

Larry: Nothing. Just pumping whatever they can. They need the money NOW. So they're pumping oil now -- despite huge waste. But it's not nearly enough because of the decaying facilities. Besides, why invest big bucks in new rigs or refineries if they could be blown up by insurgents at any moment? It just doesn't make sense right now.

Martin: And beyond Iraq?

Larry: Iran! I don't think you can rule out an attack by the United States. But if Iran moves forward with nuclear weapons development, which I suspect they will, you should also keep your eyes open for a possible pre-emptive strike by Israel.

Internally, Iran also has serious problems. The country is boiling up toward a confrontation between the fundamentalists and the reformists, which could be almost as disruptive as the fall of the Shah.

Beyond Iran, nearly all of Central Asia is a tinderbox, on the verge of a fundamentalist revolution. I'm talking about former Soviet republics that are major sources of the world's natural resources.

SOURCES OF THE WORLD'S NATURAL RESOURCES.

Martin: Bring that home to us. What does that mean for the oil markets? What does that mean for gold and other commodities?

Larry: Even if there is no blow-up, it means more support for the floor I told you about earlier -- not only a floor near \$50 for oil, but also a floor in the low \$400s for gold.

Martin: Please explain.

Larry: Oil traders are afraid they could wake one morning to the news of a major attack on an oil facility somewhere in the world, driving crude up by \$5, \$10, even more. Short-sellers are even more antsy. So that gives the market buying support on any dips. No one wants to be out of the market -- let alone short the market -- for any length of time.

Martin: What else are you worried about?

Larry: I'm worried about oil production in Venezuela, now careening toward a confrontation with the United States. I'm worried about production in Nigeria, on the verge of another ethnic civil war. I'm worried about the Soviet Union which, unlike Poland, the Czech Republic, or Hungary, has had a very choppy transition to capitalism, a transition that is now getting a lot choppier.

Plus, I'm watching the Spratly Islands in the South China Sea. These islands encompass the third largest oil reserves in the world -- under the ocean floor. But the entire territory is in dispute.

It's claimed by China, Taiwan, and Vietnam. Parts are also claimed by Malaysia and the Philippines. Japan and the U.S. also have a big stake because the islands are smack in the middle of the biggest oil shipping route in the world -- the one through which oil flows from the Persian Gulf to Japan and the West Coast of the Americas.

Martin: What could be the outcome?

Larry: The area could be blocked off due to territorial disputes, causing shipping delays. If world supplies were abundant, no big deal. They'd work around it. But with world supplies so tight, the impact could be dramatic.

Martin: This all sounds very volatile and a source of some major windfalls for aggressive investors. But if you're more conservative, what would you be buying right now?

Larry: I like the Canadian royalty trusts, like Enerplus. A nice 9% dividend yield. Great potential for capital appreciation. Nothing is guaranteed. But this stock is like an ATM machine. All they do is buy interests in solid properties, collect royalties, and pay it out in dividends.

Martin: One final question. Where is oil headed? Ultimately.

Larry: Go back to basics. When oil fell to \$10 a barrel in 1998, it was the steal of a lifetime. That was less than 24 cents a gallon for oil and the equivalent of 51 cents for a gallon of gas. Those prices hadn't been seen since 1973, and the dollar has lost 95% of its purchasing power since then.

It was artificially depressed because almost everyone was investing in the stock

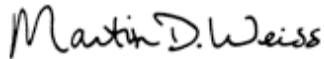
market and technology and no one cared about oil.

But a market that's depressed that much doesn't stay that way for long. Soon, it explodes higher and makes up for lost time very quickly.

Now, sure enough, the price of oil has jumped from \$10 to over \$50. And even that's cheap. Fully adjusting the price of oil for the depreciation in the dollar since 1973 means oil should be close to \$100.

Martin: Thank you for your insights.

Good luck and God bless!



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